JaguarAnalytics

Jaguar 1Q 2017 Outlook and Premium Ideas

Thank you for your interest in Jaguar 1Q 2017 Outlook and Premium Ideas. The file is divided into 5 sections as following:

- 2016 Recap and Performance
- 2017 Macro Outlook and Sentiment
- Jaguar Premium Ideas with full analysis
- Key Debates and Catalysts
- Large Institutional Option Positions

When putting this together our primary goal is to provide you noise-free in-depth research, filtered exclusively with goal of helping you make better investment decisions and be informed of risks and opportunities. With changing political landscape, tightening monetary environment, shifting focus towards fiscal policies for stimulus, rising interest rates and corresponding inflationary pressures – the only certainty going into 2017 is there is no certainty. While we remind this every year, we believe equity markets will become increasingly bifurcated with constant rotations, which is much different than passive index investing. In short, expect increasingly "stock pickers" market in which differentiated research and insights will take higher importance. We hope you'll find the information useful. Feel free to reach out to us for questions.

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2016 Recap and Performance

It has been a wild but profitable ride in 2016. The beginning of year was plagued with macro data disappointments resulting in significant risk-off environment. The US PMI and ISM Manufacturing data had slipped below 50 for three consecutive months, just in time the Fed had started hiking first time in 9 years. Calls for pending recession were starting to appear on front pages of newspapers. The US manufacturing and transports sector had slowed dramatically led by sell off in crude oil price. The CPI and PPI readings were showing no life. The M&A activity was slowing and IPO market had nearly come to a halt.

First Big Call - Given all this weak macro backdrop, our biggest call during Nov-Dec 2015 period was to stay away from banking sector despite Fed rate hike in December 2015. That view was contrarian to entire Wall Street outlook which was recommending to buy banks. We were right on the money. As S&P fell by -10% in Jan-Feb 2016 period, it was led by -21% sell off in banking sector. The money flocked into Treasuries as TLT ran up +10%. Unfortunately, some of our research is lost post my sudden transition from OptionMonster to JaguarAnalytics in May 2016, but here is a snapshot of summary from 2016 Outlook issued to clients in December 2015:

> **Selection Criteria –** In contrast to last year's picks, you will notice stark differences. Last year I was playing more offensively, picking up niche under the radar growth stories in small and mid cap stocks. For 2016, I am playing more defensively, targeting established names with reasonable chance out of outperformance. My macro views are far different from a year ago. Going into 2016, macro data points are getting weaker including ISM (below 50), Durable Goods (multi year low), Trucking Tonnage Index (at recessionary levels), Industrial Production and Retail Sales (falling), Regional Fed Surveys (weakening), Weekly Jobless Claims (6 month high), S&P Sales and EPS (falling), S&P Margins (falling) and Housing (cooling off). Meanwhile, the Fed has created more uncertainty by raising interest rates.
>
> I want no exposure to financials despite Fed hiking rates due to macro slowdown and HY dislocation. No exposure to tech in which everyone is piling into FANGs euphoria. No exposure to commodity linked sectors such as energy and metals on assumption that oil theme in 2016 remains "lower for longer" instead of V-shape recovery. No exposure to retail and consumer discretionary on macro concerns.

Second Big Call - Another big contrarian call in early 2016 which paid off handsomely was bullish case for dividend paying sectors, particularly Consumer Staples (XLP) and its components. For quite sometimes from Nov-15 to Apr-16 period this was the only sector we were recommending buying with many trade alerts. Staples was the best performing sector in 1H16 with +19% gain. At one point in Apr-May period we were holding more than 50% of open posiitons in Staples.

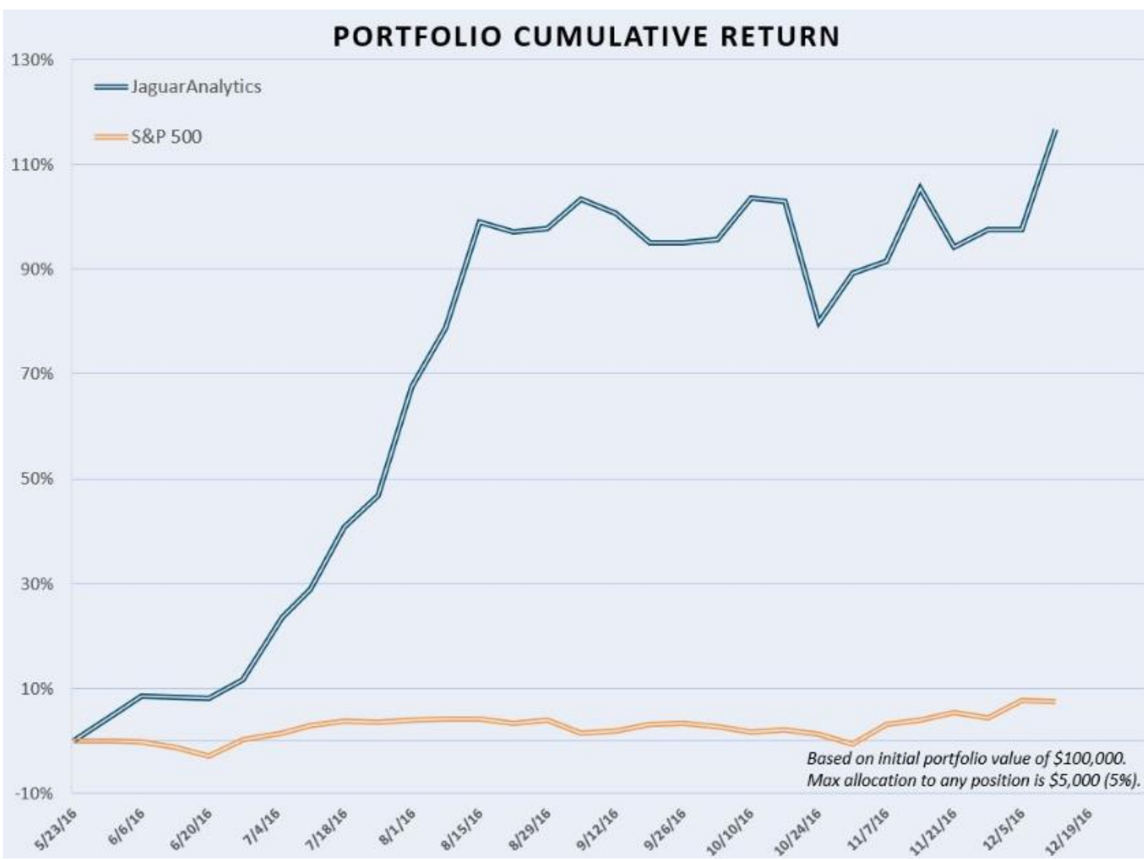
Third Big Call – This came late late Summer / early Fall with bullish case on energy sector, starting with bull case on fracking sand plays (SCLA, HCLP, FMSA), followed by Canadian oil producers (CNQ, SU), followed by selected US shale producers just before the OPEC Meeting on November 30 (DVN, MU) and more recently oil services equipment stocks (SLB, HAL). This bullish view on commodies was further extended into metals (FCX, X, AKS) and chemicals (DOW, ALB, OLN, LYB, etc.) and Transports (IYT, UPS, UNP, KSU) and autos (F, GM, MGA, DLPH, etc.).

Where we clearly missed opportunities in 2016 was in banks post elections after bond market crashed, resulting in parabolic rise in banks' Net Interest Margin. To be fair, through in Sep-Oct we recommeded buying GS and BAC but our view never extended beyond short term tactical trading. Overall, the year started out with slightly bearish view of economy but over time turned progressively bullish with improving macro backdrop.

It goes without saying there were still plenty of mistakes made along the way. Multiple times we lost money on hedges. We lost money on few tech stocks that just couldn't perform in line with cyclical recovery. The biggest losses came on healthcare positions (DVA, PDCO, PFE, MDT, SPNC) as the sector continued to struggle with political naunces threatening to erode pricing power, drying up M&A environment, and simply going out of favor with consistent fund outflows.

Nevertheless, the key is to stay nimble and patient, have the best available forward-looking research and tools available, and use your intuition and experience with balanced view of the world that cuts out the noise and focus on what matters. I am proud of our team for being able to produce highest quality research to help clients growth their portfolios with solid gains. Below is a snapshot of cumulative portfolio return with 93 closed trade ideas from the time I joined JaguarAnalytics on May 16 to Christmas Day.

Click **HERE** to see all 93 closed trade ideas.



2017 Macro Outlook and Sentiment

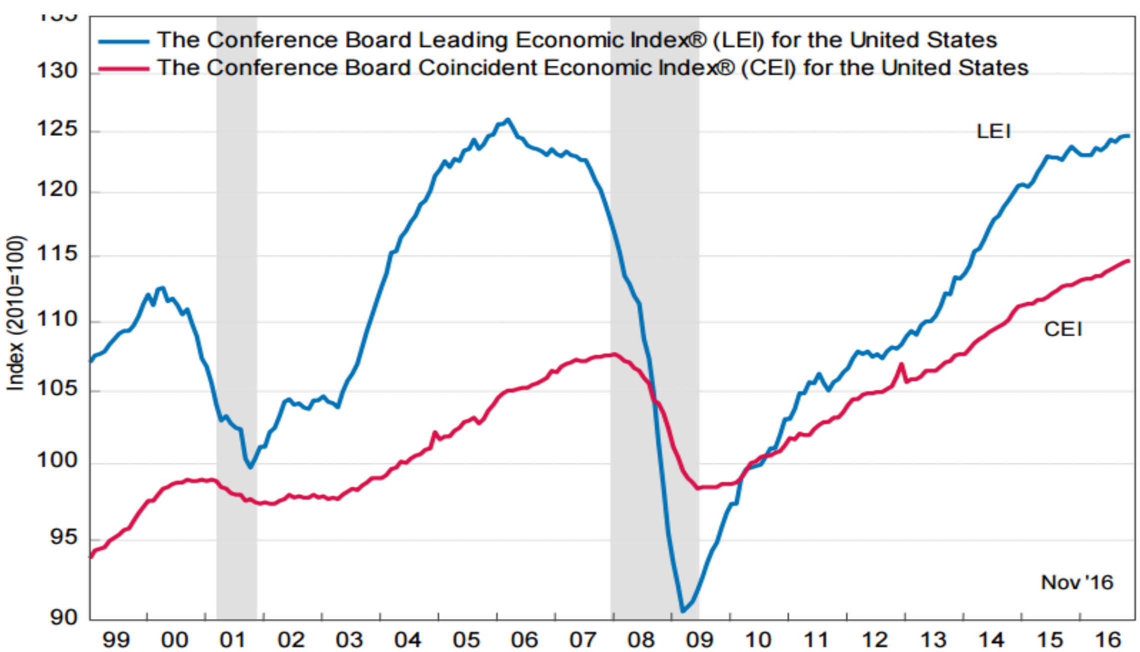
"Things can go so right … and so wrong!" – Singer and Songwriter NE-YO

2017 is embarking on completely new macro framework with paradigm shift compared to any of past 8 years since Great Recession ended. We have significant change in Washington that will translate into many new ways of thinking in terms of policies, economy, trade and regulations. We have the Fed with most hawkish tone in over a decade. Meaning, we have significantly different monetary and fiscal policy shifts currently underway, a view that was completely absent prior to 2016.

Looking at current macro conditions, we have exact opposite of where we were at the end of 2015. Seven of the ten indicators that I follow closely that make up The Conference Board Leading Economic Indicators (LEI) increased in November.

- The positive contributors – beginning with the largest positive contributor – were the interest rate spread, average weekly initial claims for unemployment insurance, stock prices, the Leading Credit Index, manufacturers' new orders for nondefense capital goods excluding aircraft, average consumer expectations for business conditions, and manufacturers' new orders for consumer goods and materials.
- The negative contributors – beginning with the largest negative contributor – were building permits, average weekly manufacturing hours and the ISM new orders index.

We can dissect the data to finer details but collectively speaking macro data is in much better shape today than a year ago. The year is closing at high note. To boil all macro economic data to one simple yet most important chart is LEI Index. Just like the saying goes, "it ain't over until the fat lady sings" … it ain't over until blue line turns and it will give you 6 months of advance notice.



Three Pillars of 2017 Macro Forecast –

1. Monetary Easing → Fiscal Stimulus

   After many years of hand holding and keeping the economy afloat, albeit at growth rate below historical averages, it is time for the Fed to step aside and let the fiscal policies in Washington after Trump victory decide the fate future stimulus package. This is key in 2017. Trump has made many big bold promises to the nation during his campaign, the most important ones are: 1) An economic stimulus package tiered towards infrastructure buildout, 2) lower corporate tax rate from 35% to 15%, and 3) cutting burdensome regulations on businesses, 4) allowing repatriation of foreign corporate cash at lower tax structure. Since elections equity markets have added $3 trillion in capitalization on hopes of boost in forward revenus and earnings as these fiscal initiatives come to fruition. The true reality check will come when Trump starts to face pushbacks from conservative Republicans which is bound to happen immediately after January 20 inaugration. But even with pushbacks, some of these growth measures should pass through even if they are only half met. That's what the stock market is pricing in currently.

2. Disinflation → Inflation

   Our core call in 2017 is return of inflation, or at minimum reversal of disinflationary trends that have gripped the market for several years. Our inflation call is closely tied to the fiscal forecast described above. Cut the noise and lets look at with simple view. The US has reached full employment with jobless rate only at 4.6%. Historically, when its below 5% no matter how much they try, the elasticity is such they can't push it down meaningfully further. When we are at full employment and there is lack of talent available to hire, any economic stimulus package (monetary or fiscal) has tendency to start to pushing wages higher, which is precisely what we have observed in past 6 months. Given the US is 60% service-driven economy, wage pressures show up quickly in monthly CPI and PPI readings. The reason why we have seen sharp rise in interest rates since elections is precisely because markets are discounting future inflationary pressures from fiscal stimulus, which tends to have more immediate impact on consumers behavior (such as tax cuts) then monetary stimulus from the Fed in previous years, which tends to boost asset prices.

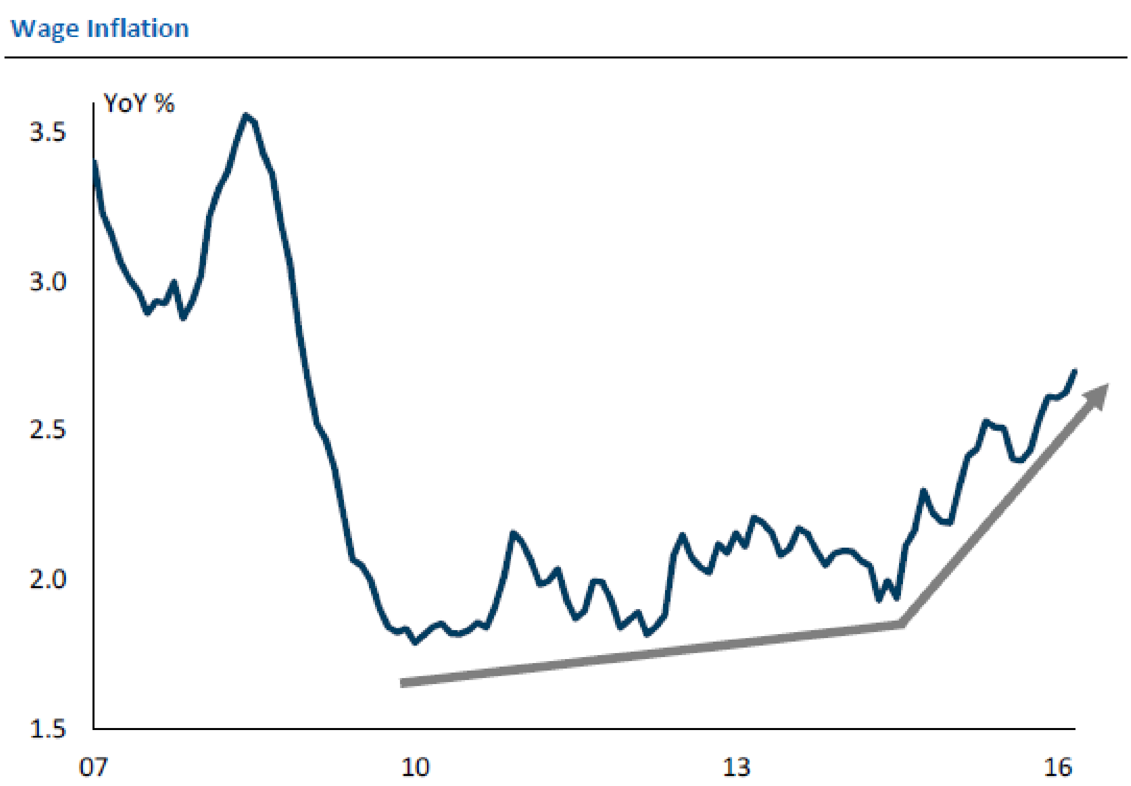
3. Uncertainty → Uncertainty

   In my opening message on page 1, I mentioned the only certainty we have going into 2017 is there is no certainty. This is the only constant each year with periodic economic shocks: Euro area crisis, US budget standoffs, China debt worries, collapse in oil prices, Mideast warfare, Brexit, Ebola fears, list goes on. I cannot tell you what random shock will hit us next year, but the mere thought that some shock may happen will certainly keep us on our toes all the time given the two pillars of growth described above are almost entirely dependent on how Trump runs the government. Perhaps the greatest shock of all will be none other than idea that nothing will get done on fiscal side.

Some Important Macro Charts Going into 2017 –

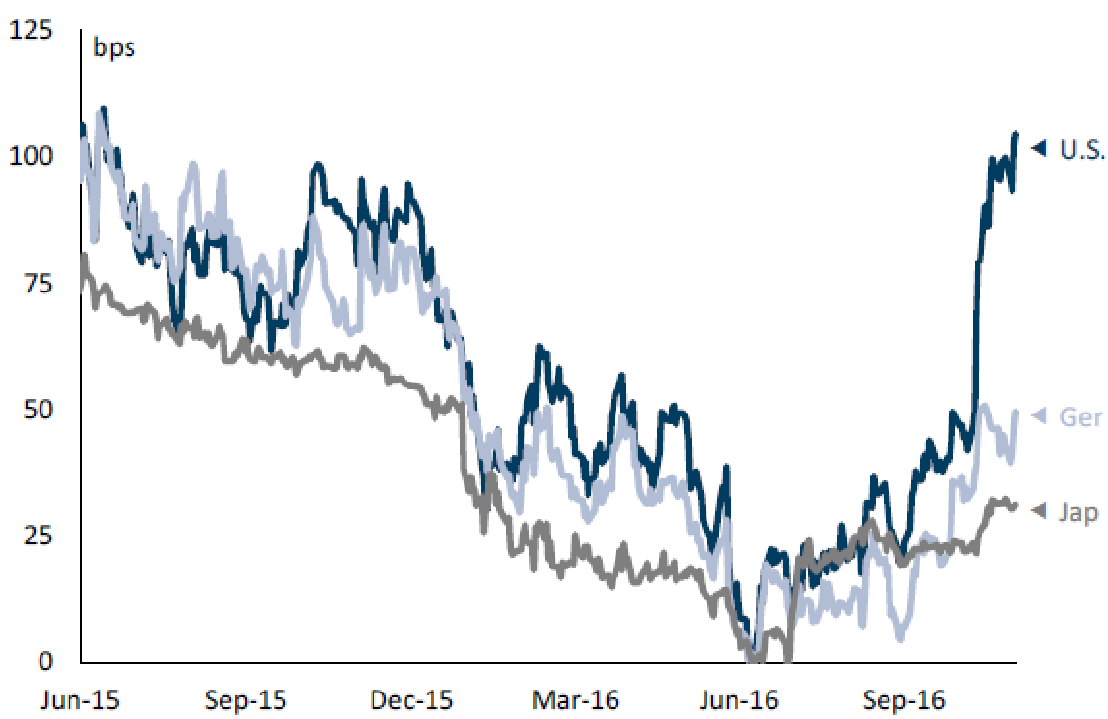
From macro stand point, the key message I am trying to send across in this outlook is our views in rising inflation pressures as explained above. This is different than previous years. During an inflationary environment, most pundits on Wall Street by default automatically assume that the economy is strong hence rising inflation. We believe that logic has many cracks, in fact outright false. Inflationary pressures can arise with or without economic strength and history is full examples going back to 1970's and 80's. We also believe one has to get highly selective in stock pickings.

<u>Sectors and individual stocks that will do the best are of those companies that have the ability to raise prices without causing demand destruction. Three particular groups: US shale, oil refiners and specialty chemicals.</u> Both sectors are discussed in detail under section "Key Debates and Catalysts." Here are some important charts and their trends to keep in mind going into 2017. These charts are telling a story and you can start to paint a picture of what should work and not work going forward. I believe you will start to see why I am so bullish on energy stocks.



