THE NELSON EXCLUSIVE

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About Your Editor

Brian Nelson is the president of equity research and ETF analysis at Valuentum Securities.

He is the architect behind the company's research methodology and processes, developing the Valuentum Buying Index rating system, the Economic Castle rating, and the Dividend Cushion ratio. Mr. Nelson has acted as editor-in-chief of the firm's Best Ideas Newsletter and Dividend Growth Newsletter since their inception.

Before founding Valuentum Securities in early 2011, Brian worked as a director at Morningstar, where he was primarily responsible for training and methodology development within the firm's equity and credit research department. Prior to that position, he served as a senior industrials securities analyst covering aerospace, airlines, construction, and environmental services companies.

Before joining Morningstar, Mr. Nelson worked for a small capitalization fund covering a variety of sectors for an aggressive growth investment management firm in Chicago. He holds a Bachelor's degree in finance and a minor in mathematics, magna cum laude, from Benedictine University. Brian has an MBA from the University of Chicago Booth School of Business and also holds the Chartered Financial Analyst (CFA) designation.

Highlights:

Brian is frequently quoted in the media and has been a frequent guest on Nightly Business Report, Bloomberg TV, CNBC, and the MoneyShow.

Mr. Nelson is very experienced valuing equities, developing discounted cash-flow models used to derive the fair value estimates for companies in the equity coverage universes of two of the largest independent investment research firms.

Brian worked on a small cap fund and a micro-cap fund that were ranked within the top 10th percentile and top 1st percentile within the Small Cap Lipper Growth Universe, respectively, in 2005.

Mr. Nelson led the charge in developing Morningstar's issuer credit ratings, creating and rolling-out one of the firm's proprietary credit metrics, the Cash Flow Cushion.

Email sent to Exclusive members February 12

Nelson Exclusive Ideas Performing Incredibly Well!

February 12, 2017 – Woodstock, IL: First of all, I am very grateful for how this market has reacted since the Nelson Exclusive launch, and the ideas within the publication are performing better than I think I could have ever imagined. I know that sometimes good performance can change on a dime, so I am doing my best to temper my enthusiasm, but I am very happy with how things are going thus far, especially as we get more months under our belt. I am so appreciative of your patience and giving me a chance. *You have to read about the performance of our short ideas considerations!*

Income

Table as of February 12

Highlight Date	Company (symbol)	Highlight Price	Current or Close Price	Div's Received	'Realized' Gain %	'Realized' Annualized Gain %	Time Horizon	Notes
Income Ideas								
Jul, 16	Universal Corp (UVV)	57.74	75.10	1.60	32.8%	53.0%	NEW: Closed - 2/12/2017	We're closing the position for now. Universal put up a fantastic fiscal third quarter Feb 7. Huge winner, and still has years of dividend growth ahead of it. Yes!
Aug, 16	B&G Foods (BGS)	51.54	46.15	0.885	-	-	0-2 yrs	Raised its dividend November 4 by ~11%, to $1.86 per common. Stock performance improving of late.
Sep, 16	Maxim Integrated (MXIM)	41.12	45.07	0.33	10.4%	23.5%	NEW: Closed - 2/12/2017	We're closing position due to fickle nature of tech. Solid net cash position, strong free cash flow -- ~3% yield. May re-establish idea in future.
Oct, 16	Douglas Dynamics (PLOW)	31.94	34.10	0.235	7.5%	20.4%	NEW: Closed - 2/12/2017	We're closing as stock had been suspiciously volatile on little news. Insider buying though. Stock has rallied back in a big way. We still like it and may re-establish in future.
Nov, 16	Ennis Inc. (EBF)	14.60	16.30	Non collected	11.6%	607.1%	Closed -- 11/12/2016	We captured more than 2 years' worth of income via capital appreciation in one week. Not being greedy so this ended in a quick trade. It happens.
Dec, 16	Watsco, Inc. (WSO)	150.57	155.96	1.05	4.3%	22.0%	NEW: Closed - 2/12/2017	We're going to lock this in. Investors assessing impact on demand from HVAC price hikes at key customer Carrier (UTX). Stock has rallied back nicely. We still like it, but it is a cyclical industrial.
Jan, 17	Star Gas Partners (SGU)	11.21	10.36	0.103	-	-	0-2 yrs	Management said it was off to a good start in fiscal 2017 when it reported first quarter results Feb 1. Posted a net gain in customer accounts during the period.
Feb, 17	Moelis & Co (MC)	35.00	37.60	NA	-	-	0-20 yrs	Recently beat out Goldman Sachs, Morgan Stanley, Credit Suisse and HSBC to be chosen as sole advisor for Saudi Aramco IPO.

In terms of income ideas, 6 out of 8 (75%) thus far are in positive territory, or have been "closed" in positive territory. Did you see Universal Corp (UVV) recently, the first income idea we ever highlighted in the Exclusive? The stock has soared! And what about Maxim Integrated (MXIM) and Douglas Dynamics (PLOW)? I don't think I could be more pleased with this showing of income ideas. I won't go into why we may or may not have "closed" the positions we have today (NEW) because everyone's time horizon is different and I don't want to send mixed messages (or create confusion), but we've locked in a number of positions today (please be sure to view the tables and ask me questions if you have any). We "lock in" winners more to gain your trust and the trust of future members, and one of the ways I believe to build this publication for the long haul is to deliver, and deliver ideas that generate meaningful profits.

Short Ideas

Table as of February 12

Highlight Date	Company (symbol)	Highlight Price	Current or Close Price	Div's Received	'Realized' Gain %	'Realized' Annualized Gain %	Time Horizon	Notes
Short Idea Considerations								
Jul, 16	Lands' End (LE)	16.76	16.10	NA	3.9%	10.7%	Closed – 12/2/2016	We were worried Eddie Lampert may start buying more heavily. Very volatile equity. Not being greedy, so closed position.
Aug, 16	Vivint Solar (VSLR)	2.94	2.85	NA	3.1%	10.8%	Closed – 12/2/2016	Stock wasn't acting right despite an ongoing negative solar backdrop. We locked gain in as a result.
Sep, 16	Lloyds Banking (LYG)	3.31	2.78	NA	16.0%	96.1%	Closed – 11/4/2016	We didn't like Lyolds' leverage and were worried about Brexit. We picked our spot to take profits.
Oct, 16	GoPro (GPRO)	16.68	11.12	NA	33.3%	400.0%	Closed – 11/4/2016	This was a big winner. We continue to have concerns, and the stock keeps falling. We're not looking back, however.
Nov, 16	Seritage Group Properties (SRG)	44.31	42.13	-0.25	4.6%	26.8%	Closed – 1/6/2017	The REIT continues to trade on euphoric expectations, but we closed this for a gain. Div's work against us as it relates to short performance. Buffett is watching.
Dec, 16	Royal Bank of Scotland (RBS)	4.91	5.76	-	-	-	0-2 yrs	The stock is rallying alongside financials peers. A steepening yield curve, and Trump optimism is running rampant.
Jan, 17	Sequential Brands Group (SQBG)	4.62	4.18	-	9.5%	96.6%	NEW: Closed 2/12/2017	Locking this short idea in. Retail continues to get pummeled, and we picked the right spot at the right time.
Feb, 17	Sportman's Warehouse (SPWH)	6.85	6.11	-	10.8%	492.9%	NEW: Closed 2/12/2017	As with Sequential Brands, we picked the right spot at the right time. We've locked in this big gain, too.

