Applied Investment Management (AIM) Program

AIM Class of 2017 Equity Fund Reports
Fall 2016

Date**:* Friday, November 4th | ***Time: *2:30 – 4:30* p.m. | ***Location: AIM Research Room 488***

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These student presentations are an important element of the applied learning experience in the AIM program. The students conduct fundamental equity research and present their recommendations in written and oral format – with the goal of adding their stock to the AIM Equity Fund. Your comments and advice add considerably to their educational experience and is greatly appreciated. Each student will spend about 5-7 minutes presenting their formal recommendation, which is then followed by about 8-10 minutes of Q & A.

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JBS S.A. Sponsored ADR (JBSAY)

November 4, 2016

Dominic Delia International Consumer Staples

JBS S.A. Sponsored ADR (OTC: JBSAY) is one of the world's largest processors of meat, including beef, pork, chicken, and lamb. The company operates through three unique business segments: Beef (~61% of total revenue), which controls slaughter, cold storage, and processing of both beef and lamb products, Chicken (25%), which includes refrigerated poultry supplied to restaurants, supermarkets, and processors, and Pork (8%), which operates slaughter, processing, and cold storage. The firm markets its products under a variety of brands including Friboi, Swift, Bertin, Searra, Primo, and Pilgrim's Pride. JBS segments its revenues by individual country: United States (~56.0% of total revenue); Brazil (~21.1 %); Argentina (~7.0%); Canada (~4.8%); Australia (~3.8%); Mexico (~3.6%); Uruguay (~0.6%), and China (~0.6%). JBS SA was founded in 1953 by José Batista Sobrinho and is headquartered in São Paulo, Brazil.

Price ($) (11/2/16):	$6.10
Price Target ($):	$10.17
52WK H-L ($):	$4.09-8.33
Market Cap (Mil):	8,597
Float:	0.00
Short Interest (%):	0.00%
Avg. Daily Vol:	28,005
Dividend ($):	$0.22
Yield (%):	3.61%

Beta:	1.20
WACC:	10.20%
M-Term Rev. Gr Rate Est:	9.00%
M-Term EPS Gr Rate Est:	1.33%
Debt/Equity:	237.80%
Debt/EBITDA (ttm):	5.85x
ROA:	4.40%
ROE:	17.40%
ROIC:	7.45%

FY: Dec.	2015	2016E	2017E	2018E
Revenue (Mil):	$48,747	$48,991	$54,338	$59,228
% Growth:	-4.78%	0.50%	10.91%	9.00%
Gross Margin:	13.87%	12.84%	13.34%	13.09%
Operating Margin:	5.60%	4.57%	5.07%	4.82%
Net Margin:	2.85%	1.79%	2.28%	2.12%
EPS (Cal):	$0.96	$0.62	$0.87	$0.88
FCF/Share (Cal):	($0.47)	$0.76	$1.00	$1.04
P/E (Cal):	6.37	9.92	7.05	6.95

Recommendation

As one of the world's largest meat processors, JBS SA boasts a diversified revenue stream and has utilized recent acquisitions to strategically positon itself both geographically and across product segments. The company has recently focused on expanding the reach of its pork business (Revenues increased 71.6% from 2Q15) through synergies with Cargill and an increasing presence in the Chinese and Southeast Asian markets. JBS SA is trading at a discount relative to its peers and appears undervalued by analysts due to the negative perception surrounding the Brazilian economic backdrop as a whole. Despite a recent setback in its plans to undergo a corporate restructuring, JBS is poised to capitalize on margin expansion in its USA Beef segment and normalization in its Brazilian operations, after a period of historically high feed corn input costs. After thoroughly examining supply trends, consumer preference data, and the unfounded legal accusations against the firm, it is recommended that JBS SA be added to the AIM International Equity Fund with a target price of $10.17, representing a 66.71% upside.

Investment Thesis

- **U.S. Beef Lower for Longer.** An oversupply of cattle has snuck up on ranchers in the US (JBS sources 85% of its beef from this region) and is projected to keep prices pressured through 2019, as recently reported by Bloomberg. Prices for beef in the US have already dropped 30% from an all-time high in May 2015 and wholesale buyers of the commodity such as JBS, Cargill, and Tyson are anticipating a spike in both revenues and margins, as the high overhead costs of running their processing facilities is being spread across a larger headcount. The same trends are also occurring in the pork and poultry industries where the JBS is poised to take advantage of these developments as early as Q1 2017.
- **Chicken Industry Expansion.** JBS currently holds an 18% share of the poultry market, through its 75% ownership stake in U.S. poultry processor, Pilgrim's Pride (PPC). When looking closer at the data, the synergistic thesis behind this acquisition looks to have some meat to it. Foodservice establishment consumption of chicken in the U.S. increased 7.5% YoY according to the USDA, while 21% of consumers saw themselves buying more chicken next year. This demonstrates that JBS management is far from complacent, despite their currently dominant market position, and

are willing to take on leverage in the present in order to ensure the expansion of their economic moat in the future.

- **Shares on Sale.** JBS was projected to undergo a massive shift in the structure of its business in 2016, moving the company's headquarters to Ireland (under UK tax code) while uniting all of its operations under one overarching holding company to be traded on the NYSE as early as 1Q17. This all came crashing down on October 26th as BNDES (JBS second largest shareholder) unexpectedly vetoed the reorganization, claiming, "It was not in the best interest of the company and the shareholders". While shares have sunk ~19% over the past week, the fundamentals driving the model (expanding EBITDA margins, accompanied by growth in USA Beef and Poultry revenues) remain intact. At nearly a 12-month low, the current share price provides an optimal entry point into this time tested, high quality meat packing behemoth.

Valuation

In order to reach an intrinsic value for JBSAY, a five year DCF model was constructed. Using a terminal growth rate of 2.00% and a WACC of 10.20%, an intrinsic value of $9.18 was reached. A sensitivity analysis on the terminal growth rate and WACC ranged from $9.01-$9.36 Additionally, a P/E multiple valuation was conducted using a comparables average P/E of 18.85x, which resulted in a valuation of $11.16. By weighting the two valuation models 50/50, a price target of $10.17 was reached, representing a 66.71% upside. JBSAY paid an annual dividend of $0.22 in December 2015, yielding 2.10%.

Risks

- **Pathological Risks.** Like any company involved in the agriculture and food production industry, the threat of disease, to either the feed crop or the livestock itself, poses a potential disaster for margins as well as for the public's perception of the firm. Supply shocks due to a lackluster feed crop harvest, or to a shortage of healthy cattle, chicken, or hogs would force input costs to soar likely leading to pass through expenses and lower volumes at the store. Accompanying this is the risk of contaminated meat products as seen earlier this year at Chipotle. Not only would revenues take a massive hit, but brand integrity and consumer sentiment towards the JBS portfolio of brands would plummet globally.
- **Political Deterrents of Trade.** The company's stock recently surged on the news of structured beef trade agreements between Brazil and the U.S. Despite presently being subjected to a quota, JBS anticipates positive results from this deal though the flexibility it provides in terms of cattle price volatility. Donald Trump has promised to renegotiate all trade deals between the US and its counterparts. This barrier to trade would certainly cripple JBSAY which sources its revenues and products from all over the globe.
- **Brazilian Legal Woes.** JBSAY has found itself in the news all too often as of recently due to the political and social corruption which have run rampant throughout Brazil. Most recently, the CEO was forced to step down (albeit for one day) and the stock price took a major nosedive. While the new president has taken measures to clean up the corruption exhibited under embattled former leader, Dilma Rousseff, the stigma surrounding Brazilian companies and the risk associated with investing in such a region must be taken into account.

Management

Wesley Mendonca Batista, 46, has served as the CEO of JBS SA for the past 6 years and has been with the company since 1987. Joesley Mendonca Batista has served as Chairman of the Board of Directors since 2007 and has been with the firm since 1988. The brothers were recently ordered to step down from their positions in the wake of a probe into pension fraud allegations against a pulp and paper plant owned by the family's holding company, J & F Investimentos SA. Despite the negative spotlight cast on JBS SA, the brothers were reinstated hours later and shares subsequently rebounded.

Ownership

% of Shares Held by All Insiders and Owners	66.01%
% of Shares Held by Institutional & Mutual Fund Owners	15.67%

Source: FactSet

Top 5 Shareholders

Holder	Shares	% Out
Batista Family	1,210,305	42.4%
Bndes Participacoes SA	581,661	20.4%
Caixa Economica Federal	197,654	6.9%
JBS SA	93,951	3.3%
Dimensional fund Advicsors LP	25,937	0.9%

Source: FactSet

Peer Comparables

Name	Ticker	Market Cap (Mil)	Debt/Equity (%)	P/E (ttm)	EV/EBITDA (ttm)
JBS SA ADR	JBSAY	8,597	250.00%	17.42x	8.65x
BRF SA ADR	BRFS	13,121	135.00%	23.58x	14.55x
Tyson Foods Inc. Class A	TSN	31,115	63.10%	16.53x	8.48x
Pilgrim's Pride Corporation	PPC	5,131	137.00%	10.96x	6.61x
Hormel Foods Corporation	HRL	19,819	9.00%	24.32x	14.44x
	Peer Averages	17,297	86.03%	18.85x	11.02x

Source: FactSet

Insteel Industries, Inc. (IIIN)
November 4, 2016

Michael Robinson — Domestic Industrials

Insteel Industries. (NYSE:IIIN) is a manufacturer and marketer of steel wire reinforcing products for concrete construction applications. The company is broken into two segments. One segment welded wire reinforcement (57% of sales) is made up of concrete pipe reinforcement and engineered structural mesh. The other segment is prestressed concrete strand (43%). The company sells its products to manufacturers of concrete products used in nonresidential construction. Insteel Industries was founded in 1953 and headquartered in Mount Airy, North Carolina.