10-Year Inflation Expectations

Change in 10-Year Government Bond Since July Low



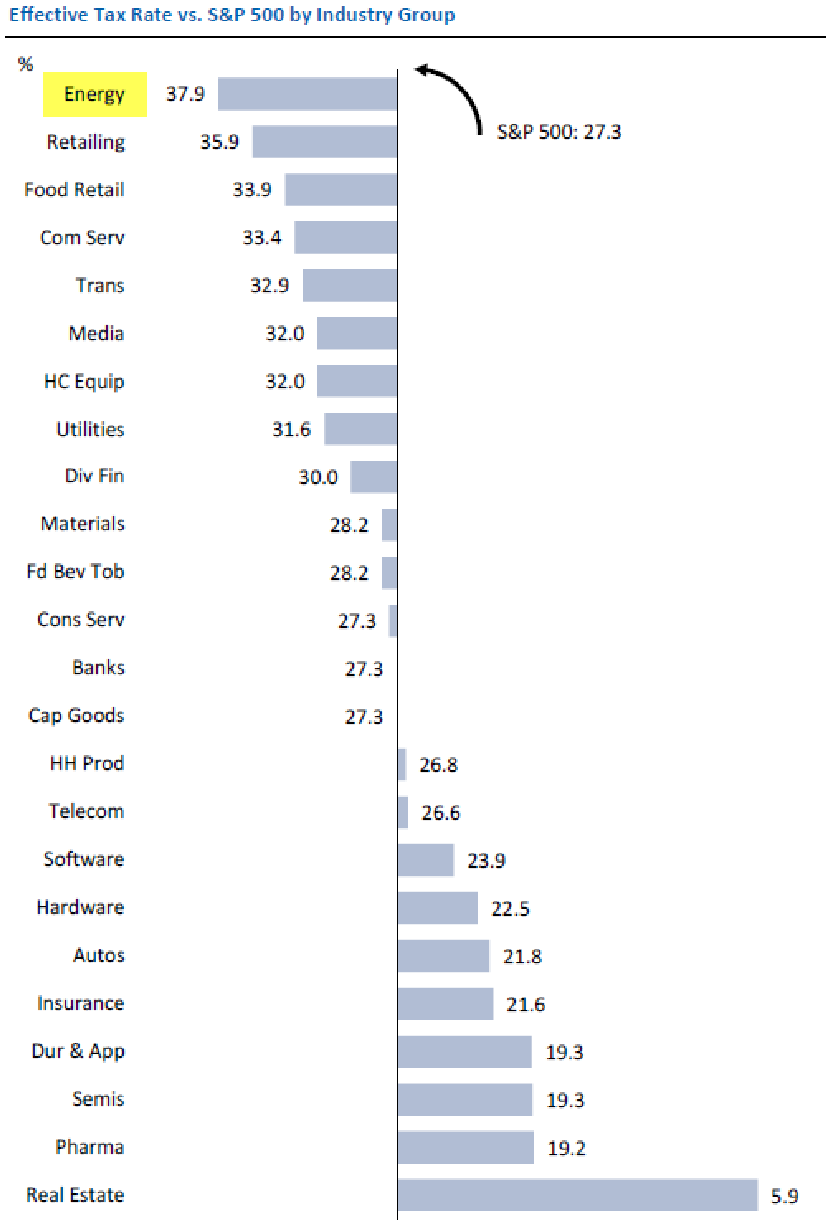
S&P 500 NTM P/E vs. 10-Year Yield

U.S. Equity Returns on Up and Down Interest Rate Days

%		Equity Return on Days When			
	All	Change in 1-Year Yield		Change in 10-Year Yield	
	Days	Higher	Lower	Higher	Lower
S&P 500	**5.7**	**34.7**	**-21.5**	**48.3**	**-28.8**
Financials	11.3	84.8	-39.8	124.7	-50.5
Energy	9.3	38.0	-20.8	111.8	-48.4
Materials	9.2	41.4	-22.8	57.7	-30.8
Industrials	13.2	41.5	-20.0	53.0	-26.0
Technology	7.7	40.2	-23.1	49.7	-28.0
Discretionary	1.3	35.5	-25.2	40.9	-28.1
Health Care	-3.4	21.8	-20.7	33.5	-27.6
Staples	2.2	12.2	-8.9	12.2	-8.9
Telecom	10.9	6.8	3.8	14.0	-2.8
REITs	-2.1	0.7	-2.7	4.3	-6.1
Utilities	9.2	0.6	8.5	-12.6	25.0
% of Days	***100***	***53***	***47***	***49***	***51***

Factor Behavior – Effective Tax Rate

Higher tax stocks should lead on the promise of lower rates



Jaguar Premium Ideas

At Jaguar, everything we do starts from bottom-up detail research and analysis. Many of you that are on website each day understand our process and ways of thinking. We like to think outside of the box. For each stock, we first take the prevailing widely-held fundamental view no Wall Street and we tear that apart into pieces. Then we compare those street opinions to what managements are telling us in their earnings reports and what industry and channel checks are showing us. Once we have the collective wisdom from all corners, only then we form our own opinion. This is the core of our process of doing fundamental research.

It is hard work and smart work. It requires inclination, the desire to get hands dirty with details that actually matter. It requires plenty of reading and understanding to form a strong opinion. As a result, quite often you will find us at opposite side of conventional Wall Street thinking, or technicals on the chart. It's not our job to agree or disagree with the street. Our job is to simply highlight risks and find opportunities where we can make money for our clients. If that goes against conventional wisdom so be it.

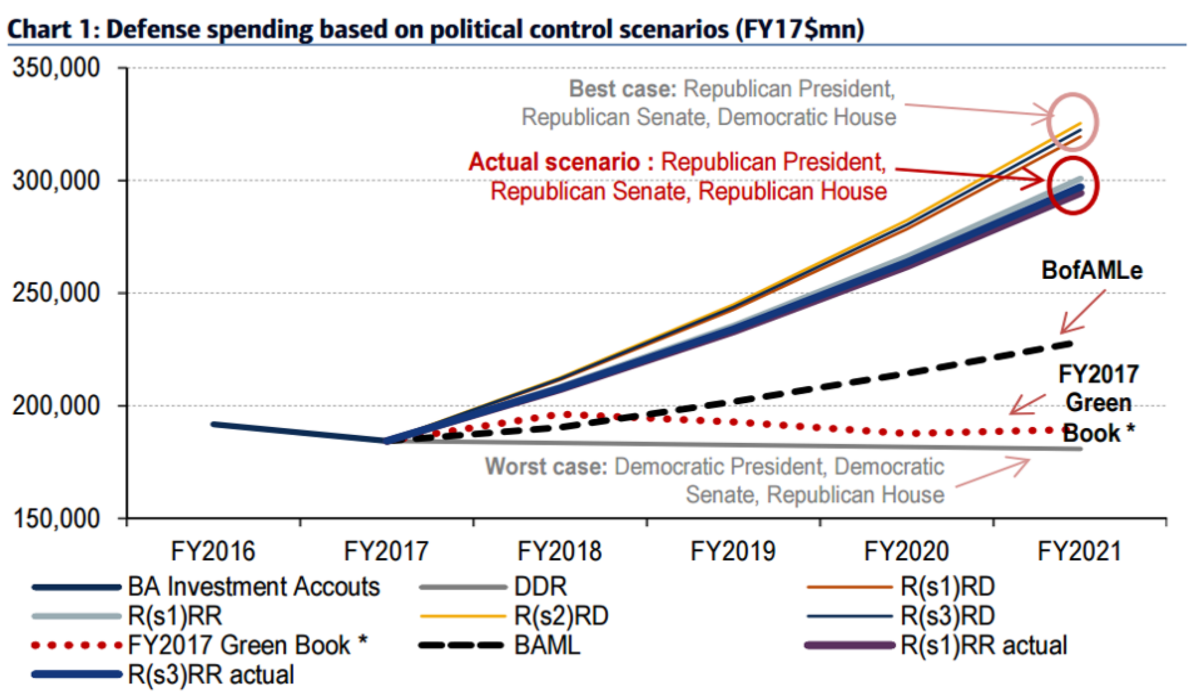
In this section you will find Jag Premium Ideas. In each idea we have tried to attach the narrative to a particular catalyst in sight.

Raytheon (RTN)

The bull case here is function of multiple reasons, some short term and some long term. Raytheon is $41 billion defense contractor that addresses military needs in command, control, communications, computers, cyber and intelligence, mission support, and cyber security. It is the biggest supplier of missile systems for home defense, space, airborne, sea and ground combat.

Defense Remains Defensive - Defense is largely insulated from weakening emerging markets, declining commodity prices, a strengthening US dollar and increasing interest rates. Defense remains defensive and the sector has historically outperformed the S&P 500 during recessions in the US and emerging markets. With drastic change in leadership in Washington after Republican clean sweep, I believe defense contractors will provide some of the best stock returns vs. the S&P in coming quarters with higher defense cash outlays.

Long Term View: Expect Defense Spending to Accelerate - Under Obama Administration specially in past two years, the sector was hurt by muted defense spending with individuals running various programs cutting corners. This is now expected to change. The US Defense Budget Authorization has grown at a +1.8% CAGR in constant dollars since post World War II. According to US Treasury data, Defense Investment Outlays were up +3.6% YoY in FY2016 through mid year. By Election Day, the Outlays had increased to +5.2% YoY and post elections consensus believes FY2017 through FY2021 forecast rises to 12-13% CAGR. Under Obama Administration, between 2011 and 2015 the annual EPS, FCF and Revenue per share stayed largely flat near $6.80, $4.70 and $74.00 per share, respectively. The investors were rather rewarded with steady increase in dividend payouts and capital appreciation due to valuation multiple expansion (19x earnings currently vs. 14x previous 5-year average). This trajectory changed in FY2016 with EPS expected to finish the year at $7.46 (up +11% YoY). From BAML:



Short Term View: US Air Force to Procure 350 T-X trainers Soon- The Air Force is expected to order roughly 350 T-X aircraft to replace its aging Northrop T-38 Talon supersonic jet trainer. This contract award is expected to be north of $16 billion and nobody has built assumptions for this consensus view given several delays throughout in 2016, which is precisely I believe recent sell off in defense contractors going into year-end is presenting buying opportunity. The final request for proposal (RFP) is expected to be released in December 2016 / early 2017.

The Advanced Pilot Trainer (APT T-X) program will replace the aging US Air Force fleet of Northrop T-38 Talons in order to train 5th-generation fighter and bomber pilots. As of February 2016, there were 505 T-38s in the US Air Force inventory, averaging over 48 years old. The 1960s-vintage jets have been exhaustively upgraded to maintain operability as F-15/F-16 era trainers, but are today incapable of performing 12 of 18 mission-critical tasks for advanced pilot training, including high-G maneuverability and tactical air-to-air tracking for 5th-generation aircraft. Four teams are vying for the T-X contract: 1) Lockheed Martin and Korea Aerospace Industries (KAI) are offering the “T-50A” based on South Korea’s T-50 trainer; 2) Raytheon, Leonardo, and CAE offer the “T-100” based on Italy’s M-346 trainer; 3) Northrop Grumman, BAE Systems, and L-3 developed a “purpose-built” clean-sheet prototype; 4) Boeing and Saab recently unveiled a clean-sheet, twin-tail design.

Figure 1: NASA T-38 Talon trainer in flight near Edwards Air Force Base

Source: NASA

Why Raytheon? - While it is entirely speculative to point out who will win the bulk of contract order, Lockheed Martin (LMT) and Raytheon (RTN) currently offer the lowest development and production risks based relative to highest edge in technology based on their existing platforms. LMT has come under scrutiny recently after Trump tweet about cost over-runs of another program (F-35), hence likely giving RTN the highest edge to be the ultimate winner (note just helmet for F-35 pilot costs $400,000 so it is understandable why the pushbacks from Washington).

Raytheon was the original manufacturer of the T-1 Jayhawk and the T-6 Texan II, both of which are currently used by the Air Force as pilot and combat systems operator trainers. Leonardo has also produced multiple trainers in the past, including the MB-326 and the MB-339. Raytheon, Leonardo, Honeywell Aerospace, and CAE are collaborating to offer the T-100 Advanced Training System, an upgraded variant of Alenia Aermacchi's M-346 Master. The M-346 first flew in 2004 and is currently operated as an Air Force trainer by Italy, Israel, Singapore, and Poland. T-100 is a fully integrated training system that incorporates flying and ground-based simulator operability. The T-100 is powered by two Honeywell F124 engines, which have a best-in-class thrust-to-weight engine ratio. The T-100 is capable of sustained high-G operations, aerial refueling, night vision imaging, and data-link operations. The T-100 will also feature Head-Up Displays, customizable Large-Area Display (LAD), and integrated helmet Mounted-Display designed to train pilots for the advanced avionics in 5th generation tactical aircraft such as the F-35. The T-100 Ground Based Training System (GBTS) allows simulators to download real-world training scenarios and are designed to mimic 5th-generation fighters/bombers using the same flight software as the real aircraft.

The only negative: while the T-100's dual-engine design is a positive from a training safety perspective, the T-100's twin F124 turbofan engines are less powerful than the GE F404 engine powering Lockheed's upgraded T-50A, Northrop's clean-sheet "Model 400," and Boeing's "purpose built" twin-tail prototype.

Figure 8: The Raytheon T-100 trainer

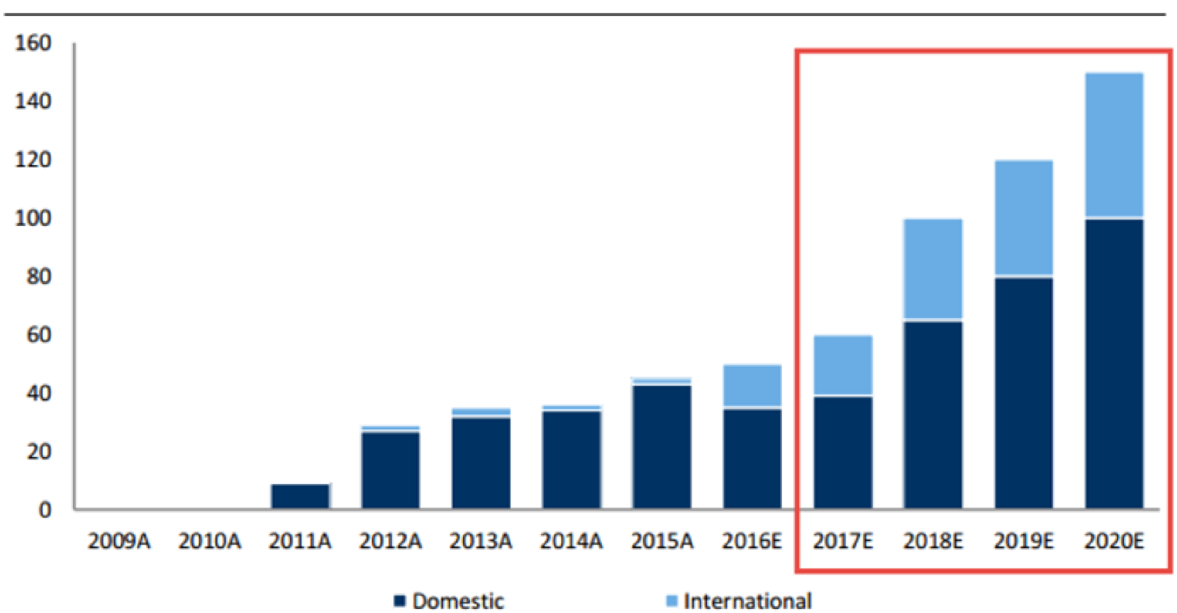
Source: Raytheon

Other Factors to Consider / Recent Earnings History – While the catalyst above is significant, even without it the growth momentum is strong. Highlights from prior quarter:

- Q3 EPS $1.79 vs. $1.66 estimate, beat
- Q3 Revenues $6.03B vs. $6.03B estimate, in line
- Q3 Integrated Defense Revenues $1.33B vs. $1.49B estimate, miss
- Q3 Intelligent & Information Revenues $1.54B vs. $1.54B estimate, in line
- Q3 Missile Systems Revenues $1.8B vs. $1.72B estimate, beat
- Q3 Space Airborne Revenues 1.59B vs. $1.46B estimate, beat
- Q3 Total Revenues +4.3% YoY
- Q3 Operating Margins 13.4%, up +130bps YoY
- Q3 Total Bookings +30.6% YoY
- Q3 Book to Bill Ratio 1.15x, highest in several years
- Q3 Total Revenue Backlog +1.4% QoQ and +6.7% YoY to $35.8 billion
- FY2016 EPS Guidance $7.33 vs. $7.23 estimate, beat
- FY2016 Revenue Guidance $24.35B vs. $2.25B estimate, beat

Note the Integrated Defense Systems revenues were down -5.9% YoY due to lower sales related to an international communication program in the Middle East that was pushed out into the future (timing issue), otherwise total revenues would've been well come consensus view. Raytheon continues to be a significant beneficiary of a global arms race. Increased instability around the world is driving demand for deterrence. Demand for the Patriot missiles is robust as the Patriot intercepted 40+ missiles in the Middle East recently. Poland is near finalizing its Patriot order that could be worth +$5bn. Poland would be the 13th Patriot customer. There is also an upgrade cycle of missile defense systems worldwide in play and "Configuration 3" upgrade launched recently is just getting started, another $4-5 billion of sales upside potential. Raytheon is currently paying effective income tax rate of 28% which is the highest in defense sector. It will be one of the biggest beneficiaries of proposed corporate tax by Trump from 35% to 15% if materializes.

Exhibit 2: F-35 Delivery Forecast, 2009A-2020E



Final Thoughts – While I am going with Raytheon as my Top Pick within defense sector, it is worth keeping in mind that long term bull case of secular specifically about higher defense spending under new Trump administration applies to entire defense and I expect many to outperform in coming quarters. The F-35 program cost over-runs may have hurt **Lockheed Martin (LMT)** stock recently but it is an important program that mostly will proceed as planned after small hiccups. See F-35 delivery forecast above. **General Dynamics (GD)** is building 12 new submarines as announced in April and has since received several other new orders, its book to bill ratio is rising. **Northrup Grumman (NOC)** saw sharpest increase in Department of Defense Cash Outlays led by the Airforce up +38.9% YoY back in September and that momentum hasn't slowed while the stock has pulled back going into year end. Bottom line is generally speaking I expect all of them to perform well over coming years.

In early 2016, all these defense contractors had to trim guidance because of negative pension cost adjustment after relentless rally in US Treasuries and sharp decline in corresponding bond yields. That also reverses the course going forward after crash in bond market into 2016 YE.

<u>Under Armour (UAA)</u>

As many of you may know, this apparel retailer has been a major laggard this year (Down 27.08% YTD). Along with **Nike (NKE)**, the company has lost share this year to the likes of **Adidas (ADDYY)** and **lululemon (LULU)**. In recent quarters, the company has been plagued by poor gross margin numbers, poor inventory management, and an increase in its debt. In its most recent earnings call, the company said that earnings growth will be in the mid-teens for 2017 and 2018 which prompted a sell-off and caused plenty of analysts to downgrade the stock (Atlantic Equities, Cowen & Co., Deutsche Bank, Mizuho, Stifel Nicolaus, and Telsey Advisory Group). Jefferies analyst Randal Konik even said that ***"promotions are rising, which suggest sell-through is slowing, and the stock's valuation is still the highest among peers (42x Forward P/E)."*** Short interest is also seen as a major problem with over 47 million shares short (12.81% short float). Needless to say, with its poor performance, deteriorating fundamentals, and analyst downgrades across the board, no individual wants any piece of this stock.

While its fundamentals have not helped Under Armour's stock, its athletes didn't do them any favors this year either. The company has plenty of extraordinary athletes under sponsorship, but this past year proved to be very unlucky. Let us first start out in early February when the Carolina Panthers battled the Denver Broncos in Super Bowl 50. The Denver Broncos went on to win the game, chalking up a loss for sponsored-star Cam Newton. However, it was the press conference afterwards that raised eyebrows as Cam Newton abruptly walked out after giving one-word answers. Now, fast forward a couple months later and the world got to see sponsored-star Jordan Spieth "choke" at the Masters tournament. With a five-shot lead heading into the back nine on Sunday afternoon, Jordan Spieth would ultimately collapse and pave the way for Danny Willett to take home the coveted Green Jacket. Finally, in June, one of Under Armour's hottest commodities, Steph Curry and the Golden State Warriors found their way back to the NBA Finals. Unfortunately, after being up 3 games to 1 against Nike's star Lebron James and the Cleveland Cavaliers, they wound up losing in Game 7.

However, with all of the negative sentiment hovering around Under Armour, there is plenty to be optimistic about heading into the first quarter of this year. Let us first take a look at recent commentary from its earnings release and the breakdown of its segments. Back in late October, the company beat on both EPS ($0.29 vs $0.25) and Revenue ($1.47B vs $1.46B) and reported North America sales increased 15.6% while International grew 73.7%. It also said it continues to expect 2016 net revenues of approximately $4.925B, representing growth of 24% over 2015, and 2016 operating income of $440M to $445M, representing growth of 8% to 9% over 2015. It reiterated its goal of achieving $7.5B of revenues by 2018. Here is a quick breakdown of its segment performance in the last quarter:

<u>Third Quarter 2016</u>

Segment	Performance
Apparel	Increased 18%
Footwear	Increased 42.1%
Accessories	Increased 17.6%
Connected Fitness	Increased 39.8%
Licensing	Increased 21.3%

Now, taking a look at channel checks, one area for Under Armour that saw massive improvement was in its inventory, which had come under heavy scrutiny in past quarters. In a Softlines Industry Inventory Tracker research note from December 9th, Credit Suisse said their analysis of apparel industry inventory trends were the healthiest level in seven quarters as total softlines industry inventories grew 1.9%.They then went on to point out how Active Apparel (i.e. Under Armour) normalized inventories after three quarters of excess growth.

Industry Segment Results

Figure 7: Leading And Lagging Segments On Sequential Sales-Inventory Growth

Sales Growth - Inventory Growth Sequential Comparison	3Q16	2Q16	Sequential Change
Active Apparel	2.4%	-6.1%	8.5%

Figure 12: Vendor Inventory Growth Has Improved Sequentially

Sales Growth - Inventory Growth Sequential Comparison	3Q16	2Q16	Sequential Change
Vendors			
DECK.K	1.9%	-25.8%	27.6%
COLM.O	1.2%	-15.3%	16.5%
UA	8.1%	-7.7%	15.7%

In addition, recent SportsScan data for the week ended 12/10 showed that athletic footwear sales increased 5.6% Y/Y. In the last four weeks, athletic footwear increased 7.6% Y/Y. Over the trailing three-month period, athletic footwear increased 8% Y/Y. The next 3 weeks will likely have seasonally higher sales for last-minute holiday shopping and should benefit from an additional Saturday between Thanksgiving and Christmas. Looking specifically at Under Armour, footwear grew 47.7% Y/Y over the last four weeks led by strong growth in basketball (48.6%) and running (62%). In terms of Apparel, Under Armour saw an increase of 19.3% last week and is now up 9.9% year-to-date.

