Applied Investment Management (AIM) Program

AIM Class of 2018 Equity Fund Reports
Fall 2017

Date**:* Friday, September 15th | ***Time: *2:15 – 3:15* p.m. | ***Location: R.W. Baird Road Show***

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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.

David S. Krause, PhD
Director, Applied Investment Management Program
Marquette University
College of Business Administration, Department of Finance
436 Straz Hall, PO Box 1881
Milwaukee, WI 53201-1881

mailto: AIM@marquette.edu

Website: MarquetteBuz/AIM AIM Blog: AIM Program Blog
Twitter: Marquette AIM Facebook: Marquette AIM

Planet Fitness, Inc. (PLNT)
September 15, 2017

Connor W. Konicke Domestic Consumer Discretionary

Planet Fitness, Inc. (PLNT) franchises and operates fitness centers across the United States with recent penetration into the international markets (Canada and Dominican Republic). PLNT operates through three reportable segments: Equipment (42% of FY 2016 Revenue, 18% EBIT Margin), Franchise (30%, 76%), and Corporate-Owned Stores (28%, 24%). PLNT offers a unique and highly attractive business model, offering a high-quality fitness experience and providing a welcoming and non-intimidating environment called the "Judgement Free Zone". PLNT was founded by Michael Grondahl and Marc Grondahl in 1992 and is headquartered in Newington, New Hampshire.

Price ($):	25.78	Beta:	0.86	FY: Dec	12/31/2015	12/31/2016	12/31/2017E	12/31/2018E
Price Target ($):	40.65	M-Term Rev. Gr Rate Est:	12.6%	Revenue (Mil)	330.5	378.2	424.2	455.4
52WK H-L ($):	25.6 - 18.32	M-Term EPS Gr Rate Est:	15.1%	% Growth	18.1	14.4	12.2	7.3
Market Cap (mil):	2,158	Debt/Equity:	N/A	Oper Inc	79.5	114.3	150.9	187.1
Insider Holdings	0.04%	Debt/EBITDA (ttm):	4.28	% Growth	27.2	43.7	32.1	24.0
Avg. Daily Vol (mil):	1.0	WACC	7.00	Op Margin	24.1	30.2	35.6	41.1
Yield (%):	0.0%	ROA (%):	3.30	EPS*	0.11	0.50	0.78	1.20
ESG Rating	N/A	ROE (%):	N/A	P/E (Cal)	30.6	40.2	33.1	21.5
		ROIC (%):	6.76	EV/EBITDA	9.2	9.9	13.4	11.3

*Class A Common Stock — Source: FactSet

Recommendation

Currently in the United States and Canada, 80% of the population over the age of 14 does not belong to a gym, providing significant penetration opportunity for PLNT to enter into the $24B TAM. While the fitness industry is not a high barrier to entry environment, PLNT offers a unique and highly attractive opportunity for potential members. PLNT coined the phrase “Judgment Free Zone” to make members of all fitness levels feel welcome and has a “No Gymtimidation” aspect to ease the initial fears of first-time gym users. While these differentiated concepts attract a broad demographic, PLNT’s unique business model allows for exceptional value, which often is a key determining factor for potential members. What continues to attract a high level of franchisees is their easy to operate store model. The PLNT franchise concept offers a strong recurring revenue model, minimal required staffing and working capital, highly attractive return on capital, and unlike many consumer discretionary companies today, is not susceptible to online competition. What continues to drive PLNT’s brand awareness is its effective adoption to digitalization, not only through advertising, but also within its gyms. PLNT secured an additional 2 years under its partnership with the New Year’s Eve celebration in Times Square, along with its ~350M spent on National Advertising Fund (NAV) since 2011. In addition, PLNT has selective fitness gyms testing interactive cardio equipment. This equipment allows users to bike/walk/run through simulated environments and enables members to access online entertainment (Netflix and Hulu) content from their cardio machines. Due to PLNT’s revenue shift, strong recurring revenue stream, and differentiated member experience, PLNT is poised to be a strong addition to the AIM Equity Fund with a target price of $40.65, representing a 57.7% upside. PLNT does not pay a dividend.

Investment Thesis

- **Shift in Revenue Mix.** As of YE 2016, PLNT’s franchise segment represented ~31% of revenue and had contributed to 76% of PLNT’s ~31% 2016 EBIT margin. PLNT’s franchise segment has grown at a 3-year CAGR of 38.2% from YE 2013 to 2016. PLNT is looking to add 1000 stores in the next 5 years, with 500 already committed by franchisees in the next 3 years compared to the 0-2 corporate stores per year guided by management. In addition, PLNT is looking at a long-term store target of 4,000+ stores, with nearly all of those coming from franchisees. Based on my franchise store estimates, PLNT's franchise segment will represent 47.5% of PLNT's 2021E revenue of $682.3M, representing an estimated 22% 5-year CAGR, which will increase EBIT margins to ~48%.

- **Strong Recurring Revenue.** PLNT's revenue model has significant strength in its recurring revenue stream. The two largest and fastest growing segments (Franchise and Equipment) made up 72.3% of YE 2016 revenue and are estimated to account for 82.0% of 2021 revenue. PLNT's franchise revenue stream has ~90% recurring revenue, made up primarily of royalties, vendor commissions, monthly dues and annual fees. In addition, 95% of the monthly dues and annual fees are collected through automatic drafts. PLNT's franchise segment growth is directly tied to equipment sales. Part of the franchise agreement requires franchisees to purchase Planet Fitness branded equipment through PLNT and replace equipment every 4-7 years. As a result of the large and expanding store base, PLNT is able to enjoy economies of scale and offer competitive pricing on all equipment giving franchisee's owners the best prices with the convenience aspect.
- **Differentiated Member Experience at Exceptional Value.** PLNT is unlike the stereotypical gym. PLNT encourages all fitness levels, incorporating a no gymtimidaton atmosphere, making it intriguing to first time gym users. In addition, PLNT offers significant discount prices vs. the industry average of $54 per month. PLNT's two membership options are the standard, priced at $10 per month and the Black Card membership, priced at $19.99 per month. As PLNT looks to aggressively penetrate new markets, both domestically and internationally, consumers will look to PLNT for unbeatable pricing options and differentiated experience relative to competitors.

