



The Cut

Introducing the latest views from a selection of Independent Research Providers working with IRF

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IRF works with 93 Research Providers covering all geographies, asset classes, industry sectors and methodologies

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Events associated with IRF

- **[London Value Investor Conference](#), 25 May, Queen Elizabeth II Conference Centre, Westminster**

Researchers visiting London in the near future

- **[Drewry Maritime Financial Research](#)** - Maritime & Shipping Companies, Rahul Kapoor, Director of Research, **24-26 April**
- **[The Retail Tracker](#)** - Consumer & Retail Companies, Marni Shapiro and Mark Friedman, both Managing Partners, **1-3 May**

- **Storm Research** - Japanese Stocks, Rowan Ewart-White, Director, **9 May**
- **Asianomics** - Global Macro with strong Asia coverage, Sharmila Whelan, Deputy Chief Economist, **22-23 May**

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- **Hedgeye - Praxair Inc.** (PX US), unwarranted investor scepticism regarding the Linde merger, provides opportunity for investors to add exposure to one of the best players in the Materials sector

Macro Research

1. Asianomics - If there is a place to hide from a USD debt meltdown, it's Asia!

IRF Note – USD credit to non-US entities is on the rise and Asian external debt is growing again. Total Asian foreign currency bonds outstanding have, led by China, Singapore and Hong Kong, grown to \$883bn (from \$822bn - Dec 15). However, Sharmila Whelan, Deputy Chief Economist at Asianomics, believes that Asia's resilience to any fallout from a USD debt meltdown has increased as well. Key points include:

- Asia ex China foreign exchange reserves are increasing, driven by a growing regional current account surplus. As a result the ratio of short-term external debt to foreign exchange reserves has fallen.
- While Asian government bond yield spreads over UST's have widened, there has been no investor panic so far, and they remain well below the levels reached during the 2013 taper tantrum (exception is Malaysia, but this is due to political uncertainty).
- Couple this with continued high USD nominal GDP growth rates (the exceptions being Taiwan, Malaysia and Thailand, where the shortfall compared to USD borrowing costs is marginal), means Asian corporates remain well positioned to meet external debt obligations.
- Asian exchange rates have held up well, with only the RMB and the Philippine peso having depreciated appreciably against the USD since the first rate hike in Dec 15.
- The rise in Chinese corporate foreign currency bond issuance and external debt against this backdrop comes as somewhat of a surprise. But this is probably Chinese corporates funding overseas acquisitions by issuing low cost foreign currency bonds, meaning USD debt servicing obligations are more than likely matched by USD revenue streams.
- The Philippines is not a great concern either. It has the second lowest short-term external debt to forex reserve ratio in Asia, its corporates are paying down foreign debt. If there is a country to worry about its Malaysia even though external debt sustainability is improving.

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2. DeSaque Macro Research - Is slowing bank lending really a concern for the economy?

IRF Note - *Since H2 2010, both consumer and C&I loans have been on an upward trajectory. However C&I loan growth has now weakened to its slowest pace since 2011, which is worrying some commenters. Such a low growth rate is seldom seen outside of recessions. But Said Desaque, founder of Desaque Macro Research, thinks developments need to be put into context. Key points include:*

- C&I loans are a lagging indicator of economic activity and are, therefore, a potentially useful insight into the build-up of inflation pressures.
- Firms will typically borrow from banks to finance an inventory build-up by boosting industrial production. The correlation between C&I loans and industrial output will, therefore, be positive, although the latter will lead the former.
- The US economy experienced a sluggish period of growth due to a prolonged inventory correction in the final 9 months of 2016 which reduced industrial production gains and, therefore, C&I loan demand.
- Historically, the lag between a shock to industrial production and loan demand is roughly 6 months. Thus, the current weak demand for C&I loans simply reflects the softness in industrial production last year.
- Political uncertainty may, however, also have played a role, with some firms having put borrowing on hold prior to the Presidential Election and are still not confident enough to resume, despite the subsequent sharp bounce in business optimism.
- Many US economic metrics are strengthening, which suggests that a recovery in C&I loan demand is in the offing at a later point, although developments should be monitored in the interim.