Table 1: SportScanINFO point-of-sale data athletic footwear summary

As of week ending 12/10/2016:

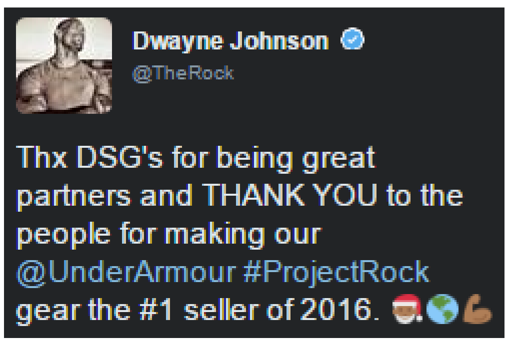
	Last Week y/y	Trailing four weeks y/y	YTD (from Jan 1)
Under Armour Footwear	49.4%	47.7%	86.8%
Under Armour Running	64.6%	62.0%	84.7%
Under Armour Basketball	49.2%	48.6%	151.7%

Table 2: SportScanINFO point-of-sale data athletic apparel summary

As of week ending 12/10/2016:

	Last Week y/y	Trailing four weeks y/y	YTD (from Jan 1)
Under Armour Apparel	19.3%	7.7%	9.9%

I believe one of the biggest "hidden gems" Under Armour has dates back to a partnership deal it made in October 2015 with megastar Dwayne "The Rock" Johnson. What makes this partnership so great for Under Armour is that The Rock can bring in sales from all different areas. The Rock launched his career in the WWE (World Wrestling Entertainment). During his tenure there, he would eventually star in movies like the Scorpion King. As we all know by now, that venture has played out very well as he is now an international star with such movies as Fast and the Furious, San Andreas, Central Intelligence, and his most recent success Moana. If you follow him on Instagram, you will also know he can bring in individuals who are adamant about working out and staying healthy. In fact, a couple of weeks ago, Under Armour unveiled The Rock's new "Project Rock" collection of apparel (shirts, hats, and bags). The Rock also has new training shoes coming out in early 2017. Looking at recent earnings transcripts, the company doesn't make any mention of this partnership or any of the future items. I have to believe that with 62 million Instagram followers, 57 million Facebook page likes, 10 million Twitter followers, and 1.5 million YouTube subscribers, his new product line will have some type of impact on the company's top line.



Looking ahead to other potential catalysts for the company:

- The release of 3 new running shoes in February that will include chip technology that allows the sneakers to connect to the company's MapMyRun app and tell when one's muscles are too tired to run at full capacity. Nike and Adidas both have shoes with chip technology that measure distance, time, and speed, but Under Armour's chip-enabled footwear dubbed Record Equipped is the first to measure one's body readiness for exercise.
- Back in July, Under Armour announced a deal with **Kohl's (KSS)** that will bring apparel, accessories, and footwear to all Kohl's locations starting in March 2017. This move into the department store is geared toward the female customer. CEO Kevin Plank said, ***"Kohl's is a great evolution for us. The female consumer is there, she's shopping and she's buying. We think there is a big opportunity."*** Sales of activewear and accessories rose by 15% at Kohl's last year, and represented $3B in sales. Kohl's Chief Merchandising and Customer Officer Michelle Gass said that more than 400,000 people have searched for "Under Armour" on the Kohl's website in the last year.
- Earlier this month, OTR Global said Under Armour is planning to open distribution to the Family Footwear channel in June, starting with Famous Footwear.

Looking at recent option flow from the last several months, you will see plenty of bullish positioning:

Symbol	Contract	Size	Price	Premium	Strategy	Date
UAA	January'18 35 Put	2000	4.20	$840,000	Put Seller	9/9/2016
UAA	April 37.5 Put	3500	3.60	$1,260,000	Put Seller	9/21/2016
UAA	April 27.5 Put	2378	1.45	$344,810	Put Seller	10/27/2017
UAA	April 30 Put	3103	3.00	$930,900	Put Seller	11/1/2016
UAA	January'18 27.5 Put	2110	3.39	$715,290	Put Seller	11/1/2016
UAA	January'18 30 Put	1233	4.40	$542,520	Put Seller	11/2/2016
UAA	April 27.5 Put	2493	1.85	$461,205	Put Seller	11/3/2016
UAA	April 35 Call	850	1.50	$127,500	Long Call	12/8/2016

Finally, as we look at the daily chart, we see that shares have been range-bound since the end of October. If the stock can climb its way back to the $33 level and break through that, you can see that there is an air pocket all the way up to the $38 level.

Del Frisco’s Restaurant Group (DFRG)

Based in Southlake, Texas, Del Frisco’s Restaurant Group owns and operates three contemporary, high-end, complementary restaurant concepts:

- The premier fine dining steakhouse in the U.S.
- Features prime beef and an award-winning wine list

- Classic American Grille in a casual atmosphere
- Leverages Del Frisco’s brand positioning at a broader range of price points

- Vibrant, energetic, white table cloth steakhouse
- Features fine hand-selected, aged steaks and a broad seafood offering

Looking at the company’s fundamentals, its restaurant margins are currently at 20%, has no debt and has seen its short interest decline significantly from the beginning of the year. Specifically, it has gone from 1,770,348 on December 31st, 2015 to currently 622,800. Unfortunately, outside of an outstanding 3 months in 2014, when the company was trading above $25/share, Del Frisco’s stock hasn’t done much since its IPO in 2012. Also, looking at its comparable sales numbers for the last four quarters, there is nothing to be excited about.

Restaurant	Symbol	Q316 Comps	Q216 Comps	Q116 Comps	Q415 Comps
Del Frisco's Double Eagle Steakhouse	DFRG	-3.70%	-1.90%	-0.10%	-1.60%
Sullivan's Steakhouse	DFRG	-3.20%	2.90%	-1.80%	-1.80%
Del Frisco's Grille	DFRG	-1.40%	-2.00%	-2.80%	-4.50%

However, in late November, Reuters reported, citing people familiar with the matter, that an activist investor was urging the company to create a sharp turnaround of the company’s performance or seek to sell the company. Engine Capital, which currently holds a 1.25% stake in DFRG told top company executives that the steak house chain needs to immediately improve its operations and cash management or find a buyer. In the same Reuters report, they said that Ancora Advisors, which owns a 0.84% stake in the company, also wants them to find a buyer.

While many may have gravitated toward the Reuters report, one should pay closer attention to another holding company - Fidelity National Financial Ventures. In late-December 2015, Fidelity National disclosed that it had raised its stake in the company to 8.1% with purchases made between October 21st and December 24th, 2015. According to the filing, it would now allow for talks between the two companies. So, who is Fidelity National Financial? It is a publicly traded company that acts in many ways like a hedge fund when it comes to the restaurant industry. And it is no stranger to the business. Fidelity’s Chairman, Bill Foley, is a dealmaker who spent seven years as CEO of CKE Restaurant Holdings. Between 2009 and 2012, it acquired several concepts including a 55% stake in American Blue Ribbon Holdings, a restaurant owner and operator of the O’Charley’s, Ninety Nine Restaurants, Village Inn, Bakers Square and Legendary Baking concepts. Since that increase last year, Fidelity’s stake has grown even larger to 13% **(2016 insider purchases are listed on the next page)** and observers have speculated that Fidelity would one day take the Southlake, Texas-based company private. As Nation’s Restaurant News said in a recent article, ***“The company is just unlikely to get much in the way***

of appreciation on Wall Street. Outside of Ruth's Hospitality Group (RUTH), relatively few upscale concepts last long on the public markets before ultimately being taken private."

Date	Symbol	Company	Role of Purchaser	Purchase Price	Total Value
1/13/2016	DFRG	Del Frisco's Restaurant	10% Owner	$14.91	$2,894,443
1/19/2016	DFRG	Del Frisco's Restaurant	10% Owner	$14.85	$717,231
1/22/2016	DFRG	Del Frisco's Restaurant	10% Owner	$14.95	$1,327,904
2/9/2016	DFRG	Del Frisco's Restaurant	10% Owner	$14.61	$3,339,387
2/12/2016	DFRG	Del Frisco's Restaurant	10% Owner	$14.68	$2,257,679

On November 21st, the company announced that CEO Mark Mednansky had chosen to retire from his position as CEO. At that time, it was announced that current Director and member of the Board of Directors, Norman Abdallah would be taking over the role, effective immediately. Based on his pedigree, Mr. Abdallah has a long track record of operating restaurants for private-equity investors. Here is a quick biography:

- His most recent job was as an operating partner for CIC Partners, where he was an investor and operator for the private-equity firm's restaurant companies.
- In 2014, he was interim CEO of Dinosaur BBQ and helped establish a restaurant investing platform for a family office, leading to the acquisition of Jim 'N Nicks BBQ.
- He was the CEO of Romano's Macaroni Grill starting in 2010, after Golden Gate Capital acquired the company. Macaroni Grill was later sold to **Ignite Restaurant Group** (IRG).
- Mr. Abdallah worked with Restaurants Unlimited, a 14-concept company that was owned by Sun Capital.

Based on his resume, Mr. Abdallah is clearly experienced in operating companies for private investors, who have different demands than public investors. After the CEO news, Raymond James analyst Brian Vaccaro said, ***"We believe this news increases the potential that the company could pursue a sale."***

Here are some other potential catalysts for DFRG to keep in mind for the first quarter of 2017:

- From January 9th – January 11th, the ICR Conference, featuring more than 150 public and private companies, will be taking place in Orlando, Florida. Del Frisco's will be speaking at 10:00AM and 3:00PM on Tuesday, January 10th. If history is any indication, Del Frisco's could possibly make some time of announcement. At last year's conference, the company pre-announced its Same-Store-Sales for the upcoming quarter as well as mulling a decision on what to do with its Sullivan's Steakhouse chain. For those interested, here is the complete ICR Conference Schedule: **https://goo.gl/2FwR9W**
- The company's Q4 results, while not officially announced, usually take place at the end of February/beginning of March based on prior history.
- Donald Trump's tax reform. Under President-elect Trump's proposal, consumers in the top two income brackets would see their after-tax incomes rise by ~2.2% and ~6.6% respectively, vs 0.8% to 1.8% for those in the bottom three brackets. With Del Frisco's being one of the most upscale chains, it should be best positioned to benefit from a high-income consumer with more disposable income. Also, revitalized business spending from a corporate tax cut could also drive an increase in DFRG's private dining business (which does ~15% of sales excluding the Grille chain).


DFRG Del Frisco's Restaurant Group, Inc. Nasdaq GS
© StockCharts.com
Cyclicals / Restaurants & Bars
Friday 23-Dec-2016
Open: 17.80 Ask: 35.00 P/E: 19.61 Options: no
High: 17.90 Ask Size: 3 EPS: 0.90 Annual Dividend: N/A
Low: 17.50 Bid: 16.15 Last Size: 4980 shrs Yield: N/A
Prev Close: 17.90 Bid Size: 2 VWAP: 17.62 SCTR (Small): 51.8
-1.40%
Chg: -0.25
Last: 17.65
Volume: 152,436
RSI(14) 58.85
DFRG (Daily) 17.65
MA(8) 17.99
MA(20) 17.78
MA(50) 15.99
MA(200) 15.39
Volume 152.44K, EMA(60) 196.53K
MACD(12,26,9) 0.543, 0.688, -0.145

Dunkin' Brands (DNKN)

Under the direction of CEO Nigel Travis, Dunkin' Brands is a 100% franchised business that operates approximately 12,000 Dunkin' Donuts restaurants and 7,600 Baskin-Robbins restaurants worldwide.

According to their recent investor presentation, 76% of revenues come from Dunkin'-only stores, 18% of revenues come from a Dunkin'/Baskin-Robbins combined store, and 6% of revenues come from Baskin-Robbins-only stores. In mid-October, the company reported its third quarter results where they announced total revenues increased by 1.3% and that Dunkin' U.S. comparable store sales increased 2%. For reference, here are the comparable sales numbers for both Dunkin' and Baskin-Robbins in the past four quarters:

Restaurant	Symbol	Q316 Comps	Q216 Comps	Q116 Comps	Q415 Comps
Dunkin Brands	DNKN	2.00%	0.50%	2.00%	1.40%
Baskin Robbins	DNKN	-0.90%	0.60%	5.00%	6.10%

There have also been some exciting developments for the company that should help drive sales numbers in the first quarter. The most notable news came this past September, when the company announced a partnership deal with **Coca-Cola** **(KO)** to produce ready-to-drink cold beverages that will go up against the **Starbucks** **(SBUX)**/**Pepsi** **(PEP)** Frappuccino and DoubleShot bottled beverages. According to reports, the new Dunkin' RTD drinks will be available in Dunkin' stores, convenience stores, and other retailers in early 2017.

Then, in early December, the company announced a multi-year agreement with the National Hockey League, making Dunkin' Donuts the official U.S. coffee, donut, and breakfast sandwich of the NHL. The partnership, which marks Dunkin's first national sports league partnership, will officially launch during the 2017 Bridgestone NHL Winter Classic outdoor game in St. Louis on January 2nd, 2017. As part of the deal, Dunkin' Donuts will be prominently featured at several of the NHL "jewel" events, including the NHL Winter Classic, NHL All-Star Weekend, NHL Stadium Series, and the NHL's year-long Centennial celebration. Dunkin' will be included in advertising, LED signage and jumbotron displays, as well as on-site activations at each jewel event. Dunkin' will also have significant presence across the NHL's broadcast and digital platforms. It already has a multi-million dollar partnership with NBC Sports that will include custom in-game features and dashboard visibility, as well as advertising across broadcast, digital, and social media channels beginning on January 2nd, 2017 and continuing throughout the NHL season.

In terms of the current menu, Dunkin' has never shied away from innovation and its attempt to bring in more sales via new products. Per RBC Capital, here is just a quick sample of some of the products the company introduced in 2016:

05/04/2016	Caramel Latte Square
05/26/2016	Heath and Almond Joy Iced Coffee
06/13/2016	On-the-Go ordering released nationwide
06/20/2016	Wildberry Smoothies, limited release
06/27/2016	Cold Brew Coffee in NY and LA
06/28/2016	Lemon Croissant and Key Lime Square donuts
08/01/2016 3Q16	Cold Brew Coffee Nationwide
08/18/2016	Pumpkin Lattes and Macchiatos
08/18/2016	Pumpkin and Salted Caramel flavored Coffee
08/24/2016	Belgium Waffle Breakfast Sandwich
08/29/2016	Reese's Peanut Butter Squarweand Caramel Apple Croissant Donut
09/27/2016	Oreo flavored hot chocolate
09/29/2016	Ready-to-drink (RTD) coffee in the US in early 2017

Now, several weeks ago, Credit Suisse was able to conduct channel checks across Dunkin' stores in which they spoke with many of its franchisees. The franchisees indicated to Credit Suisse that it has been able to sustain the sales momentum that emerged in Q3, driven by continued strength from Cold Brew and Premium Sandwiches. The franchisees also said that the company's transition into these higher-quality/premium products is proving to be more difficult for convenience stores to replicate, so sales should see a boost. The franchisees also indicated that SSS have improved steadily since the end of Q3, with the strongest sales seen in recent weeks.

The company also understands that its digital and mobile segments are an untapped opportunity. At last check, Dunkin' now has over 5M Perks members and President of Dunkin' U.S. and Canada David Hoffman announced that digital investments (especially on-the-go) will be a major component of the Dunkin' strategy moving forward. For what it's worth, Mr. Hoffman spent the last 22 years at McDonalds where he recently ran the company's Australia business, which was well ahead of the rest of MCD's in areas such as digital kiosks.

On Friday, December 16th, rumors started to circulate amongst traders that JAB Holdings was interested in acquiring Dunkin'. Does this rumor have any merit? Well, let us take a look at who JAB Holdings is and their background.

JAB Holdings is becoming a "household" name that is run by a trio of senior executives (also minority partners in JAB), all with fairly extensive and impressive resumes. The three executives are: Peter Harf (JAB Senior Partner), Lambertus J. Becht (JAB Partner and Chairman), and Oliver Goudet (JAB Partner and CEO). Peter Harf is the longest-tenured executive at JAB of the three, and is responsible for guiding the transformation of the holding company to focus on its current key sectors: **Coffee, Beauty Care, and Luxury** ***(with the bulk of assets in the first two)***.
We will obviously focus our attention in this write-up on its interest in Coffee. So far, over the past year, the company has made 2 coffee-related acquisitions. First, in December 2015, they announced they would be buying Keurig Green Mountain for $13.90B. Then, this past May, they

announced they were acquiring Krispy Kreme Donuts for $1.35B. Susquehanna has calculated that the group has now invested close to $30B in coffee alone (two-thirds of JAB's pro forma assets post-GMCR, as per their math). Coffee is now "spread" over three areas:

- 1. U.S. Retail Coffee (Keurig and Krispy Kreme)
- 2. Coffee Chains (Peet's, Caribou, plus the chains Noah Einstein Bagels)
- 3. International Coffee (73.5% ownership in Jacobs Douwe Egberts) comprising both retail and foodservice assets.

If one was able to go back to December 10th, 2015 and read Susquehanna's note on JAB Holdings, they will notice that Susquehanna was able to accurately predict that Krispy Kreme would be bought. In the note, Susquehanna said, ***"In coffee, we believe they will eventually buy the coffee assets/holdings of Kraft Heinz (KHC) and Mondelez (MDLZ) and delve in coffee chains (although at $4B and $900M, respectively, Dunkin' Brands and Krispy Kreme may be small for the growing JAB appetite, but do fit)."*** While these are just rumors circulating around JAB and Dunkin', do not put it past JAB to, once again, empty their pockets on a well-known U.S. coffee brand.

Finally, since the end of September, traders have been initiating bullish option positions via straight calls and risk reversals. Here are some of the notable trades since September 28th:

Symbol	Contract	Size	Price	Premium	Strategy	Date
DNKN	March (2017) 45 Put	5000	1.35	$675,000	Bull Risk Reversal	9/28/2016
DNKN	March (2017) 52.5 Call	5000	2.20	$1,100,000	Bull Risk Reversal	9/28/2016
DNKN	March 45 Put	2321	1.10	$255,310	Bull Risk Reversal	10/4/2016
DNKN	March 52.5 Call	2321	2.60	$603,460	Bull Risk Reversal	10/4/2016
DNKN	January'18 57.5 Call	1000	1.30	$130,000	Long Call	11/2/2016
DNKN	January 55 Call	2500	0.98	$245,000	December 52.5 Roll	11/21/2016
DNKN	January 47.5 Put	3005	0.21 - 0.32	$75,000	Bull Risk Reversal	12/15/2016
DNKN	January 60 Call	3005	0.22 - 0.26	$72,000	Bull Risk Reversal	12/15/2016
DNKN	March 47.5 Put	1000	0.92 - 0.94	$93,000	Bull Risk Reversal	12/15/2016
DNKN	March 60 Call	1000	0.75 - 0.79	$77,000	Bull Risk Reversal	12/15/2016
DNKN	January 57.5 Call	2163	1.20	$259,560	December 52.5 Roll	12/16/2016

Here are some other potential catalysts for Dunkin' to keep in mind for the first quarter of 2017:

- While nothing has been made official, the company will be announcing its Q4 earnings sometime in early February, based on past history
- Looking at the NASDAQ website, we can see that short interest has dropped off by almost half over the past year. On 12/31/2015, short interest was at 14,217,002 and currently stands at 8,580,095


DNKN Dunkin' Brands Group, Inc. Nasdaq GS
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Cyclicals / Restaurants & Bars
Friday 23-Dec-2016
Open: 55.64 Ask: 53.69 P/E: 23.50 Options: yes
High: 55.84 Ask Size: 1 EPS: 2.28 Annual Dividend: 1.2
Low: 53.05 Bid: 53.00 Last Size: Yield: 2.24%
Prev Close: 55.44 Bid Size: 1 VWAP: 53.53 SCTR (Mid): 69.2
-3.34%
Chg: -1.85
Last: 53.59
Volume: 5,265,026
RSI(14) 61.19
DNKN (Weekly) 53.59
MA(8) 52.15
MA(20) 50.25
MA(50) 46.51
MA(200) 44.24
Volume 5.27M, EMA(60) 7.13M
MACD(12,26,9) 2.163, 1.740, 0.423
Jul Aug Sep Oct Nov Dec 2016 Feb Mar Apr May Jun Jul Aug Sep Oct Nov Dec 2017 Feb

<u>DineEquity (DIN)</u>

In July 2007, IHOP CEO Julia Stewart announced that they would be acquiring bar and grill chain Applebee's for $1.9B. This new DineEquity combination would have 3,250 restaurants and $6.8B in annual sales. Julia Stewart, a former Applebee's International executive said she would revive the Applebee's brand. The stock took an absolute beating from 2007 – 2009, going from $71/share to $5/share. However, the turnaround finally came to fruition as the stock grinded all the way to a lifetime high of $114 in early 2015. But now, the stock is looking very weak as it has been trending lower ever since hitting that all-time high and a lot of the issues seem to be stemming from the Applebee's brand.

Let's take a quick look at the company's last earnings release:

- Q316 EPS: $1.46 vs $1.40 (Beat)
- Q316 Revenue: $156M vs $160.89M (Miss)
- IHOP's Domestic System-Wide Comparable Restaurant Sales decreased 0.10%
- Applebee's Domestic System-Wide Comparable Restaurant Sales decreased 5.20%

These comp sales numbers were plain ugly this past quarter. But, as you will see from past earnings releases, this is an unfortunate trend as sales at Applebee's have been falling for the past 4 quarters while sales at IHOP have gone from green to red after posting 13 consecutive quarters of positive comp sales. Here is a quick breakdown:

Restaurant	Symbol	Q316 Comps	Q216 Comps	Q116 Comps	Q415 Comps
IHOP	DIN	-0.10%	0.20%	1.50%	1.40%
Applebee's	DIN	-5.20%	-4.20%	-3.70%	-2.50%

On the company's conference call, CEO Julia Stewart admitted that this was a very challenging time for our industry. She said ***"Consumers are very sensitive to value stemming from tighter budgets."*** She also said, ***"But we are taking action to meet these challenges and emerge even stronger. At the heart of these steps we are taking is the continued strong collaboration with our IHOP and Applebee's franchisees."***

Unfortunately, that statement from the CEO conflicts to what was said in the November 2016 Restaurant Finance Monitor. In this specific report, it talks about current issues underway in the Applebee's system. The article states that Applebee's franchisees were seeing red when parent DineEquity raised the dividend payout by 5.4% in the third quarter. They said, ***"A nickel a share on top of a buck each quarter is pittance, yet it was more smoke and mirrors on the heels of a 5.2% decline in same store sales for the Applebee's brand."*** DineEquity reported flat earnings in the third quarter and would have been down if it weren't for G&A cuts. By its own measure, the chain reported 12.5% lower free cash flow year to date than a year ago, yet the dividend was raised annually by $3.6M, perhaps in order to keep the stock price from tanking. Franchisees also were reported as saying, "***That DineEquity CEO Julia Stewart could muster an increase in the dividend payout when the sales and marketing at Applebee's had collapsed is a testament to the audacity in which the "asset-light" model has been hijacked by the "shareholder value" crowd".*** Ultimately, the report drives home the fact that things are getting tight there and franchisees are saying that corporate support is eroding.