Valuation

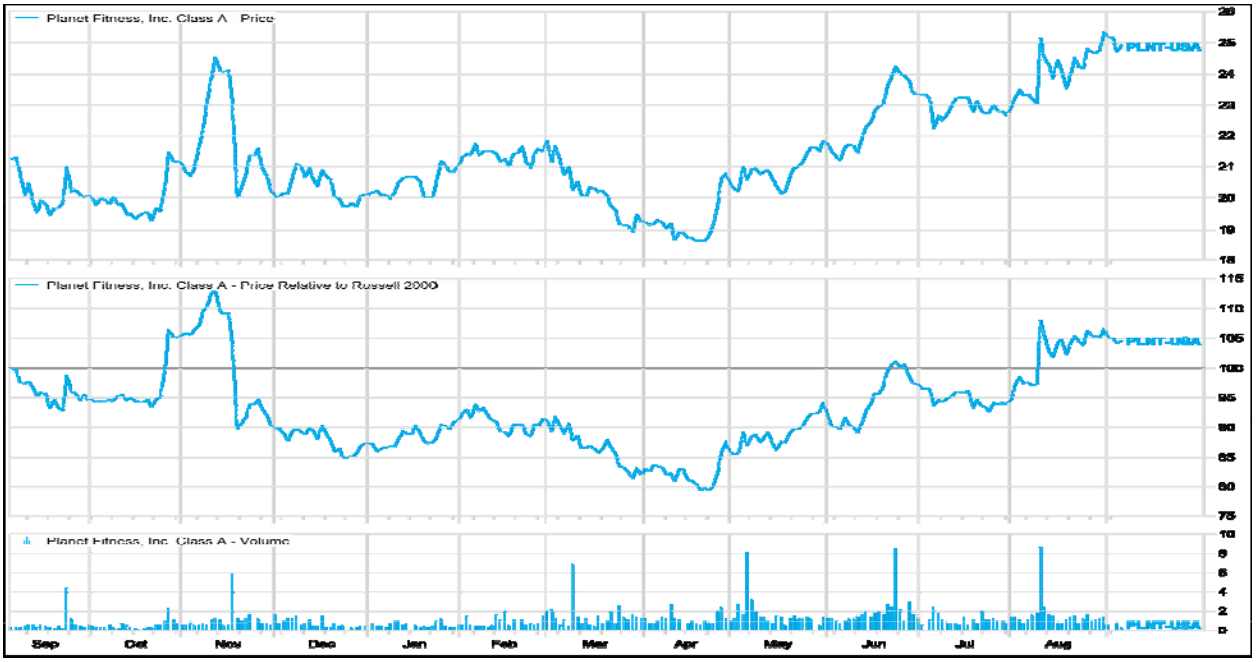
In order to reach an intrinsic value for PLNT, both a 5-year discounted cash flow model and a comparable weighted averge NTM EV/EBITDA model were employed. A 5-year discounted cash flow model was constructed using a terminal growth rate of 2.5% and a WACC of 7.00%. These numbers resulted in a valuation price target of $43.49. A sensitivity analysis on the terminal growth rate and WACC resulted in a spread ranging from $21.94 and $75.17. A comparable weighted average NTM EV/EBITDA multiple of 17.9x and 2017E EBITDA of $182.62M yielded a valuation of $32.12. Weighing the 5-year DCF model 75% and the EV/EBITDA multiple of 25%, an intrinsic value of $40.65 was obtained. PLNT does not pay a dividend.

Risks

- **Declining Memberships.** Due to PLNT's business model, store profitability is driven by increased customer/volume. In the event that PLNT fails to execute on its strategy to retain the current customer base and attract new customers, PLNT's profitability would be severely impacted.
- **Low Barrier to Entry Environment.** Low barriers to entry to a high profitability environment exposes PLNT to significant competition which could crowd the gym market and could cause an oversupply of fitness gyms.
- **International Expansion Failure.** Recently, PLNT has looked to expand in international markets (Dominican Republic and Canada) and given their continued progress into the Latin American environment, PLNT may be subject to increased regulation, foreign relationship and currency exposures.

Management

Chris Rondeau was elected to serve as CEO of Planet Fitness in 2013. Chris previously served as COO since 2003 and joined Planet Fitness in 1993. Dorvin Lively was named President and CFO in 2017. Dorvin has served as CFO since 2013. Stephen Spinelli, Jr. has led the Board since 2012. In addition, Stephen Spinelli, Jr. serves on the board at Jiffy Lube International, Inc., a franchised model business.



Peer Valuation

Name	Ticker	Market Cap (mil)	P/E - YE'16	P/E - NTM	EV/EBITDA	P/FCF
Planet Fitness, Inc. Class A	PLNT	2,158	40.2	30.4	9.9	27.1
Wingstop, Inc.	WING	939	55.8	47.1	31.1	42.3
Papa John's International, Inc.	PZZA	2,705	31.7	24.7	18.3	39.6
Dunkin' Brands Group, Inc.	DNKN	4,700	24.9	20.9	15.8	25.0
Choice Hotels International, Inc.	CHH	3,452	22.8	20.9	14.8	17.9
RE/MAX Holdings, Inc.	RMAX	1,086	43.4	31.6	9.5	23.2
Peer Valuation Averages		**2,949**	**35.7**	**29.0**	**17.9**	**29.6**

Source: FactSet

Peer Fundamentals

Name	Ticker	Revenue	ROIC	ROE	Debt/Equity	Est. 5YR NI Growth
Planet Fitness, Inc. Class A	PLNT	2,158	4%			
Wingstop, Inc.	WING	939	20%			78%
Papa John's International, Inc.	PZZA	2,705	35%	815%		12%
Dunkin' Brands Group, Inc.	DNKN	4,700	9%			16%
Choice Hotels International, Inc.	CHH	3,452	29%			5%
RE/MAX Holdings, Inc.	RMAX	1,086	3%	5%	50%	12%
Peer Averages		**2,576**	**19%**	**410%**	**50%**	**25%**