Price ($) (10/28/16):	$26.33
Price Target ($):	$38.13
52WK H-L ($):	18-37
Market Cap (Mil):	499.6
Float (%):	93.1%
Short Interest (%):	3.20%
Avg. Daily Vol:	206,068
Dividend ($):	$1.12
Dividend Yield (%):	4.25%

Beta:	1.09
WACC:	9.99%
M-Term Rev. Gr Rate Est:	10.00%
L-Term Rev. Gr Rate Est:	1.00%
Debt/Equity:	0.00%
Debt/EBITDA (ttm):	0.00
ROA:	13.47%
ROE:	17.45%
ROIC:	17.47%

FY: Sep.	2015	2016	2017E	2018E
Revenue (Mil):	$447.50	$418.55	$460.40	$506.44
% Growth:	9.42%	-6.47%	10.00%	10.00%
Gross Margin:	12.98%	20.35%	19.52%	19.84%
Operating Margin:	7.19%	14.12%	13.65%	14.31%
Net Margin:	4.85%	8.90%	8.89%	9.34%
EPS (Cal):	1.15	1.95	2.15	2.48
FCF/Share (Cal):	35.61	68.08	71.28	78.66
P/E (Cal):	13.38	17.74	11.99	10.88

Recommendation

Insteel holds a very advantageous market position as they head into 2017. The macroeconomic conditions are aligning for them and they will be in the best position to capitalize on the situation. Last year, President Obama signed the Fixing America's Surface Transportation Act, a five year, $305 billion authorization for the repair of highway and public transportation services. In 2017, it is expected that the next United States President will pass another bill, and even more funding will be on its way for America's infrastructure. According to the American Institute of Architects (AIA), overall nonresidential construction is expected to grow at 8.3% and 6.7% in 2016 and 2017, respectively. These conditions are creating a perfect storm and Insteel is the company that will best take advantage of them. Insteel is the market leader and low cost provider for concrete reinforcing wire products. They are also performing cost reductions procedures to their plants that will have a positive impact on their margins. Therefore, it is recommended that Insteel Industries Inc. be added to the AIM Equity Fund with a price target of $38.13, which represents a 44.94% upside.

Investment Thesis

- **Infrastructure Spending.** Insteel's concrete reinforcing wire products sales are directly correlated to nonresidential construction spending. Even with the $305 billion, 5 year highway bill passed by President Obama in December of last year, industry groups say the United Stated needs to invest more than $1 trillion in infrastructure spending over the next decade. Investors currently have an increased appetite to fund long term infrastructure projects. Assets under management seeking infrastructure opportunities is growing with a shortage of suitable projects being a constraint. The current low interest rate environment provides an incentive for the government to begin projects now to lock in low interest rates for the long term and receive a favorably positive return on public investment. The two current Presidential candidates, Donald J. Trump and Hillary Clinton, have both talked of the need for infrastructure investment to kick-start economic growth. Clinton said that she would send a $275 billion infrastructure plan to Congress within her first 100 days in office. Trump was vaguer but proposed a $1 trillion dollar rebuilding program and promised to set up a fund where private investors could help finance the projects. Predicting the precise increase in infrastructure spending is impossible. What we know is that there is a clear need for it, an incentive to do it now with the low interest rate environment, and many investors currently backing it.

- **Market Leadership.** Insteel is the nation's largest manufacturer of prestressed strand and welded wire reinforcement. In 2010, Insteel was able to acquire Ivy Steel & Wire Co. for $50 M. At the time Ivy was the second largest domestic producer of PC strand and welded wire reinforcement. In 2014, Insteel bought American Spring & Wire Corp. for $33.5 M. At the time ASW was the second largest producer of PC strand materials. These two acquisitions have differentiated Insteel from the competition and made them the hands-down largest steel concrete reinforcing company in the US. They currently have 10 manufacturing facilities located all around the country in close proximity to the primary raw material suppliers and the largest construction markets.
- **Cost Saving Initiatives.** In order to cut expenses, Insteel is consolidating and streamlining their plants. In March of 2015, Insteel closed their Georgia facility and reassigned their manufacturing capabilities to three other facilities, saving $3mm annually. Insteel has also upgraded and expanded their Houston, Texas facility, replacing older production lines with the equipment from their Georgia facility. Over the course of 2016, the company has eliminated high cost processes that constrained the Houston plant's capacity and adversely impacted their yield and productivity. The company estimates these changes to lower annualized costs by $5mm starting in 2017. Insteel is the largest manufacturer of PC strand and welded wire which allows them to take advantage of economies of scale and price leverage and be the lowest cost provider amongst their competition. These initiatives will help expand their margins and grow their bottom line.

Valuation

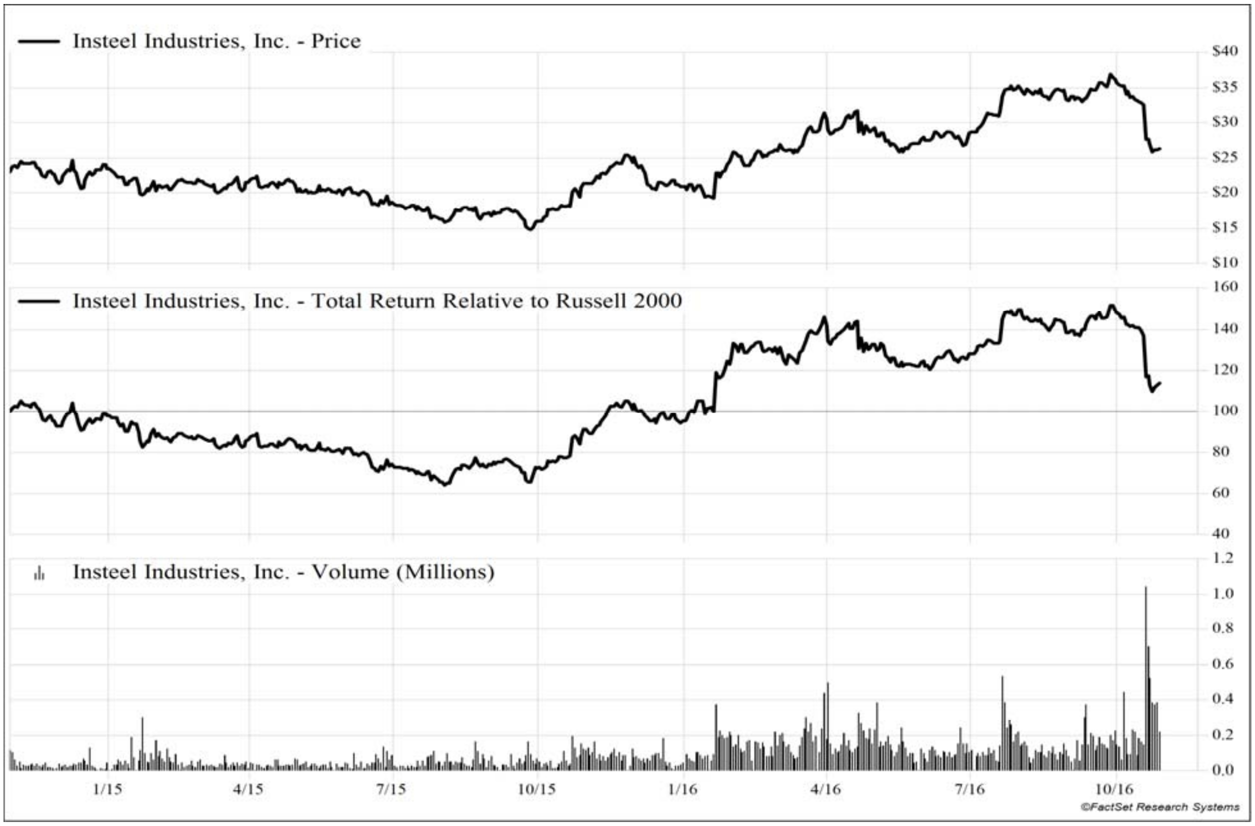
To reach an intrinsic value for Insteel, a five year DCF model was constructed. Using a terminal growth rate of 2.0% and a WACC of 9.99%, an intrinsic value of $50.82 was reached. A ± 0.5% sensitivity analysis on the terminal growth rate and WACC ranged from $41.52-66.28. Additionally, a price-to-earnings multiple valuation was conducted, resulting in a valuation of $25.45. By weighting the two valuations 50/50, a price target of $38.13 was reached, resulting in a 44.94% upside.

Risks

- **Hot-rolled Steel Prices.** Insteel's primary raw material is hot-rolled carbon steel wire rod. Fluctuations in the cost and availability of this commodity can have a negative impact on the business. Insteel can obtain this material from both domestic and foreign suppliers, but has not hedged against the fluctuations.
- **Government Reductions.** As Insteel heavily relies on the construction of highways, bridges, and other infrastructure projects, reductions in funding for these projects would adversely affect the business.
- **Cyclicality of the Business.** Demand for Insteel's customers is largely driven by construction activity, which heavily correlates to the conditions of the general economy. Economic downturns will reduce the level of construction activity and demand for their products.