My goodness!!! What about our short idea considerations? Now, 7 out of 8 (88%) are in the money, and all that are in the money have been "closed." This is simply amazing from where I stand. I am grateful to be in good graces with the "market gods," as picking 75% of stocks, as in the income ideas, that go up and 88% of stocks that go down over the same time period of time is simply incredible to me, and I'm not sure if there is another publication in history that has done this. I hope to continue to work as hard as I can to deliver on the expectations that the performance thus far is setting. Sequential Brands Group (SQBG) and Sportsman's Warehouse (SPWH) were two positions that we closed today. I am so pleased by the performance of our short idea considerations. **7 out of 8 in an up-market is absolutely incredible.**

Capital Appreciation

Our capital appreciation "hit rate" isn't performing as well as I would have liked, given our international ventures in the face of a strong US dollar, but I really can't be too disappointed with 5 out of 8 (63%) in the black, especially in the context of the other ideas highlighted thus far in the Nelson Exclusive. Only our three "foreign" capital appreciation ideas are in the red, and if the US dollar starts to weaken, these could turn into some very, very strong performers, too. Both Texas Capital Bancshares (TCBI) and Arconic (ARNC), the latest two highlighted companies in this area, have really picked up the pace, getting our capital appreciation ideas (on a collective basis) back on track. Please be sure to read the notes in the tables, as some ideas we have "closed," we may potentially re-open in the future.

Email sent to members February 12

Table as of February 12

Highlight Date	Company (symbol)	Highlight Price	Current or Close Price	Div's Received	'Realized' Gain %	'Realized' Annualized Gain %	Time Horizon	Notes
Capital Appreciation Ideas								
Jul, 16	Bloomin Brands (BLMN)	17.87	19.28	0.07	8.3%	22.6%	Closed -- 11/12/2016	Taking what the market gives us. May re-open idea again. We still believe in long term. Stock very cheap.
Aug, 16	Healthcare Srvs Group (HCSG)	38.91	41.02	0.369	6.4%	11.9%	NEW: Closed 2/12/2017	We're going to close this one. Nice streak of consecutive quarterly dividend increases. Very strong end market, and we may re-open in the future.
Sep, 16	Grupo Aeroportuario (ASR)	157.87	156.85	-	-	-	0-20 yrs	The strength in the US dollar is hurting. We still love the long-term picture though. Travel to Cancún not going away.
Oct, 16	Swedish Match (SWMA.ST)	314.80SEK	289.70SEK	-	-	-	0-20 yrs	Tobacco (snus) demand is about as resilient as it gets through the economic cycle. Currency is hurting shares.
Nov, 16	Symrise AG (SYIEY)	16.25	15.23	-	-	-	0-20 yrs	EBITDA margins don't get much steadier than Symrise's (18-22% from 2006-2015). Down in sympathy with peers. We're disappointed.
Dec, 16	Tootsie Roll (TR)	37.80	37.75	0.09	-	-	0-20 yrs	A fantastic company with excellent financials. Potential big dividend growth story with takeout catalyst as a growing possibility. Stock not acting well.
Jan, 17	Texas Capital Bancshares (TCBI)	78.05	85.10	-	9.0%	91.6%	NEW: Closed 2/12/2017	Stock is now very extended. We're closing with expectations to re-establish. It's important to gain your trust -- and profits go a long way in doing so.
Feb, 17	Arconic (ARNC)	25.90	29.62	-	14.4%	655.3%	NEW: Closed 2/12/2017	Holy cow! We have to take profits here. We may re-establish again, but this type of gain in one week is hard not to be prudent with.

In all, that's 18 out of 24 (75%)! To me, that is a great "hit rate." But to be "directionally" right 75% of the time with both long and short ideas over the same time period is amazing to me, and the Nelson Exclusive has achieved this thus far. As I mentioned before, I know that performance can change on a dime and that happiness can turn to sadness quickly, but I must say that things are going better than expected. I'm available for any questions. Thank you!

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The tables are provided for the sole purpose of transparency, to allow readers to track the ongoing performance of Nelson Exclusive ideas in a way that they feel is most appropriate. Ideas within the Nelson Exclusive are not constructed as a portfolio, nor should they be viewed as a model portfolio, and performance returns are hypothetical. 'Realized' annualized returns cannot be achieved and are provided for the sole purpose of rightsizing each idea to a common measurement period (one year), to compare ideas closed within one year to ones held longer than one year, taking into account capital efficiency. A reader, for example, may view a 20% return over a period of five weeks as much better than a 20% return over a period of five years. Whereas both represent 20% returns, annualized performance is much different under each case. Readers may have different views and time horizons. To retain independence, neither Valuentum nor Brian Nelson own any shares, nor do they plan to own any shares, of any companies highlighted in the Nelson Exclusive. Importantly, shorting stocks involves a number of abnormal risks, including theoretically the infinite loss of capital, and is not for everyone. Valuentum is a financial publisher not a financial advisor. Please contact your personal financial advisor to determine if any idea in the Nelson Exclusive may be appropriate for you.

Updates to Previous Exclusive Ideas (Income & Cap Appreciation)

Income Ideas

Universal Corp (UVV)

Universal put up very strong nine month and third-quarter results February 7 that sent shares soaring. Operating income for the nine months ended December 31 increased 17%, while segment operating income performance was even better during the nine-month period (+25%). Universal is achieving these results, despite difficult supply conditions and a weather-related crop reduction in Brazil. Cash flow from operations remains very strong at the company thanks to reduced working capital requirements, and Universal not only noted that cash balances have increased nicely, but that its seasonal borrowing requirements have decreased. Cash and cash equivalents stood at $411 million at the end of 2016, comfortably above its long-term debt position of $367 million. Universal last raised its quarterly dividend ~2%, to $0.54 per share November 8. This was its 46th consecutive annual raise.

B&G Foods (BGS)

B&G Foods has been somewhat of a thorn in our side in an otherwise very satisfactory start to the Nelson Exclusive. We've highlighted it as an income consideration, and while we've been excited about its *Green Giant* acquisition, shares could be doing better in this euphoric market environment. The company continues to raise equity and appears to be committed to reducing debt, but it is still pursuing new deals (e.g. the spices and seasoning business of ACH Food Companies and the Victoria Fine Foods brand). There was a lot of noise in its fourth-quarter report, released February 23, and we didn't like the headline print at all. The base business declines on the top line of 1.6% were a little more than we anticipated, but they were mostly currency-related "primary a result of pure maple syrup deflation due to the strength of the US dollar relative to the Canadian dollar." The competitive environment, however, as we've heard from other consumer staples entities, remains very challenging. It's important to note that we've highlighted B&G Foods as one of the more risky, speculative income ideas with a very short-term horizon, and in that respect, it is behaving largely as expected (large dividend increase but volatile equity). For the full year 2017, adjusted diluted earnings-per-share is expected to be $2.13-$2.27. We continue to monitor its trading activity. B&G Foods hiked its quarterly dividend ~11%, to $0.465 per share, November 4.

Maxim Integrated (MXIM)

Maxim surprised us to the upside in its January 26 fiscal second-quarter 2017 earnings report. Here's what CEO Tunc Doluca had to say: "Our December quarter marked the beginning of our return to revenue growth, as Automotive, Core Industrial and diversification in Consumer all contributed gains from the same quarter last year. In the March quarter, we expect to build upon our growth momentum in our Automotive and Industrial businesses." To get a feel for the cash-flow generating power of Maxim, the tech company hauled in $193 million in cash flow from operations during the fiscal second quarter, while gross capital spending was $16 million, good for $177 million in free cash flow. Cash dividend payments during the period were $94 million, suggesting excellent coverage. Maxim retired a short-term loan of $250 million and fiscal third-quarter revenue and EPS guidance looked solid. Shares yield ~3% at last print.

Douglas Dynamics (PLOW)

There's really nothing new to report since Douglas Dynamics' October 31 third-quarter report. Here's what CEO James L. Janik had to say then: "When combined, our second and third quarter results slightly exceeded our initial expectations and so we are comfortable reiterating the increased and narrowed guidance we issued last quarter. We are pleased with the initial results from the Dejana acquisition and expect a strong overall performance again in 2016. While the structure and focus of the Company has changed this year, and the influence of weather has diminished, we know our fourth quarter results will still be impacted by the magnitude, timing and location of snowfall. As we look towards the winter season, we are well prepared to execute our strategy and well positioned to deliver long-term future success." We look forward to its fourth-quarter report. Shares yield ~2.9%.