Source: FactSet

Ownership

% of Shares Held by All Insider Owners:	0.04%
% of Shares Held by Institutional & Mutual Fund Owners:	>90%

Source: FactSet

Top 5 Shareholders

Holder	Shares	% Out
AllianceBernstein LP	6,892,227	8%
The Vanguard Group, Inc.	6,481,876	8%
BlackRock Fund Advisors	4,368,588	5%
Capital Research & Management Co. (World Investors)	4,123,511	5%
Newbrook Capital Advisors LP	3,810,528	4%

Source: FactSet

KMG Chemicals, Inc. (KMG)
September 15, 2017

Holly Kuffel — Domestic Materials

KMG Chemicals, Inc. (NYSE:KMG) is primarily engaged in the manufacture and distribution of specialty chemicals for the semiconductor, pipeline and energy services, and industrial wood preservation markets. It operates through two main segments: Electronic Chemicals (88% of total revenue) and Performance Materials (12%). The Electronic Chemicals segment is structured around the formulation of high purity and ultra-purity wet process chemicals for the semiconductor industry, while the Performance Materials segment consists primarily of two businesses: industrial lubricants and wood-treating chemicals. The company was founded in 1985 and is headquartered in Fort Worth, Texas.

Price ($):	48.30
Price Target ($):	60.78
52WK H-L ($):	61.1 - 25.87
Market Cap (mil):	574
Insider Holdings	21.65%
Avg. Daily Vol (mil):	0.1
Yield (%):	0.2
ESG Rating	B

Beta:	1.07
M-Term Rev. Gr Rate Est:	6.5%
M-Term EPS Gr Rate Est:	22.7%
Debt/Equity:	20.96
Debt/EBITDA (ttm):	0.68
WACC	8.60
ROA (%):	8.90
ROE (%):	14.53
ROIC (%):	11.62

FY: July	07/31/2015	07/31/2016	07/31/2017	07/31/2018
Revenue (Mil)	320	298	317	359
% Growth	-9.3	-7.0	6.5	13.0
Oper Inc	24.89	29.53	36.49	46.62
% Growth	55.32	18.63	23.59	27.74
Op Margin	7.77	9.91	11.50	13.00
EPS	$1.52	$1.57	$1.93	$2.84
P/E (Cal)	21.19	17.51	25.02	16.98
EV/EBITDA	7.83	7.94	12.90	13.54

Recommendation

Technology is a focal point in our day-to-day lives and as it undergoes continual advancements, so does the semiconductor market. Semiconductor units have grown at a CAGR of 8.9% between 1978-2018E, while global semiconductor revenue grew 2.6% in 2016. KMG Chemicals has strategically positioned themselves to grow with the technology bubble in 2008 after acquiring their Electronic Chemicals segment play from Air Products. This segment consists of the production of high purity process chemicals (HPPC) utilized to clean and etch silicon wafers for semiconductors, an expense that makes up approximately 1-2% of the cost of every semiconductor. While this acquisition provided a solid entry into the electronic chemicals market, the purchase of Ultra Pure Chemicals from OM Group in 2013 positioned KMG as the only global supplier of HPPC, a position that remains today. Furthermore, KMG has the leading HPPC market share in the U.S. and Europe - and is improving their position in Asia. As such, KMG serves many of the world's major semiconductor manufacturers, such as Intel, Samsung and Micron Technology. Intel alone generated 26% of KMG's electrical chemicals revenue in 2016. The global semiconductor market, excluding silicon wafers, consists of about $12B in market opportunity, 13% ($1.5B) of which includes HPPC. In addition to Electronic Chemicals, KMG has recently redefined their Other Chemicals segment as Performance Materials after two key acquisitions in February and June of 2017. These acquisitions brought KMG's exposure to the pipeline performance industry, which includes industrial lubricants and sealants utilized primarily to optimize pipeline efficiency in the railroad, construction and energy sectors. KMG completed three acquisitions of premier industrial lubricant brands since 2015, exposing KMG as the leading industrial lubricant supplier in the U.S. Furthermore, the two acquisitions in 2017 added a top-tier customer base and are expected to comprise more than 25% of the company's overall revenue in 2018. Management indicates that the acquisitions bring in a strong customer base and are directly accretive toward KMG's EBITDA. The firm's consolidated segments experienced a 9% YoY sales growth to $81.6M, while EBITDA improved to a record high of $14M, which reflects increases in all businesses. Due to a disciplined growth strategy, leading positions in key markets, and strengthened profitability and earnings, it is recommended that KMG Chemicals, Inc. be added to the AIM Equity Fund with a target price of $60.78, representing a 25.84% upside. KMG pays a regular quarterly dividend, yielding 0.20%.

Investment Thesis

- **Expanding Electrical Chemicals Business.** With their long-term growth strategy in mind, KMG focused largely on the Electrical Chemicals segment in terms of global expansion and plant consolidation. Since 2008, KMG has completed four acquisitions that not only allowed the company to gain market exposure throughout the U.S., Europe and Asia, but their acquisition of the Ultra Pure Chemicals business from OM Group in 2013 transformed KMG into the only global HPPC supplier. In 2016, KMG acquired Singapore-based Nagase FineChem, which has enhanced the company's global capabilities, expanding their customer base to market-leading customers, and helping KMG retain their leading global market share.
- **Expanding into New Businesses.** KMG first gained exposure to the performance materials market in 2015 after acquiring Val-Tex, a manufacturer of industrial valve lubricants and sealants. With minimal exposure to the market, KMG initially included these operations in the Other Chemicals segment with their wood treatment chemicals operations; however, KMG acquired Sealweld and Flowchem in February and June of 2017. While Sealweld provided KMG exposure to high-performance products and services to global pipeline operators, Flowchem strengthened KMG's position as a leading global manufacturer of performance chemicals and lubricants for pipeline operations. With these acquisitions, KMG anticipates strong cash flow generation and robust EBITDA growth during 2018.
- **Preserving the Wood Treatment Chemicals Segment.** KMG's wood treating chemicals were fundamental to the company's early success. KMG's primary customer segment includes electric power and telecom utilities companies who rely on wood treating chemicals to protect and preserve utility pole infrastructure. Long-term demand is driven from replacement and installation of utility poles, which historically has been consistent in demand. KMG is the only major producer of pentachlorophenol (penta) in North America, which allows KMG access to 45% of the utility pole preservation market in North America.