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3. OM Research - Is the WTO in peril?

IRF Note - *Jamie Davis, co-founder of OM Research, examines whether the Trump administration is really looking to circumvent and undermine the WTO dispute settlement mechanism. Historically, presidents have been pro-trade but Trump is up-ending this orthodoxy, showing a protectionist tendency. This administration dislikes any dilution of US sovereignty and has found that the WTO is too institutionalist for its realist leanings. Key points include:*

- Trade is an area of high political sensitivity for US voters and so provides a highly tempting area for aggressive action.

- The dispute resolution mechanism at the WTO was designed to alleviate trade tensions through a legalistic and institutionalised process rather than through the exercise of relative power.
- A US refusal to accept adverse rulings would result in a fracturing of the system and would accelerate movements towards economic nationalism around the world – nearly impossible for future US administrations to reverse.
- It would also bring trade relations firmly back into a realist framework which emphasises relative power and direct negotiation between states. Obviously, this would benefit the strongest party with the most desired domestic market – the US, while harming the interests of smaller export-orientated states.
- Ironically, it is likely to reinforce the usefulness of a central EU trade negotiating process, despite it being a Liberal Institutional construct. Countries with high trade surpluses will be easier to target, for the US especially, and any undermining of the WTO would increase the probability of future trade wars.
- Regarding Brexit, it could undermine UK transition trade arrangements with the international community but also underline relative weakness vs. a large EU when trade deals are done.
- The WTO could survive a Trump attack only with remarkable resilience and restraint on the behalf of countries around the world.

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4. Roskill - The niobium industry in its current form is really only a few decades old; it has seen big changes over the last decade or so and there may well be more to come

IRF Note – *Roskill considers it pretty impressive that there has been +\$5bn of investment in the last 5 years in a metal that is unfamiliar to many people. Equally remarkable is that, from a standing start, Asian investors have gained control of at least a third of global ferroniobium production capacity. This seems strange considering growth prospects for steel are unspectacular and production capacity is far bigger than demand, and is expected to remain so. Key points include:*

- Producers divested for reasons including locking-in key customers, getting rid of non-core businesses and reducing debt.
- Companies had initially wanted to invest in the industry, due to the benefits of its use in steel (e.g. strength enhancement), not to mention the explosive growth in global steel production, particularly in China (who wanted to gain greater influence over its raw material supply chains).
- Although prices have recovered close to pre-financial crisis levels, the outlook for global steel production now seems starkly different to what it was just a few years ago. Overall growth in steel production is not going to be the main future driver of demand.
- Despite existing (huge) surplus production capacity, new producers are trying to enter the market. But is there even a place for them? It all boils down to the market's desire for diversity of supply of what is, essentially, a commodity product, made using similar and well-understood processes by existing producers.

- On the non-steel supply side, the markets show trends that generally mirror overall economic trends very closely and future growth in demand for niobium will reflect that of the global economy.

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5. Simon Hunt Strategic Services - USD to start a near 8-yr down cycle during H2 this year

IRF Note – *There is a near universal view that the USD can only strengthen. However, Simon Hunt, founder of SHSS, believes it will soon meet resistance as each of the perceived bull points don't come to pass. Key points include:*

- Relative growth favours the ROW over the US - brass mill activity, a solid leading indicator of business activity, confirms growth in China, Europe, Asia and even in Japan is especially strong.
- The US Administration does not want a Border Tax - a 3% tariff on imported goods is a more likely option. This option would negate a large part of the dollar's optimism.
- Repatriation of dollars - given how the dollar has risen against most currencies in the past year these funds will be held in dollars anyway. Corporations will utilise some off-shore funds for further investment in foreign markets. And regarding a USD shortage, no central bank wants a financial crisis! It's likely that the Fed will engage in swap agreements with central banks to protect against any liquidity issues.
- The Fed is leading the world onto a path of rising interest rates – NIRP will come under huge pressure to be abandoned, especially given economies are strengthening. While China's recovery is sufficiently robust to be able to absorb a rate rise, thus supporting the RMB.
- Foreign holders of USTs running down holdings – e.g. China's strategic decision in 2014, where they began reinvesting the proceeds in infrastructure and factories etc. Other Asian central banks are doing the same.
- Slowly but surely, governments are developing trade relations that bypass the American system and thus the use of dollars to conduct trade, e.g. Russia and China.