In December 2015, Applebee's selected Barkley as its creative advertising agency. Senior VP of Marketing and Culinary for Applebee's, Darin Dugan, said "***As we take the iconic Applebee's brand to new places, we're excited about the creative potential of the Applebee's-Barkley relationship."*** In May, the company announced what it called "The largest and most comprehensive marketing and advertising campaign in its history," with ads from Barkley centered around its new hand-cut, wood-fired steaks. The campaign would include TV, online, and movie theater placement. But, there looked to have been issues with this new launch as the company failed to market it correctly and failed to execute on the overall product, leaving consumers wanting more. This statement was echoed in a research note by KeyBanc in July where they said the quality improvement initiative, which also included purchasing new kitchen equipment and investments in employee training and marketing, was met by a consumer demanding value. As KeyBanc points out, steak is a higher-priced protein at restaurants and the decision to exclude a price point on the commercials likely resulted in consumers assuming it was a premium-priced offering, dampening enthusiasm for the upgraded product.

While Applebee's failed to deliver on a new product launch earlier this year, they now look to be scrambling to fix this mess-up. Early last week, on December 15th, Applebee's announced that it was searching for another advertising agency after working with Barkley for less than one year. Changes in leadership and new advertising and communications agency relationships have not ignited sales at Applebee's stores, as I pointed out earlier. The company announced, ***"While Barkley has proved themselves to be creative and valuable partners, Applebee's felt the time was right to make a creative shift given the evolving restaurant landscape."*** It said Select Resources International is assisting with its search for a new creative agency. Barkley will work with Applebee's through March 31st, 2017.

For what it's worth, Barrons, in the December 17th weekend edition, had a bear call on shares of DIN, saying that the franchiser looks to be rewarding shareholders more than Applebee's and IHOP franchisees as they are seemingly underinvesting in existing units. They say shares could fall 30%.

While not getting much media attention, it should be noted that a handful of store closures have been reported this month. First, two area Applebee's are shutting down, including the first one in the Kansas City market that has been around for three decades. An Applebee's spokesman issued this statement: ***"From time to time, like other brands with large, national footprints, locations close. Restaurant closures occur for many reasons ranging from changes in trade areas to lease and franchisee agreement expirations."*** However, the spokesman said Applebee's and the franchise owner remain committed to the Kansas City market with 21 locations. There was also a closure of a Chesterton, Indiana location in which a message was put on its voicemail saying it was permanently closed. However, no reason was given as to why this location closed.

A couple of other potential catalysts to keep in mind:

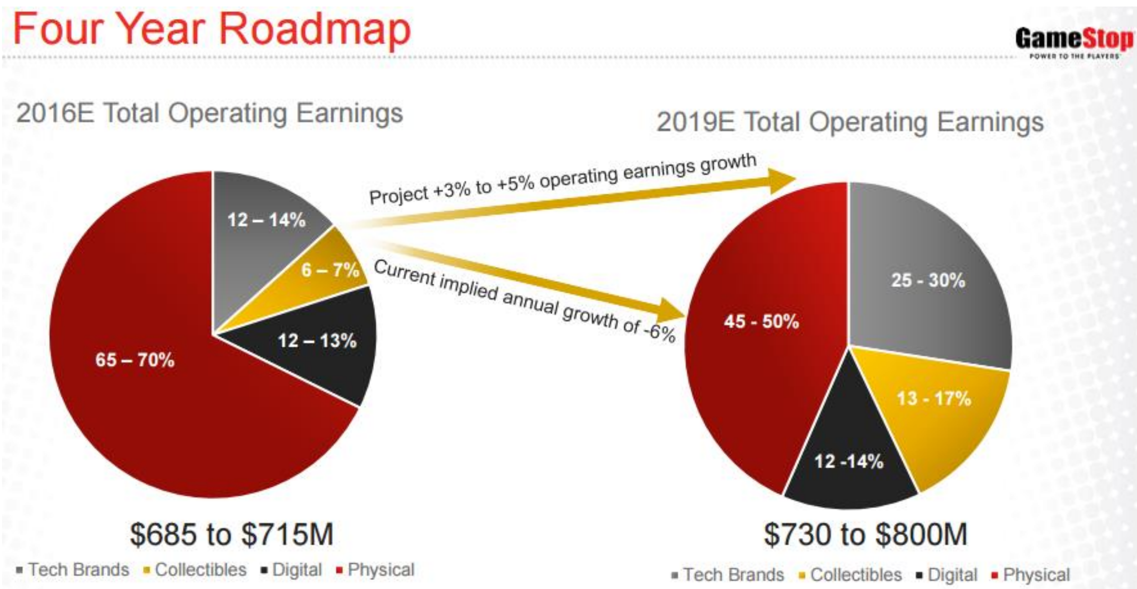
- Looking at the company's Investor Relations page, there are no upcoming events listed. However, the next major catalyst will be its Q4 earnings release that typically is reported at the end of February.
- While small, a couple of Directors unloaded some shares at the beginning of this month:

Date	Symbol	Company	Role of Seller	Purchase Price	Total Value
12/1/2016	DIN	DineEquity	Director	$85.41	$2,263,420
12/1/2016	DIN	DineEquity	Director	$85.41	$2,263,420

Finally, looking at the long-term weekly chart, we can see that shares have begun another descent downwards after being rejected at trendline resistance. However, the key level to watch out for is $75 as the bulls have been defending this spot for quite some time now.

GameStop (GME)

Under the leadership of CEO Julian Raines, GameStop operates as an omnichannel video game retailer that sells new and used video game hardware, physical and digital video game software, video game accessories, as well as mobile and consumer electronics. According to the Entertainment Software Association, 63% of American households have at least one person who plays video games three or more hours a week. The average gamer is 35 years old and has been playing video games for 13 years. In a recent investor presentation at the Oppenheimer Consumer Conference, the company broke down its current segments and its potential roadmap:

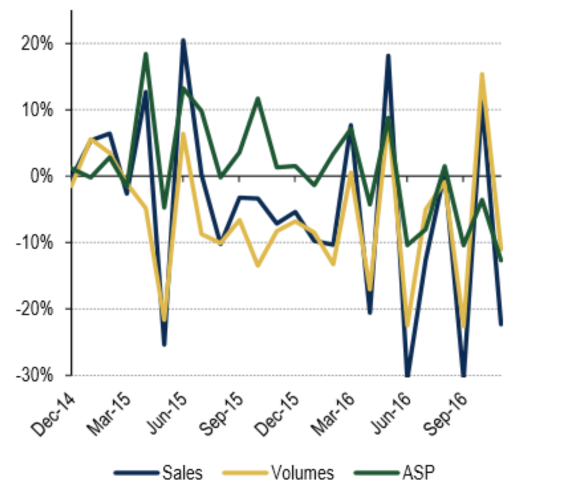


What strikes me as odd is that they don't plan on increasing their footprint within its Digital division. Instead, they will make a slight change by decreasing its Physical segment and adding on to its Tech Brands segment. We will touch on this a bit later. For now, let's take a look at the company's Q3 earnings report from November 22nd:

- EPS of $0.49 vs 0.47 (Beat)
- Revenue of $1.96B vs $1.99B (Miss)
- Q4 EPS Guidance of $2.30 vs $2.37 (Miss)
- Q4 Comparable Store Sales Guidance of -7% vs -12% Y/Y
- Total Global Sales decreased 2.8%
- Comparable Store Sales decreased 6.5%
- New Hardware Sales decreased 20.6%
- New Software Sales decreased 8.6%
- Pre-Owned Sales decreased 6.4%
- Digital Sales increased 11.8%
- Technology Brands increased 54.4%
- Collectibles increased 37.3%

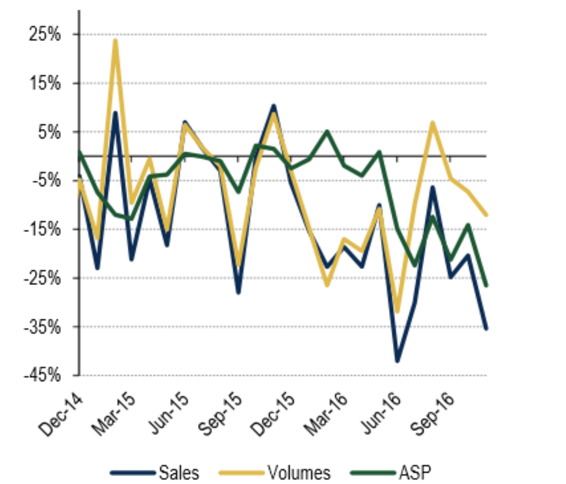
These numbers from its last earnings release coincide with the data that was released earlier this month from the NPD Group and seem to indicate that there is more pain ahead for this electronics retailer. In the month of November, NPD reported that U.S. software sales fell 22.3% based on an 11% decrease in volume and a 12.7% decrease in Average Selling Price (ASP). On a two-year stack, trends decelerated to (29.4%) from 7.9% in October and (34%) in September. Current gen software decreased 26%, prior-gen fell 69%, and hardware volumes fell 12%. As Piper Jaffray noted, these comparisons were difficult to match after last year's success with Fallout 4 and Call of Duty: Black Ops 3. This year's Call of Duty: Infinite Warfare was among the titles that were down significantly relative to prior iteration. The lone bright spot was Pokemon, which helped portable sales rise 268%.

Chart 1: Software decreased (22.3)% in November



Source: NPD

Chart 2: Hardware sales decreased (35.4)% y/y in November



Source: NPD

As I stated earlier, it was odd to see the company not want to build on its digital segment as we can clearly see from its last report that those sales were up 11.8%. Gamers today want to be able to access video games and its downloadable content as easily as possible. Currently, one just has to go to the GameStop website and they can purchase a video game digitally. Ultimately, a code will be sent to them via email and they can plug that in to their console dashboard and be on their way. As you can see, this saves the consumer the trip of going to the physical brick and mortar location. However, GameStop would still have their work cut out for them as other retailers like **Best Buy** (BBY), **Amazon** (AMZN), and **Wal-Mart** (WMT) have the same digital offerings. Also, with consoles today, all gamers need to do is start up their Xbox One or PS4, head over to the marketplace and simply purchase the game of their choice, helping drive sales for **Microsoft** (MSFT) or **Sony** (SNE).

Another possible headwind the company may have to deal with sooner or later is a possible drop in its PowerUp Rewards memberships. For those that do not know, this membership gives members points when they purchase or trade in video games and/or systems. They can then use these points to buy accessories from the GameStop Rewards catalog. Currently, the company has over 35 million loyalty club members. However, this past September, Amazon announced its new Twitch Prime subscription. This service, that goes for $10.99/month without an Amazon Prime Membership, gives free game loot every month, discounts on new release box games, a free channel subscription, and free stuff like “exclusive emotes and chat badges.” When the company releases its next report, keep an eye out to see if there is any negative commentary surrounding its membership statistics.

Surprisingly, the company is still trying new things within its brick and mortar locations. In a CNBC report from this past Tuesday, it was announced that GameStop would be working with advertising and technology company Playwire Media to place commercials on GameStop TV, its in-house television network that airs inside its locations. Playwire will find brands that want to reach the gamer demographic, and work with them to create ads that fit with the programming. As CNBC put it, ***“The partnership will provide it with a way to make money on customers whether or not they buy anything.”***

Taking a look at the options market, we can see that there have been a handful of bearish bets placed in the last several months:

Symbol	Contract	Size	Price	Premium	Strategy	Date
GME	January 30 Put	2000	3.85	$770,000	Long Put	9/26/2016
GME	January 24 Put	4000	1.28	$512,000	Long Put	10/6/2016
GME	January 22 Put	4900	1.14	$558,600	January 27 Roll	10/31/2016
GME	January 24 Put	3400	1.30	$442,000	Long Put	11/30/2016

Some other potential catalysts for you to keep in mind:

- NPD Monthly Data
- While not official, the company’s Q4 results should be released in late March.
- In an article from December 3rd, Barron’s said that a corporate tax cut from President-elect Donald Trump would not save a company like GameStop.


GME Gamestop Corp. NYSE
© StockCharts.com
Cyclicals / Specialty Retailers
Friday 23-Dec-2016
Open: 25.56 Ask: 27.00 P/E: 6.58 Options: yes
+1.40%
High: 26.01 Ask Size: 4 EPS: 3.86 Annual Dividend: 1.48
Chg: +0.35
Low: 25.32 Bid: 25.17 Last Size: Yield: 5.82%
Last: 25.41
Prev Close: 25.06 Bid Size: 1 VWAP: 25.52 SCTR (Mid): 26.7
Volume: 1,974,990
RSI(14) 52.91
GME (Daily) 25.41
MA(8) 25.61
MA(20) 25.40
MA(50) 24.06
MA(200) 27.26
Volume 1.97M, EMA(60) 2.57M
MACD(12,26,9) 0.447, 0.513, -0.067

<u>SPS Commerce (SPSC)</u>

SPS Commerce is a rather unknown small-cap company that identifies itself as the retail industry's largest trading community with more than 65,000 customers in over 60 countries. This is a company that enhances the way that customers and retailers fulfill online orders. The company acts as an advisor to retailers and suppliers. It will help manage inventory, improve margins, and grow revenues through the use of analytics.

Retailers and suppliers need to quickly address the ever changing expectations and shopping habits of consumers and the inability to adapt the supply chain can cause increased cost and missed opportunities. According to recent surveys, it showed 75% of retailers list e-commerce growth as their top priority. Fortune magazine has said that more than 61% of retailers use Buy Online, Pick-Up In Store as a way to attract more e-commerce customers, while reducing shipping costs. However, the stunning fact is that more than half of customers, who buy online or pick up in store experience problems related to their orders, often resulting in customers going elsewhere. The surge in online shopping has been a boon for customers, but a challenge for supply chains.

That being said, one of SPS Commerce's most important solutions focuses on EDI, or Electronic Data Interchange. By using EDI, companies send information from one business system to another, using a standardized format. EDI allows companies to electronically exchange documents, such as purchase orders, invoices, shipping notices, etc., without human intervention. A paper-based order can cost $70 or more per transaction, while the more efficient electronic transactions are processed for less than a dollar. Online EDI solutions eliminate hidden costs when compared to packaged EDI software. Cloud-based EDI solutions save an average of 25-75% in upfront costs, plus 50-75% in long-term expenses like software updates and hardware upgrades. Once companies have the ability to exchange information electronically, they will need to utilize SPSC's Analytics. As I mentioned earlier and what SPSC has said, ***"In the fast-paced era of digital retailing, the ability to react to the rapidly changing market is imperative to the success of a retailer. With the right data followed by the best practices and analyses, they will uncover trends before they occur to make profitable, fact-based decisions."*** From the company's website, here are just a couple of comments from retailers who use SPSC:

Costco benefits from SPS Commerce's EDI expertise. We manage the entire **EDI onboarding process,** including the initial calls to vendors, finding the right contact to speak to, and the EDI testing process.

To understand and maximize product sales, Regis Corporation kicked off a **Point of Sale (POS) Analytics program** with SPS Commerce. Regis suppliers have seen so much value in the SPS Analytics service that every single one has adopted the service to bolster collaboration and sales in partnership with Regis.

Over the last couple of years, the company has made some tuck-in acquisitions that have helped them expand their supply-chain and analytics segment domestically and globally. First, on October 13th, 2014, the company announced it was acquiring Leadtec, a leading provider of cloud-based supply chain solutions in Australia and New Zealand with thousands of trading partners. The acquisition would expand the SPS community in the region and Leadtec's customers would be able to take advantage of a powerful suite of cloud-based products that provide the integration and collaboration needed for the omnichannel retail era. Leadtec has the largest trading partner network in Australia featuring established relationships with thousands of companies including most of the region's largest retail companies such as 7-Eleven stores, Coles Supermarkets Australia, David Jones, and Myer and Woolworths Supermarket.

Then, on January 6th, 2016, the company announced the acquisition of ToolBox Solutions, a provider of point-of-sale analytics and category management services to retailers and consumer packaged goods suppliers in North America. The acquisition expands the SPS Commerce retail network, building on its current network of more than 65,000 organizations in 60 countries, and strengthens its analytics offerings. The deal was worth $18.4M in cash and $4.5M in stock. For fiscal 2016, the company expects the acquisition will add approximately $6M of revenue. After this acquisition, Canaccord Genuity was out saying, ***"The ToolBox acquisition by SPS Commerce accelerates its entry into new business segments. Canaccord continues to like SPS Commerce due to its limited direct competition, the virility of its network business model, and predictable organic subscription growth."***

Taking a look at the company's last earnings release in October, the company reported that total revenue grew 22%, recurring revenue grew 22%, and wallet share grew 15%. This marked the 63rd consecutive quarter of revenue growth. According to their presentation, the company has its sights set on future customer growth:

	Current	Future Opportunity
Customers	20,000	200,000
Revenue / customer (adding connections / size of customer)	$5,000	$10,000
Revenue /customer (2 products)		$20,000

Also, on the company's latest earnings call, CEO Archie Black spoke very highly of some of its customers. He commented specifically on Bodybuilding.com, the number 1 online-sports nutrition retailer with over 29 million unique visitors. They recently embraced SPSC's EDI solution system to continue to grow their business. Previously, they were using a manual system to process orders and communicate with their suppliers by email, fax, and phone. Because of this, they had limited visibility in the inventory of their suppliers. They made the necessary upgrades to their internal systems and ran an enablement campaign with SPSC to ensure that their suppliers were compliant with their new EDI system. Bodybuilding.com is now able to expand their product selection by enabling dropship capabilities, as well as efficiently scaling in the U.S. along with their growing European business. From the looks of it, these reviews from individuals on Twitter prove that SPSC's system truly works:

Wall Street currently has 8 Buy ratings on the stock with a consensus price target of $79. Some of the most recent actions include:

- Benchmark initiating coverage on 12/6 with a Buy rating and $84 price target
- Pacific Crest initiating coverage on 9/29 with an Overweight rating and $85 price target
- First Analysis initiating coverage on 9/26 with an Overweight rating and $86 price target
- Needham & Co. keeping its Buy rating, but boosting their price target from $70 to $83 on 9/26. In their note, analyst Scott Berg said he believes the visibility to the company's accelerating revenue growth rate in the second half of 2017 has increased. Further, he believes significant customer demand trends combined with a well-positioned product can sustain the company's desired 20% organic revenue growth profile for several years.
- Canaccord Genuity reiterated its Buy rating on 4/23

Other catalysts to keep in mind for the first quarter:

- Q4 Results in February


SPSC SPS Commerce, Inc. Nasdaq GM
© StockCharts.com
Technology / Software
Friday 23-Dec-2016
Open: 72.55
High: 73.16
Low: 68.80
Prev Close: 71.88
Ask: 72.57
Ask Size: 4
Bid: 70.77
Bid Size: 2
P/E: 203.17
EPS: 0.35
Last Size: 5394 shrs
VWAP: 70.41
Options: yes
Annual Dividend: N/A
Yield: N/A
SCTR (Small): 47.8
-1.06%
Chg: -0.76
Last: 71.11
Volume: 571,804
RSI(14) 60.69
SPSC (Weekly) 71.11
MA(8) 67.66
MA(20) 68.10
MA(50) 58.74
MA(200) 61.13
76.37
75.47
72.77
70.00
69.06
70.50
68.01
67.94
66.15
65.34
65.17
65.43
45.81
44.15
40.07
38.35
68.29
63.65
74.85
61.40
Jul Aug Sep Oct Nov Dec 2016 Feb Mar Apr May Jun Jul Aug Sep Oct Nov Dec 2017 Feb
Volume 571.80K, EMA(60) 658.07K
MACD(12,26,9) 2.353, 2.414, -0.061

Nord Anglia Education (NORD)

Many of my loyal clients that have been with me for several years would remember my vague references in late 2015 and early 2016 in chat room that I was shopping for a new house and wanted to move to Windermere, Florida region (few miles outside of Disney World in Orlando), primarily due to warmer climate, no state income tax and better quality of living. Plans later changed after thinking hard about keeping my 4-year old daughter during her youth years close to the family with many cousins, aunts and uncles, grandparents most of them live in Michigan. I picked Windermere region precisely for one reason: Windermere Preparatory School, which is voted the best private school in Central Florida. Click HERE for school website.

Windermere Preparatory School is owned by parent company Nord Anglia Education, which operates one of the largest networks of English curriculum premium private schools globally. NORD is $2.4 billion company based in Hong Kong. As of August 31, 2016, the Company taught over 37,000 students, from kindergarten through the end of secondary school (K-12), at its 43 schools in China, Europe, the Middle East, South East Asia and North America.

These are highly sought after private schools with cutting edge multi-cultural curriculum, personalized learning environment, globally trained experienced instructurs, low student-to-teacher ratio, extremely disciplined environment for students, punctuality, uniforms and many other major important attributes all come together in a beautiful campus (and naturally at a high cost for parents). Large percentage of their high school graduates find themselves in Ivy League universities for higher learning.

2016 was a Build Year – NORD has been expanding globally in key markets through acquisitions and build outs, as well as organically by increasing campus sizes to accommodate more students while keeping pace of tuition increases above local inflation. In 2016, stock mostly traded flat between $21 and $23 due to higher capex keeping a lid on margins and Free Cash Flow from accelerating. Net result was FY2016 ended (in August) with $856 million in revenues, up +48%

YoY while EBITDA expanded by +54% YoY to $187 million with only slight improvement in margins from 20.9% to 21.9%. But after accounting for negative forex translation, growth was more moderate than reported in headline figures.

2016 Geographical Sales Breakdown –

- **China:** Sales rose +21.2% YoY and EBITDA margins rose +495 bps to 45.7%. The margin improvement was due largely to enrollment fees ahead of the opening of the Shanghai start-up.

- **Europe:** Sales grew +52.3% YoY driven by the acquisition of College du Leman in Geneva, enrollment growth and tuition increases. Margins improved significantly YoY.

- **Southeast Asia:** Sales grew +35.4% YoY, driven by enrollment growth (namely among its Vietnam Schools) and tuition increases. Margins rose sharply YoY.

- **North America:** Sales rose +27% YoY driven by the Meritas acquisition together with modest enrollment and tuition growth. Margins fell sharply YoY due to the lower-margin Meritas schools and start-up costs among its Chicago campus (Sep 2015) and Houston school (Sep 2016).