Valuation

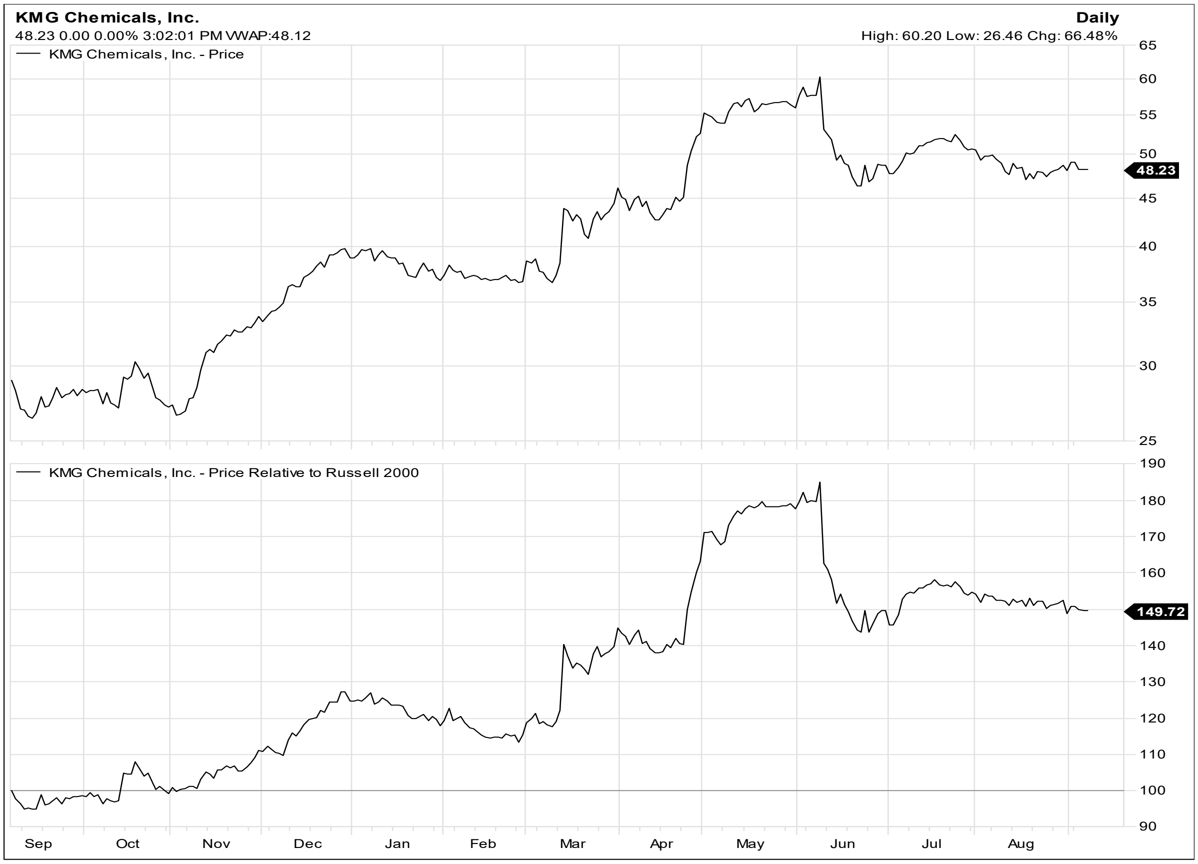
To reach an intrinsic value for KMG, a five year DCF model was constructed. Using a terminal growth rate of 3.00%, WACC of 8.60%, an intrinsic value of $56.27 was reached. A ± 0.25% sensitivity analysis on the terminal growth rate (2.5-3.5%) and discount rate (8.1-9.1%) ranged from $52.3-$62.1. An EV/EBITDA multiple valuation was conducted utilizing a comparables average EV/EBITDA multiple of 11.65x and a FY 2018 EBITDA of $66.6M, yielding a value of $65.29. By weighting the DCF and relative valuation model 50/50, a price target of $60.78 was reached, yielding a 25.84% upside.

Risks

- **Reliance on Semiconductor Demand.** As of FY 2016, approximately 88% of revenue was generated through the electronic chemicals segment, indicating a high reliance on semiconductor demand. Demand for semiconductor devices is projected to continue its growth, but KMG could struggle if demand growth is slower than expected.
- **Too Much Consolidation.** KMG's main value revolves around acquiring businesses where they can establish leading positions through organic growth; however, the company has relied heavily on consolidating their locations in order to cut costs. Although the company has experienced robust growth and expansion of their segments since 2008, relying solely on plant and location consolidation may hurt their long-term expansion plans.

Management

Christopher Fraser has served as President and CEO of KMG Chemicals, Inc. since June 2008 and was elected Chairman of the Board of Directors in December 2012. Prior to KMG, Fraser was President and CEO at Chemical Lime Co and OCI Chemical Corporation.