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6. Topdown Charts - Nigerian equities looked to have bottomed and are trading on attractive valuations

IRF Note – *Callum Thomas, founder of Topdown Charts, recently examined the World Economics' SMIs (Sales Managers' Index), the sales manager version of the PMI and noticed Nigeria was showing an interesting and sharp turnaround from recession back to growth. He then looked at Nigerian equities and noticed the following (see attachment for charts):*

- The MSCI Nigeria Index (in USD) is trading around a 14-yr low and is down -83% from the all-time high and down -68% from the more recent peak (in 2014). While low stock prices/benchmarks can go even lower, a glance at the chart suggests it might have bottomed.
- Nigeria has a PE of 10x vs. 8yr avg of 12x, a price to book ratio of 1.4x vs 2.2x and a dividend yield of 4.7% vs 3.5%. Relative to (a brief) history these stats look interesting, they're also fairly low valuations by global standards.
- The currency remains under downside pressure with the black market rate trading at a discount to the official rate, but the central bank is running a tightening bias, partly in order to prevent the currency from weakening further. In terms of the USDNGN vs. its IMF calculated PPP, it does appear to be undervalued, basically as 'cheap' as it was back in 2004.
- For country allocations, if you're going to invest on a valuation basis it should be when the economy is starting to turn up, which is the case now for Nigeria, evidenced by a favourable price chart, rebounding SMI, and FX and equity valuations that all looking appealing.

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Macro Research Snippets:

Andrew Hunt Economics - Although the Federal Reserve has of course not been running a new official QE policy, the Treasury's management of its debt issuance/cash balances has nevertheless provided a \$300bn stimulus to US monetary conditions in an almost QE-like way over the last six months. This public-sector activity has masked a fundamental level of weakness within much of the domestic credit data. The Treasury will soon exhaust its ability to boost monetary conditions within the economy and so they are expecting a significant slowdown in monetary growth and an increase in real rates (FX and interest rates?). [Click here](#) for a short overview of this researcher

J Capital Research - Last month, China's banks came to the brink of a crisis. Several small banks defaulted on interbank borrowings. The problems arose because the PBOC is trying to squeeze leverage out of the system. But asking banks to take less risk just isn't realistic. The new regulations will raise lending rates, and that will slow the industrial economy. This may be the year when property developers go into distress. [Click here](#) for a short overview of this researcher

Company Research

1. Blueshift Research - Is the subprime auto loan industry in a bubble that will burst in the next 18 months?

IRF Note - *Subprime auto loan market conditions have deteriorated since Blueshift last reported in February. Unsurprisingly all five of their subprime lender sources said a bubble does not exist; however, four of these five indicated that subprime loan delinquencies and defaults are rising. Six of the remaining twelve sources (dealerships, repossession companies and industry specialists) said a bubble exists or is likely – a 50% increase in 2 months. Key points include:*

- Seven sources said the subprime lending market has been experiencing higher loan delinquencies and default rates. Nine sources said lending standards are tightening while interest rates are rising.
- Despite the subprime lenders denying a bubble, industry projections from them and other sources indicate that challenges are ahead; longer loan maturity periods of 72, 84 and even 96 months are troublesome and risky.
- Profitability is expected to decline and the industry to consolidate because of regulatory restrictions that hinder collections, declining used car values and overall car sales. While forecasts are of higher defaults and delinquencies for next year due to high volumes of subprime loans written during the past 2 years, and lenders trying to outgrow their delinquencies.
- One source said some large banks have stopped/capped their subprime lending; a signal that credit terms will be tightening and interest rates will increase throughout the entire industry. Actions that suggest they are bracing for a difficult H2.
- Meanwhile, four sources said credit unions and Capital One Financial Corp. are increasing their portfolios in the subprime auto loan space, which could add to the subprime bubble.
- Sources were unclear when the bubble would burst, if at all. Some said the industry has been policing itself and would have a soft landing.