Management

Howard Woltz has served as the CEO of Insteel since 1991 and has been with the company since 1981. Before that, he served as the President of Florida Wire and Cable Inc., a former subsidiary that was merged with Insteel in 2002. Michael Gazmarian has served as the CFO and Treasurer since 1994 at Insteel. Over the years they have defined their goals as achieving leadership positions in the market, operating as the lowest cost provider, and pursing growth strategies opportunistically.



Peer Comparables

Name	Ticker	Market Cap (Mil)	Debt/Equity (%)	EBITDA (Mil)	EV/EBITDA (ttm)
Insteel Industries	IIIN	499.6	0.0%	68	6.47x
Nucor Corp	NUE	15,163	54.0%	1826	9.85x
Gerdau Long Products NA	GGB	5,317	74.5%	1257	5.04x
L.B. Foster	FSTR	131.4	59.7%	56	4.89x
US Concrete	USCR	756.4	210.2%	129	13.79x
	Peer Averages	5,342	99.59%	667.22	12.63x

Source: FactSet

Ownership

% of Shares Held by All Insider and 5% Owners:	6.68%
% of Shares Held by Institutional & Mutual Fund Owners:	>90%

Source: FactSet

Top 5 Shareholders

Holder	Shares	% Out
BlackRock Fund Advisors	1,230,000	8.07
Vanguard Group, Inc.	892,000	5.86
Hodges Capital Management	859,000	5.64
Next Century Growth Investors	558,000	3.67
Copper Rock Capital Partners LLC	542,000	3.56

Source: FactSet

Canadian Solar (CSIQ)

November 4, 2016

Tyler Sucharzewski — International Technology

Canadian Solar (NASDAQ:CSIQ)is a Canadian Alternative Energy company that designs, develops, and manufactures solar cells, wafers, and other solar power products, as well as providing consulting services. Canadian Solar is one of the largest solar power providers in the world, with operations spanning nearly the entire globe. Canadian Solar's range of products include various residential, commercial, and industrial solar power systems, as well as customized and specialty solar modules that are used in third-party products. The total solutions segment consists of solar power project development consulting, Engineering, Procurement, and Construction services, and Operations & Management services. The manufacturing segment focuses on generating electricity through different solar projects, and then selling to grids or other power purchasers. Canadian Solar was founded by Shawn Qu in October 2001 and is headquartered in Ontario, Canada.

Price ($): (11/1/2016)	$14.66
Price Target ($):	21.75
52WK H-L ($):	11.72 - 29.83
Market Cap (mil):	866.20
Float (mil):	662.64
Short Interest (%):	15.60%
Avg. Daily Vol (mil):	0.907
Dividend ($):	-
Yield (%):	-

Beta:	1.73
WACC	7.00%
M-Term Rev. Gr Rate Est:	25.0%
M-Term EPS Gr Rate Est:	48.0%
Debt/Equity:	2.64
Debt/EBITDA (ttm):	4.10
ROA:	4.6%
ROE:	22.4%
ROIC:	13.3%

FY: Dec	2015	2016E	2017E	2018E
Revenue (MM)	3,467.63	3,814.39	4,767.99	5,721.58
% Growth	17.12%	10.00%	25.00%	20.00%
Gross Margin	16.63%	21.00%	21.00%	21.00%
Operating Margin	7.13%	11.50%	12.64%	13.34%
EPS (Cal)	$2.93	$4.19	$6.20	$8.17
FCF/Share	$0.44	$0.61	$0.78	$0.86
P/E (Cal)	33.0	23.9	18.8	17.1
EV/EBITDA	8.6	5.0	3.7	3.0

Recommendation

As questions about the feasibility of fossil fuels continue to circulate, many are starting to turn to alternative forms of energy. This technology, while experimental, has the opportunity to provide clean and sustainable power to the world. To many, solar energy, or Photovoltaics (PV), is one of the pathways to solidifying a foundation in clean energy. Unfortunately, these experimental technologies are expensive, and few companies are able to actually turn a profit from it. Canadian Solar, however, has been able to consistently net profit from PV technology. Canadian Solar is one of the largest PV companies with the world, with 4.33 Gigawatts of total annual solar module manufacturing capacity, 2.7 Gigawatts of annual solar cell manufacturing capacity, and 400MW of annual ingot and wafer manufacturing capacity in 2015. By December 31, 2016, Canadian Solar plans on expanding these numbers to 5.73GW, 3.9GW, and 1.0GW respectively. The total amount of estimated solar installations in the world is estimated at 60GW for 2016, which would give Canadian Solar nearly 15% market share globally. For reference, 1.0 GW of electricity has the capacity to power about 725,000 homes. In regards to margins, Canadian Solar's Q2 2016 Net Margin was 5.01% compared to the industry average of 2.10%. This is mostly due to greater control of costs due to a vertically integrated supply chain, sustainable levels of R&D spending, and more focus on the total solutions side of the business. PV technology is starting to become commoditized, lowering prices and thus revenue for PV companies. While competitors have turned to making their solar panels and wafers more unique, Canadian Solar has found success in providing consulting, engineering, and other services to parties interested in utilizing solar energy. As more of the population starts to adopt solar energy, the demand for professionals with an expertise in fully utilizing PV technology will grow as well. With the subjects of clean energy, energy independence, and alternative technologies continuing to make noise in the spotlight, the opportunities for Canadian Solar will only increase. For the reasons above, I recommend that Canadian Solar (NASDAQ: CSIQ) be added to the AIM International Portfolio with a price target of $21.75, representing a 49% upside.

Investment Thesis

- **Tax Incentives and Worldwide Green Initiatives.** Consumers get incentives by the government to use solar panels by making the cost of the panels an investment tax credit. In the United States, the federal government will take 30% of a resident's solar cost off of their tax bill. As a provider for residential solar energy, Canada Solar benefits from these tax incentives with increased panel sales volume, as well as more consulting revenue. The United States is not the only government to take these types of initiatives; the Paris Agreement, which limits greenhouse gas emissions on more than 155 countries goes into effect November 4, 2016.
- **Unmatched Vertical Integration.** Though Canadian Solar is based in Canada, most of its manufacturing takes place in China. From 2014 to 2017, the company's manufacturing capacity has grown at a CAGR of 15%. The company's manufacturing plants have been able to cut costs for each of their products, contributing greatly to the positive bottom line. Canadian Solar has also continued to expand downstream with its acquisition of Recurrent Energy, adding almost 4.0GW worth of downstream projects.
- **Global solar installations growing at a rapid pace.** Since 2008 global annual PV installations grew at a CAGR of 38.1%, growing from 6.5 GW in 2008 to a projected 67.0 GW in 2016. Installation rates are projected to grow at a continuing rate of 8.3% through 2019. According to the US Energy Information Administration, investments in renewable energy sources continued to grow through low fossil fuel prices. This growing market presents the opportunity for growth in key markets that Canadian Solar operate in, including China, Brazil, and Japan.

Valuation

To reach an intrinsic value for CSIQ, a five year DCF model was constructed. Using a terminal growth rate of 2.75% and a WACC of 7.00%, an intrinsic value of $21.75 was reached. A ± 1% sensitivity analysis on the WACC and a ± .25% on the long term growth rate ranged between $19.78 and $24.23. Using this model, an intrinsic value of $21.75 was reached. The company does not pay a dividend.

Risks

- **Cyclicality of the Market.** In the past Fiscal Year, solar stocks have been suffering. This is due to a number of things, including low prices of fossil fuels as well as the threat of high interest rates. Low fossil fuel prices reduce the incentive for people to invest in expensive solar power. With interest rate hikes looming on the horizon, investors will demand even higher returns from Solar energy projects.
- **Commoditization.** Over the past year the entire solar industry has been suffering from lower prices. Unfortunately for the industry, the market sees solar panels and cells as commodities, and rarely sees any difference between two types of panels. This has driven the price down, making it difficult for companies to differentiate themselves and build a competitive moat.
- **Uncertain Government Policies.** Solar companies benefit greatly from subsidies and tax credits, which are subject to change at any time. Should the government decide to change the amount of subsidies consumers or companies get for utilizing solar energy instead of traditional electricity sources, this could adversely affect Canadian Solar's cash flows.

Management

Dr. Shawn Qu is the Chairman, President, CEO, and founder of Canadian Solar, Inc. A Chinese immigrant, Qu earned a master's degree in physics and a Ph. D in materials science. Qu started Canadian Solar in 2001, and has seen the company through the past 15 years. Dr. Huifeng Chang is the CFO of Canadian Solar with over 17 years in capital markets experience. He earned his MBA and Ph. D in soil physics from University of Hawaii.

Ownership

% of Shares Held by All Insider and 5% Owners:	23.52% ▲
% of Shares Held by Institutional & Mutual Fund Owners:	49.46% ▲

Source: ThompsonOne

Top 5 Shareholders

Holder	Shares		% Out
Qu (Shawn Xiahua)	13,469,096	▲	23.45%
DNB Asset Management AS	3,312,002	▼	5.77%
Millennium Management LLC	1,373,088	▲	2.39%
Ruffer LLP	1,061,914	▲	1.85%
Quentec Asset Management	1,025,265	▲	1.79%

Peer Analysis

Name	Ticker	Market Cap (mil)	D/E	Sales (mil)	P/S	Net Margin
Canadian Solar	CSIQ-US	866.20	2.64	3497.40	0.26	4.40%
First Solar	FSLR-US	4,202.90	0.04	3995.0	1.07	17.50%
SunPower	SPWR-US	1,070.70	1.71	1552.1	0.69	-21.90%
Hanwha Q Cells	HQCL-US	969.20	3.04	2691.9	0.43	8.00%
Trina Solar	TSL-US	956.10	1.86	3507.8	0.31	2.50%
Peer Averages		1,613.02	1.86	3,048.84	0.55	2.10%

Source: Factset

Franklin Electric Co. (FELE)

November 4, 2016

Sarah Hillegass | Domestic Industrials

Franklin Electric (NASDAQ: FELE) designs, manufactures, and distributes water and fuel pumping systems. FELE's products are used in groundwater, wastewater, and fuel transfer applications for the residential, agricultural, and industrial markets. FELE has two operating segments: Water Systems (80% of revenues, 12% OPM), and Fueling Systems (20%, 24%). The Water Systems segment produces submersible electric motors, drives, and groundwater and surface water pumps. The Fueling Systems segment manufactures submersible fuel containment systems for gas stations, including the pumps, pipes, electronic controls, and monitoring devices. FELE has manufacturing and distribution facilities in 15 countries spread throughout North America, South America, Europe, Asia, and South Africa. Franklin Electric was founded in 1944 and is headquartered in Fort Wayne, IN.