Source: FactSet

Peer Fundamentals

Name	Ticker	Revenues	ROE	ROA	Debt/ Equity	Est. 5 yr NI Growth
KMG Chemicals, Inc.	KMG	298	14.53	8.90	20.96	8.94
Cabot Microelectronics Corporation	CCMP	430	12.84	8.57	31.21	8.53
Entegris, Inc.	ENTG	1,175	11.41	5.79	65.02	13.03
Koppers Holdings, Inc.	KOP	1,416	482.35	2.59	2,178.95	-0.70
Quaker Chemical Corporation	KWR	747	15.70	8.84	15.29	1.40
Valvoline Inc.	VVV	1,929	190.18	19.48	-	-
Peer Averages		942	142.50	9.05	572.62	5.57

Source: FactSet

Peer Valuation

Name	Ticker	Market Cap (mil)	P/S	P/E	EV/ EBITDA	P/B
KMG Chemicals, Inc.	KMG	574	1.10	17.51	7.94	2.28
Cabot Microelectronics Corporation	CCMP	1,824	3.01	21.77	11.30	2.61
Entegris, Inc.	ENTG	3,779	2.16	26.32	10.59	2.81
Koppers Holdings, Inc.	KOP	802	0.60	28.99	9.07	27.39
Quaker Chemical Corporation	KWR	1,837	2.26	27.63	16.26	4.22
Valvoline Inc.	VVV	4,429	2.50	17.66	11.01	-
Peer Averages		2,534	2.11	24.47	11.65	9.26

Source: FactSet

Companhia de Saneamento do Basico de Sao Paulo (SBS)
September 15, 2017

Thomas Dietz International Utilities

Companhia de Saneamento do Basico de Sao Paulo (NYSE: SBS), also known as Sabesp, is a state owned Brazilian water utility and waste management provider. Sabesp delivers water (56% of revenue, 45% of op. income) and waste management services (44% of revenue, 55% of op. income) to over 28mm and 21mm people in the Brazilian state of Sao Paulo. Sabesp is responsible for over a third of the country's investment in water and waste management infrastructure. SBS is a pioneer in accessing new utility demographic bases, covering diverse geographies and income groups. Sabesp was founded in 1973 and has been traded on the NYSE since 2002.

Price ($):	10.85
Price Target ($):	13.64
52WK H-L ($):	$11.33/$7.76
Market Cap (mil):	7,248
Insider Holdings	50%
Avg. Daily Vol (mil):	1.8
Yield (%):	2.7
ESG Rating	B

Beta:	1.30
M-Term Rev. Gr Rate Est:	11.0%
M-Term EPS Gr Rate Est:	8.1%
Debt/Equity:	0.5
Debt/EBITDA (ttm):	2.31
WACC	14%
ROA (%):	8.1
ROE (%):	20.2
ROIC (%):	11.4

FY: Dec	2017E	2018E	2019E	2020E
Revenue (Mil)	4884	5464	5816	6235
% Growth	19%	12%	6%	7%
Oper Inc	1124	1319	1432	1602
% Growth	14%	15%	8%	11%
Op Margin	23%	24%	25%	26%
EPS	$1.19	$1.38	$1.49	$1.68
P/E (Cal)	9.1	7.9	7.3	6.5
EV/EBITDA	6.9	6.1	5.8	5.3

Recommendation

Sabesp is well situated to take advantage of several opportunities in the near term. The utility had previously been restricted to only investing in infrastructure with proceeds from water tariffs, but the Sao Paulo State Assembly passed a bill on September 6, 2017, allowing for foreign investment in Sabesp. Several foreign pension funds have already expressed significant interest, especially with the likelihood of large dividend payouts. The projected foreign investment is 1.9bn USD, which equates to 2.5 years of Sabesp's capex spending. The government of Sao Paulo has set lofty goals of increasing the number of people with sewage and basic sanitation access by approximately 10 million people in the next 15 years. Sabesp is an industry leader in finding new ways to provide water and sanitation to favelas and will be partnering with government agencies to reach the targeted 10 million potential users. Sabesp supplies water and waste treatment to over 370 municipalities, some of which have defaulted in past years. SBS had previously written off several of the debts as unrecoverable, but has recently renegotiated with the municipality of Guarulhos to recover 40mm USD per year, plus 0.5% interest per month with an inflation adjustment for the next 40 years. This has also encouraged the potential for renegotiating with other defaulting municipalities to recover written off accounts. Sabesp is currently pursuing recovery of 322mm USD and 160mm USD from the municipalities of Santo Andre and Maua. With recovering defaulted municipal debt, sewage expansion to millions of people, and increased foreign investment, it is recommended that SBS be added to the AIM portfolio with a target price of $13.64, representing an upside of 25.7%. The firm currently pays a 2.7% dividend.

Investment Thesis

- **Brazilian economy growth.** Brazil's economy has suffered over the past five years, seeing high real GDP growth shrink to zero and then fall by 3.8% in 2015 and 3.4% in 2016. 2017 has seen the Brazilian economy steady and strengthen, with the UN, World Bank, and IMF all projecting positive GDP growth. Rising Brazilian GDP will give millions with lower incomes access to sewage and sanitation that Sabesp can provide.
- **Increasing FCF and dividend potential.** Increased capex over the next five years is going to be more than compensated for with the growth with Sabesp's high margin waste management segment. Free cash flows are projected to increase more than 50% by 2021. Sabesp was forced to

cut their dividend in the previous economic downturn, but the large cash influx over the coming years makes SBS a good candidate for increased dividends. Analysts project dividend yields of 4% by 2019 and as much as 8% by 2021. The increased dividend potential is a major factor in attracting up to 2bn USD foreign investment in Sabesp.

- **Strong leadership.** Sabesp is fortunate to have one of the most capable directors in the South American utility space. Mr. Jerson Kelman is highly educated and extremely knowledgeable regarding water and energy, having served both in the public and private sector in Brazilian utilities, as well as serving as an advisor to the World Bank. The CFO, Mr. Alvares, is also highly regarded and previously worked as an advisor to the Brazilian Secretary of Economy and Planning of Sao Paulo. Mr. Alvares brings both financial expertise and crucial experience and insight to navigating the relationship between business and government.