Ennis Inc (EBF)

Ennis reported fiscal third-quarter results December 20 that were modestly better than expectations, but nothing to write home about. This was one of our ideas that turned into a trade rather quickly, and we think we've optimized capital efficiency quite well with this idea. Part of the reason why we wanted to cash in the chips on this one had to do with top-line performance. Though we may stretch fundamentals a bit for income, we just weren't too pleased with the fact that the company's net sales dropped 9% during its fiscal third quarter ended November 30. Gross profit margins and diluted earnings per share also fell in the period. Ennis retains a very strong balance sheet, however, with cash of ~$88 million versus long-term debt of $30 million. Shares yield ~4.3%.

Watsco Inc (WSO)

Watsco put up a solid fourth-quarter report February 14 that revealed quarterly records for sales, earnings, EPS, and cash flow. Sales nudged up 1%, operating income increased 7%, while net income and earnings per share advanced at a 12% and 8% pace during the quarter, respectively. Operating cash flow performance was solid, in our view, setting a record at $131 million in the quarter thanks in part to better inventory turns. Watsco did all of this, despite what could be described as a challenging year internationally from a strong US dollar, something that has hurt a few of the ideas in the Nelson Exclusive. About the dividend: "Watsco has paid dividends for over 40 consecutive years with the philosophy of sharing increasing amounts of cash flow through higher dividends while maintaining a conservative financial position. Dividends paid in 2016 increased 30% to $128 million. Watsco recently raised its annual dividend rate 24%, to $4.20 per share."

Star Gas Partners (SGU)

We didn't see anything wrong with Star Gas Partners' first-quarter fiscal 2017 results, released February 1, and we think the entity's equity is merely correcting to long-term support, which will likely be a bit more painful until buyers step in. For the fiscal first quarter of 2017, revenue jumped more than 20% as weather drove increases in home heating oil and propane volume (higher per gallon product prices helped, too). Net income increased by more than 50% in the period, though adjusted EBITDA faced headwinds. Overall, I liked CEO Steven Goldman's commentary: "We got off to a great start this year and were pleased to see temperatures in the first quarter rebound nicely from fiscal 2016, when temperatures were much higher than normal across our operations…In part due to the colder weather, an increased demand for service, and a more responsive approach to managing margins, we were able to post a net gain in customer accounts during the period –

which reflects well on the efforts of our employees as well as the strength of our brands. We also acquired three small businesses in the quarter, including the one in Michigan previously announced, as we continue our drive to expand and diversify our overall operating footprint." Shares yield ~4.4%.

Moelis & Co (MC)

Moelis & Co is a gem. The company's fourth quarter and full-year 2016 results, released February 8, were solid across the board. It noted record fourth-quarter revenues, up 17%, while adjusted net income of $0.66 per share (diluted) was 27% better than the prior-year period. We absolutely love its balance sheet. Moelis ended 2016 with cash and short-term investments of $352 million and no debt. It declared a special dividend of $1.25 per share in December 2016, and last raised its regular quarterly dividend to $0.37, a 16% increase in January of this year. Here's what CEO Ken Moelis had to say in the quarterly press release: "We achieved record revenues in 2016 as our investments in talent around the globe and exceptional collaboration across geographies and products led to an increasing number of client relationships. We are experiencing significant momentum not only in the U.S., but in emerging regions such as India, Asia, the Middle East and Brazil as the M&A cycle continues and restructuring activity grows."

Capital Appreciation Ideas

Bloomin' Brands (BLMN)

Bloomin' Brands has been trading largely range-bound since we highlighted the idea, as its same-store sales continue to be under pressure in the difficult restaurant environment. In its fourth quarter of 2016, results released February 17, combined US comparable restaurant sales fell 3.5%, but Outback Steakhouse in Brazil continues to be a positive, with comps up more than 6%. CEO Liz Smith remains optimistic, and she has good reason: "Although 2016 was a challenging year for both Bloomin' Brands and the industry, we made real progress on our strategy to reallocate spending away from discounting toward investments to strengthen brand health...We are pleased with how our brands are performing so far in 2017, particularly at Outback

where we believe our investments are beginning to gain traction." On February 22, Bloomin' Brands raised its dividend more than 14%, to $0.08 on a quarterly basis. Shares yield ~1.9%.

Healthcare Services Group (HCSG)

We didn't see anything wrong with Healthcare Services Group's fourth-quarter results, released February 7. Revenues for the year ended December 31, 2016, increased more than 8%, while net income for the year edged up modestly on an earnings-per-share basis. Here's what you have to know about Healthcare Services Group's incredible quarterly dividend track record: "As previously announced, on January 31, 2017 our Board of Directors declared a quarterly cash dividend of $0.18625 per common share, payable on March 24, 2017 to shareholders of record at the close of business on February 17, 2017. This represents the 55th consecutive quarterly cash dividend payment, as well as the 54th consecutive increase since our initiation of quarterly cash dividend payments in 2003." Shares yield ~1.8%.

Grupo Aerportuario (ASR)

Look at the power of patience. Grupo Aeroportuario's shares have how breached the $160 mark, despite what has been a very, very difficult currency-exchange environment due to the strengthening of the US dollar relative to the Mexican peso. News on March 3 showed that Grupo Aeroportuario's airports witnessed an incredible 15%+ increase in domestic passenger traffic, while total traffic was up nearly 9% during the month of February. Its fourth quarter report, released February 22, showed a nice increase in EBITDA, too, advancing 19%, on the back of a near 6% increase in total revenue. Enviably, the company posted an adjusted EBITDA margin north of 70%, just incredible levels of profitability.

Swedish Match (SWMA.ST)

Performance at Swedish Match continues to be solid. The company reported fourth-quarter results February 17 that showed sales increasing 6% and operating profit advancing 5%; the full-year performance was a bit better. The board proposed a dividend of 16 SEK per share consisting of an increased ordinary dividend of 8.50 SEK (8.00) and a special dividend of 7.50 SEK, in part a result of Swedish Match's divestment of shares in STG in January of this year. The markets for cigars, snus in Scandinavia and snus and moist snuff in the US remain strong. Swedish Match's dividend policy remains returning 40-60% of earnings per share, with net debt not to exceed 3 times EBITDA, a mark that currently stands ~2. Tobacco M&A has brought interest to the industry.

Symrise AG (SYIEY)

Symrise's latest fundamental data point was its third-quarter report, released November 2. Through the first nine months of the year, sales advanced 16% (in local currency), to €2.19 billion, as the company retained a rather attractive EBITDAN (n=normalized for one-time effects) margin of nearly 22%. CEO Dr. Heinz-Jürgen Bertram had the following to say about the year-to-date results: "After the dynamic expansion of our business and the strong, profitable growth in the first nine months, we are anticipating the final spurt in 2016 with optimism. We will use the remaining weeks to push ahead with our innovations, maintain our market presence and align our products with our customers' needs. We confirm our aspiration for 2016 to grow faster than the market, to operate our business in a highly profitable way and thus to remain among the industry leaders." We're anxiously awaiting full-year results and commentary surrounding its outlook for 2017.

Tootsie Roll (TR)

Tootsie Roll's fourth-quarter results, released February 8, didn't get much fanfare, as many investors may have been taken aback by the "weak" year-over-year performance, which showed a rather material decline. Chairman Ellen R. Gordon pointed to timing issues surrounding the year-end and the effects of a strong US dollar, and we'll be anxiously awaiting first-quarter 2017 results to see if there was any slippage of performance, or if it truly was a benign timing dynamic. Tootsie Roll continues to benefit from product price increases and manufacturing improvements, but ingredient costs and changes in product labeling requirements can impact profitability. We continue to believe Tootsie Roll will be acquired in the coming years. It's a controlled company, but a cash cow.

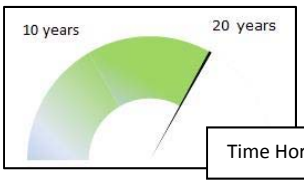
Texas Capital Bancshares (TCBI)

Finally, a banking equity to consider? Here's what CEO Keith Cargill had to say about Texas Capital's 2016 during its fourth-quarter press release, issued January 25: "We are extremely pleased to finish 2016 with solid earnings and continued growth in loans, deposits and fee income. Our recent capital raise positions us to fully support potentially stronger growth by our clients in an environment that is expected to be more business-friendly," said Keith Cargill, CEO. "Continuing to attract and develop great talent and partnering with exceptional clients will drive future risk-appropriate assets and earnings growth, and solidify our outlook for a bright future as a leading organic-growth company." We continue to like the growth prospects of the bank as Texas comes roaring back, and as its diversification endeavors play out.