Price ($): (10/26/16)	35.6	Beta:	1.14	FY: Dec	2015A	2016E	2017E	2018E
Price Target ($):	44.20	WACC	8.63%	Revenue (Mil)	924.92	956.15	1,000.42	1,060.45
52WK H-L ($):	41-24	M-Term Rev. Gr Rate Est:	5.32%	% Growth	-11.73%	3.38%	4.63%	6.00%
Market Cap (mil):	1,645.22	M-Term EPS Gr Rate Est:	7.73%	Gross Margin	32.18%	34.28%	35.30%	35.50%
Float (%):	55.94	Debt/Equity:	24.15%	Operating Margin	10.56%	12.28%	13.30%	13.50%
Short Interest (%):	3.40%	Debt/EBITDA:	1.47	EPS (Cal)	$1.50	$1.59	$1.84	$1.97
Avg. Daily Vol (M):	6.00	ROA:	6.90%	FCF/Share	$1.54	$1.00	$1.25	$1.39
Dividend ($):	0.40	ROE:	12.38%	P/E (Cal)	18.02	22.44	19.38	18.06
Yield (%):	1.12%	ROIC:	9.61%	EV/EBITDA	10.50	11.16	10.09	9.50

Recommendation

Franklin Electric will rebound profitably from the subdued water pumping systems market by designing and manufacturing top-of-class equipment that will be demanded due to increased investment in infrastructure, residential housing, and a stronger consumer environment. For FELE, FY2015 saw sales decrease nearly 12%, while profits increased by 5%. Sales decreased primarily due to the strong USD, the drop in oil prices, and the record wet weather in the US. However, FY2015 was the third most profitable year ever because of FELE's commitment to reducing the fixed cost run rate and improving pricing. FELE has a five-pillar approach to doing business by providing quality, availability, service, innovation, and value. This approach has resulted in world-class customer service, on-site installation, and custom-made products and applications. For example, FELE can provide dewatering applications or solar-powered groundwater pumping systems to meet the needs of their clients throughout the world. Additionally, FELE incorporates ESG into its business operations. FELE has a "Wells for the World" foundation in which it provides wells and water pumping systems to regions of Africa. This initiative brings water to the surface to allow for a better standard of living for communities where walking miles to find fresh, clean water is the norm. FELE is actively seeking accretive bolt-on acquisitions to its portfolio of products, but at this time thinks most potential targets are too highly valued. Due to its focus on increasing profitability through fixed cost reduction, introducing more innovative products to the marketplace, and expanding distribution wider into emerging markets, FELE will achieve a greater exposure to emerging market growth, while maintaining a profitable domestic water systems presence. Therefore, it is recommended that Franklin Electric be added to the AIM Equity Fund with a target price of $44.20, representing a 24.15% upside. FELE pays a $0.40 annual dividend with a 1.12% yield.

Investment Thesis

- **Gas Station Conversion.** In emerging markets, there is rapid demand to convert gas stations from small stations to large pressure pumping systems. In the US and Canada, 97% of the 175,000 filling stations use pressure pumping systems. However in emerging markets, only 30% of the 565,000 filling stations use pressure-pumping systems. Emerging markets constitutes nearly 40% of FELE's fueling system sales and has been growing at double the rate of organic domestic sales. This is because of urbanization and the increased purchasing power of those in the middle class to buy cars and drive farther. This growth in the fueling systems segment will be driven by FELE's strong interests in emerging markets, specifically India and Brazil, and the increased demand to change from steel to plastic underground piping. Additionally, this growth in the fueling systems sales will help improve net margins, since the OPM for the fueling systems segment is 12% higher than the water systems segment due to the increased service capabilities.

- **Water Systems Recovery.** In 4Q15, FELE saw the bottom of the agricultural and residential markets related to surface and groundwater motor/pump demand. The agricultural market grew sales 13% in 2Q16, complemented by residential pumping sales increasing 8%. The water systems segment increased sales by 5% in 3Q16 due to 17% growth in residential groundwater systems. FELE's products are more of replacement items than capital goods, which means that when pumps are turned on and operating, FELE will profit since 80% of its business is garnered from replacement parts incremental revenue. Therefore, the more pumps that are turned on this year compared to 2015, the more revenue for FELE. To further stabilize water systems demand, FELE is introducing new products, such as coal-seam gas applications, vertical multi-stage pumps, and solar product offerings to provide custom, whole systems to reduce a customer's total cost of ownership.
- **Capital Allocation Focus.** After the severe headwinds faced in FY 2015, FELE has implemented a strict capital deployment strategy. First, FELE is searching for complementary acquisitions that can be accretive as soon as the transaction closes. While currently acquisitions appear too expensive, FELE is searching for ways to penetrate new markets and product lines. Second, FELE has initiated a stock buyback program to increase shareholder wealth, buying about 300,000 shares a year. The increased FCF is tied to the payment of the dividend and the repayment of debt. Third, FELE continues to focus on increasing margins by capitalizing on better pricing and stabilizing raw materials costs. This led to an increase in GPM by 400bps from 4Q15 to 2Q16 and a lowered direct exposure to oil to only 1%.

Valuation

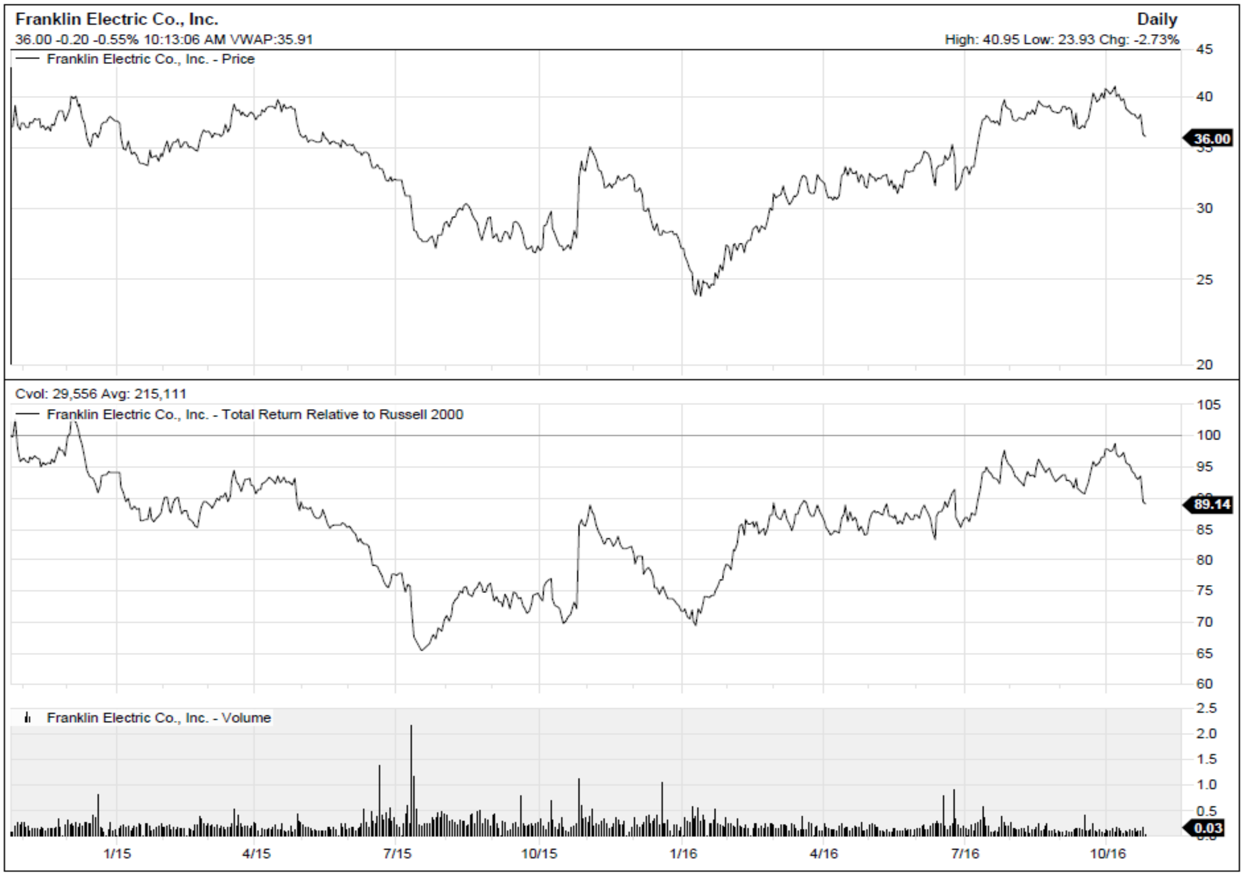
In order to reach an intrinsic value for FELE, a five year DCF model was constructed. Using a terminal growth rate of 2.0%, WACC of 8.63%, an intrinsic value of $47.62 was reached. A sensitivity analysis on the terminal growth rate of 50bps and WACC of 50bps ranged from $41.10-56.37. Additionally, a P/E multiple valuation was conducted using EPS NTM of $1.77 and a comparables average P/E of 21.73x, which resulted in a valuation of $38.56. Finally, an EV/EBITDA relative multiple valuation was calculated using EBITDA NTM of $159.15 and a comparables average EV/EBITDA of 12.48x, which resulted in a valuation of $42.98. By weighting the three valuation models 50/25/25, a price target of $44.20 was reached, which yields an 24.15% upside.