Valuation

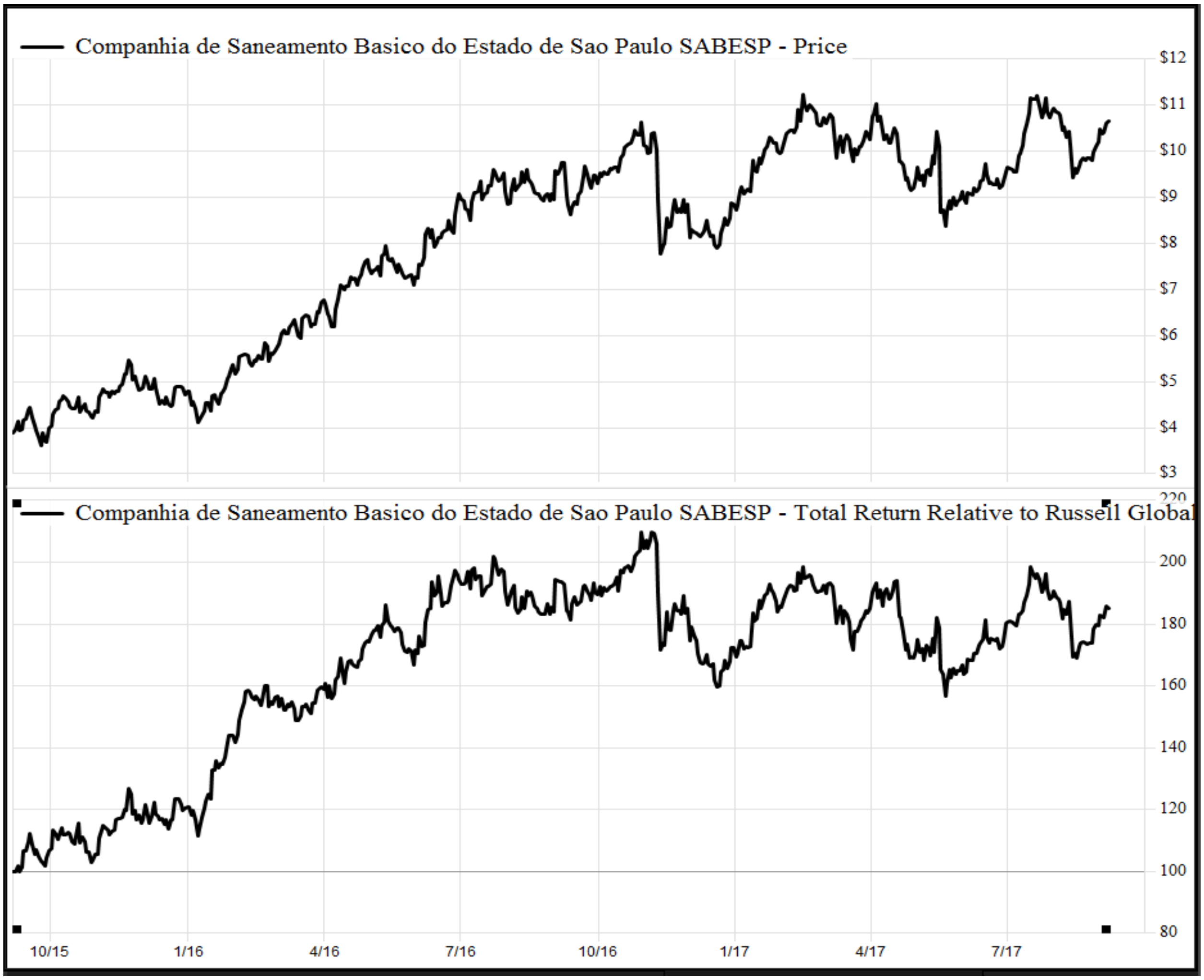
To determine the present value of Sabesp, a five year DCF was constructed. Government-assisted company guidance on top line and margin growth and capex were factored in along with recent news that SBS will be able to recover written off debt from defaulted municipalities. With a WACC of 13.72% and a conservative terminal growth rate of 2%, an intrinsic value of $14.31 was reached. A sensitivity analysis on the DCF valuation with growth rates ranging from 1.60 to 2.40% and WACC ranging from 11.72 to 15.72% resulted in valuations from $14.28 to 15.30. A EV/EBITDA multiple was calculated with three Brazilian utility companies, resulting a target price of $13.71 and a P/B multiple was also calculated giving a target of $11.32. Using weights of 60/20/20, a price target of $13.61 was obtained, representing an upside of 25.7%.

Risks

- **FX risk.** The BRL/USD futures curves shows the USD appreciating 5% against the BRL in the next 12 months – and each modeled yearly cash flow thereafter was depreciated another 5% per year. A shock to the Brazlian economy or a surge in the strength of the US Dollar could depress the Real up to 20% in a year could significantly devalue future FCF. A 20% depreciation in 2019E would decrease the potential upside by approximately 10%.
- **Government corruption.** Brazil has seen a wave of government corruption in past years, with both the notorious car wash scandal and the impeachement and removal from office of former president Dilma Rousseff in 2016. Brazil has a powerful government and a history of taking bribes from powerful oil, construction, and meatpacking corporations. If the interests of both the federal and state government cease to align with Sabesp, it could be extremely problematic.
- **Tariff contention.** A significant portion of Sabesp's revenue comes from the progressive volume tariff. Water and waste customers pay a per volume charge that increases with use. The tariff (as a percentage of consumption) is frequently up for review by regulators and is highly varied among utility providers. Sabesp currently receives a smaller tariff of $\$7.22/m^3$ of water than the industry average of $\sim\$10.33/m^3$. Sabesp is currently in negotiations for a tariff increase, but a lower than expected tariff increase could weaken future sales expectations.

Management

Jerson Kelman has served as the Director of SBS since February 2015 after serving as the CEO of Rio de Janiero power company CEMG and Director of Brazil's power sector regulator ANEEL. Mr. Kelman has a Master's degree degree in civil engineering and a PhD in hydrology and water resources.