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2. EquiVal Research - Valuation comparison of outdoor advertisers JCDecaux (DEC FP) and **Ströer** (SAX GR)

IRF Note - *Outdoor advertising's share of advertising budgets has remained fairly flat, although this might be about to change, due to the digitalisation of out-of-home advertising and its convergence with online and mobile to reach on-the-go consumers. Piers Nestler, founder of EquiVal Research, provides a valuation comparison of two family-controlled businesses operating in the sector. Key points include:*

- Ströer's share price has recovered somewhat after a damning report last year; but rising out-of-home advertising budgets in the German market and cross-selling opportunities in digital advertising are still providing strong momentum, which are not fully reflected in the valuation.

- Sales grew by a CAGR of ~13% (2012-2015, and 36% in 2016 thanks to acquisitions). And this was achieved without corresponding capital growth. While sales more than doubled to EUR 1.12bn in 2016, net assets increased at a slower pace, improving the asset turn from ~0.7x to ~1x sales.
- JCDecaux, by contrast, has seen a substantial slowdown from past growth rates, accompanied by pressure on margins. Although the share is some 20% below its peak, it is still not seen as a bargain.
- The market currently attributes higher potential for value creation to Ströer than JCDecaux with 30% of valuation underpinned by existing assets and 70% to future economic value added, compared to JCDecaux's 40:60%.
- Using the same long-term cost of capital of 7.5%, the implied returns of JCDecaux and Ströer are fairly similar, ~13% and ~14% respectively. This is well above both their 2011-2019E average returns, reflecting the expectation that outdoor advertising will increase as a percentage of total media ad spend.
- Model assumptions yield a fair value of ~31 Euros for JCDecaux and ~54 Euros for Ströer; meaning JCDecaux is already fully valued while Ströer is trading at a discount of ~15% to fair value.

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3. Etalon Investment Research - Alex Gavrish, founder of Etalon, explains why best investments are just like good stories or movies: with three part structure, important turning points, intrigue, drama, and surprises

IRF Note - [click here](#) for a link to the whole article:

- "Art is a lie that makes us realize truth", - Pablo Picasso
- Best investments are just like good stories or movies, with three part structure, important turning points, intrigue, drama, and surprises. One of the highlights of their approach is the proposal to develop both a historical perspective as well as future narrative for the company and its share price. It is not only a question of providing verbal and common sense explanations of the numbers.
- Strictly analytical approach to investment management does not provide us tools for dealing with uncertainty. The closed and fixed form of analytics leaves no place for imagination. And without imagination, we are just not capable of fathoming uncertainty, fathoming the future.
- Isaac Bashevis Singer, Nobel Prize laureate in literature said: "A story to me means a plot where there is some surprise. Because that is how life is - full of surprises". The same holds true for investing, because companies, markets and economy by their very nature are social processes. And when there are humans involved, there will always be surprises.
- When activist investors communicate their investment thesis to the general public, they often tell a story; about a struggling business, a corrupt CEO or management team, a restructuring process that failed or is not reflected in the share price yet, a strategy for improving business and a myriad other types of stories. Activists tell these stories with an intrigue, with drama, with conflict, with struggle, with emotions.

- Jerome Bruner, a famous cognitive psychologist, explains that narrative mode of thinking leads to conclusions not about certain absolute truths, but about varying perspectives that can be constructed to make experience comprehensible. By telling stories, we formulate these different perspectives.