Arconic (ARNC)

Arconic remains in the midst of a proxy fight, with activist Elliott Management pushing for change, and CEO Klaus Kleinfeld fighting for his job. We think the end result will be in the best interest of shareholders, no matter who ends up at the helm of Arconic when the dust settles. On February 23, Elliott Management raised its stake in the company to ~13% and continues to believe shares are significantly underpriced. We think they are, too, but not by the same magnitude. Could Arconic turn into the next Precision Castparts? It's likely.

Stay tuned – next month we'll walk through the fantastic performance of the short ideas!



Time Horizon: Long-term

Park National Corp (PRK)

"We ended 2016 as we hoped, increasing loans, deposits, assets under management and net income over 2015," said Park Chief Executive Officer David L. Trautman. We are grateful to our associates for another excellent year, and we look forward to finding new ways to serve our clients and communities in 2017." – Park National Fourth Quarter 2016 Press Release Jan. 23, 2017

Thesis

The Ohio economy may not be an exciting one (we can't all have Silicon Valley in our backyards), but it has heartily participated in the national economic recovery from the doldrums of the Great Recession and looks to be on as solid ground as any other state in the union. As of 2015, the state of Ohio represents the 27th largest global economy, just behind Saudi Arabia and just ahead of Argentina, in terms of GDP, a testament to the resiliency of the local economy following the recession that impacted manufacturing cities in the Rust Belt, perhaps more so than other areas of the country.

A 2011 study conducted by Ernst & Young LLP ranked Ohio's effective tax rate on new investments as the third lowest in the nation, suggesting businesses or individuals looking to invest without geographic restrictions could make a viable case to invest in Ohio, thus driving demand for banking services such as those provided by this month's income idea. What's more is the tax reform that has taken place in Ohio since Governor John Kasich was elected in 2011. Gov. Kasich has cut the state income tax rate, eliminated the estate tax, and significantly reduced small business income taxes. The next steps in his tax reduction plan are the full elimination of small business income taxes in 2017, as well as additional income tax cuts for all Ohio taxpayers. The goal behind such moves is ongoing investment into the state's economy from job creators and entrepreneurs as well as increased economic activity from consumers.

So how does this information tie into the analysis of this month's income idea? It's simple--Park National Corp (PRK) is a part of the Ohio economy. Its loan book is part of what drives the dreams and aspirations of Ohio citizens. The aforementioned investments in the Ohio economy would not be possible without the services of Park National and its peers.

Corporate Profile

Park National Corp is holding company whose subsidiaries engage in the commercial banking and trust business, generally in small and medium population Ohio communities. The company's banking operations are conducted through Park National Bank. It deals with consumers as well as with a wide cross-section of businesses and corporations located primarily in the 28 Ohio counties served by the financial service offices of Park National.

Image Source: Park National

Key Statistics	
Last Close	$108.59
52-week range	$85.35 - $122.88
Market Cap	$1.7 B
Avg Daily Volume (30 wks)	34,992
Book Value	$48.38
Price/Book	2.24
Return on Equity	11.68%
Net Interest Margin	3.52%
Annual Dividend Yield	3.5%
Trailing Dividend Payout Ratio	67.3%

What then separates Park National apart from any other bank that pays a dividend? Let's get into it.

With a net loan-to-deposit ratio (LDR) of ~0.95, Park National almost exclusively generates its income via loans. This loan book is threaded into the heart of Ohio's economy, and it has grown nicely in recent years, advancing to more than $5.1 billion in 2016 from ~$4.4 billion in 2012. As of December 31, 2016, just under 41% of Park National's total aggregate loan portfolio consisted of commercial loans (commercial, financial and agricultural loans and commercial real estate loans) and outstanding commercial leases. Just over half of this total represented commercial real estate loans. Nearly 38% of its total aggregate loan portfolio was made up of construction real estate loans and residential real estate loans, the vast majority of which came from residential real estate loans. The balance of its aggregate total loan portfolio (roughly 21%) is made up of outstanding consumer loans (including auto loans and leases). As of the end of 2016, Park National Bank had no concentration of loans to borrowers engaged in the same or similar industries that exceeded 10% of its total loans.

Park National's net interest margin on its loan book is another key differentiator, though it has fallen in recent years along with the national average due to the rolling over of portions of its loan book at historically low interest rates. However, it has easily outperformed the net interest margin for all US banks over the past decade. For example, in 2016, the company's net interest margin came in at 3.52%, an improvement over 2015's mark of 3.39%, and well above the rate for all US banks, which sat just above 3%. Its peer median was much closer in terms of comparing, checking in at 3.45% in 2016.

Image Source: Park National

PERFORMANCE RATIOS (%)	PRK	PEER MEDIAN	PEER AVERAGE
ROAA	1.16	1.02	1.00
ROAE	11.68	8.29	8.46
Net Interest Margin	3.52	3.45	3.39
Efficiency Ratio	62.17	59.07	59.66
Loans / Deposits	95.28	92.61	92.69

How might this net interest margin behave as the Fed continues to slowly hike interest rates? The answer is not exactly cut and dry. That is, the impact can be net-neutral over the long run as rising interest rates almost certainly lead to higher revenues, all else equal, but they also increase bank funding costs. Net interest margins tend to rise and fall with interest rates. However, there is the potential for short term dislocations. It is important to understand that banks generally lend long and borrow short, meaning the average maturity of a bank's loans is longer than that of its deposits. As such, bank funding costs (interest required to be paid on deposits) change more rapidly than interest income received from the longer-term loans. This was on display after the Great Recession as net interest margins across the country spiked as quantitative easing methods were deployed before leveling off into a multi-year decline.

Park National has been able to best the net interest margin for all US banks throughout the entire course of the most recent economic cycle, from 2007 to the present. The company was also able to continue growing its loan book throughout the Great Recession, a very positive sign of its resiliency, and its dividend did not waver at any point during the Financial Crisis. In fact, the firm's payout advanced each year from 1989 through 2008, and it has since remained at a $0.94 per share quarterly dividend.

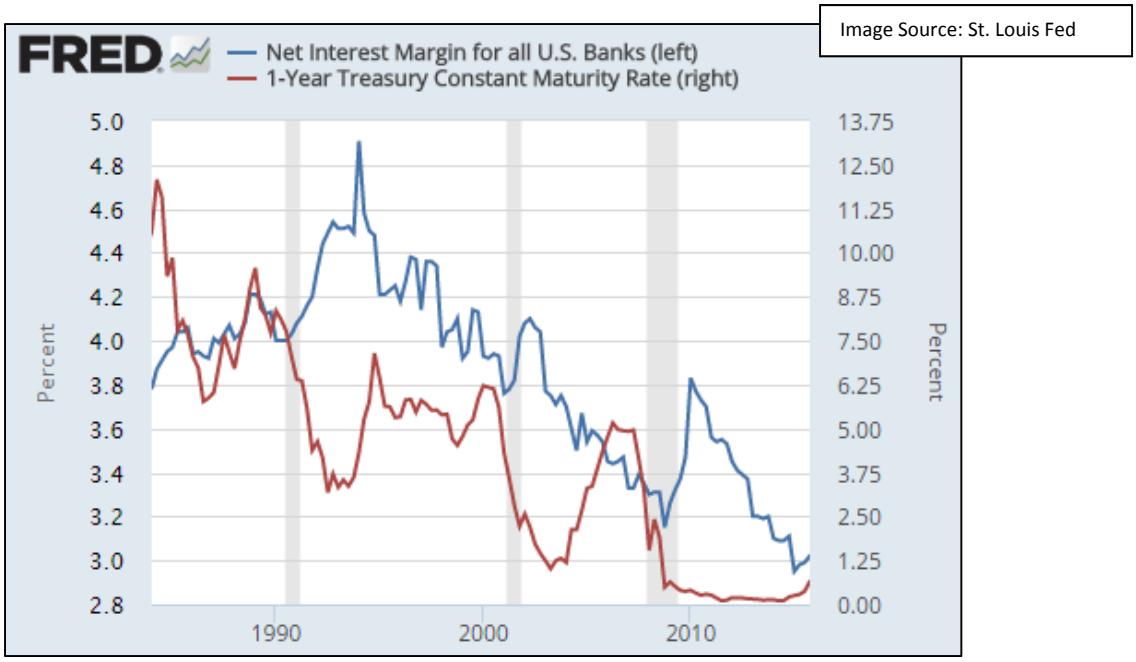


Image Source: St. Louis Fed

An area of improvement for Park National moving forward continues to be its efficiency ratio (non-interest expenses divided by net income). The company is investing in process improvement and efficient revenue generation, but the metric remains well above (lower is better) its post-recession 'peak' that occurred when its net interest margin was materially higher in 2010. Though there is room for improvement in the efficiency of Park National's operations, it already boasts a solid return on equity (ROE) measure. In 2016, the company's ROE came in at 11.68%, well above its stated peer median of 8.29%. Its dividend yield of ~3.5% is also substantially higher than its peer median of ~2.2%.