Risks

- **Currency impacts.** Due to the strength of the dollar over the last two years, international operations have faced significant headwinds in translating sales into USD. In the first nine months of 2016, net sales decreased 3% due to foreign currency translation. Additionally, FELE's operations in Europe (Turkey), the Middle East, and South Africa have been severely hurt from foreign currency translation (6% decrease in water systems net sales) for the first nine months of 2016. FELE's exposure to Turkey is only $30M, primarily in the water systems segment.
- **Wet Weather.** In FY 2015, wet weather was a major headwind for sales in the United States for FELE, especially in Texas. The wet weather decreases how hard the groundwater pumps have to work, which decreases replacement demand. Therefore, if more unusual wet weather were to occur, this would negatively impact FELE's sales.

Management

Gregg Sengstack has been CEO of FELE since May 2014. He was previously the Chief Operating Officer from 2011-2014 and has been with the firm in numerous other roles since 1988. John Haines has been the CFO since April 2008. He was previously in finance roles at GE and HSBC Auto Finance.



Source: Factset

Ownership

% of Shares Held by All Insider and 5% Owners:	18.08% ▲
% of Shares Held by Institutional & Mutual Fund Owners:	>81.37% ▲

Source: FactSet

Top 5 Shareholders

Holder	Shares		% Out
Schaefer, Patricia	4,000,000	▬	8.66
BlackRock Fund Advisors	3,659,000	▲	7.92
The Vanguard Group, Inc.	3,340,000	▼	7.23
Humphrey, Diane	3,160,000	▬	6.84
Earnest Partners, LLC	2,290,000	▼	4.96

Source: FactSet

Peer Analysis

Name	Ticker	Market Cap (mil)	Net Margin (%)	Debt/EBITDA	P/E FY1	EV/ EBITDA
Franklin Electric Co., Inc	FELE	1,645	7.8%	1.5	19.4	12.6
Interpump Group	IP-IT	1,735	9.6%	2.5	17.2	11.0
Pentair	PNR	10,127	-1.3%	4.0	18.4	12.8
Xylem	XYL	8,606	9.1%	1.9	23.5	14.5
Dover	DOV	10,559	7.2%	2.7	22.5	11.4
Peer Averages		7,757	6.2%	2.8	20.4	12.4

Source: FactSet

Comfort Systems USA, Inc. (FIX)

November 4, 2016

Andy Krueger — Materials

Comfort Systems USA, Inc. (NYSE:FIX) engages in the provision of comprehensive mechanical installation, renovation, maintenance, repair and replacement services within the mechanical services industry. FIX competes in the commercial, industrial and institutional heating, ventilation and air conditioning (HVAC) markets. Most work is performed in office buildings, retail centers, apartment complexes, manufacturing plants, healthcare, education and government facilities. FIX earns all revenue in the United States. The firm's revenue breaks out into approximately 81% on installation of mechanical systems in newly constructed or replacement systems in existing facilities and 19% from maintenance and repair services on existing HVAC systems. FIX was founded December 12, 1996 and is headquartered in Houston, TX.

Price ($):	28.05
Price Target ($):	34.91
52WK H-L ($):	34 - 24.22
Market Cap (mil):	1,042
Float (mil):	36.6
Short Interest (%):	2.1
Avg. Daily Vol (mil):	0.3
Dividend ($):	0.28
Yield (%):	1.0

Beta:	1.13
WACC	8.05%
M-Term Rev. Gr Rate Est:	3.0%
M-Term EPS Gr Rate Est:	12.0%
Debt/Equity:	7.6
Debt/EBITDA (ttm):	0.22
ROA (%):	8.67
ROE (%):	17.44
ROIC (%):	16.52

FY: Dec	12/31/2015	12/31/2016	12/31/2017	12/31/2018
Revenue (Mil)	1,580.52	1,663.90	1,741.00	1,793.23
% Growth	12.0%	5.3%	4.6%	3.0%
Gross Margin	20.1%	20.9%	20.8%	20.9%
EBITDA Margin	7.15%	7.83%	7.94%	8.30%
EPS (Cal) ($)	1.30	1.73	1.84	2.06
FCF/Share	$2.03	$2.24	$2.46	$2.71
P/E (Cal)	21.9	16.1	14.7	14.7
EV/EBITDA	9.89	9.32	7.64	7.09

Recommendation

FIX is a national provider of comprehensive mechanical installation, renovation, maintenance, repair and replacement services. As of the end of the third quarter 2016, FIX had 4,518 projects in process across a variety of sectors. FIX reduces exposure to negative trends in any one sector by diversifying their exposure across end markets. The average project takes six to nine months to complete and has an average contract price of $463,000. Customers typically pay periodically throughout the project, helping FIX maintain reliable free cash flows. FIX has benefited from the value of nonresidential construction put in place increasing on average 1% monthly from $38.6 to $63.9 billion (annualized, not seasonally adjusted) from 2013 through 2015 (US Census Bureau). From 2015 to the present, value of construction spending has fluctuated while remaining above the five year average spend. FIX management highlighted strength in its industrial end-markets over this time; more specifically, data centers, pharma manufacturing and food processing. Strong construction spending and GDP growth in the US will make management's goal of 3-6% organic growth achievable in the foreseeable future. FIX management has also indicated it will target an additional $100 million in revenues annually from inorganic growth acquisitions. The two accretive acquisitions FIX completed in the first quarter of 2016 have already surpassed this $100 million revenue target. FIX acquired the remaining 40% non-controlling interest in Environmental Air Systems for $42 million cash, and the ShoffnerKalthoff family of companies for $20.1 million cash. FIX remains active in executing strategic share repurchases with the Board recently approving an additional 0.6 million shares available for repurchase; evidence FIX management will continue to support the stock going forward. Management at FIX has proven the ability to maintain company performance through industry cycles and execute strategic M&A when the opportunity exists. With positive spending reports from FIX's end-markets, a proven business model with strong FCF generation and experienced leadership from the firm's top management, it is recommended FIX be added to the AIM Equity Fund with a price target of $34.91, representing a 25% upside. Notably, the company pays a dividend of $0.28, yielding 1.03%.

Investment Thesis

- **Strong Nonresidential Building Construction.** Being a mechanical and building control services provider serving the nonresidential construction services industry, FIX reacts to trends affecting their customers' industries. According to the Associated Builders and Contractors, Inc.

(ABC), the value of nonresidential spending started slipped 1.3% since July. Notably, a significant portion of the decline came from areas FIX does not typically serve: transportation, public safety, highway and street. Sectors affecting FIX such as office, lodging and healthcare, saw spending increases month-over-month. ABC also reports a nonresidential construction confidence index, which remains comfortably in positive territory for sales, profit margins, and staffing levels. Positive sentiment suggests confidence towards macroeconomic factors that drive nonresidential construction spending remains among builders and contractors. FIX will continue to see sales growth as the activity levels and macroeconomic environment continue to grow.

- **Quality Management Team.** The management team at FIX has an average tenure of 11 years at the company, with multiple founders retaining leadership positions at the firm. FIX CEO created a very strong balance sheet as illustrated by the Altman Z-Score for FIX of 4.9, well above the 2.9 threshold to be a "safe" company. FIX management also maintains a low amount of debt on the balance sheet ($39.5 million). FIX's Total Debt/EBITDA currently sits at 0.3x, with a $247.5 million revolving line of credit outstanding serving as a source of capital for M&A activity or share repurchases. FIX has repurchased 7.3 million shares since the Board approved the program in 2007. Through the first three quarters of 2016, they repurchased 0.4 million shares at an average price of $28.56 per share, illustrating management is committed to supporting the stock. All factors considered, management's record of accomplishment proves an investment in FIX would bring value into the AIM fund.
- **Consistent Free Cash Flow Generation.** FIX's average project duration of roughly 6 months allows the firm to complete the realization of revenue and earnings within twelve months (including the typical retention terms). As a result, FIX returned positive free cash flow for the last seventeen calendar years (current FCF is $61.2 million). Consistent FCF through challenging economic and industry conditions highlights the viability of the firm's business model. Reliable FCF generation, along with the $38.3 million in cash and short-term investments on FIX's balance sheet allows the company to stay nimble in the market place, taking advantage of M&A deals when the opportunity presents itself. It also provides a safety net from any unexpected interruptions of cash flow to the firm's business model.