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4. Insight Investment Research - Eurotunnel (GET FR) moves to No.1 stock pick as market is over discounting near term Brexit concerns

IRF Note – *The weighted average share prices in stocks they follow having increased +8% YTD. But Robert Crimes, founder of Insight, remains Overweight the Global Infrastructure sector, anticipating a further weighted average upside of 18% for their stocks as real bond yields still remain low and equity is considered attractive relative to debt. Their new top selection, is Eurotunnel, arguing that the share price has suffered unjustifiably since the EU referendum vote; concerns relating to the £/€ exchange rate and UK trade volumes are overdone. Key points include:*

- Improving UK outlook - UK consensus GDP has recently increased 120bps to +1.7% for 2017 and although the £/€ rate has fallen only 5% over -12M (a 10% fall in £/€ leads to 6.5% lower EBITDA) blended UK and French sovereign 10-yr bond yields are broadly flat over -12M (a 100bps fall increases their TP by €3.1 or 19% via a lower WACC). These variables are fully marked to market within their TP.
- Solid volumes – expect shuttle traffic growth to continue, but at a lower level; 2.0% for trucks and 1% for cars in 2017E. They forecast a slight recovery in Eurostar traffic growth from -4% in 2016E (terror attacks) to +1% in 2017E. New hi-speed routes, most notably to Amsterdam, should in the future prove beneficial.
- Price increases should continue – forecast truck prices will increase 3% in 2017E and expect the ferries, now a duopoly on the Short Straits, to continue to price rationally, especially given no meaningful new capacity.
- Strong underlying FCF – further potential here, regarding C1 and C2 refinancing.
- Eurotunnel has historically looked unattractive on near term ratios but is becoming attractive on a dividend yield of 3.7% in 2017E increasing to 5.4% in 2020E.
- Price target is €15.1, offering 72% upside.

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5. Mithra Forensic Research - BTG (BTG LN) to be forced to record substantial impairments to a key asset; 36% downside available

IRF Note – *Melvin Glapion, founder of Mithra Forensic Research, believes BTG, a pharmaceutical company, specialising in antivenoms, oncology drugs and treatments for varicose veins, will have to record significant impairments to a key asset, Crofab, a*

treatment for snakebites. This follows a settlement and subsequent new licensing agreement with a competitor; the target price is 364p. Key points include:

- Crofab accounts for 15% of BTG's total revenues and 28.5% of the company's total contribution.
- In 2013, Instituto Bioclon applied to launch its own snakebite antivenom in the US. Throughout 2013-14, BTG failed to disclose key facts or limited disclosure regarding the threat that Bioclon's drug, Anavip, would be approved; probably to prevent discussions around potential impairment charges to Crofab.
- Following a lawsuit filed by BTG alleging that Bioclon had infringed upon its US patent and were illegally importing and selling Anavip in the US, they agreed a settlement at the end of 2014.
- The licensing agreement between the two companies will lead to significant declines in BTG's revenues generated from Crofab. Anavip is significantly cheaper at \$5,500 per individual vs. \$23,700 for Crofab and many medical experts believe it is far more effective. Crofab recorded flat/declining revenue growth from 2013-15, suggesting Anavip was impacting sales.
- Since 2014, the Specialty segment to which Crofab belongs, has improved its contribution margin by 1,210 basis points. BTG claims that cost efficiencies and mix account for the improvement, but Mithra suspect that costs may have been reallocated in order to show higher cash flow margins, resulting in less likelihood of any impairment charges.
- BTG will need to begin recording impairments in either its FY2017 or FY 2018 results of at least ~£22m or 18% of FY2017E.