Exhibit 1. NORD Premium Schools Revenues and Y/Y Change (F1Q12 – F3Q16)

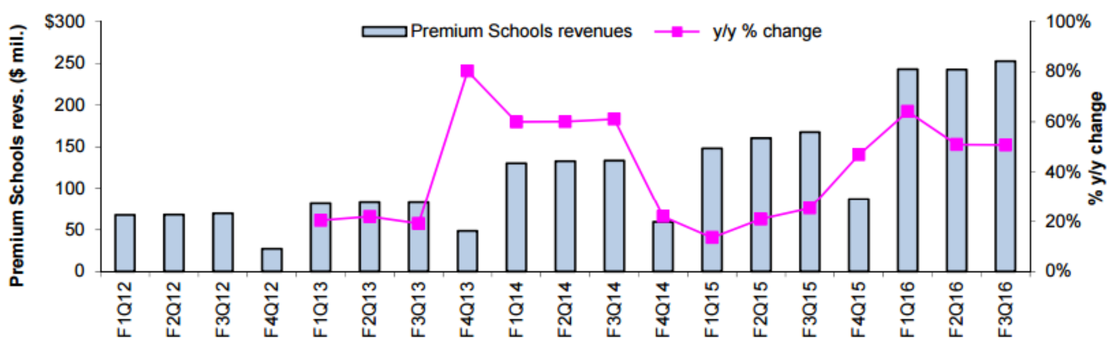


Exhibit 7. NORD Gross Profit and Margins (F1Q12-F3Q16)

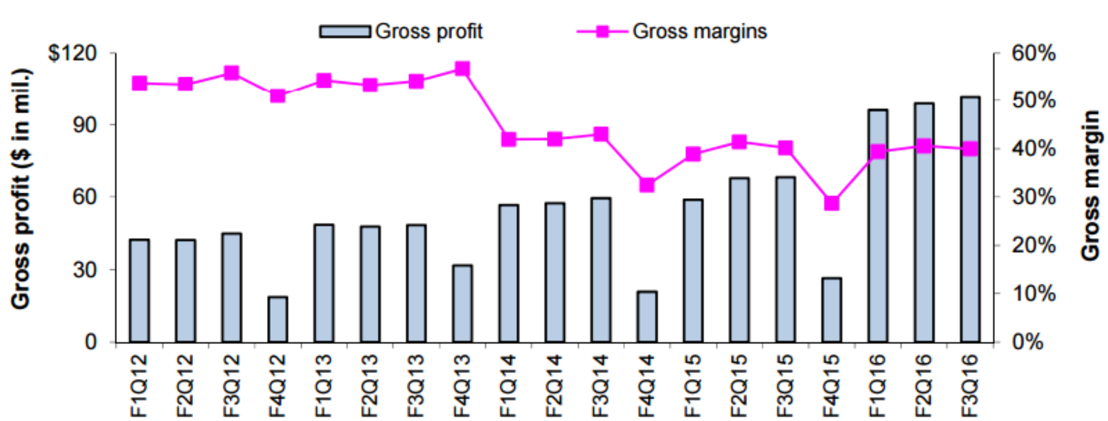
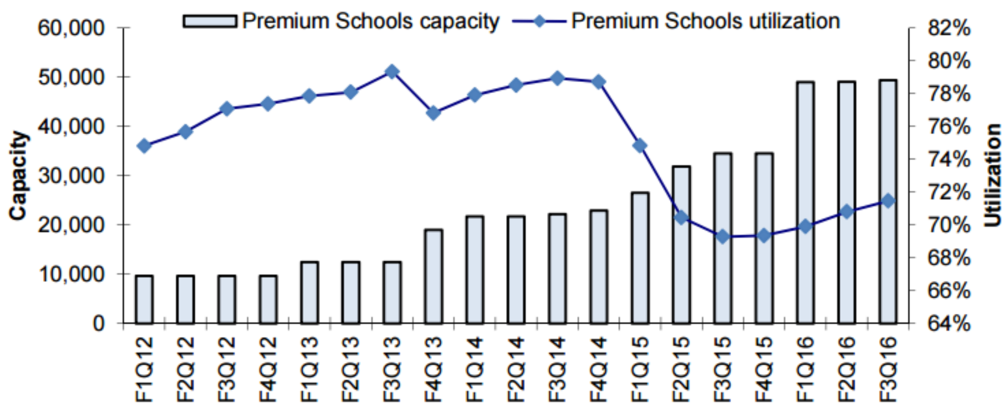


Exhibit 5. NORD Premium Schools Capacity and Utilization (F1Q12 – F3Q16)



2017 will be the Year to Reap Rewards - This hyper growth rate in FY2016 laid down the foundation for strong brand globally. The growth rate will moderate somewhat to near +9% YoY top line growth. Management highlighted they will continue to acquire / build 2 to 3 schools each year. Additionally, after significant expansion in geographically reach in FY2017, the goal has now shifted to bringing costs in line with historic norm. The SG&A expenses are expected to come down by -320 bps in FY2017 and another -440 bps in FY2018. Combine this with projected +9.6% increase in enrollment in FY2017 and another +12.6% increase in enrollment in FY2018 the company is essentially embarking on sharp acceleration in profit margins and Free Cash Flow growth in next two years. And that's assuming flat growth in tuition fees which is highly conservative assumption given historic raises above inflation in local markets. To be clear please note the fiscal year starts in September, so essentially FY2018 will start in September 2017, about 9 months from now. ***It is this commitment to improving financials after big build year why I believe stock is finally starting to breakout and has room to run higher next year.***

Key model assumptions	FY15E	FY16E	FY17E	FY18E
Enrollment (FTE)	23,735	34,898	38,245	43,101
ASP (US$000/FTE)	23.7	24.4	24.1	24.2
Capacity (000 FTE)	32,727	49,892	51,888	55,963

Source: Company and J.P. Morgan estimates.

Sensitivity analysis	EBITDA		EPS	
Sensitivity to	FY17E	FY18E	FY17E	FY18E
Enrollment (1% chg)	0.0%	1.4%	5.5%	7.6%
Tuition (1% chg)	0.0%	3.6%	14.2%	19.9%
SGA (1% chg)	0.0%	-0.8%	-3.2%	-4.4%
1% chg in GM	0.0%	3.7%	14.4%	20.2%

Upside Potential Catalysts –

- Raised $167 million from sales leaseback transactions last quarter bringing total cash position to new record high of $372 million while maintaining leverage net debt / equity below prior'r low. Meaning the company is ready to make more acquisitions any time.

- The latest regulation in China that compulsory education provider (K-9) should be non-profitable in China should not have an impact on the existing bi-lingual school in Shanghai or on the company's expansion plans for new bilingual schools in China. The current school is already registered as a not-for profit school and is in compliance with local regulations. The final decision from Chinese regulators is expected in February 2017 which will de-risk the stock and will allow the company to double the capacity in China by opening a second Chinese bilingual school, a view management discussed in last earnings call but not baked into consensus view.

- Several new capacity expansion projects planned for FY2017 including 1) new campus in Hong Kong with 500 seats, 2) new camputs in Abu Dhabhi with 400 seats with eventual goal to reach 2,000 seats, and 3) new camputs in Bangkok with 1,500 seats. All three expected to be done by September 2017.

Bottom Line - I believe that over the next three to five years, Nord Anglia is likely to generate +15% revenue growth (8–10% organic and 5–7% from M&A), 15–20% adjusted EBITDA growth, and 20%+ earnings and cash flow growth. The company uses a three pronged growth strategy that has enabled it to increase its total seat capacity four-fold since 2018. The English language premium school market is large (~$58B) and highly fragmented, with ~9,000 operators. 88% of the market is run by single-school operators. With FY16 revenue of ~$850 million and 43 schools, Nord Anglia is nearly three times as large as the next biggest operator, but still has a vast addressable market to pursue. Nord Anglia solely operates premium schools, giving it a well-respected reputation. It has cornered leadership in large and growing yet very fragemented market thus creating higher barriers to entry. The company enjoys 97% persistence rate and 4.4-year average student tenure and enjoyes higher 20%+ EBITDA within relatively price inelastic consumers.

This will not be fast and furious momentum stock. But it should provide slow and steady upside with high visibility into growth.


NORD Nord Anglia Education Inc. NYSE
© StockCharts.com
Cyclicals / Special Consumer Services
Friday 23-Dec-2016
Open: 22.89
High: 23.15
Low: 22.52
Prev Close: 22.65
Ask:
Ask Size:
Bid:
Bid Size:
P/E: 50.47
EPS: 0.45
Last Size: 306 shrs
VWAP: 22.72
Options: no
Annual Dividend: N/A
Yield: N/A
SCTR (Mid): 40.6
+0.26%
Chg: +0.06
Last: 22.71
Volume: 76,630
RSI(14) 43.21
NORD (Daily) 22.71
MA(8) 23.28
MA(20) 23.39
MA(50) 22.80
MA(200) 21.93
Volume 76.63K, EMA(60) 81.97K
MACD(12,26,9) 0.009, 0.171, -0.162
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct
Nov
Dec
2017

AstraZeneca (AZN)

It was November 30 when I made this as my Top Pick for 1Q17 with stock at $25.90. Was hoping it would stay there until year end to provide clients the best entry. But in past few weeks stock has been recovering, now in high $20's and I believe it still goes higher from here with high chance of beating market averages, hence keeping it on the list. Several parts of the bull case:

Recent Upside Call Accumulation –

On September 14 – Buyer of 9,500 April 32.5 calls paid $2.80
On November 17 – Buyer of 4,000 April 32.5 calls paid $1.02
On November 28 – Buyer of 20,000 July 30 calls paid $1.55
On November 28 – Buyer of 20,000 July 32.5 calls paid $0.90
On December 2 – Buyer of 10,000 July 30 calls paid $1.40

In less than two months large bulls have accumulated over $7 million worth of calls and majority of it is focused on April and July months.

2017 Pipeline: Buckle Your Seatbelts – As I scan across the entire large pharmaceutical space, few standout with most interesting catalyst-rich pipeline. AZN offers a broad and under-appreciated pipeline which offers potential for premium growth vs. pharma sector in FY2017. AZN has five key Phase-3 read outs in FY2017 (durvalumab, roxadustat, Tagrisso, Lynparza and acalabrutinib) which overall represent as much as $18 billion peak sales potential vs. current consensus view of $8.8 billion based on probability-driven or risk-adjusted. Additionally, there are 3 new launches happening in FY2017 (Bevespi, ZS-9 and benralizumab) with combined peak sales estimate of $3.3 billion at a time when stock is down from -21% in past 3 months washing out the sentiment and creating new low-risk entry for stronger bulls to step in. The next 12-18 months should provide a rich run of news flow for AZN.

Table 4: AstraZeneca key potential product launches

Drug	Indication	Launch	Risk-adjusted peak sales ($m)
Lynparza	ovarian cancer BRCA +ve	2015	594
Tagrisso 2nd line	lung cancer	2015	1,200
Brilinta PEGASUS	ACS 1-3yrs	2016	1,000
Durvalumab tumors	Solid tumours ex lung	2017	1,284
AZD2014	Torc1/2, 2nd line ER+ve mBC	2017	450
PT003 and aclidinium/formoterol	COPD	2017	759
ZS-9	hyperkalaemia	2017	525
Lynparza other indications	Breast/pancreas/prostate cancer	2017	900
Benralizumab	asthma	2017	1,050
Volitinib (C-met)	Multiple tumours	2017	300
Acalabrutinib	BTK inhibitor	2017	1,600
AZD1775	WEE1, ovarian and lung cancer	2017	225

Immuno-Oncology MYSTIC Trial – The race to providing lung cancer treatment is on with full force between several players. For a long time it was thought by many, including myself, that BMY's Opdivo had the lead. While Opdivo worked for treating other forms of cancer, it failed to address lung cancer, leaving the competitive edge to AZN and MRK. AZN's MYSTIC Trial will report Phase-3 data in investigating durvalumab / tremelimumab for potential $16 billion 1st lung cancer opportunity during first half of FY2017. It is perhaps the most important catalyst next year, though only one of several important catalysts.

Chart 3: Potential DCF valuation upside from de-risk adjusting Phase III pipeline

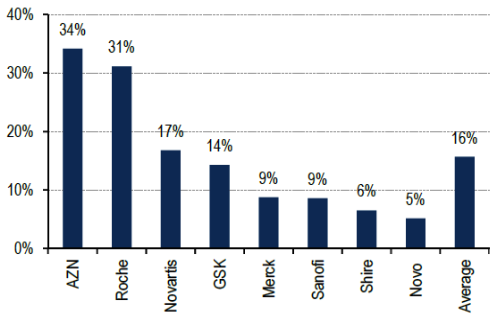
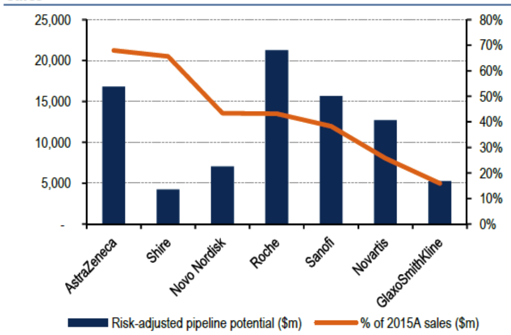


Chart 4: Risk-adjusted peak pipeline sales ($m) and as % of group 2015A sales



<u>The key message is MYSTIC represents almost total upside vs. street forecast for many reasons:</u>

- Consensus risk-adjusted models are based on 30% positive outcome of MYSTIC trial
- If MYSTIC fails, a separate ARCTIC trial with different combos will supersede
- If ARCTIC fails, a Stage III PACIFIC trial with different combos will supersede
- MYSTIC success immediately opens opportunity into Head and Neck cancers
- If MYSTIC fails in 1L of defense, then Ph-3 KESTREL and EAGLE trials are important in 2L
- Consensus $16 billion addressable market size is significantly underestimating potential due to longer period of therapy (potentially >1yr 1L vs. 5m 2L), significantly more addressable patients (260k pts vs. 140k pts), and potential for premium combination pricing ($160k/yr vs. $115k)

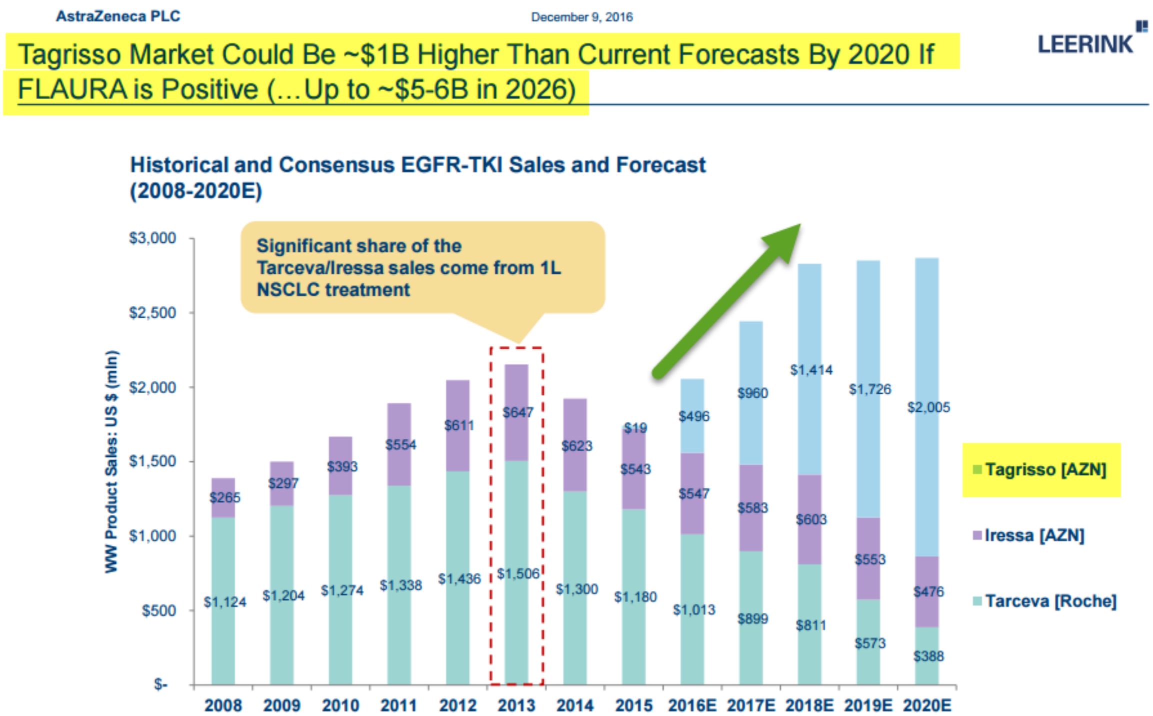
MYSTIC is a 3 arm study involving 1092 patients: durvalumab + tremelimumab vs durvalumab monotherapy vs Standard of Care. At 3Q16 results, AZN indicated that many aspects of statistical analysis can be changed if needed, including primary endpoint. The trial completed recruitment in May-16. The initial focus for combination use was in PD-L1 negative patients (who do not benefit from PD-1/PD-L1 monotherapy). <u>***Post BMY data presented at ASCO16, which showed a stronger benefit in PD-L1 positive patients, AZN incrementally believes that the combination can show benefit in all-comers.***</u>

Why MYSTIC Should Prevail? – After Checkmate study of BMY failed to meet expectations and BMY stock crashed, many had wondered if AZN would follow next. BMY's Checkmate failure at even high expression was attributed to patient baseline imbalances. This raised questions as to how MYSTIC has been stratified to prevent these imbalances. AZN commented on its 3Q16 call:

"Stratified for the meaningful known prognostic factors in non-small lung cancer within MYSTIC. So we're confident there that we've incorporated what we can anticipate into the trial".

Leerink in its stock initiation with Outperform rating on December 9 points out the drug response rate and efficacy appears to have improved modestly as the combo progressed from Phase 1B to Phase 3 trials, this is despite lower number of patients enrolled in AZN's MYSTIC study compared to BMY's Checkmate study. Nevertheless, the progression is in right direction. Based on this and after reviews from MEDACorp experts they conclude the efficacy of combos in MYSTIC trial should at least be the same or better vs. BMY.

Tagrisso Provides the Backstop – If we still assume MYSTIC to fail, Tagrisso then likely to provide the backstop but this becomes 2H17 event when Tagrisso will report Phase 3 data in 1st line of lung cancer. Note Tagrisso has already presented positive data in 2nd Line lung, for which Tagrisso is approved and selling well. In most optimistic scenario, both MYSTIC and Tagrisso report positive data in 1st line of cancer and thus launch simultaneously giving different price points and alternatives to practitioners and thus controlling the market with commanding lead (only to still be faced with Merck's Keytruda in FY2018 and BMY's Opdivo in FY2019).



Weak British Pound to Provide Tailwind – We discussed this previously in September and worth repeating here considering consensus hasn't fully adjusted models accordingly. Post Brexit the collapse in British Pound against the US Dollar makes forward earnings depressed by as much as 17%. In Q4 GBP is down another -3.7% (as of this writing on December 17) which I expect would provide further tailwind benefit next year.

Bottom Line – My top picks in biotech space remain Celgene (CELG) and Incyte (INCY) but as I look at risk/reward profile of AZN given its catalyst-rich pipeline, major Phase 3 upcoming reports, risk-adjusted street models vs. upside potential, valuation (12.3x next year's earnings), significant room to cut fat (SG&A as % of sales is highest among European pharma, potential $800M upside from this alone), and lastly forex positive tailwind, there is plenty to like here for very compelling upside potential vs. downside risk. While I am presenting this as Top 10 pick for Q1, it is quite possible shareholder value creation from de-risking of pipeline will continue throughout next year.

H&R Block (HRB)

H&R Block offers assisted income tax return preparation and related services to the general public primarily in the United States, Canada, and Australia. It also develops and markets do-it-yourself (DIY) online income tax preparation software, provides a range of online tax services, including preparation of federal and state income tax returns, advice and reviews by professionals, access to tax tips and other related assistance.

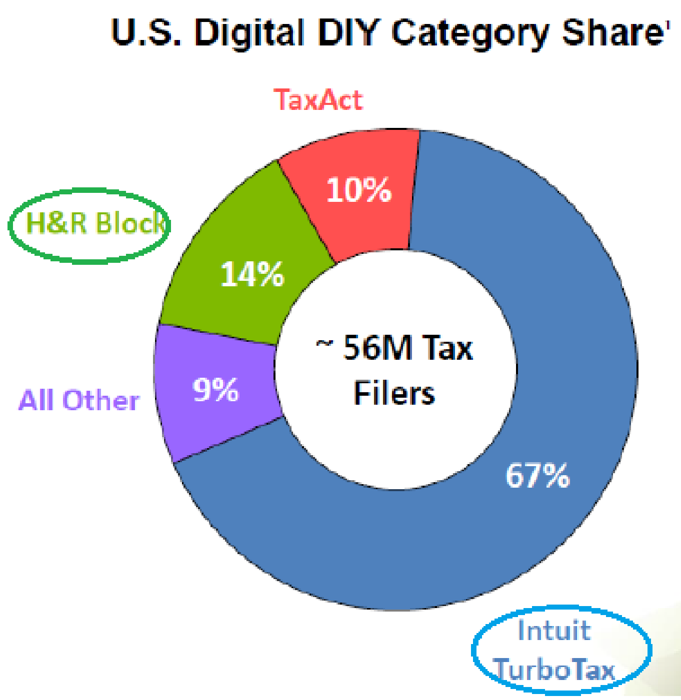
Shift to Online

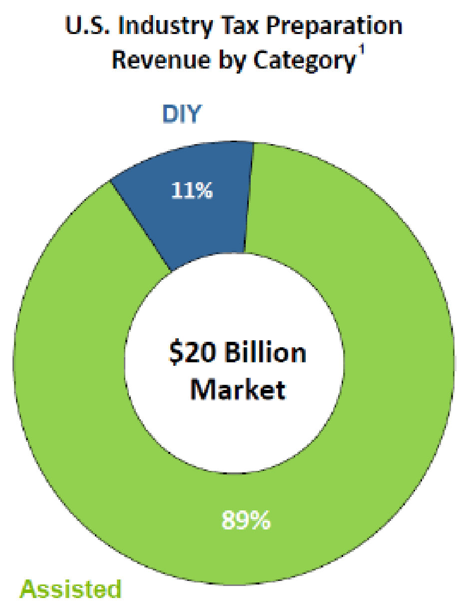
IRS filing statistics for 2015 show receipt of 150.9 million returns of which 128.8 million (85.3%) were electronically filed and of those, 50.4 million were self-prepared, meaning without the intermediary of a tax professional. This emphasises the importance of tax software quality, ease of use, accessibility and price to remain, or even attempt to start being competitive. The good news for H&R Block is that *assisted* tax preparation is the revenue generating segment and it has managed to see total annual volume growth at ~1-2%, correlated partly with non-farm payroll changes. In this highly fragmented industry, HRB is the top player with a 14% share of the $20 billion market.