Park National's above-average returns are the basis of our confidence in its ability to continue generating healthy levels of income for investors. However, the company has participated in the post-election rally that has brought many financial stocks along with it, making shares less attractive on a valuation basis than they were only a few months ago. However, the outsize rally in the financial sector has largely been thanks to the Trump administration's plans for material regulatory rollbacks, including the repeal of Dodd-Frank. The extent and effect of a lessened regulatory framework have yet to be fully ironed out, but the general consensus is that banks and financial firms will benefit materially from the Trump administration's plans.

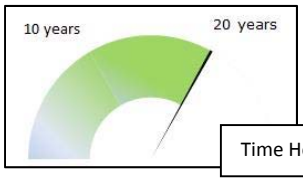
Image Source: Park National

Market Ratios			
Price / Earnings (x)	19.34	21.27	22.80
Price / Book (%)	223.42	165.23	176.18
Dividend Yield (%)	3.48	2.19	2.07

All things considered, Park National has the typical risks associated with relying on a bank for income. Its business model is based on the confidence its market places in it; that confidence is the duct tape that holds everything together. Nevertheless, we expect the company to continue churning out competitive quarterly dividend payments for the foreseeable future thanks to its above average net interest margin and solid returns on equity. Shares look a bit pricey at recent levels, changing hands at more than 19x 2017 consensus earnings estimates and a price/book ratio of 2.2x, but a yield of ~3.5% helps offset some of these concerns. We like Park National as a consideration for income.

Kris Rosemann contributed to this article.

Capital Appreciation



Time Horizon: Long-term

Speculative: Biotechnology stocks are not for all types of investors. Shares will be extremely volatile, and a significant loss of principle is possible, if the pipeline disappoints or an expected takeout doesn't materialize.

Tesaro (TSRO)

Tesaro, a developmental biopharmaceutical firm has put together one of the most impressive share price runs in recent memory. The equity has more than tripled since mid-2016, a remarkable run. The catalyst was the stellar results of Tesoro's lead compound Niraparib, a PARP inhibitor for use in an oncology setting.

Thesis

Developmental stage biotechnology stocks carry a high degree of risk that fall outside the purview of ideas in the Valuentum newsletter portfolios. The Nelson Exclusive, however, has a bit of a different focus, and we haven't highlighted one for consideration in this publication just yet. Even though these types of equities come with tremendous uncertainty, both with respect to their fundamentals and their equity prices, let's fix the current void of a speculative biotech play in the Exclusive by highlighting one in this March edition. We've chosen Tesaro Inc.

Corporate Profile

Tesaro provides hope to those facing cancer. It is a biopharmaceutical company devoted to providing transformative therapies. The company prides itself on innovation and seeking and commercializing new possibilities in areas that rivals may come up short. Tesaro was founded in 2010.

First, let's cover the major financial risks. Despite Tesaro's revenue performance improving to $44.8 million in 2016 from a mere $317k in 2015, its market capitalization is a whopping $9.3 billion and the company is still generating considerable losses, to the tune of $387.5 million in the last reported year alone. Tesaro revealed a cash balance of nearly $786 million at the end of 2016, however -- good enough to cover a couple years of run-rate losses at the current pace, *but the size of its revenue relative to market cap should be noted.* We estimate quarterly cash burn at $80-$100 million (its cash and cash equivalents balance declined ~$96 million during the fourth quarter, for example).

Key Statistics	
Last Close	$180.84
52-week range	$36.68 - $192.94
Market Cap	$9.3 B
Avg Daily Vol (30 wks)	1,039,226
Annual Dividend Yield	0.00%
Trailing Dividend Payout Ratio	N/A
Trailing P/E	N/A
Net Cash (LFY)	$109 M

Tesaro has some convertible notes on the books ($131.8 million), but total liabilities aren't overwhelming at $228.6 million. In light of the company's recent equity performance (and cash infusion in November), capital access appears very good at the moment, but capital-market dependence risk is still a big one. Said differently, if the market loses confidence in shares as a result of disappointments in its development pipeline or other, namely if a suitor doesn't materialize, its equity price could be taken to the woodshed in a hurry, threatening solvency. Tesaro's share price will be extremely volatile, and to illustrate its ongoing need for equity capital to fund R&D, shares outstanding increased to 47.65 million from 39.39 million during the past year.

With the considerable financial risks presented up front and center, 2017 looks to be a very exciting year for the company (source: Tesaro's fourth-quarter results). Here's what CEO Lonnie Moulder had to say:

> "2017 is poised to be an eventful year for Tesaro as we prepare for four product launches across the United States and Europe…2016 was an important year for the Company, highlighted by the landmark NOVA trial results for Niraparib, which were published in the New England Journal of Medicine and presented in a presidential session at the European Society of Medical Oncology annual meeting. We intend to build upon these successes in 2017 with the planned launch of Niraparib in the U.S. during the first half of this year and in Europe by year end. Looking beyond ovarian and breast cancer, we aim to finalize our registration program for Niraparib in lung cancer in the first half of this year. Lastly, we are excited about the progress in our immuno-oncology pipeline, and expect to initiate a registrational program for TSR-042 in the coming months."

I've worked with my colleague Alexander J. Poulos, who specializes in healthcare and biotech, and we've put together the following discussion of Tesaro's drug portfolio.

Varubi

Tesaro's first commercially available product was Varubi, a treatment of chemotherapy-induced nausea and vomiting. The oral dosage form is currently on the market with an intravenous formulation assigned a PDUFA date of January 2017. Tesaro received a complete response letter stating the FDA found some deficiencies in the manufacturing of the product, which will delay the entry of an IV formulation onto the market.

Varubi is not an internally developed product; it was licensed from Opko Health (OPKO) with Tesaro responsible for the ultimate development and commercial sales of the product. Under terms of the deal, Opko will receive $95 million in milestone payments in addition to double-digit royalties, an outstanding deal for Opko. Varubi is protected by a composition of matter patent that runs through 2023, giving the partnership a clear runway to ramp sales.

Thus far, sales growth is rather tepid with roughly $2.8 million in sales for the most-recent quarter recognized by Tesaro. We view Varubi as a complementary product for the central star of Tesaro's pipeline Niraparib. Tesaro will need to build out a sales force to promote Niraparib upon its expected approval. By actively supporting Varubi before gaining marketing approval for Niraparib, the company is successfully building a relationship with oncologists, the ultimate end users. The early work by the sales force supporting Varubi will ease the initial ramp for Niraparib, in our view, but the oncology field remains fiercely competitive.

Niraparib

Niraparib belongs to the PARP class a novel treatment with extensive applications in the area of oncology. A PARP inhibitor class mechanism of action works by inhibiting the enzyme polyADP ribose polymerase, which is abbreviated as PARP. The field of study is cutting-edge with a competing product on the market (in addition to two others in the lab in addition to Niraparib) that targets breast cancer. The theory holds the product class will have broad applications beyond breast cancer.