Valuation

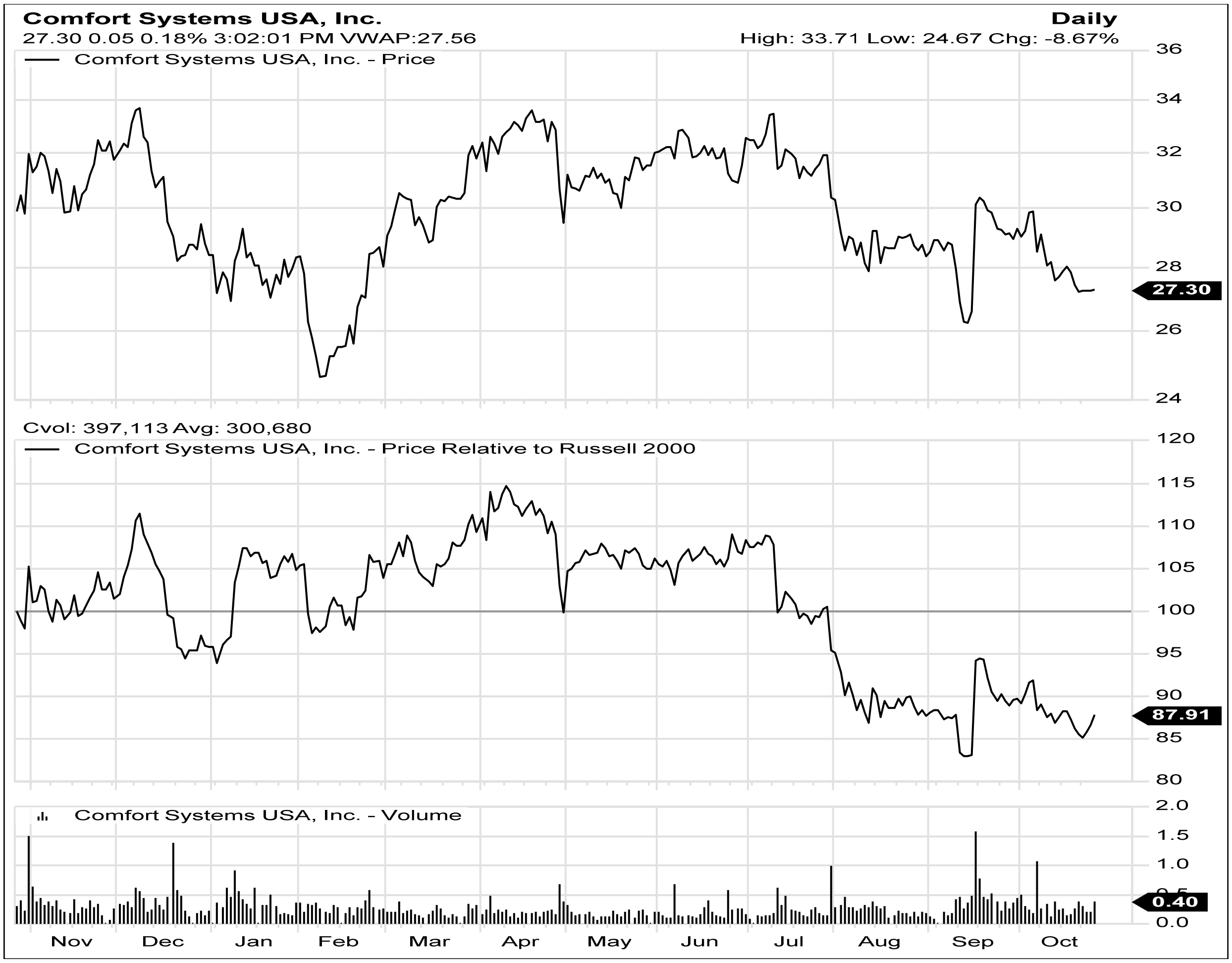
To reach an intrinsic value for FIX, a five year DDM model was created. Using a terminal growth rate of 2.00% and a discount rate of 8.27%, an intrinsic value of $33.12 resulted. A ± .25% sensativity analysis on the terminal growth rate and ± .5% sensativity to WACC ranged from $30.65-36.78. Additionally, an EV/EBITDA multiple valuation was conducted using 2016 EBITDA of $130.23MM and peer comparable multiple of 11.42x, resulting in a valuation of $36.70. By weighting the two valuation models 50/50, a price target of $34.91 was reached, resulting in a 25% upside.

Risks

- **Cyclicality/Seasonality in End Markets.** The construction industry is known for being a cyclical industry, exposing FIX to any adverse movements in these end-markets. HVAC installations are subject to seasonality, with the greatest demand for services in the second and third quarters.
- **Competitive Industry.** Customers seek bids from FIX and FIX's competitors before choosing a partner, limiting pricing power in the industry and making margin expansion difficult.
- **Execution Delays.** Extreme weather or client funding concerns can affect near- and medium-term performance of ongoing projects, potentially impacting cash flows of FIX.

Management

Brian E. Lane began his tenure as President and CEO of FIX in 2011. Lane joined FIX in 2003 as VP of Region One. Bill George has been with FIX for 19 years and is currently the CFO and EVP; he helped found the company in 1997. Jeff Coleman serves as the President of Strategic Accounts at FIX. Jeff has 30 years of experience in the HVAC industry between Carrier and Comfort Systems USA.



Peer Analysis

Name	Ticker	Market Cap (mil)	Sales (mil)	EBITDA	Dividend Yield	EV/ EBITDA
Comfort Systems USA, Inc.	FIX	1,022	1,626	125.129	0.88	9.32
EMCOR Group, Inc.	EME	3,624	7,379	401.5	0.67	7.94
Lennox International Inc.	LII	6,242	3,579	502.8	1.10	14.51
Tretra Technology, Inc.	TTEK	2,197	2,282	198.4	0.94	12.14
Stantec Inc.	STN-CN	2,544	2,457	230.1	1.51	14.20
Myr Group, Inc.	MYRG	469	1,057	70.6	0.00*	6.94
Peer Averages		3,015	3,351	280.7	1.06	11.1

** Removed for computation of average dividen yield*

Ownership

% of Shares Held by All Insider Owners:	2.29%
% of Shares Held by Institutional & Mutual Fund Owners:	>90%

Source: FactSet

Top 5 Shareholders

Holder	Shares	% Out
The Vanguard Group, Inc.	4,309,516	11.51
BlackRock Fund Advisors	3,621,286	9.67
Barrow, Hanley, Mewhinney & Strauss LLC	2,269,485	6.06
Dimensional Fund Advisors LP	1,659,426	4.43
T. Rowe Price Associates, Inc.	1,287,639	3.44

Source: FactSet

Fabrinet (FN)

November 4, 2016

Joseph Kennedy — International Consumer Discretionary

Fabrinet (NSYE: FN) is a sophisticated optical, electronic equipment manufacturing services company that provides a range of services and products to major original equipment manufacturers (OEM). FN's servicing arm offers failure analysis, reliability testing, and real-time traceability analysis, and its core products include industrial lasers/sensors (28% of revenue) and optical communication modules (72%). The Company has established an ability to penetrate many industries and regions across the United States (49.5% of Revenue), China (16.0%), and Japan (6.2%). FN's key industries include automotive, medical, industrial, and aerospace. Fabrinet was founded in August 1999 and is headquartered in George Town, Cayman Islands.

Price ($): (10/29/16)	37.8	Beta:	0.84	FY: Jan	2016	2017E	2018E	2019E
Price Target ($):	54.32	WACC	8.9%	Revenue (Mil)	976.75	1,085.44	1,227.94	1,413.70
52WK H-L ($):	46-21	M-Term Rev. Gr Rate Est:	12.7%	% Growth	26.3%	11.1%	13.1%	15.1%
Market Cap (mil):	1,369	M-Term EPS Gr Rate Est:	2.0%	Gross Margin	12.2%	11.3%	11.5%	11.6%
Float (mil):	95.1%	Debt/Equity:	11.0%	Operating Margin	7.1%	6.9%	7.0%	6.9%
Short Interest (%):	2.6%	Debt/EBITDA (ttm):	0.70x	EPS (Cal)	$1.68	$1.95	$2.23	$2.54
Avg. Daily Vol :	558,616	ROA:	8.1%	FCF/Share	$2.18	$2.97	$3.31	$4.10
Dividend ($):	-	ROE:	12.0%	P/E (Cal)	25.2x	27.8x	24.3x	21.3x
Yield (%):	-	ROIC:	11.5%	EV/EBITDA	13.1x	12.3x	10.8x	9.4x

Recommendation

The Telecommunication and Data Communication industries are growing at a booming pace. Mobile data traffic has grown 4,000-fold since 2006 and is poised to continue expansion as 400 gig is the next push. Fourth-generation (4G) data connections have overtaken third-generation (3G), forcing providers to seek wider bandwidth connections and more dense networking capabilities. There is a new technology at the heart of the push to faster connections: silicon photonics. This new technology aims to replace copper wiring with silicon as the optical medium for digital communication. The silicon medium connects an integrated circuit through a semiconductor laser to transmit data through light; the benefits of the new system include smaller datacenters, higher speed, and easier installation. The Silicon Photonics Market is expected to grow at a CAGR of 22.1% from 2016 to 2022, driven by the immense demand from data communication applications. Fabrinet contributes to the emerging market by providing manufacturers with highly sophisticated lasers (19% of revenue) to communicate with the silicon photonics' integrated circuits. The Company's advanced packaging laser development is in the early stage and has grown 50% since FY14. FN's largest customer, Lumentum Holdings Inc. (NASDAQ: LITE), generates 20% of the Company's revenue, which derives a portion of the silicon photonics revenue. Lumentum Holdings has robust revenue growth averaging 6.2% YoY since FY13. Management has not stated FN's relationship with Lumentum Holdings, but has highlighted the three-year contract relationships that they have with clients. With the significant growth in the telecommunications and data communications industry, in conjunction with the Company's potential expansion into Europe, it is recommended that Fabrinet be added to the AIM International Fund with a target price of $54.32, representing a 41.23% upside. The company does not pay a dividend

Investment Thesis

- **Time is Money-** Growth in global mobile data traffic is set to increase at a CAGR of 53% from 2015-2020. Telecomm and Datacom providers are shifting demand from 40-gig bandwidth solutions to 100-gig to accommodate consumers' rising mobile video usage. The shift in technology is going to propel the Optical Component Market to grow at a CAGR of 9% from 2013-2020. Of that growth in data traffic, 45% is to be in Asia. Fabrinet has ideally placed itself in the Asian region to fulfill its customers' needs as network growth continues. As one of

Thailand's major employers and having recently completed a state-of-the-art manufacturing center, the Company is poised to trump its competitors in the future.