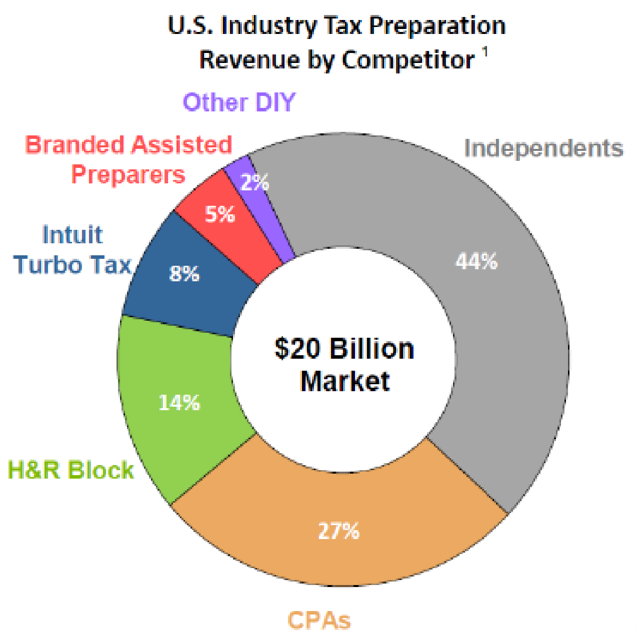
	Total (including extensions/late filers)						
	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	CAGR: FY2010-FY2015
IRS Filing Statistics:							
Individual income tax returns (in mil							
Total receipts	142.4	145.3	148.2	148.2	149.7	150.9	1.2%
Total processed	142.2	145.1	147.7	147.9	149.5	150.7	1.2%
Individual income tax returns (y/y % change)							
Total receipts		2.0%	2.0%	0.0%	1.0%	0.8%	
Total processed		2.0%	1.8%	0.1%	1.1%	0.8%	
E-filing receipts (in mil.)							
Tax professionals	63.9	72.4	76.3	77.3	77.9	78.4	4.2%
Self-prepared	34.8	39.8	43.2	45.2	47.9	50.4	7.6%
Total	98.7	112.2	119.6	122.5	125.8	128.8	5.5%
As % of total receipts	69.3%	77.2%	80.7%	82.7%	84.1%	85.3%	
E-filing receipts (y/y % change)							
Tax professionals		13.4%	5.4%	1.2%	0.8%	0.7%	
Self-prepared		14.2%	8.6%	4.6%	6.0%	5.1%	
Total		13.7%	6.5%	2.5%	2.7%	2.4%	
By method as % of total e-filed receipts							
Tax professionals	64.7%	64.5%	63.8%	63.1%	61.9%	60.9%	-1.2%
Self-prepared	35.3%	35.5%	36.2%	36.9%	38.1%	39.1%	2.1%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	

Loss of Market Share

For a number of years, H&R Block has been losing customers to the growing DIY tax-filing segment led by their main competitor Intuit (INTU) with its ***Turbo Tax*** software having attained 67% category share, easily outpacing H&R Block's 14%. Management admits that one of the biggest problems here is lack of the public knowledge of H&R Block product offerings, with 40% of the addressable market not being aware of their electronic filing programs, and 96% thinking of them solely as tax preparers.







- While assisted constitutes ~57% of returns, it accounts for 89% of industry revenues
- H&R Block tax preparation generates more revenue than all assisted and DIY branded competitors combined

Problem Solving

During their 4Q2016 earnings release and conference call in April, their largest revenue generating quarter, management acknowledged they needed to do something to counteract losses brought on by early season filers of 1040EZ forms as well as returns claiming Earned Income Tax Credit (EITC). At the same time, H&R Block also indicated a 2.6% decline in tax returns prepared using their online products, in both desktop and mobile, blaming it primarily on “aggressive pricing strategies by industry competitors”, one of which in this case was a zero-cost offering by Intuit versus their own $10 service. CEO Bill Cobb assured investors they were working to " fully understand the outcomes from the season” and would take the actions necessary to improve results, adding that the volume losses were unacceptable, and finished by saying that investors would see a “very different” H&R Block in FY17. Quickly outlined, 1040EZ is the simplest of the three tax forms with sub-$100k taxable income, no adjustments, only earned income credits and no dependant claims. The other two forms are 1040A and 1040.

Promotions for 2016 Tax Season

As management promised back in April, they mapped the plan for their 2016 filing season promotions:

- **Refund Advance** – Interest free, no fee loan to qualifying assisted filers which will cost the company an estimated $32-$36 per return. These advances will be via a pre-loaded H&R Block Emerald Card, which can be assumed that the company hopes clients will re-use, thereby generating additional income from associated usage and re-loading fees. With the enactment of the PATH act, this promotion is expected to benefit those who would otherwise have to wait until at least February 15th for the IRS to release refunds after the required time frame intended to counter fraudulent tax credit filings resulting from identity theft and deceitful wage reporting.

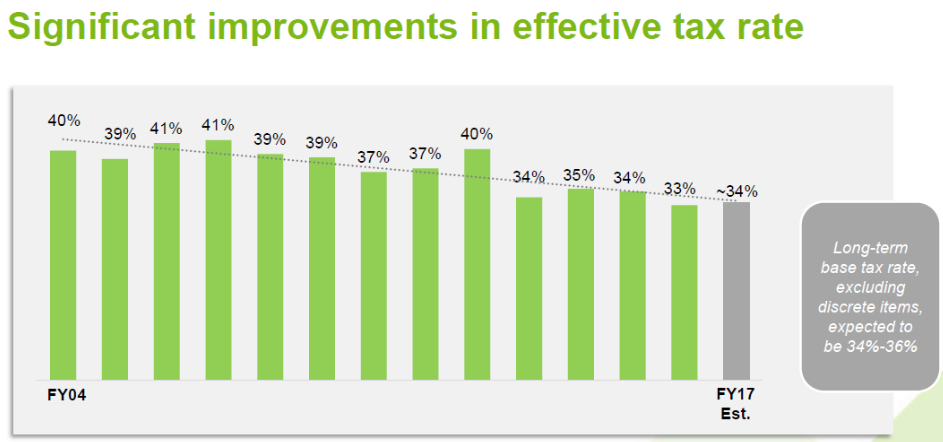
- **Free 1040Z assisted returns** - This is in an effort to simply bring more people through their doors and possibly sell them services such as state returns as well as other financial products. A similar promotion back in FY2011-FY2013 resulted in successful volume growth.

- **Free DIY offering** - A direct competition to other companies offering free products, such as Intuit’s Turbo Tax. Last year’s promotion of a $10 product failed in light of Intuit’s free service, especially with EITC filers who are the most price sensitive demographic.

Management has continued to acknowledge their mistakes of past tax seasons that brought them to where they are and have implemented these aggressive strategies to stop client declines. Their expectations aren’t of client growth in FY2017 but rather a significant moderation in the trend. They are also keen on enhancing customer experience by updating their long-neglected service delivery model, something they hadn’t done in decades. Retraining sales agents through newly developed programs and bringing in experienced managers is also expected to improve the overall customer service aspect within the company.

Corporate Tax Reform

H&R Block has taken into consideration a 34%-36% tax rate for the next three years. If Trump holds true to his proposal of a 15% rate, BMO estimates this would add nearly $0.42 in EPS for FY2018. Any of these new regulations would most likely take effect, or at least start to be formally proposed after February, past the first quarter for calendar 2017 that this outlook covers.



H&R Block may benefit from future corporate tax reform

Path To Growth

The objective with these promotions is to ultimately see a return to volume growth. While actual uptick may still be a few quarters away, investor focus will be on the slowdown of the decline rate, an early signal of a turnaround. With their aggressive marketing and competitive, zero-cost promotional products in place, a change in trend should be forthcoming as the 2016 tax season gets under way in January. As investor and analyst sentiment is at best neutral, any positive shift of client numbers could be construed as supportive of the company's path to market share accretion and instil confidence H&R Block's position in the tax software and preparation services sector.

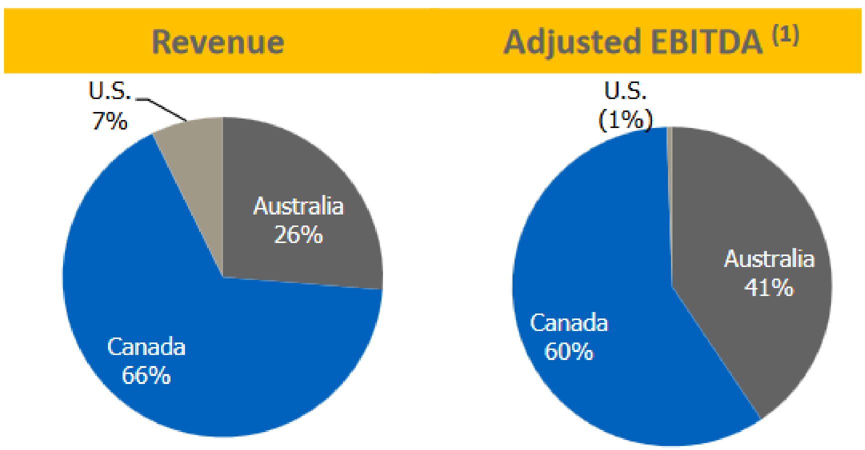

HRB H & R Block, Inc. NYSE
© StockCharts.com
Cyclicals / Special Consumer Services
Friday 23-Dec-2016
Open: 23.270 Ask: 23.400 P/E: 19.24 Options: yes
High: 23.330 Ask Size: 2 EPS: 1.21 Annual Dividend: 0.88
Low: 23.120 Bid: 22.350 Last Size: Yield: 3.78%
Prev Close: 23.300 Bid Size: 10 VWAP: 23.255 SCTR (Large): 33.7
-0.09%
Chg: -0.020
Last: 23.280
Volume: 2,364,567
RSI(14) 54.73
HRB (Daily) 23.28
MA(8) 23.20
MA(20) 22.77
MA(50) 22.70
MA(200) 22.67
Volume 2.36M, EMA(60) 3.05M
MACD(12,26,9) 0.199, 0.165, 0.034

Civeo (CVEO)

On November 31st 2016, two years after deciding to let markets dictate oil price, OPEC announced it would cut crude production by 1.2 million barrels a day in an effort to rebalance the glut and stop further price drops, a move that was followed a few days later by non-OPEC members reducing their output by 558,000 barrels per day through the end of June 2017.

Fueled by this news, crude prices have climbed over 10% near the $50 mark which has not been seen since July 2015's relentless decline. This bodes well for North American explorers and producers as well as to companies that provide logistics support, namely in lodging and accommodations, which brings us to the bull case for Civeo (CVEO).

Civeo is a Houston-based provider of logistics, facility management services and scalable modular facilities for temporary or long-term remote site accommodations catering to the natural resource industry. The $250 million company was spun-off in 2014 from Oil States International (OIS) as a stand-alone accommodations entity for operations in active oil, natural gas, coal and iron ore producing regions in Canada, the United States and Australia. Its two primary locations with the largest concentration of rooms are the oil sands region in Western Canada and the metallurgical coal region of Australia's Bowen Basin.



Crude Awakenings
A few short months after its IPO, CVEO stock began its decline from the mid-$20 range as it mimicked crude's price action. With little incentive for energy explorers to continue large-scale operations from oil's rapid descent from $105 down to $60 and then subsequently all the way to $30, nearly 40,000 jobs were cut from oilfields in the region and in supporting positions that threw Alberta's economy into chaos. In February of 2016, oil's price finally bottomed but remained on uncertain ground through rumors and one failed OPEC meeting in the summer, all the way to November's deal.

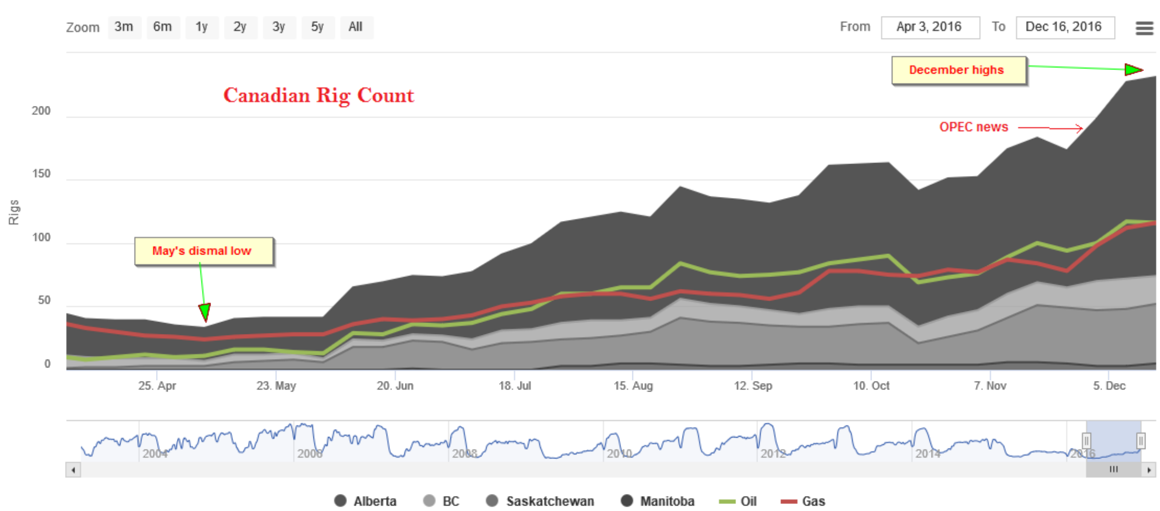
Shortly after OPEC and non-OPEC countries announced their decision, a multitude of energy exploration companies released revised CapEx guidance for the upcoming quarters. As of mid-December, 65% of companies that have so far reported 2017 production guidance are expecting an increase in volumes over the next 12 months that sets the tone for a rebound in activity.

Recent renewed project announcements include:

- **Cenovus Energy (CPG)** 24% boost to capital budget and asking contractors to re-submit bids to continue work on their Christina Lake 50kbd operations expansion, on hold since late 2014
- **Suncor (SU)** while lowering CapEx by about $1 billion, is planning to spend roughly 40% of their allocation in Alberta's Athabasca region where Civeo's largest camps operate
- **Husky Energy (HSE.to)** has plans to increase spending by about $2.6 billion
- **Center Point (CPG)** increased its planned expenditure by nearly half a billion to $950 million due to their expectations of higher crude prices in the second half of 2017

Alberta's Modernized Royalty Framework that comes into effect at the beginning of 2017 is also said to be another beneficial point in helping the oil and gas industry to remain competitive. The provincial government has been receiving early applications since August for drilling operations for which it expects to see an increase in job and investment numbers through next year, estimating 135 jobs (direct and indirect) per operational rig.

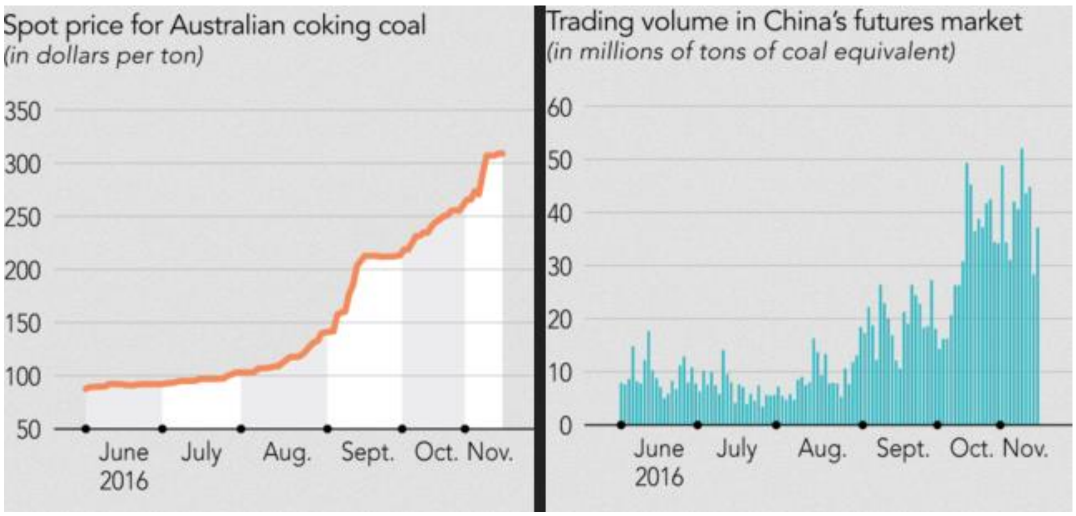
Increasing Rig Count
Since hitting a dismally low 35 rigs in May, operational count has steadily climbed to mid-December's 234 with expectations of further increases as winter operations, the busiest time of the year, begin.



A far more stable oil price, as well as the past 18-months of adapting to a lower-for-longer pricing environment, has increased confidence among Canada's oil and gas companies. More robust drilling and completion plans have proliferated as a result.

Australian Operations and coking coal price
Since June, coking coal prices have been on a tear rising from $80 a ton to $300. The rally was triggered by the Chinese government's decision to limit coal mine operations from 330 days a year to 276 or fewer days as it seeks to restructure the industry. The resulting 10% drop in output, combined with safety closures and weather-related supply curbs in both China and

Australia only added fuel to the fire with speculative futures trading volumes increasing nearly four-fold from their prior levels. While there are many calling this move irrational and unsustainable, Goldman Sachs recently raised its 2017 coking coal price forecast to $135 a ton, a 64% increase from their previous expectations, albeit below current price levels. Other analysts contend that futures prices dictate this move to last until March 2017.



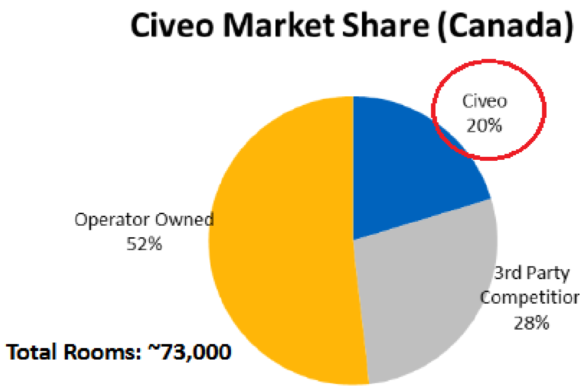
Despite this impressive run, Civeo management said that they had not seen a trickle-down effect to their lodgings and accommodations operations' benefit. This, however, was during their post-earnings conference call on October 31st, and it is possible that since then there has been further expansion of the labor force as this rally is expected to add billions of dollars in earnings to Australian mining companies. Since it was not in management's guidance view, this could add an unexpected small tailwind for 4Q.

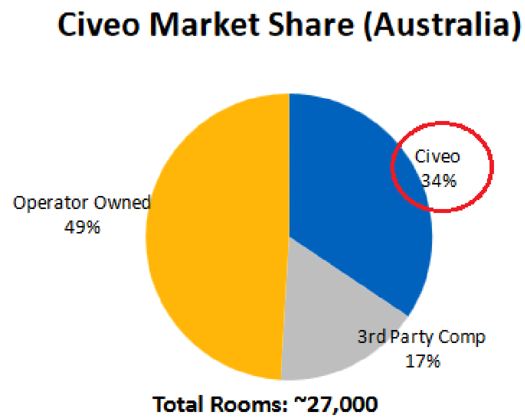
Waiting on LNG Opportunity

A delayed LNG liquefaction project led by Shell, KOGAS, Mitsubishi and PetroChina could potentially add a major new market segment for Civeo if it were to materialize. The facilities would be located in Kitimat, British Columbia, and take 3-5 years to complete with an estimated requirement of 4,500-7,000 rooms. This project is awaiting final decision by all parties with a tentative date of 1H2017 and if it does go through, would add a sizeable amount of revenue to the company's bottom line.

Operations Overview

Civeo maintains and operates 19 lodges and villages with a total of 23,000 rooms. Additionally, in the U.S. and Canada they have nine smaller open camp properties as well as a fleet of mobile accommodation assets. Their largest lodge is the Wapasu Creek Lodge north of Fort McMurray, Alberta with 5,174 rooms, and their second largest is the Copabella Lodge with over 3,000 rooms on the other side of the world, literally, in Queensland, Australia.





Wapasu Creek Lodge

Guidance was Pre-OPEC

As mentioned earlier, Civeo reported their earning prior to OPEC's November decision. As such, their outlook more likely than not wouldn't be inclusive of a speculative possibility. Therefore, it is very likely that estimates and expectations may lag this upcoming quarter's actual numbers. Considering the share price action we have seen, it is very evident that this stock can and will move along to the underlying commodity and industry's pace and with forecast production and higher oil prices it is very likely that Civeo shares will continue to appreciate in the early months of 2017.


CVEO Civeo Corp. NYSE
© StockCharts.com
Cyclicals / Hotels
Friday 23-Dec-2016
Open: 2.22 Ask: 2.42 P/E: -2.69 Options: yes
High: 2.29 Ask Size: 50 EPS: -0.85 Annual Dividend: N/A
Low: 2.18 Bid: 2.10 Last Size: 5953 shrs Yield: N/A
Prev Close: 2.23 Bid Size: 32 VWAP: 2.22 SCTR:
+2.69%
Chg: +0.06
Last: 2.29
Volume: 456,814
RSI(14) 57.61
CVEO (Daily) 2.29
MA(8) 2.33
MA(20) 2.22
MA(50) 1.75
MA(200) 1.56
Volume 456.81K, EMA(60) 809.33K
MACD(12,26,9) 0.167, 0.202, -0.035

Key Debates and Catalysts

Critical underpinnings of our market view are subject to vigorous debate in the marketplace. We looked for debates that are likely to matter to investors, that are likely to be settled (or significantly advanced) in the future. Some of these are particularly relevant for Q1, most would likely take longer and play out throughout in 2017 and beyond.

The key here is taking an alternative yet high-probability view of certains sectors and stocks which will matter the most in the future. As such, at minimum, being able to provide you with view on risks and opportunities.