To effectively harness the class' potential beyond breast cancer, additional collaborations will be needed. Johnson and Johnson (JNJ) Janssen division struck such a partnership agreement with Tesaro to develop Niraparib for the indication of prostate cancer. Under terms of the agreement, Johnson & Johnson will be responsible for worldwide commercial rights to the product except for Japan. We view this development as an exciting first step in realizing the full potential of Niraparib. As a developmental stage entity, Tesaro does not have the financial resources to conduct costly clinical trials for all possible indications for Niraparib. Tesaro will need to partner up with the deep pockets of Big Pharma; the Johnson & Johnson collaboration is an excellent first step. The full terms of the deal were not made public in regards to the upfront payment to Tesaro, nor were details of the expected royalty stream.

What we found to be the most fascinating portion of the deal is Johnson & Johnson taking an equity stake in the outfit. By taking an ownership claim in Tesaro now, Johnson & Johnson will have a say in how the company will evolve over the next few years. For instance, if a rival entity steps up and makes a bid for Tesaro, Johnson & Johnson will likely have the opportunity to top the offer, or as in the case with Pharmacyclics with its lead product Imbruvica, allow another entity to gain control of the portion that Johnson & Johnson does not own. Johnson & Johnson was in the running to acquire the part of Pharmacyclics it did not own, yet in an excellent display of fiscal discipline walked away. Keep in mind, Johnson & Johnson derives a significant amount of revenue from the product, due to having the foresight to partner with Pharmacyclics well in advance of Imbruvica displaying its full potential.

As a general rule, the most efficient pharmaceutical deals are often struck in the early stages, well before the compound reveals its real potential. As the compound works its way through the various stages of clinical trials, it becomes increasingly "de-risked" (i.e. the potential becomes increasingly more apparent). As the risk of the product begins to diminish the price tag generally begins to inflate, as is the norm with any product--the ultimate value derived is highly dependent on the price paid for the asset. Identifying a great company or product is half the battle; the more difficult portion is to determine its fair value and purchase at a discount to intrinsic fair value. The pharmaceutical world adds to the complexity of this task as the products are viewed as "wasting assets" backed by a patent with a finite time.

Niraparib PDUFA

Tesaro has submitted a New Drug Application (NDA) to the FDA for Niraparib for the indication of Ovarian Cancer. The PDUFA date or deadline where the FDA must submit a decision on the application is June 30, 2017. Tesaro has posted some impressive data for Niraparib including a preclinical study demonstrating an increase in tumor regression when a patient is switched from Olaparib to Niraparib. The important thing to keep in mind is the results are preclinical; additional data will be required. A key suspected advantage of Niraparib over the others in the class is Niraparib's selective ability to inhibit the PARP1&2 enzymes. The PARP1&2 enzymes are responsible for DNA repair, thus the theory holds by actively targeting this process a greater overall result should ensue.

The theory has come under fire from Medivation, which was recently acquired by Pfizer (PFE). Medivation's competing product Talazoparib selectively works across a host of PARP enzymes, yet the company does not believe inhibition is the key. Medivation has put forth an interesting thesis where PARP "trapping" is far more efficient that PARP enzyme inhibition. The theory is when combining Niraparib with Alkylation chemotherapies and radiation, a single strand break of DNA will occur. Single-strand breaks are optimal set-up for a compound

that can trap PARP. Once the PARP is caught on the damaged DNA strand, it can lead to the optimal outcome of the destruction of the tumor cell.

Medivation believes it has the best in class PARP (Talazoparib) as its product has demonstrated a far higher potency in trapping PARP than the others on the market. Niraparib is the second-most potent, which may explain the advantage seen thus far in comparison with Olaparib, which is the only commercially available product.

Takeout Speculation

The field of oncology remains the area of the most intense focus in the pharmaceutical universe. The oncology market blends the unique characteristics of life-saving therapies, cutting-edge research with a vast and growing end market. The field, thus far, has generally been shielded from the intense price competition seen in other areas, most notably in diabetes and Hepatitis C, thus the industry continues to develop additional resources with a renewed focus on oncology.

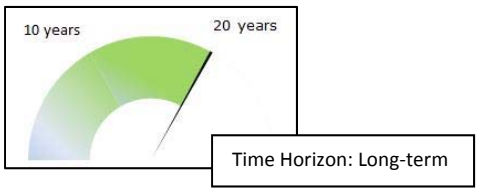
With the above backdrop in mind, developmental stage companies with a promising compound will likely generate significant interest from the industry. A couple of recent examples to illustrate the trend was AbbVie's (ABBV) audacious take-out of the portion of Imbruvica that was not licensed out to Johnson & Johnson. AbbVie outbid its rival by offering $21 billion of $261.50 per share for Pharmacyclis, topping the $250 per-share maximum bid submitted by Johnson & Johnson. The final bid delivered by AbbVie nearly doubled the value from where Pharmacyclics was trading at the prior year before the deal.

Pfizer (PFE) recently enacted a similar transaction with the takeout of Medivation. The Medivation deal was initially viewed as a major stretch by Pfizer as Medivation's lead product Xtandi was not worth the $14 billion Pfizer acquired the company for, in our view. The hidden gem in the deal is Talazoparib if the PARP trapping thesis pans out—Talazoparib itself may be worth the price tag paid. Talazoparib was not an internally generated compound of Medivation; it was acquired from Biomarin (BMRN) for an initial payment of $410 million upfront in addition to milestone payments. Biomarin can earn an additional $160 million in payments and is entitled to a mid-single digit royalty rate that will now come from Pfizer.

The Plight of Tesaro

Tesaro's current market cap is north of $9 billion, and the current share price almost certainly reflects the Street's optimism for Niraparib along with the potential of a near-term acquisition. Tesaro does have a collaboration deal with Merck (MRK) for a combination study of Niraparib along with Pembrolizumab (Keytruda) in phase 2 for the indication of triple negative Breast and Ovarian Cancer. The market is currently pricing the equity as if a deal is imminent, however. Traditional valuation metrics really don't apply with this idea, but when it comes to considering a speculative biotech consideration with long-term promise, Tesaro fits the bill. *Please be careful though* – considerable loss of principle is possible, but we wanted to fill a void when it comes to Exclusive idea considerations. This idea is certainly not for everyone.

Alexander J. Poulos contributed to this article. Alex is long Pfizer and was long Tesaro.



Fitbit (FIT)

Thesis

How could we possibly be so willing to bet on the continued fall of a company with such a popular product line-up? The answer lies somewhere between the news flow that has led to its shares getting crushed since its 2015 IPO and our opinion of the viability of its long-term strategy.

Most consumers in our increasingly health-conscious society know Fitbit's products. A sizeable portion of our population has become obsessed with health and fitness and the metrics that help individuals track their progress against their goals. Users of fitness-tracking wearable technology fall into three main categories: everyday users, active users, and performance users, in order of increasing importance placed on advanced fitness metrics. Fitbit boasts the leading position in the health-tracking wearable technology market, but it is quickly finding that it may be more difficult to remain top dog in the market it essentially created.

Corporate Profile

Fitbit is a wearable technology company with a bent toward health and fitness. Its products allow users to track measures such as calories burned, sleep quality, steps taken, and distance traveled. Its platform enables the collection and organization of data such that each user can monitor his or her progress towards personal fitness or health goals. The company was founded in 2007 and is headquartered in San Francisco, California.

Key Statistics	
Last Close	$6.07
52-week range	$5.62 - $18.85
Market Cap	$1.4 B
Avg Daily Volume (30 wks)	10,233,426
Shares Outstanding	170.12 M
Float	153.84 M
Shares Short	52.08 M
Short Ratio	3.69
Short % of Float	41.7%
Shares short (prior month)	54.29 M

Fitbit's IPO in June 2015 was a resounding success at the time. The company priced its IPO at $20 a share, but opened 52% higher at $30.40. Shares would surpass the $50 mark before the summer was over, but the action seen in shares since has been anything but a success. A company that was valued at ~$4 billion at its IPO has seen its market cap fall to ~$1.4 billion as of this writing.