- **Movement to Europe-** Fabrinet recently acquired Exception Global CEM Solutions Ltd., who generates 80% of its revenue in Europe, to provide the Company with exposure in the European market. The acquisition opens up Exception Global CEM Solutions to FN's low-cost production facilities in Thailand while retaining its European presence. Western Europe is set to have the second fastest growth in mobile devices and connections from 2015 to 2020, with a projected CAGR of 14%.
- **Production Capacity-** Following the completion of Fabrinet's advanced-packaging production facility in Chonburi, Thailand, the Company's production capacity will increase by 32%. With the company only holding 20 customers, the production facility will expand its capability in customer growth. Further, customer contracts typically last three years, and customers must provide rolling forecasts for demand requirements. CFO, Toh-Seng Ng, stated that the new manufacturing plant would operate at approximately 75% capacity upon completion. Further, the Company recently established Fabrinet West, Inc. as a New Product Introduction facility in Silicon Valley. The subsidiary acts as a business development arm equipped with advanced technologies to create a foothold in Silicon Valley. The interconnectedness between Fabrinet West, Inc. and FN's production facilities in Thailand will easily communicate consumer demands to remain on the cutting edge.

Valuation

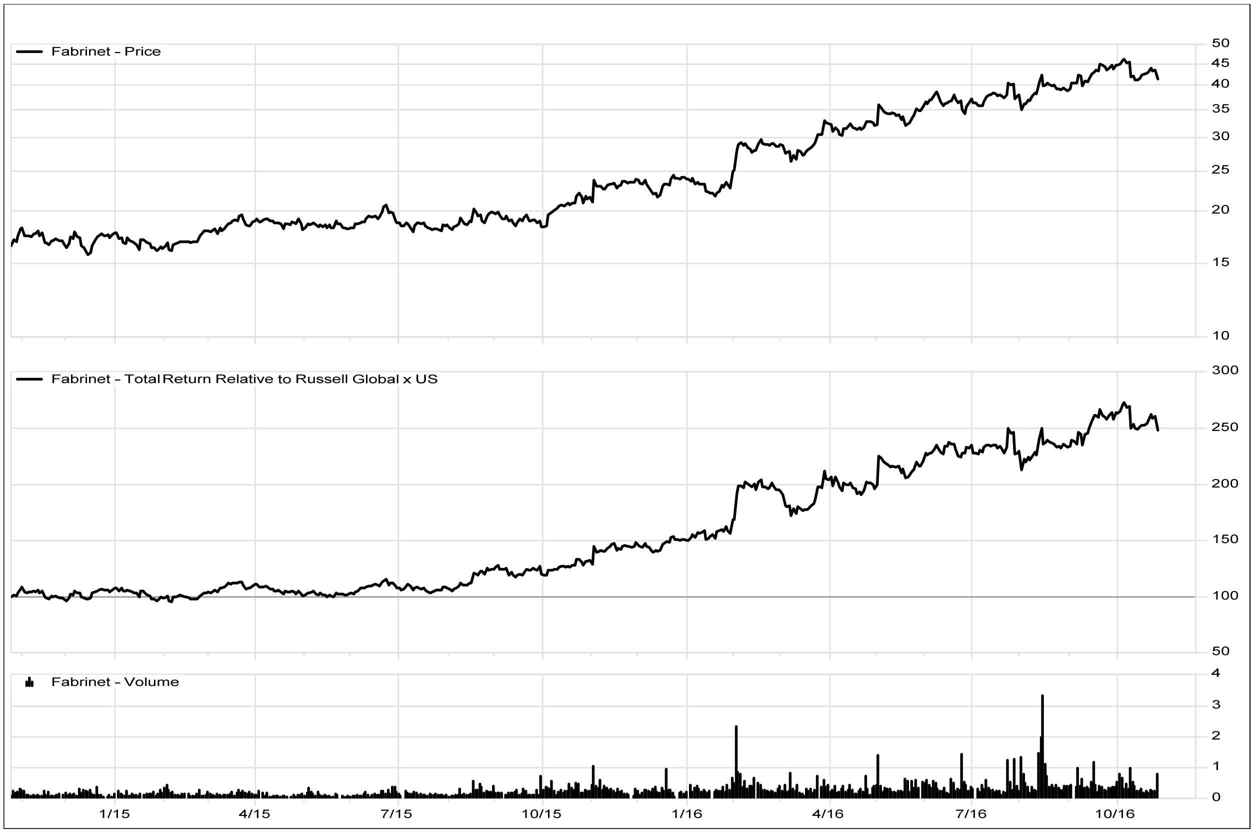
In order to reach an intrinsic value for Fabrinet, a five year DCF model was constructed. Using a terminal growth rate of 2% and WACC of 8.9%, an intrinsic value of $59.71 was reached. Additionally, a P/E multiple valuation was conducted using NTM EPS of $1.68, a comparables average P/E of 33.1x, and FN's NTM P/E of 25.2x which resulted in a valuation of $48.93. By weighting the two valuation models 50/50, a price target of $54.32 was reached, which yields a 41.23% upside. FN does not pay a dividend.

Risks

- **Loss of a Major Customer** – Since Fabrinet only holds twenty customers, and one customer generates 20% of the Company's revenue, their sales figures could face a moderate decline if a customer opts for a competitor.
- **Geopolitical Issues –** Fabrinet depends on Thailand as its base for production, and the political landscape could create volatility due to the change in leadership.
- **Customer Demand –** Telecomm and Datacom providers have projected significant growth in demand for higher networking speed capabilities. If their numbers are significantly below projections, Fabrinet's production facilities will not operate to the most cost advantageous manner.

Management

David Mitchell, founder and CEO of FN, has over 33 years of experience in the electronics and semiconductor industries. Mitchell has led Fabrinet since its inception in 1999 and is also the co-founder of Seagate Peripherals, Inc., a manufacturer of rigid magnetic disk drives. Toh-Seng Ng, the Company's CFO, has worked in various capacities within Fabrinet since 2009. Seng has 28 years of experience in the semiconductor and data storage industries, serving in a multitude of global financial management roles. FN recently hired Craig Coochi as their Executive Vice President of Operations.



Ownership

% of Shares Held by All Insider and 5% Owners:	4.89% ▼
% of Shares Held by Institutional & Mutual Fund Owners:	90.85% —

Source: Factset

Top 5 Shareholders

Holder	Shares	% Out
BlackRock Fund Advisors	16,666,000 ▲	7.98%
Dimensional Fund Advisors LP	2,890,000 ▲	5.70%
The Vanguard Group, Inc.	1,558,000 ▲	4.30%
Fidelity Mangement & Research Co.	1,475,000 ▲	4.07%
Whale Rock Capital Management LLC	1,374,000 ▲	3.80%

Source: Factset

Peer Analysis

Name	Ticker	Market Cap (mil)	Net Income (mil)	D/E	P/E	EV/ EBITDA
Fabrinet	FN	1,577	62	0.11	25.18x	15.5x
Alps Electric Co.	6770-JP	4,877	278	0.25	16.95x	8.1x
Finisar Corporation	FNSR	3,251	56	0.19	57.82x	18.4x
Infierna Corporation	INFN	1,322	45	0.15	30.77x	9.1x
EXFO Inc.	EXF-CA	230	9	-	26.72x	11.1x
Peer Averages		2,420	97	0.2	33.07x	11.7x

Source: Factset

Nippon Telegraph and Telephone Corporation Sponsored ADR (NTT)
November 4, 2016

Anthony DiSanto | International Telecommunications

Nippon Telegraph and Telephone Corporation (NYSE: NTT-US) is a Japanese holding company that engages in telecommunication services. The company operates in five segments: Mobile Communications Business (36%), Regional Communications Business (26%), Long-Distance and International Communications Business (17%), Data Communications Business (12%), and other business (9%). The company was founded August 1, 1952 and is headquartered in Tokyo, Japan.