Source: FactSet

Name	Ticker	Market Cap	P/E	P/B	P/TBV	Div Yld
SABESP	SBS	7,248	6.7	1.28	-	2.70%
Alupar Investimiento	ALUP11	1,513	12.0	0.70	0.74	2.70%
ENGIE Brasil Energia	EGIE3	7,542	13.1	3.30	3.59	0.00%
Cia Energetica de Minas	CMIG4	3,429	28.6	0.88	38.20	0.00%
Peer Averages		4,161	17.9	1.63	14.2	0.90%

Source: FactSet

Name	Ticker	Revenues	ROE	ROA	Debt/Equity	Est 5 yr NI growth
SABESP	SBS	4,120	20	8	0.5	11.0%
Alupar Investimiento	ALUP11	116	11	3	157	-1.8%
ENGIE Brasil Energia	EGIE3	493	23	10	82	7.5%
Cia Energetica de Minas	CMIG4	781	-9	-2	207	-25.6%
Peer Averages		637	9	3.7	149	-6.6%

Source: FactSet

Argan, Inc. (AGX)

September 15, 2017

Stephen Arcuri | Domestic Industrials

Argan, Inc. (NYSE: AGX) a holding company for four wholly owned subsidiaries: Gemma Power Systems (87.5% of revenue), an engineering, procurement, and construction company (EPC) focusing on energy production; The Roberts Company (8.6%), an industrial steel fabricator; Atlantic Projects Company (2.4%), which manufactures and installs boilers and turbines; and SMC Infrastructure Solutions (1.5%), which provides telecommunications data infrastructure services. Founded in 1961, the company is headquartered in Rockville, Maryland.

Price ($):	$61.35
Price Target ($):	$73.24
52WK H-L ($):	76.7-51.27
Market Cap (mil):	$953.60
Insider Holdings	5.18%
Avg. Daily Vol (mil):	0.12
Yield (%):	1.6%
ESG Rating	A

Beta:	1.47
M-Term Rev. Gr Rate Est:	8.6%
M-Term EPS Gr Rate Est:	29.7%
Debt/Equity:	0%
Debt/EBITDA (ttm):	0%
WACC	10.6%
ROA (%):	10.9%
ROE (%):	24.1%
ROIC (%):	24.1%

FY: January	FY2017	2018E	2019E	2019E
Revenue (Mil)	675,047	794,047	725,358	733,433
% Growth	63.3%	17.6%	-8.7%	1.1%
Oper Inc	112,254	124,963	113,835	122,378
% Growth	50.9%	11.3%	-8.9%	7.5%
Op Margin	16.6%	15.7%	15.7%	16.7%
EPS*	$4.50	$5.23	$4.90	$5.90
P/E (Cal)	16.4	11.7	12.5	11.4
EV/EBITDA	5.3	4.7	5.2	4.8

Recommendation

Argan operates primarily through their EPC subsidiary Gemma Power Systems (GPS), which focuses on designing and building natural gas and alternative energy power plants. To date, Argan has created more than 14,500 megawatts (MW) of power capacity, including 435 MW of wind turbines and 370 million gallons of biomass fuel capacity annually. Unlike many of its competitors, Gemma keeps a significant portion of their construction operations in-house, which offers better control over both their costs and product. This model has served Argan well, as revenues have increased at a 24.8% CAGR over the last 5 years, also benefiting from the transition to natural gas from coal-based power plants. More efficient drilling techniques have decreased the price of natural gas and increased the viability of natural gas power plants in recent years. The U.S. Energy Information Administration (EIA) has identified 14 gigawatts of coal capacity to be retired through 2028 and expects 100.5 gigawatts to be brought online through 2023. This additional capacity stems from an effort to match new population concentrations, as cities are increasingly under strain from the influx of new residents. In addition to an economic death, coal is dying a legislative one as well. Some states, like Washington, have recently passed laws outlawing construction of future coal-based electrical capacity. Gemma has distinguished itself by remaining profitable despite taking on smaller scale projects in this space. This has helped them to build a national reputation in the renewable energy space as they simultaneously continue to complete large scale projects, such as Panda Patriot (800MW) and Panda Liberty (800MW). Therefore, it is recommended that Argan, Inc. be added to the AIM Small Cap Fund with a target price of $73.24, representing an upside of 19.4% upside. Argan pays a small dividend which currently yields 1.6%.

Investment Thesis

- **Decreasing Backlog.** Argan's aggregated backlog is an important metric for both management and investors and its decline explains the stalling stock price despite high revenue and operating cash flow growth. Gemma recently completed two large projects and has reached peak construction activity in its current ventures. The announcement of a new large-scale project and subsequent increase in the backlog should improve investor sentiment.
- **Natural Gas Power Plants.** Natural gas offers a clear and cleaner path forward, costing only $16 per megawatt hour compared to coal's $22, while producing half as much pollution. Total energy capacity is only expected to grow 1% a year through 2030 in the United States; however, natural

gas is expected to grow at a 3.5% rate. According to the EIA, the capacity weighted average age of a coal-based power plant is 39 years and many will need to be replaced over the next 5 to 10 years. With wind and solar now making up 60% of utility-scale power generation capacity added and with another 33% coming from natural gas, Gemma faces an excellent environment to win contracts moving forward.

- **Capital Deployment.** Argan's increasingly large cash position has improved the likelihood of subsequent acquisitions and an increased dividend that has not been properly priced in due to a lack of discussion from management. Cash equivalents and short-term investments total $557 million or 79.5% of Argan's total book value as of 2Q'18. Management has made no mention of what they specifically intend to do with capital; however, last year's special cash dividend and the all-cash acquisition of The Roberts Company implies that management is looking to deploy capital or return it to the shareholders.