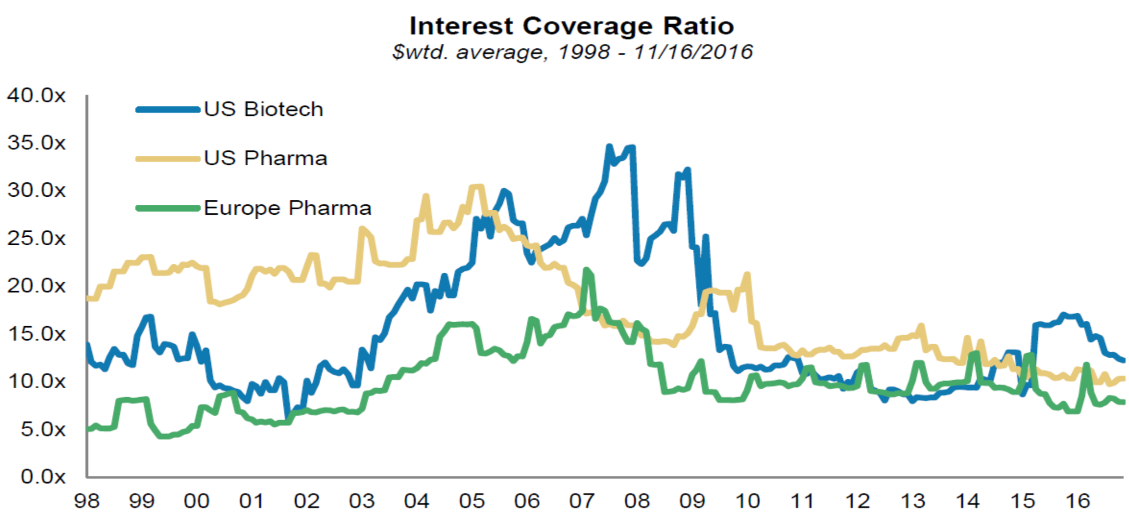
Biotechnology – Will M&A Pick Up in 2017?

Managements have indicated the industry wants grow at +5% CAGR through 2020. To get there industry needs additional $125 billion in sales. The industry has the most cash on record of over $250 billion. Interest coverage rates are ~10x for US and EU pharma putting them in a low leverage position that would allow them to finance potential M&A deals. Structural issues specially around pricing uncertainty remains a clear barrier in reaching that +5% goal, though arguably with lesser hurdles after Trump victory who will incentivize companies for repatriating foreign cash. M&A has to remain key part of equation for industry to meet long term objectives. In 2015 there were 20 deals, 10 of which were about $5 billion. In 2016 there have been 12 deals and only 3 of these were above $5 billion. The slowdown was due to threat from Clinton campaign that compressed valuations to 10-year low creating M&A attractiveness at time of scarcity of strong pipeline assets. We believe Oncology provides the greatest possible upside in biotech sector, followed by rare disease. Favorite picks: **BMRN, INCY, CELG** and **AZN**.

Industry growth versus mid-single-digit target

	2015	2016	2017	2018	2019	2020
Actual (USD, $m)	845,130	864,228	898,211	934,466	971,277	1,018,592
Growth		*2.3%*	*3.9%*	*4.0%*	*3.9%*	*4.9%*
Targeted (5% y/y) (USD $m)	845,130	887,387	931,756	978,344	1,027,261	1,078,624
Growth		*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*
Differential	0	23,159	33,545	43,878	55,984	60,033
			44.8%	*30.8%*	*27.6%*	*7.2%*
No Pipeline (USD,$m)	845,130	863,828	897,100	919,380	935,259	954,787
Growth		*2.2%*	*3.9%*	*2.5%*	*1.7%*	*2.1%*
Targeted (5% y/y) (USD $m)	845,130	887,387	931,756	978,344	1,027,261	1,078,624
Growth		*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*
Differential	0	23,559	34,657	58,964	92,002	123,838
			47.1%	*70.1%*	*56.0%*	*34.6%*

Interest Coverage ratio for US and EU

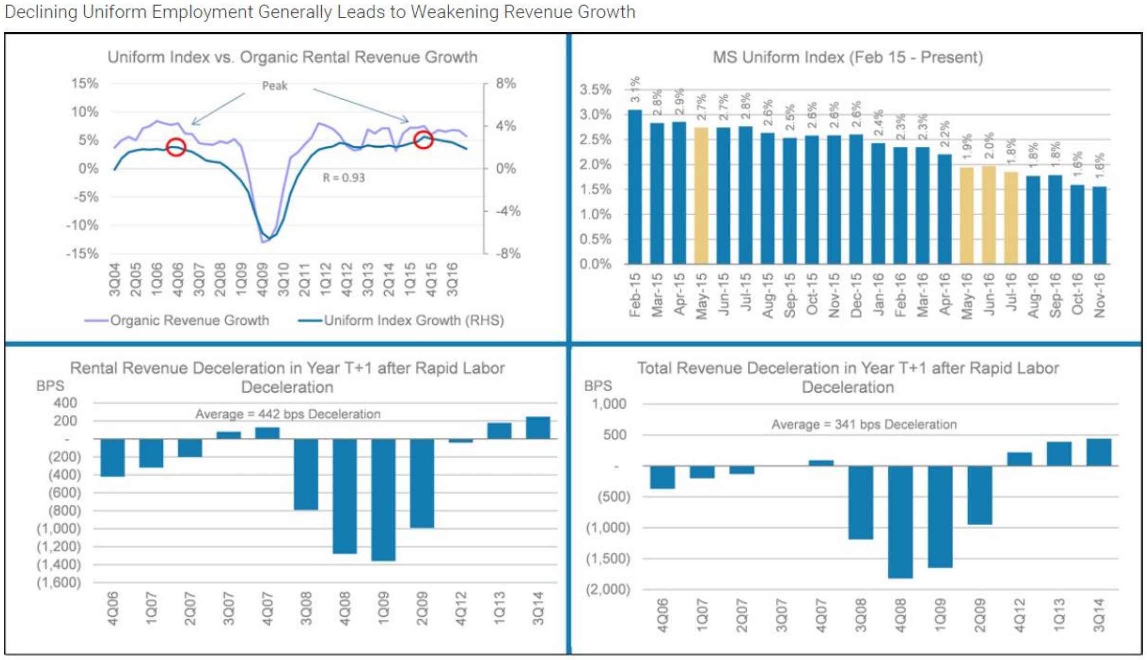


<u>Cintas (CTAS) – Don't Let Strong Chart Fool You</u>

Over the years, Cintas has benefited in recent years from a growing uniform employment market, while sales of ancillary services such as mats and restroom supplies have outperformed historical averages. Additionally, there is much optimism around pending acquisition of G&K as value-enhancing. But issues here are more structural and history is not on company's side. Since peaking in Feb 2015, uniform sales in the US have decelerated by 150bps to +1.6%, as Cintas' organic revenue growth has fallen from +7.5% to +5.7%. As chart shows below, the index peaked 23 months before prior cycle slowdown which coinceded with US reaching full unemployment rate of below 5%, resulting in less elasticity in the business. In current cycle growth peaked 22 months ago. CTAS competitors (ARMK) is already showing similar weakness as seen with blow up after Q3 earnings. At G&K (which is being acquired by CTAS), in August 2015, management introduced a 2-4 year revenue growth target of +5%, but since that point, growth has decelerated by -340bps. Another competitor UNF which has exposure to energy sector posted major revenue shortfall in Q3 resulting in stock gap down. Even as growth slows, much of this is driven not by increasing customer count, but improving penetration of its existing customer base which is unsustainable in long run given cyclical nature. For example, in FY16, dust control revenue grew 7% vs. its 2% CAGR from 2007-16, while restroom supplies improved 15% y/y compared to its 8% average growth from 2007-16. If both of these verticals reverted to their historical mean in FY17, it would result in a ~2% headwind to Uniform Rental segment growth or a ~1.5% headwind to total company growth.

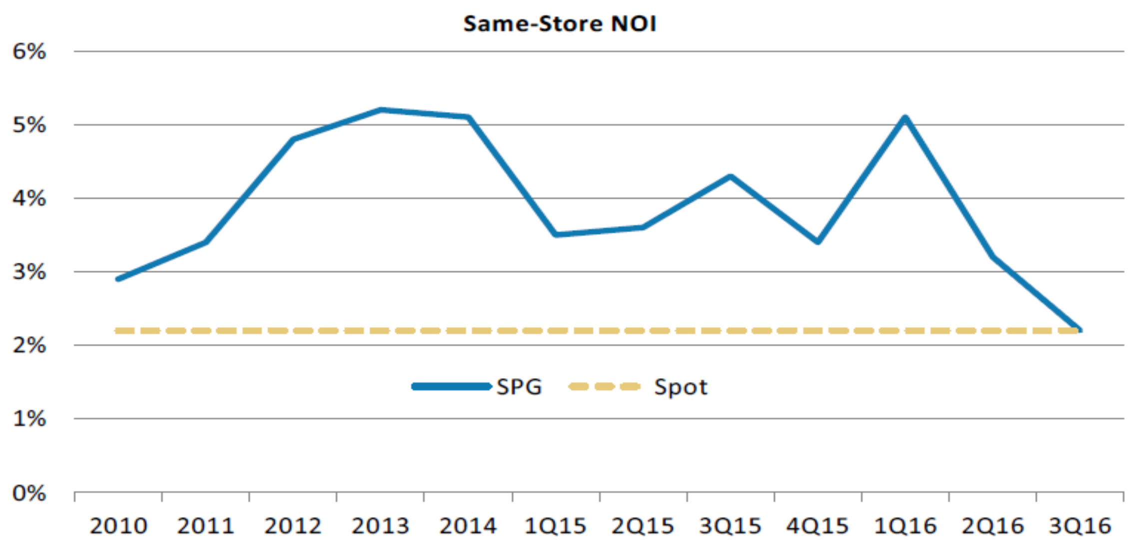
The sector remains highly correlated to payroll data. We believe if monthly job report continues to steady deceleration in net job gains, it will start to weigh more rapidly on **CTAS, ARMK** and **UNF**.

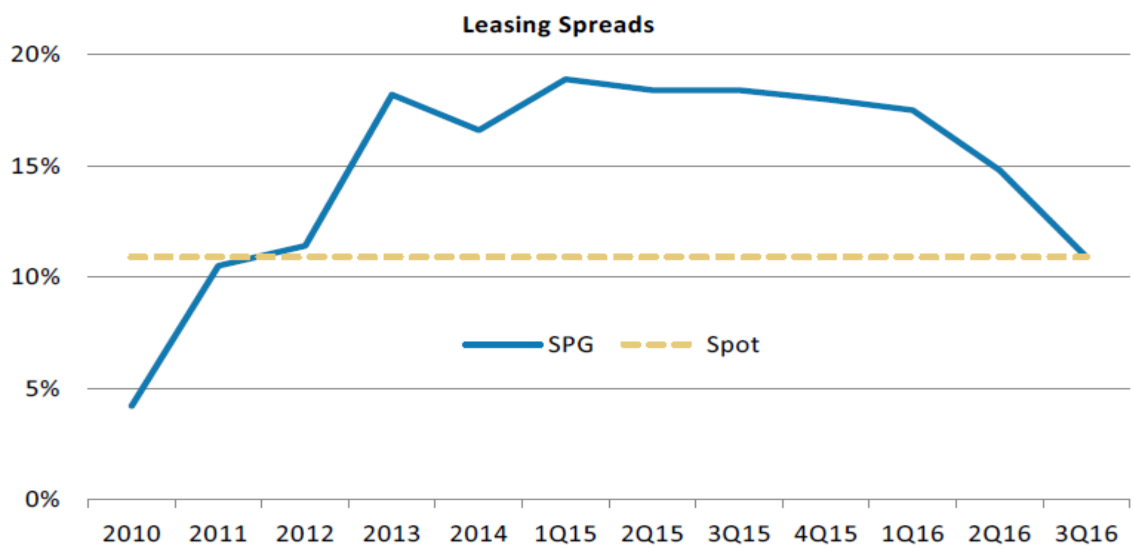
Declining Uniform Employment Generally Leads to Weakening Revenue Growth



Simon Property (SPG) – Operating Metrics Worst in 5 Years

Troubling picture emerging on operating metrics. In Q3, re-leasing spreads were 10.9% compared to 14.8% last quarter, lowest level since 4Q12. Comparable property NOI growth was 2.2% compared to 3.2% last quarter, lowest level since 1Q10. Sales per square foot declined to $604 the lowest level since 1Q14. Occupancy costs increased to 13%, the highest level 3 years. Lease amendments are becoming increasing headaches and main driver of lower lease spreads. A secular trend playing out nationwide in malls and outlets that can perhaps be justified by simple logic of loss of market share to online retailers. Aeropostale has announced closure of 500 stores and Macy's wants to cut 100 stores. The company staunchly blamed strong US dollar in Q3 negatively impacting sales at tourists destinations leading to lower overage rent. It's worth noting in Q3 USD was up +2% and so far in Q4 it's up +7.5%. We believe there is more pain ahead for the sector given secular structural shifts. Avoid stocks: **SPG** and **EQR**.





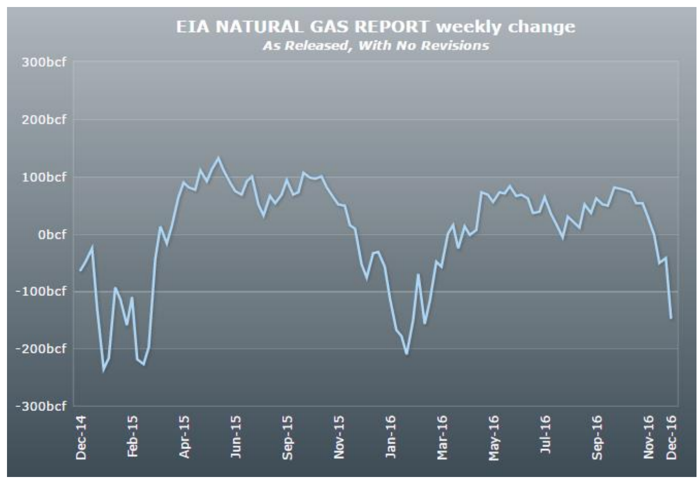
Short Coal-Exposed Railroad / Buy Auto-Exposed Railroad

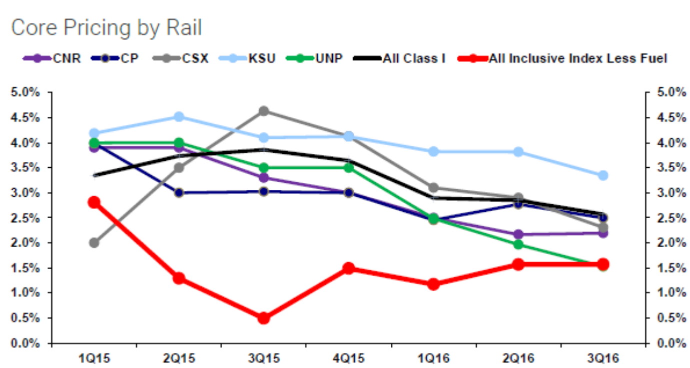
In recent months, coal has been shining like its gold with market turning increasingly bullish primarily led by two reasons:

1) Surge in China steel stockpiling with metallurgical coal as major input for production.
2) Natural gas rallying +38% since mid Oct providing utilities incentive to switch to coal.

Point #1 Counter Bear Case - China stockpiling has historically shown tendency to come to sudden halt after brief moments of spikes. We believe it happens in Q1 after rising steel prices in itself leads to cut back on buying spree. Its also to be noted the precise reason for rising steel prices since September was Dept of Commerce investigations on anti-dumping after China was observed circumventing the rules (post +550% imposed duties by Obama Administration in 2015), by shipping through Vietnam. We discussed this in a bull case previously **HERE**. This resulted in supply cuts, not increase in demand, to explain the surge in steel prices and we believe it reverts back in Q1 taking down coal with it.

Point #2 Counter Bear Case – Don't lose sight of seasonality. Natural gas inventory each winter depletes sharply with obvious case of higher consumption. See chart below. Inventories to tend to bottom in Jan/Feb period then starts to rebuild gain through out the year. This year is no different except that natural gas price increase is exaggerated by cyclical rotations post elections. We believe utilities will start resisting the urge to switch to coal after inventory normalization in Jan, resulting in further erosion in coal prices.





CSX stock has surged +22% since October with coal price on assumption that it will give the railroad pricing power. Reality is only 2% of CSX revenues come from met coal exports, pricing will have to surge meaningfully to make an impact on the overall pricing number or Operating Ratio. Coal pricing has declined gradually all year at each railroad despite increase in the underlying commodity. On other hand, we continue to like KSU setup given its heavy exposure to auto manufacturing facilities buildouts in Mexico despite political uncertainty from Trump. **<u>We like long KSU / Short CSX setup for 2017</u>.**

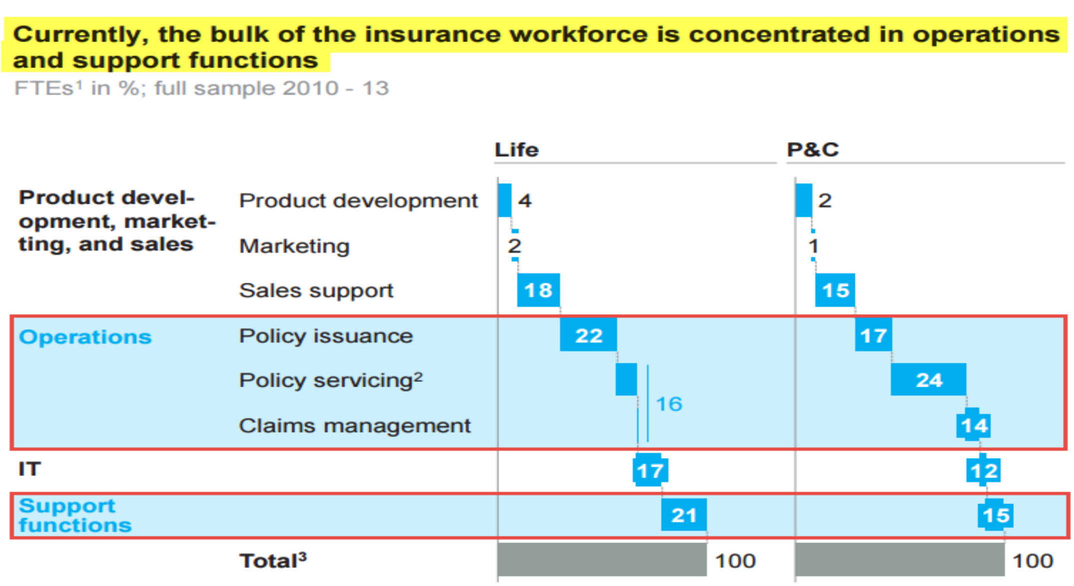
P&C Insurance – Major Growth Ahead w/ Digital Transformation

The digitally underwritten small business insurance (SBI) market is expected to grow at accelerating rate from its current $4b to $26b by 2020 representing +50% CAGR substantially higher than +2% overall commercial insurance market, and we believe over $5b profits are up for grabs. SBI offerings will take on more digital character led by new InsurTech startups. Key winners will be large players with cash and drive for technical innovation. By 2020 more than 60% of small businesses will be owned by Millennials and Gen Xers, two groups that prefer to do as much as possible digitally. From Morgan Stanley:

"Among early movers in the market include AIG's joint venture with Hamilton Insurance Group and Two Sigma to create a technology based platform for direct sales to small businesses (April 2016); Travelers online platform to sell directly to small businesses in the UK (June 2016). Chubb and W.R. Berkley have been talks about entering the market. InsurTech startups that have recently raised funds include CoverHound (a rate comparison site for personal and commercial insurance) that raised $33m in 2015 from a consortium of investors including American Family Insurance and Chubb; Lemonade (direct to consumer insurer) recently raised $33m and has investors from XL Capital among others."

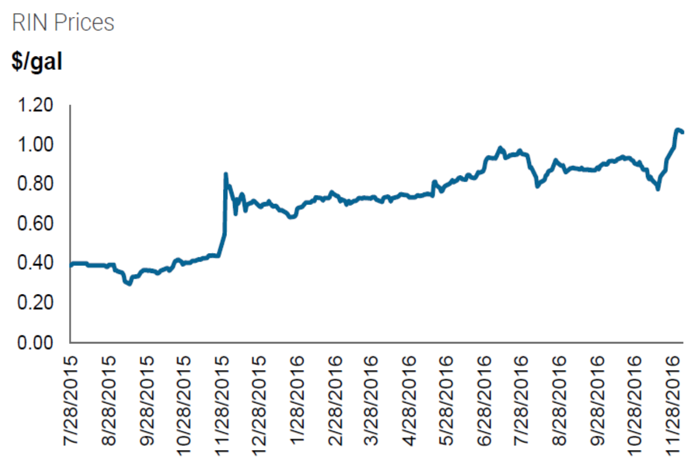
Put it simply, the industry is full of inefficiences with traditional ways of conducting paper processes, creating layers of fat that need to be taken out. Chart below shows only 30% of cost structure supports the sale function, all the rest is clouded with excessive support functions that is subject to major automation at accelerating rate going forward. Conservatively, McKinsey estimates that P&C and life insurance carriers have up to 40% of their expenses locked up in their top 30 core processes. Digitizing those processes end-to-end, through automation, integration and straight-through-processing will yield major improvement in operating profit margins and offerings of new differentiated policies to customers. McKinsey wrote detail paper on this a year ago, now we see this accelerating. See **HERE**.