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6. SmartInsider Consulting - The CFO's reversal and other Director purchases look promising for **Computacenter** (CCC LN); while significant additional sales at **Medical Properties Trust** (MSW US) are a concern

IRF Note – *Investing on the back of 'insider' transactions can lead to outperformance as senior management knows their own company better than anyone else. The volume and complexity of announcements makes it difficult to analyse and act upon this data. SmartInsider provides the solution. Two recent examples include:*

- Computacenter – Francis Conophy (CFO) purchased 13,812 shares at £7.29, spending £100k and taking his holdings to 2.3m. He also exercised 70,941 shares, without selling any. This is a reversal as he was a seller of options in March 2016 and 2015. He last purchased stock in January 2008 at £1.88.
- Gregory Lock (CB) purchased 50,000 shares at £7.25, spending £360k, taking his holdings to 655,000. Lock has been a frequent buyer of the stock, but he seems to make his larger purchases into price declines.
- Additionally, Michael Norris (CEO) exercised 124,732 shares and sold just 58,801 shares for tax purposes. As a result, the stock is assigned a +1 rank (Positive Insider Pattern).

- Medical Properties Trust (*see attachment for chart*) - Edward Aldag (founder, CEO) sold 301,845 at \$12.74, reducing his holdings to 1.7m. Aldag last sold stock in August 2016, 50,000 shares at \$15.52, so this recent sale is larger and at a lower price point.
- Aldag has made large sales the past few years in March, so while it may be a seasonal sale, the concern is that it is occurring at a 52-week low.
- William McKenzie (Director, Vice Chairman) sold 41,270 shares at \$12.46, reducing his holdings to 42,189 shares. This is a large percentage sale for McKenzie, who last sold in 2012. The stock is assigned a -N rank (Negative side of Neutral).

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7. The Retail Tracker - Under Armour (UA US), despite stock selloff and Kohl's launch, shares still expensive

IRF Note – *UA initially burst onto the scene emphasizing Compression for fitness which differentiated themselves from other brands and allowed them to quickly build brand awareness. With Kohl's recently heralding the launch of UA in their stores (as you would expect!), The Retail Tracker takes a closer look at the near-term challenges for UA, in this highly competitive market. Key points include:*

- Nike and adidas continue to dominate most stores.
- UA owns fitness - the problem is that fitness is not a shoe and fitness is everything! Nike owns basketball and running; adidas, soccer and classics fashion. So every brand that makes a pair of shorts or a tank top to exercise in is competition.
- Lack of differentiation - while both Nike and adidas are known for certain things, both extended their assortments, offering each brand the ability to be in many different retailers at different price points at the same time. The UA assortment in Kohl's is more or less what you would find anywhere.
- Unless UA can develop a sub brand, Kohl's is negative to the long term health of the brand. UA has always held some snob appeal, available in Dick's and Nordstrom primarily at full price but now much broader.
- Other issues include – Active as Fashion trend has now peaked; and UA has been unable to get strong momentum in either Women's or Footwear.
- Although the stock's down ~60% from its 52 week high, it is still not 'cheap', trading around 47x EPS. Nike trades at ~23x and adidas (which has been on a tear recently) at ~29x. UA could see a bounce from good news coming out of Kohl's, but this would be temporary, investors are recommended to avoid.

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Company & Sector Research Snippets -

Belkin Report - Opportunity to buy into gold miners, Michael Belkin's favourite sector in 2017. With the South African rand having just fallen sharply vs. the US dollar, it represents a special long opportunity in depressed South African gold mining stocks. Their dollar revenues just went up ~10% in a week, while their costs remained the same. They expect further rand weakness to come. South African miners are listed in ADRs in US dollars in the US. Recommendations include, **Sibanye Gold** (SBGL US) and **Harmony Gold Mining** (HMY US). [Click here](#) for a short overview of this researcher

Hedgeye - Shares of **Praxair Inc.** (PX US), an industrial gases company, have lagged the market since the election, providing a favourable opportunity to add exposure to one of the best players in one of the highest quality parts of the Materials sector. They do not share investor scepticism regarding the Linde merger, as local corporate operating cultures have a history of reasonably successful merger and roll-up activity. They see the combination as complimentary, providing further industry consolidation as a key benefit. Praxair shares could readily be valued north of \$150 on successful execution (+25% upside). [Click here](#) for a short overview of this researcher

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