Price ($): (9/23/15)	$44.23	Beta:	0.13	FY: Dec	2016	2017E	2018E	2019E
Price Target ($):	$52.21	WACC	1.8%	Revenue (mil)	96,137	100,229	104,179	108,179
52WK H-L ($):	36.54-49.67	M-Term Rev. Gr Rate Est:	3.7%	% Growth	-4.47%	4.26%	3.94%	3.84%
Market Cap (bil):	92.70	M-Term EPS Gr Rate Est:	17.7%	Gross Margin	35.95%	36.65%	37.83%	38.69%
Float (mil):	-	Debt/Equity:	47.5%	Operating Margin	11.96%	15.45%	18.39%	20.11%
Short Interest (%):	-	Debt/EBITDA (ttm):	1.23	EPS (Cal)	$2.92	$3.82	$4.75	$5.41
Avg. Daily Vol (mil):	254812.00	ROA:	3.4%	FCF/Share	$5.72	$5.20	$6.20	$7.04
Dividend ($):	1.18	ROE:	8.1%	P/E (Cal)	17.9	13.7	11.0	9.7
Yield (%):	2.66%	ROIC:	5.8%	EV/EBITDA	5.32	4.9	4.3	4.0

Recommendation

The telecommunication industry is facing massive consolidation as the market becomes saturated with smart phones. As new customers are becoming more difficult to find, operators must focus on gaining market share, sometimes leading to pricing pressure and lower margins. Thus, NTT is breaking away from competition amongst telecommunication operators to a new stage as a “value partner.” As a result of this change, the *Hikari Collaboration Model* was launched in early 2015. This was the world’s first full-scale fibre-access services offered through a wholesale service. Through this model, NTT East and NTT West will provide the fiber access service to other market players who will offer their services to consumers – a B2B2X business model. Outside of Japan, NTT is aggressively pursuing global services, utilizing their strengths in networks and data centers to build out their cloud services. Through mergers and acquisitions, they positioned themselves to be a full-stack, full life-cycle service globally. Furthermore, understanding the importance in a world where more devices are becoming connected, they have established NTT Security in August 2016. Through consolidation of their specialized security technologies, it will focus solely on developing and providing individual security solutions to firms. Currently, overseas sales are $15 billion and predict it to grow to $22 billion by the end of 2018. Additionally, through the transition of becoming a value added company, they are focusing on cost reduction initiatives which have been extremely successful and plan on reducing costs further with a target of ~$7.627 billion by 2018, and have currently reached half of that goal. Thus, through transitioning to a value partner, global expansion, cost reductions, and the creation of NTT Security, it is recommended that Nippon Telegraph and Telephone Corporation be added to the International AIM Portfolio with a price target of $52.21, representing an upside of 18.0%. NTT pays a dividend representing a 2.66% yield.

Investment Thesis

- **Shift to Value Partner.** As mentioned prior, with the telecommunication industry becoming increasingly competitive, NTT has shifted to a new business plan. They will focus on collaborative arrangements with other entities, such as corporations, governments, and others, to provide a B2B2X framework. They are currently expanding this model to the J. Leaugue soccer stadiums and will be working with the 2020 Olympic Games.
- **Global Market Development.** NTT is expanding their overseas presence and capitalizing on current trends in the market. One of those is the information and communication market, where

corporate expenditures is currently growing at an annual rate of 7% and is forecasted to reach a global market of $2,700 billion by 2020. Cloud services are another market they are in, which as mentioned prior, is expected to reach a market of $242 billion. As stated prior, they forecast to have sales of $22 billion by 2018, with $15 billion currently.

- **Enhancing Profitability.** After achieving sooner than expected cost reductions, NTT increased their overall goal by $1.906 billion. Of the overall ~$7.627 billion reduction goal, they will target reductions in human resources costs (~$950 million), facilities costs (~$2.86 billion), and other marketing costs (~$3.80 billion). They believe they can reach this goal within the next year, one year ahead of plan.
- **NTT Security**. In June 2016, through consolidating the specialized security technology within all of NTT they established NTT Security. With the dawn of the internet of things, security is an ever-increasing concern to people and corporations. They saw this as a key component of their globalization efforts and as integral to their shift to a valued partner. Going forward, the cybersecurity market is expected to reach $170 billion by 2020.

Valuation

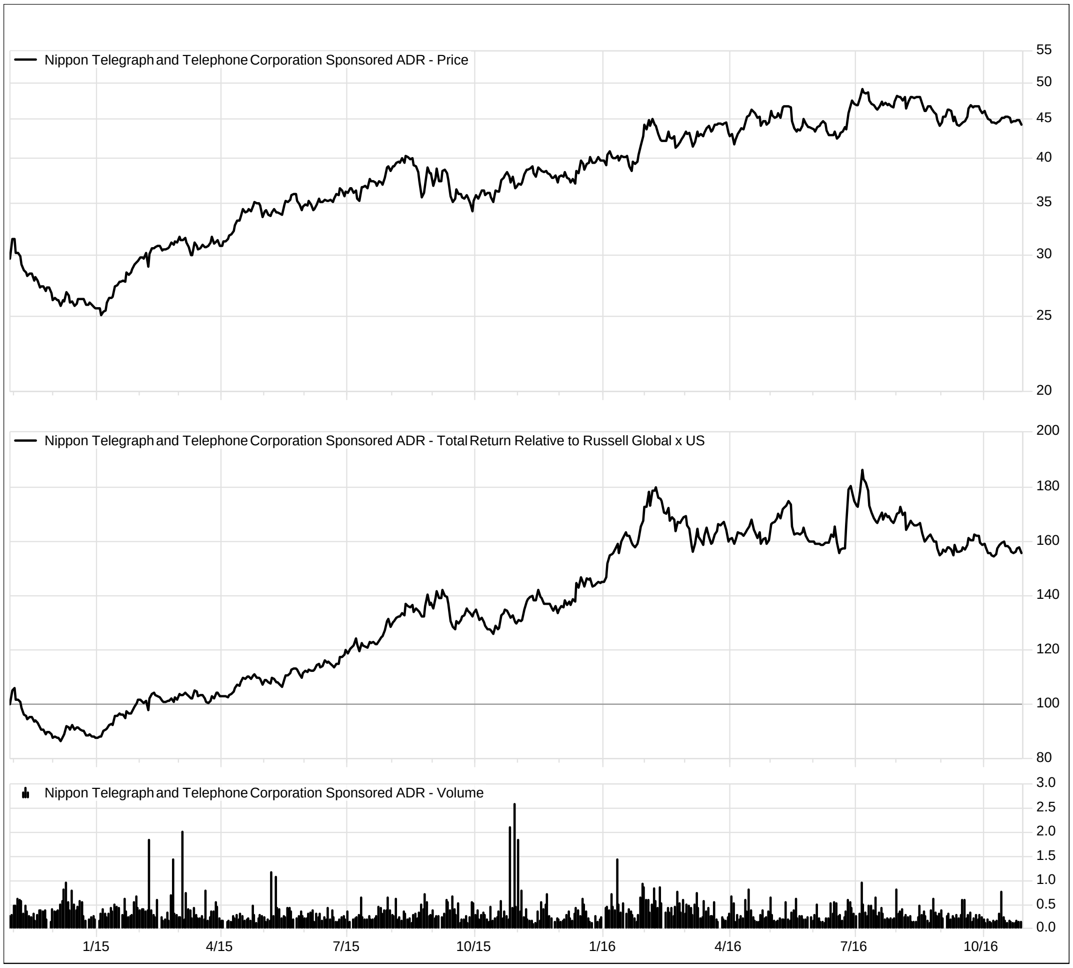
A five year DCF model was constructed to reach NTT's intrinsic value. Using a terminal growth rate of 1.50%, WACC of 1.83%, an intrinsic value of $52.21 was reached. A sensitivity analysis ranged from $42.48 to $67.83. Using the DCF model solely, a price target of $52.21, representing a 14.0% upside, was reached. NTT pays a dividend representing a 2.66% yield.

Risks

- **An aging consumer market.** Japan is facing a serious problem with nearly a third of the population over the age of 65, in 2015. Thus, if something is not done, the market in Japan will continue to shrink.
- **Regulations.** Regulations continue to limit the ability of telecommunication companies rates in the market. The government continues to pursue ways to prevent a monopoly within the market due to three service providers.
- **Substitutes.** Apart from other carriers, over-the-top competitors are taking away market share. These include products such as WhatsApp and Skype.

Management

Mr. Hiroo Unoura has been with NTT since 1973 and has held various positions throughout the corporation until he was installed as CEO in June 2012. Prior to his position he was head of corporate strategy in 2007 and head of strategic business development in 2008. Through these positions, he has gained knowledge in guiding the firm towards a successful and profitable future. Mr. Jun Sawada joined NTT in April 1978 and has held various roles throughout his time with the firm until being appointed CFO in June 2016. Prior to his position, he was involved with corporate strategy since 2008.



Source: FactSet

Ownership

% of Shares Held by All Insider and 5% Owners:	38.52%
% of Shares Held by Institutional & Mutual Fund Owners:	61.48%

Source: ThompsonOne

Top 5 Shareholders

Holder	Shares	% Out
Deutsche Asset Management Investment GmbH	25,731 ▲	1.23
Nomura Asset Management Co., Ltd.	23,100 ▼	1.10
Norges Bank Investment Management	12,546 ▲	0.60
BlackRock Fund Advisors	11,937 ▼	0.57
Nordea Investment Management AB (Denmark)	11,791 ▲	0.56

Source: FactSet

Peer Analysis

Name	Ticker	Market Cap (mil)	Sales (mil)	Debt/Equity	Div. Yld.	EV/ EBITDA
Nippon Telegraph and Telephone Corporati	NTT	92,260	96,136	47.5%	2.7%	5.3
SoftBank Group Corp. Unsponsored ADR	SFTBY	75,792	76,249	456%	0.6%	7.1
KDDI	KDDIF	78,085	37,192	37.3%	0.0%	6.7
Deutsche Telekom AG Sponsored ADR	DTEGY	76,236	76,404	209.6%	3.7%	7.4
Vodafone Group Plc Sponsored ADR	VOD	75,543	61,533	46.9%	5.3%	7.6
	Peer Averages	76,414	62,845	188%	2.4%	7.2

Source: FactSet