The most recent leg down in Fitbit's shares brought the severity of its long-term plight to our attention. The company's announcements surrounding its 2016 fourth quarter results were troublesome, both as they relate to its performance in the most recent holiday period and on a forward-looking basis. The firm, whose investment thesis has been tied to the once rapidly expanding wearable technology market, now expects 2017 revenue to come in considerably lower than that of 2016. Specifically, it is anticipating revenue to be in a range of $1.5-$1.7 billion in the year, compared to nearly $2.2 billion in 2016, a drop of 22%-31%.

Fitbit is also looking to reduce operating costs and improve efficiencies as it adapts to its rapidly-evolving environment. Management is targeting a reduction in 2016 exit operating expense run rate of roughly $200 million by realigning sales and marketing costs to its new market growth expectations and improving the efficiency of its research and development efforts. The company is also cutting approximately 6% of its global workforce, something we are not accustomed to seeing from a leader in a relatively young market. Despite its

cost reduction efforts, Fitbit does not anticipate reporting a profit on a non-GAAP basis, or positive free cash flow, for 2017. Its co-founders, CEO James Park and CTO Eric Friedman also plan to take a salary of $1 in 2017 as part of their personal efforts in returning the company to efficient, profitable growth.

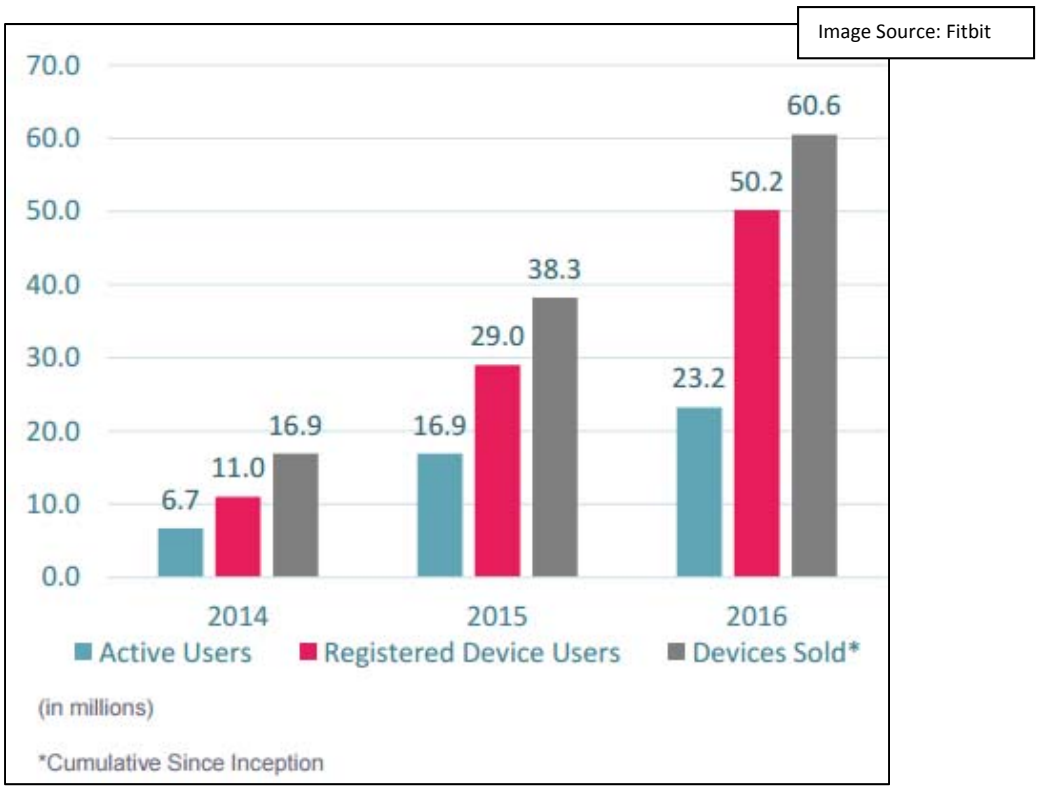
Perhaps most damning from Fitbit's recent announcements is the material revision management has made in its long-term non-GAAP gross margin target. Management now expects its long-term non-GAAP gross margin to normalize somewhere around the 45% mark, down from its previous target of 50%. The materially lower margin target suggests there are additional competitive forces at play in the wearable technology market that Fitbit was unable to foresee. While similar conclusions could be drawn from the company's decision to restructure and pursue cost saving initiatives as we move into 2017, management cannot portray the long-term target reduction as a "temporary slowdown and transition period" as it suggests the drivers behind its restructuring decisions is.

The reality of the matter is Fitbit is experiencing greater levels of competition that it was anticipating, and this competition is coming from multiple angles. The most obvious hurdle is competing with the vast resources and cache of Apple's (AAPL) Apple Watch, but lower cost competitors have also entered the evolving wearables market, including Xiaomi's Mi Band device. The dust is far from settled in the market, but we're growing increasingly concerned about Fitbit's staying power.

Fitbit's long-term strategy to positively impact the way consumers lead their lives with respect to fitness and activity tracking is a noble one, but we posit that the company may be understating the difficulty it might have in achieving it. Fitbit does have an impressive installed base of over 23.2 million active users, which will help in its quest to become the wearable technology partner of choice for the healthcare ecosystem, but Apple has similar aspirations for its Apple Watch.

A measure worth watching as the wearables market evolves is the level of active users the competing firms boast. As of the fourth quarter of 2016, only 46% of all registered Fitbit device users were active users. Though complete conclusions cannot be drawn from such a figure, it suggests that its product is already showing signs of "faddish" tendencies. Less than half of the people who took the time to register their devices, not just purchase or receive a device as a gift, but actually register their device, were actively using a Fitbit as of the fourth quarter of 2016. The company may be able to carve out a niche with its more 'hardcore' fitness conscience customer base, but these types of figures hardly suggest it is effectively building itself into a necessity in the everyday lives of consumers.

Such troubles tie directly into the issues we see in the achievement of Fitbit's long-term goal of becoming the partner of choice for the healthcare ecosystem, which is dependent in part on its continued success in its largest customer base, everyday users. As we know, however, everyday users are Apple's wheelhouse. The tech giant has done better than any other company in recent memory in finding its way into the everyday lives of consumers via its massive ecosystem of apps. These everyday users are not interested in the advanced functionality of higher level Fitbit devices. Instead, they are interested in tracking the impact of their everyday lives on their fitness levels, making measures such as steps taken, distance walked, active minutes, and calories burned in a day. Even Fitbit's active user base, extending metrics tracked to heart rate and the like, could see material erosion as the Apple Watch gains momentum.



Simply stated, we do not believe Fitbit, a company that has seen its market cap deteriorate significantly over the past year and a half, will be able to keep up with the combination of innovation and brand strength that Apple boasts.

Our short thesis for Fitbit is largely the confluence of two major factors: the "faddish" tendencies we've observed in the firm's products, and the potential for a cash-burn to return in a material way. A meaningful step back in Fitbit's top line in 2017 could be just the beginning of the competitive pressures coming its way and support evidence that its products are part of a fad that may very well peter out. The company was unable to avoid the overly promotional retail environment in the 2016 holiday season, a core factor in its underperformance relative to its targets in the fourth quarter of the year and further evidence that its products are not differentiated enough to continue driving material demand growth beyond its current state as a "fad."

The evidence continues to stack against Fitbit when considering a key driver behind its 2016 revenue, and a portion of the reasoning for the projection of poor comparative performance in 2017, was an aggressive product launch cycle--new product launches represented 52% of 2016 first half revenue. Though revenue growth may be reasonably expected to ebb and flow with the product update/launch cycle, particularly for a firm like Fitbit, we would expect a market leader with material competitive advantages, which Fitbit claims to be, to maintain significantly more revenue on a year-over-year basis. A 20%+ drop in revenue is something a leader in a growing, consumer-facing market should not experience, and what's worse is the window it is potentially opening for competitors, particularly Apple, who boasts significantly more resources to invest in the next generation of wearable technology than any other player.