Jag's Favorite Pick: **Progressive Corp (PGR)**

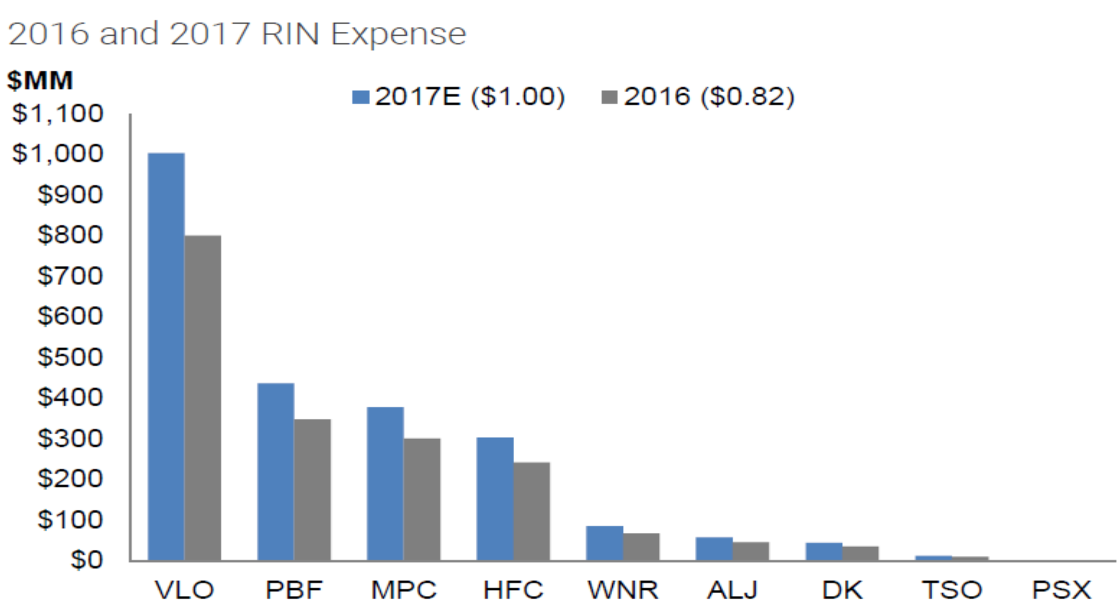


Oil Refiners – Renewal Fuel Standard Changes to Boost Outlook

The EPA enforces a law called Renewable Fuel Standards (RFS) which governs how much ethanol has to be blended with carbons to make fuel cleaner. This law assigns a serial number called Renewable Identification Number (RIN) to a batch of biofuel for the purposes of tracking its production and use. RINs can be sold and traded by anyone. RIN prices averaged $0.51/gallon in 2015, rising to $0.74 in 1H16, ended at $1.06/gallon in November. This is significant cost to refiners that eats into margins.

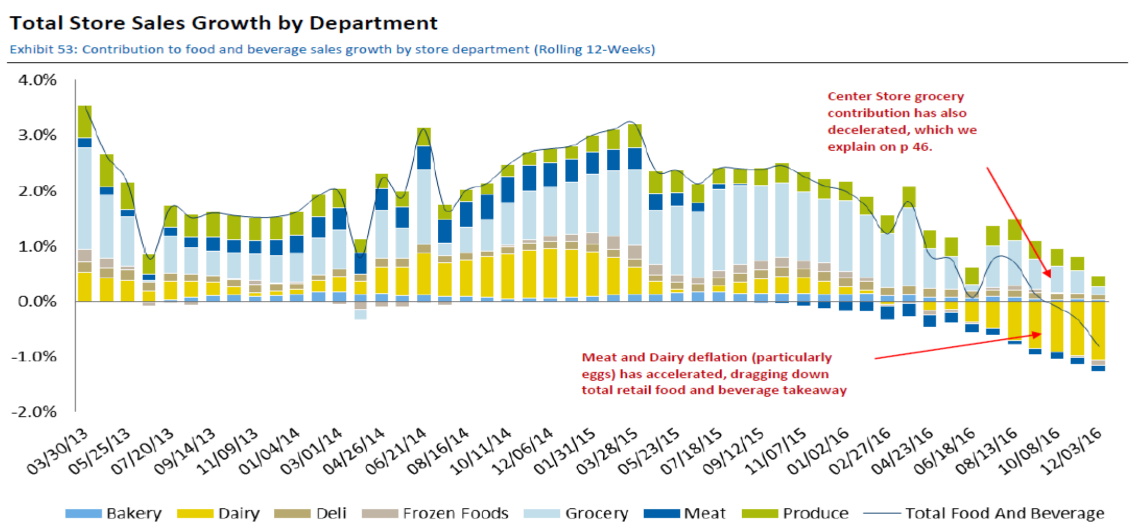


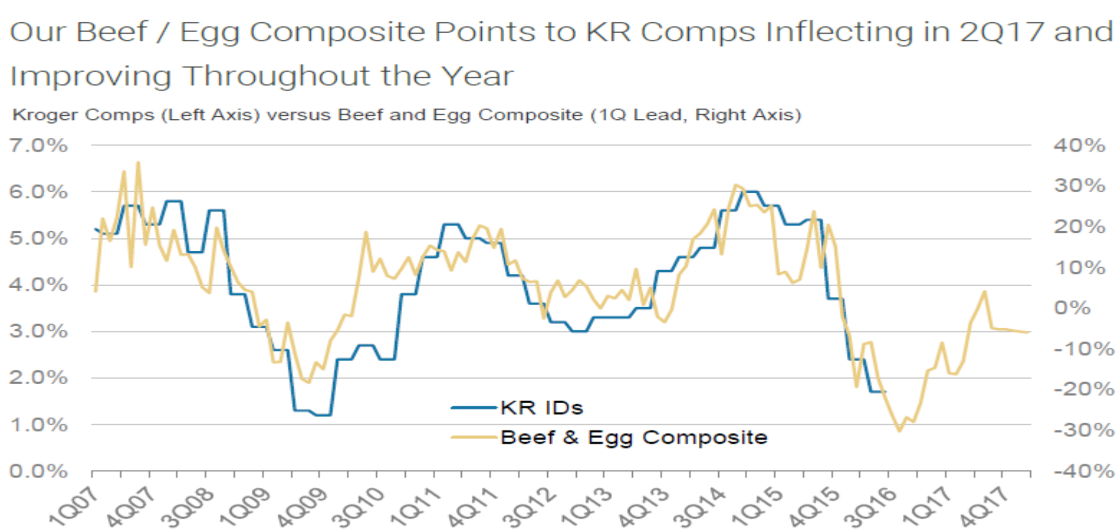
Additionally, in early December EPA also set the final Renewable Volume Obligation (RVO) for 2017 at 15.0 Bn gallons, above the proposed 14.8 Bn, further increasing the amount of ethanol required for the industry, providing no near-term reprieve for refiners. But given political change in Washington, all these recent changes were postponed by 60 days until formal adoption, which means now new EPA adminstrator under Trump gets to decide sometime in Jan/Feb period. Trump openly suggested in campaign that he wants to reduce or eliminate "RIN Tax" (note this tax didn't even exist before 2005). Trump's appointment of Carl Ichan, who has large positions refiners, for running National Trade Council is probably the best thing could have happened for the group. This is a major catalyst. Who is going to benefit the most? Consensus is modeling $1 billion in RIN expense for VLO, about $400 million for MPC. TSO will benefit after it acquired WNR plus our primarly bull case in TSO is better than expected growth in Marketing business. Best Long Ideas: **VLO, MPC, TSO**.



Kroger (KR) - Will We See Uptick in Food Inflation?

Food deflationary pressures have been building for 2 years but in recent months accelerated. This has led to significant erosion in SSS growth of grocery retailers such as Kroger, which has 0.8% correlation with beef and egg prices. While there are many reasons for deflationary pressures, we don't believe it is structural but rather cyclical and transitory and we believe 2017 will see normalization by 2H. Based on RBC Capital's discussions with industry experts from "CircleUp" history suggests this extreme extent of deflation is in final 3 to 6 months before a snapback. Conclusion is entirely driven by >100% rise in crude oil price and food prices lag by 9 months historically. Separately, using quantitative studies from Morgan Stanley in its "Sinisi' Shop" review points to the same conclusion. To further validate this, we looked at regression model from JP Morgan showing Kroger's 91% correlation to CPI Food reaching near exhaustion point. Kroger has been aggressively cutting costs to maintain margins. We will have to monitor how Food CPI evolves from here and if there is any uptick in inflation, given the company is running very lean, we would immediately expect significant upward earnings revisions.



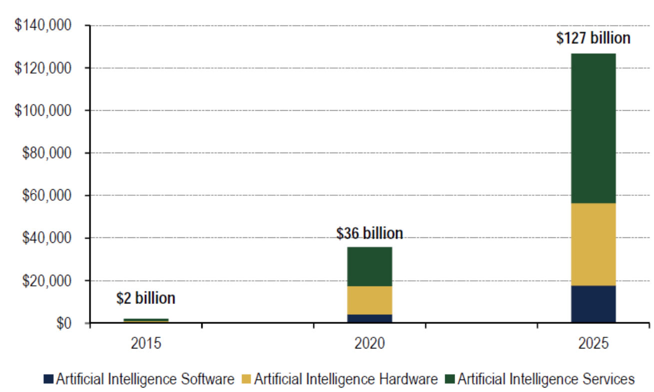


Xilinx (XLNX) – Next Major Player in Artificial Intelligence?

Back in Jan 2016, we turned bullish view on NVDA at $28/share on expectations of rising demand of Pascal and other graphic chips ahead of Oculus Rift launch in March. We believed it could go to $42. Clearly we were not bullish enough with stock now at $107 but to be fair through out the year we highlighted accelerating growth outlook and were first to point out $3.00+ EPS power in May, nearly double of consensus view. The most fascinating part about NVDA chips is that it was actually never originally designed to address AI applications, which is precisely why it caught many off guard. When AI use cases exploded in early 2016, engineers learned they didn't need traditional linear microprocessors despite their ability of solving hugely computationally intensive tasks. Instead they needed more focused, low latency, lower power consumption and with high degree of flexibility. NVDA solved that problem perfectly and ended up taking a commanding lead, leaving competition behind in dust. As a result, its data center business grew +130% YoY. But realistically, there are new entrants coming soon and after thorough research we believe XLNX is a unique case that is providing that opportunity.

XLNX has been building Field Programmable Gate Arrays (FPGA) chips, which is currently dominantly used in $4.4 billion communication infrastruce market. Similar to NVDA, the intended use for FPGAs is not AI but it is quickly seeing surge of use cases. At least 7 research academic papers have been writing in past 6 months showing the benefits of FPGAs (a quick Google search brings up a long list) including even lower latency and lower power consumption that NVDA. Additionally, XLNX chips are easily reconfigurable, hence better utility for use in many AI applications. Late November Amazon AWS started offering XLNX FPGAs for use in its enterprise customers. Microsoft is currently testing both Altera (owned by Intel) and XLNX FPGA's. Baidu signed contract for XLNX FPGA in September. In total, 7 large cloud vendors just in past 6 months have signed.

Figure 1: Artificial Intelligence revenue by segment 2015-2025



NVDA will continue to maintain its commanding lead but research shows in many AI applications it is an overkill. Use cases for XLNX are rising because it is easily scalable, and similar to NVDA it is all happening very fast. BAML believes within AI hardware revenues will grow from $840M in 2015 to $13.3B in 2020, about +74% CAGR. There will be many players in AI hardware that have yet to emerge but looking at use cases XLNX is #2 trying to catch up to NVDA.

Chemicals – Expect Strong Earnings Season in Jan/Feb

If you look under Jaguar Activity Tracker you will notice one consistency – increasingly long list of bullish call option activites in chemical space spanning many stocks: **DOW, ALB, AXTA, LYB, OLN, EMN, BERY**, **WLK, CE** and others. We have written extensively and profited handsomely from improving fundamentals in chemicals in past 6 months. While much of this bullish action is driven by company-specific news, there is one common theme, which I discussed in length in webinar in early Dec, which I believe will likely result in good earnings season from the group.

Chart 1: 1990-2015 Brent Oil vs. China PE price

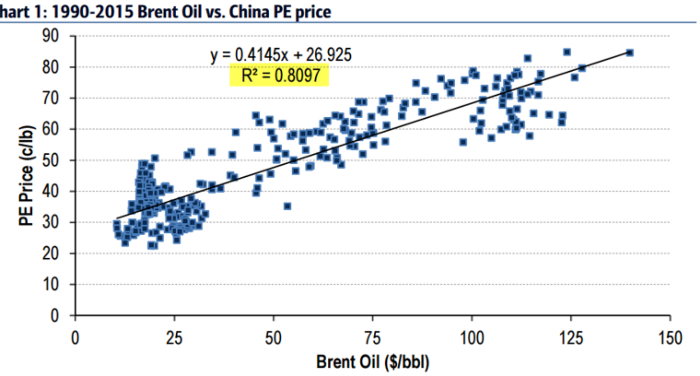
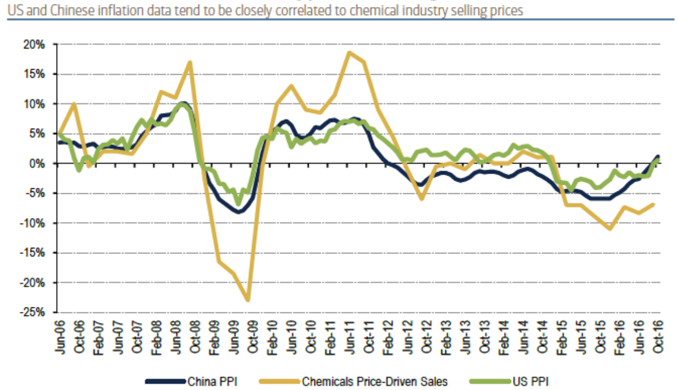


Chart 17: Inflation versus Chemical industry price driven sales growth

US and Chinese inflation data tend to be closely correlated to chemical industry selling prices



There is 81% correlation between price of crude oil and Chinese polyethylene (PE) prices. Two biggest producers are DOW and ALB. Every $10 move in crude oil moves PE prices higher by 4 cents, which in turn equates to $0.20 and $0.60 upside for DOW and ALB, respectively, over the course of year. Multiply that delta with their respective earnings multiple and you get fundamental upside bull case. To get a better gauge at macro level, rising China and US PPI is a leading indicator of chemical industry selling prices. September 2016 marked the first one month since January 2012 when PPI turned positive. How significant is this? Since September basket of 12 chemical companies have reported "price-driven" positive change in sales equivalent to 2.5x the reported increase in China and US PPI. Meaning if PPI is up +2%, expect chemical companies to post +5% revenue upside vs. street estimate and that's before announting for organic volume growth. Lets take this one step further. On December 1, we mentioned IHS data showing $20/ton increase in Chlor-Alkali prices, see **HERE**. Every week Celanese (CE) has been hiking prices in Acetic Acid, MIBK, MIBC, Paraform, Formaldehyde, Emulsion, Vinyl, Polymers, etc. We've been writing about this since May (see **HERE**) but it wasn't until October when analyst upgrade cycle started. AXTA which makes coating for autos and is owned by Warren Buffett and several others incl. BASF, Huber, Oxea, Unimin, Allnex, Evonik all raised prices multiple times since November (see **HERE**). On November 1, citing global ethylene shortage and higher Chinese demand LYB raised prices and discussed reaching 95% operating rates, see **HERE**.

In big picture, all this ties to rising China and US PPI which accelerated in Q4 while their stock charts just starting to breakout. I expect green shoots from the group in Jan/Feb earnings season.

Paccar and Wabco – European Truck Registrations Strong

On December 22, ACEA reported EU heavy truck market returned to positive territory in November with heavy truck registrations up +12%, reversing sharp decline of +8% in October. That's despite relatively tough YoY comparisons (November 2015 up +25%) and remains difficult in December (up +22% last year). Regarding the light commercial vehicle market (relevant for CNHI), registrations increased +14% YoY in November. Italy showed the strongest positive growth in heavy truck registrations for November, increasing +91% YoY. This significant increase in Italy is most positive for CNHI (light commercial vehicles in Italy also up, Nov +66%). Spain posted a strong increase of +25%, followed by France +14%, and the UK +9%. Germany registrations declined -1% in November, but were less negative than the previous month (Oct -17%). The 9% increase in the UK is positive for PCAR and the broader European strength is a good sign for truck supplier WBC given that EMEA accounts for 60% of sales.

On the US side, On December 20, ACT released its monthly truck data for November and it was strong all around. The cancellation rate fell to 8% in November, one of the lowest levels in two years. In our view, October could mark the bottom of the cycle with the month experiencing a significant 'backlog cleanse' from some fleets (big cancellations, culling of dead orders). The inventory to sales ratio was 2.7x in November, down from October (2.9x). While 2.7x is elevated based on historical standards, we have observed some gradual progress over the last few months (July 3.3x, Aug 2.8x, Sept 2.8x, Oct 2.9x).

Chart 2: Cummins Class 8 Engine Market Share

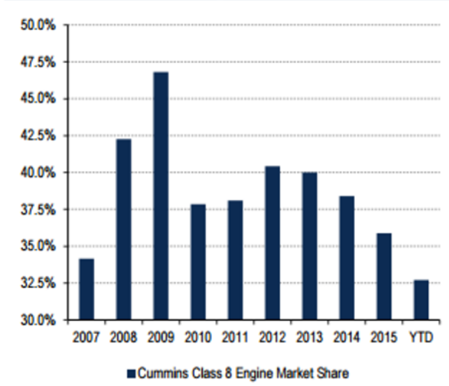
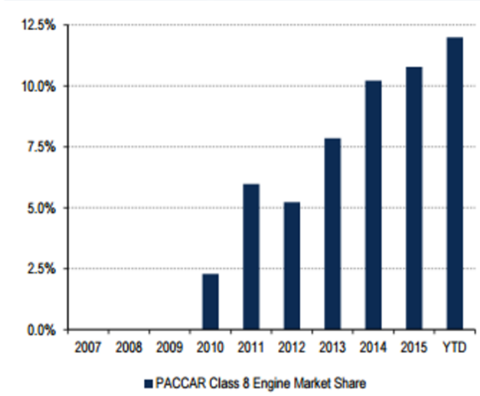


Chart 3: PACCAR Class 8 Engine Market Share



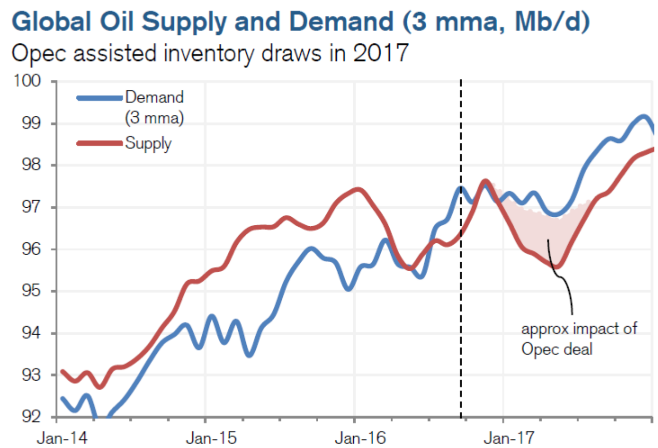
The data above supports a bullish view going into PCAR and WBC earnings in January. Paccar has also been taking market share away from Cummins (CMI) for several years and back in June 2016 Paccar introduced MX-11 heavy duty truck engine targeted at the vocational, refuse, and lighter line-haul truck market. The MX-11 engine is 400lbs lighter than the MX-13L engine, which is 400lbs lighter than the Cummins 15L engine. Since Q3 was mostly spent on collecting orders, Q4 is first full quarter that should see significant benefits of it.

We believe the coast is clear for PCAR outperformance during 1H17, but then watch for specific catalyst from CMI. In late 2017/early 2018, CMI will introduce its 12L engine, which will have a best-in-class power-to-weight ratio. Pricing has not been announced yet, but the 12L should boost CMI's position in vocational and regional haul markets. New 12L customers might start to make product adoption announcements by April 2017.

Can Oil Go To $70/Barrel by the End of 1H17?

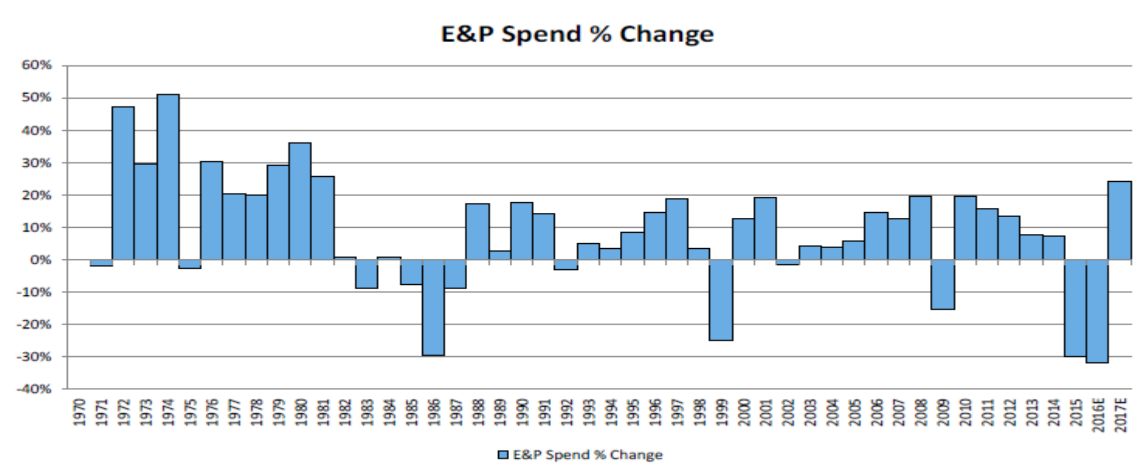
It may sound like a ridiculous idea but lets back this up with some facts and then time will tell whether we get any close to $70/barrel. First of all, I am very proud of our Jag research team that has done steadfast and remarkable job in nearly perfectly navigating oil stocks in past 6 months with many lucrative trade ideas, particularly positioning before the OPEC Meeting on November 30.

The big assumption here is no demand destruction in next 6 months, meaning no material economic slowdown which in itself is big leap of faith. Given where we are currently with 1) improving macro backdrop, 2) rising weekly rig count, and 3) falling crude oil inventories – when all these factors are taken into account the net result is OPEC cuts will create worldwide supply shortage starting in February by as much as 1.5 million barrels and that defecit will continue through year end. Excess demand will result in sharper depletion in crude inventory levels. Simultaneously, I believe during earnings season in Jan/Feb we will see shift in tone in management of oil/gas companies. There might be sudden realization that they are not raising production fast enough, resulting in acceleration in capex and production outlooks. Some of this is already evident by significantly better rig count increases since Nov 30, but I believe there is more to come. With imbalance between demand and supply and US shale industry behind the curve and playing catch up, there is decent chance crude price goes parabolic. It is a set up of a perfect storm. Chart below shows global E&P capex is expected to see the highest percentage increase in 2017 than any other time since 1981.



We continue to favor the most levered names exposed to rising oil and capex: **DVN** and **MUR**.

Exhibit 3: We expect global E&P capex to rise 25% y/y in 2017



Large Institutional Option Positions

At Jaguar we track unusual institutional size option activities and provide that info to clients in real time under Jaguar Activity Tracker with links to research reports and charts. Click **HERE** for quick access to see how large option traders are positioned going into next year with expiration period January through May.

Note: To access Jaguar Research Reports you have to be signed in as a Pro subscriber.

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