Valuation

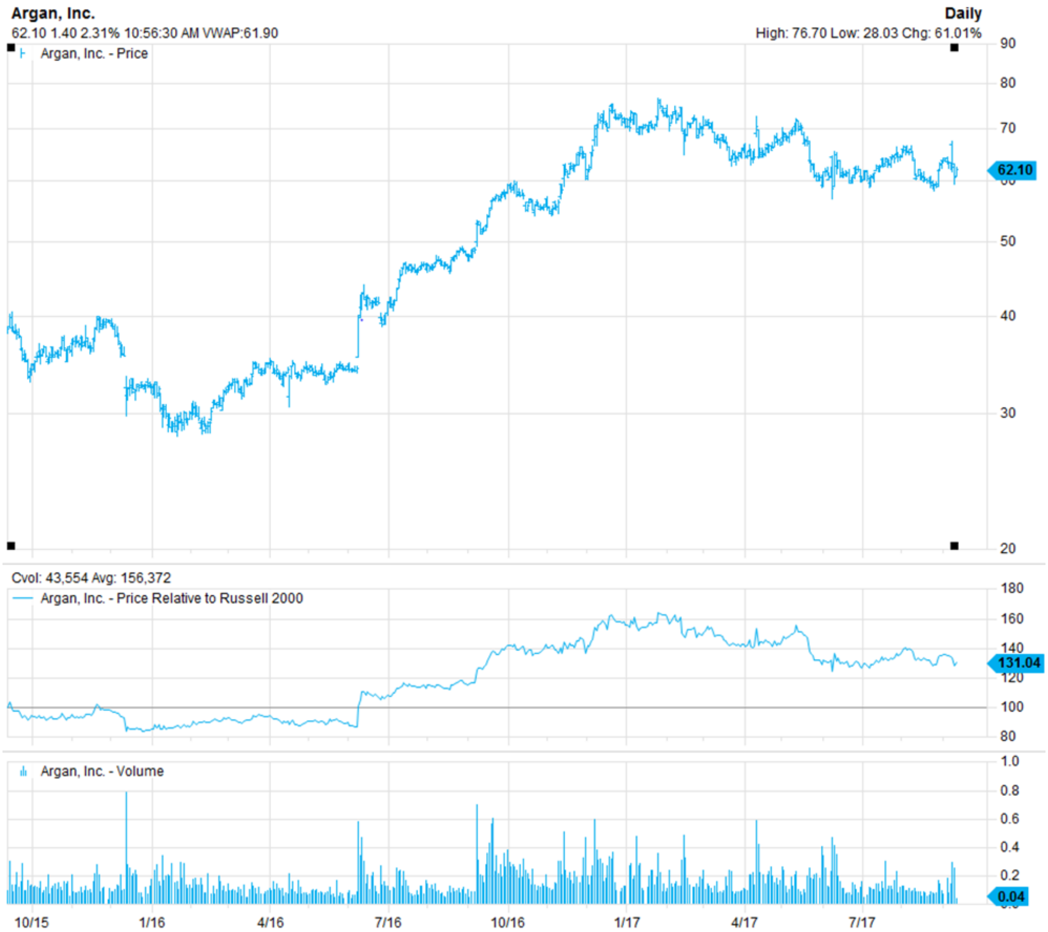
In order to reach an intrinsic value for Argan, Inc., a 5 year DCF model was constructed. Using a terminal growth rate of 1.7% and a WACC of 10.64%, an intrinsic value of $73.24 was reached. A sensitivity analysis on the terminal growth rate and WACC of 25bps ranged from $76.80 to $70.52. Additionally, a P/E multiple valuation was conducted using NTM EPS of $5.23 and a 5 year historical average P/E of 13.1x which resulted in a valuation of $68.30. Finally, an EV/EBITDA multiple valuation was calculated using peer average multiple of 9.6x and a NTM EBITDA of $127.5M, which resulted in a valuation of $77.72. Weighting the three valuation models 60/20/20, a price target of $73.24 was reached, representing a 19.4% upside.

Risks

- **Concentration Risk.** Gemma's limited project load has allowed them to be successful at large scale opportunities versus their competitors, but it also increases their exposure to individual projects. In fiscal 2017, five projects made up 70% of consolidated revenue and 97% of aggregate backlog. The industry standard fixed-rate pricing structure further increases execution risk on these projects.
- **Failure to Secure Future Projects.** Argan's total contract backlog has been steadily decreasing from a high of $1.4 billion in June 2016 to $676 million in September 2017. At 100% of annual revenues, this remains above a low of 65.3% of annual revenues observed in 2013. Management's failure to secure long-term contracts could jeopardize future revenue and earnings growth.
- **Natural Gas Prices.** Prolonged increases in the price of natural gas could make coal comparatively more attractive, which may decrease Gemma's project opportunities.

Management

Rainer Bosselmann has been the CEO and Chairman of Argan Inc. since 2003, after serving as CEO of Arguss Communications, a telecommunications infrastructure company. David Watson joined Argan in 2015 after working as CFO for Gladstone Investment Corp. beginning in 2010. William Griffin Jr. serves as the CEO of Gemma, which he co-founded in 1997. Previously he had 20 years of experience as a service contractor in the power industry.



Name	Ticker	Revenues	ROE	ROA	Debt/ Equity	Est 5 Yr NI Growth
Argan Inc	AGX	$ 873	28.7%	14.6%	0.0%	66.6%
Fluor	FLR	$ 19,308	3.5%	1.2%	50.3%	-81.5%
Chicago Bridge and Iron	CBI	$ 8,427	-50.2%	-10.1%	172.0%	-403.7%
Primoris Services	PRIM	$ 2,302	9.6%	4.2%	46.2%	10.8%
Quanta Services	PWR	$ 8,523	8.2%	5.0%	13.8%	19.3%
Peer Averages		9,640	-7.2%	0.1%	70.6%	-113.8%

Source: FactSet

Name	Ticker	Market Cap (mil)	P/S	P/E	EV/ EBITDA	P/B
Argan Inc	AGX	931,010	1.1	11.5	3.2	2.8
Fluor	FLR	5,470	0.3	48.9	9.9	1.7
Chicago Bridge and Iron	CBI	1,431	0.2	-	0.0	1.3
Primoris Services	PRIM	1,441	0.6	30.5	9.7	2.8
Quanta Services	PWR	5,462	0.7	20.6	9.2	1.6
MasTec	MTZ	3,323	0.6	14.1	7.5	2.7
		3,425	0.5	28.5	9.3	2.0

Source: FactSet