Not only is Fitbit anticipating material revenue erosion and a net loss in 2017, but it is expecting free cash flow to be in a range of negative $50-$100 million in the year as well. If this cash burn is contained to a

one-time occurrence, its net cash position of $705 million will be able to handle the transitory weakness in its business. However, should management fail to deliver on its promises of a materially reduced cost base and optimized R&D program, this cash burn could get ugly in a hurry. Though consensus estimates call for a return to top-line growth in 2018, the company is not expected to turn a profit on a non-GAAP basis in the year, which would mark the third consecutive year in which it reported a net loss should the projections prove correct.

Image Source: Fitbit

FY'17 Guidance

	Low	High
Revenue (billions)	$1.5	$1.7
y/y decline	*(31%)*	*(22%)*
Non-GAAP gross margin	42.5%	44%
Non- GAAP free cash flow (millions)	($100)	($50)
Non-GAAP EPS	($0.44)	($0.22)

We're not buying into the hype that Fitbit is anything more than a fad, even if it stretches its corporate life out for years. Management grossly underestimated the level of competition it would encounter in the wearables market, evidenced by is material downward revision of long-term margin targets, and we're still not convinced it has a great handle on the business. Material top-line erosion and a return to net losses and negative free cash flow generation are not signs of a market leader poised to expand its dominant position.

Kris Rosemann contributed to this article.

July 1, 2016

Inaugural Letter to Members

Dear Valued Member,

Welcome! You are one of a very limited number of members that will ever bear witness to the pages that follow.

The launch week of the Nelson Exclusive coincided with news that Britain has voted to leave the European Union. The decision, while sending the European banks tumbling violently, does little to muddy the context setting the background of the inaugural edition of this publication.

Broader stock market valuations are at frothy levels, and interest rates continue to hover near all-time lows. The investment-decision landscape is more complicated today than ever before for all types of investors, from those seeking long-term capital appreciation to those that are targeting certain income goals. Cyclicals today are trading at peak multiples on peak earnings, and even consumer staples equities have reached valuation levels that may be more appropriate for aggressive growth equities, not mature operators. *Said differently, the market has laid down the gauntlet.*

The next few years in the markets may be among the most difficult witnessed since the Great Recession. Even a broader market pullback 20% from current all-time highs wouldn't be abnormal given that the collective market valuation of S&P 500 companies has effectively tripled from the March 2009 panic bottom. The launch of the Nelson Exclusive in such conditions can be considered perilous as broader market performance inevitably will act as ballast to the returns of ideas surfaced. In this spirit, I want to remind you that not all ideas in this publication will be successful, and some that are eventually may encounter tough sledding over extended periods of time. As a swimmer cannot achieve his best time swimming against the current, a stock selector cannot achieve his best performance in a down market. Regardless, the value placed on a steady hand during challenging times is priceless.

Let's first cover what the Exclusive is and then we'll talk about what it is not. As you know, the Valuentum investment coverage universe is vast, and what we're seeking to deliver in this publication is ideas that fall outside its reach. We're breaking down the traditional barriers of equity coverage to identify underfollowed gems across the investing spectrum, delivering in each monthly edition one idea for income investors, one idea for readers seeking long-term capital appreciation, and a bonus idea for those looking for a "short" consideration (1). Underfollowed doesn't mean obscure, however, and the ideas that we're targeting will be investable ones, avoiding thinly-traded instruments and penny stock "traps." We'll clearly define our expected time horizon for each consideration, and where applicable, we'll update our theses in subsequent editions. We'll keep score, tracking performance over time.

Let's talk about what the Exclusive isn't. The Exclusive does not constitute individual investment advice, and the ideas within it are not personal recommendations. Each of you reading should always work with your

personal financial advisor who knows your individual goals and risk tolerances. I do not. Only you and your personal financial advisor know what's best for your life circumstances. The personal financial advising markets and what we do at Valuentum via financial publishing are two different verticals in the same industry, but they are different nonetheless. I just want to be very clear about this because I can never tell you to buy or sell anything at any time, even if this may be what you want. It's not that I don't have conviction in my work – it's the rules of the business.

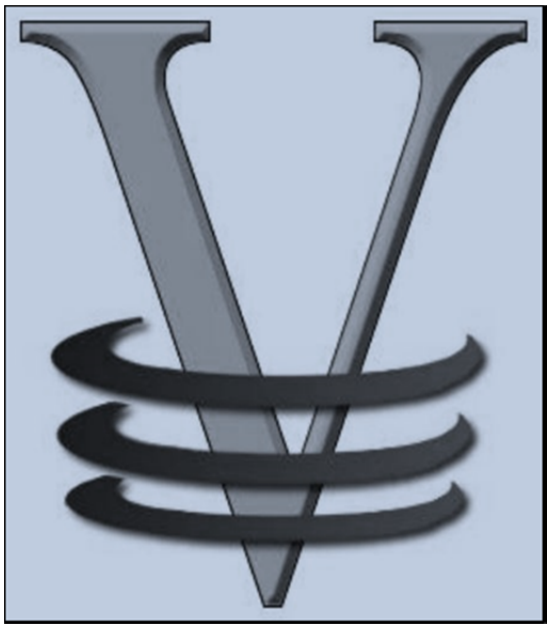
Within the twelve editions of the Nelson Exclusive each year, we'll be highlighting in total 36 ideas for consideration with varying investment parameters. That's a lot. Depending on the time horizon set forth with each idea, fantastic performance might mean a success rate of 60%, great performance might be 55%, average performance might be 50%, while anything below that mark may constituent a poor showing. Obviously, I'm aiming for a 100% success rate, but I also have to be realistic. The great Joe DiMaggio may have hit safely for 56 consecutive games in the last baseball season before the United States was thrust into World War II, but he "only" hit .357 that year. That season of '41, the great Ted Williams would be the last player to hit .400, meaning that one of the best hitters in baseball…ever…was still called out ~60% of the time.

The greatest investors face a similar paradigm. Stock selection is a process where there will be homeruns and strikeouts. You know me. The Exclusive is not a "get-rich-quick" product, and you should keep a close eye on your wallet if you encounter anyone promising anything of the sort. In the inaugural edition of the Nelson Exclusive, I'm going to take 36 swings – they are going to be hard and through the zone, and I'm not going to pull my shoulder out or take my eye off the ball. Market conditions are expected to be stormy in coming years as "reversion-to-the-mean" dynamics rain down, and a crafty lefthander with great "stuff" may be on the mound, but we're stepping up to the plate and digging in.

Batter up!

Sincerely,

Brian Nelson, CFA
President, Investment Research & Analysis
Valuentum Securities, Inc.
brian@valuentum.com



P.S. On a very personal note, I wanted to thank you for your continued support. Without you, neither the Nelson Exclusive publication nor Valuentum would exist. This fact is not lost on me. I thank you deeply.

The Nelson Exclusive: Volume 2, Issue 3

The Nelson Exclusive is published monthly. Contact us at info@valuentum.com for more information.

(1) From the SEC's website: A short sale is the sale of a stock that an investor does not own or a sale which is consummated by the delivery of a stock borrowed by, or for the account of, the investor. Short sales are normally settled by the delivery of a security borrowed by or on behalf of the investor. The investor later closes out the position by returning the borrowed security to the stock lender, typically by purchasing securities on the open market.

Investors who sell stock short typically believe the price of the stock will fall and hope to buy the stock at the lower price and make a profit. Short selling is also used by market makers and others to provide liquidity in response to unanticipated demand, or to hedge the risk of an economic long position in the same security or in a related security. If the price of the stock rises, short sellers who buy it at the higher price will incur a loss.

Brokerage firms typically lend stock to customers who engage in short sales, using the firm's own inventory, the margin account of another of the firm's customers, or another lender. As with buying stock on margin, short sellers are subject to the margin rules and other fees and charges may apply (including interest on the stock loan). If the borrowed stock pays a dividend, the short seller is responsible for paying the dividend to the person or firm making the loan (Source: SEC https://www.sec.gov/answers/shortsale.htm)

Short selling is not for all types of investors, and readers should consult their personal financial advisor that understands their individual goals and risk tolerances before considering any investment or any strategy. Potential losses for an investor engaging in a short selling strategy are theoretically infinite.

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