Jefferies

US Insights
Finding Fresh Arms in the Bottom of the 12th; Stocks That Can Still Work

Jefferies Equity Research *
Equity Analyst
(888) JEFFERIES research_support@jefferies.com
Laurence Alexander, CFA *
Equity Analyst
(212) 284-2553 lalexander@jefferies.com
Brandon Couillard *
Equity Analyst
(212) 284-2462 bcouillard@jefferies.com
Raj Denhoy *
Equity Analyst
(212) 336-7070 rdenhoy@jefferies.com
Ramsey El-Assal *
Equity Analyst
(212) 284-4649 ramsey.elassal@jefferies.com
Jason Gammel §
Equity Analyst
+44 (0) 20 7029 8709 jason.gammel@jefferies.com
Randy Giveans *
Equity Analyst
(713) 651-3829 rgiveans@jefferies.com
Casey Haire *
Equity Analyst
(212) 707-6418 chaire@jefferies.com
Brad Handler *
Equity Analyst
(212) 336-7249 brad.handler@jefferies.com
John Hecht *
Equity Analyst
415-229-1569 jhecht@jefferies.com
John Janedis, CFA *
Equity Analyst
(212) 284-2187 jjanedis@jefferies.com
Sheila Kahyaoglu *
Equity Analyst
(212) 336-7216 sheila.kahyaoglu@jefferies.com
David Katz *
Equity Analyst
(212) 323-3355 dkatz@jefferies.com
Randal J. Konik *
Equity Analyst
(212) 708-2719 RKonik@jefferies.com
Ashik Kurian §
Equity Analyst
+44 (0)20 7029 8785 ashik.kurian@jefferies.com
Christopher LaFemina, CFA *
Equity Analyst
(212) 336-7304 clafemina@jefferies.com
Mark Lipacis *
Equity Analyst
(415) 229-1438 mlipacis@jefferies.com
Christopher Mandeville, CFA *
Equity Analyst
(646) 805-5407 cmandeville@jefferies.com
Philip Ng, CFA *
Equity Analyst
(212) 336-7369 png@jefferies.com
Anthony Petrone, CFA *
Equity Analyst
(212) 708-2703 apetrone@jefferies.com
Seth Rosenfeld, CFA §
Equity Analyst
+44 (0) 20 7029 8772 srosenfeld@jefferies.com
Christopher Sighinolfi, CFA *
Equity Analyst
(212) 707-6420 csighino@jefferies.com
Brian Tanquilut *
Equity Analyst
(615) 963-8338 btanquilut@jefferies.com
Brent Thill *
Equity Analyst
(415) 229-1559 bthill@jefferies.com
Stephen Volkmann, CFA *
Equity Analyst
(212) 284-2031 svolkmann@jefferies.com
David Windley, CFA, CPA *
Equity Analyst
(615) 963-8313 dwindley@jefferies.com
Stephanie Wissink *
Equity Analyst
(212) 284-1713 swissink@jefferies.com
Michael J. Yee *
Equity Analyst
(415) 229-1535 michael.yee@jefferies.com

* Jefferies LLC
§ Jefferies International Limited
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Key Takeaway

Amazingly, nine years into this expansion, economic growth seems to be strengthening. Still, with S&P operating margins close to all-time highs, 2017 having the best EPS growth rate since 2011, and 2018 growth expected to exceed 2017's, we believe there is appetite for analyst top picks which also have accelerating EPS growth from other than just tax, outsized op. margin expansion, were '17 laggards, or all three.

Most Jefferies analysts published their 2018 outlooks in the last several weeks and while you may not be surprised to see some mega cap tech names among the top picks, there were also a number of less obvious, less well performing, turnaround-type stocks that ascended the ranks. Starting with the stocks that Jefferies analysts had recently listed as top picks for 2018, we looked for stocks with 2018 estimated earnings growth acceleration, 2018 expected margin expansion that's better than the respective sector, and 2017 underperformance vs. the sector. We weren't so rigid to require every name meet every one of the criteria--ultimately whether a name was included had much to do with analyst conviction levels and prospects for improvement.

All of the selected stocks have one thing in common as far as Jefferies analysts are concerned--operationally, things can get better from here. Some have seen recent improvements, some have seen recent setbacks, but in all cases, there is a path to greater things driven by factors other than just tax. The improvement generally comes from one of several drivers, and we offer those below, along with the stocks that fit into each. Some stocks fit into more than one category, and in those cases we've listed them more than once. Also, though we tried to include all the stocks that made sense, since this was not as simple as just a screen, arguments could certainly be made for other stocks--it would be impossible to say that a piece like this is exhaustive.

Underappreciated revenue opportunity. CELG, GLNG, GT, HAE, HOLX, KSS, MLM, PAGP, PX, SBGI, STLD, TXT, UAA, ULTA

Accelerating cash flow/earnings growth. BIO, BLD, CASY, CJ, CVX, EXPE, FM CN, KMT, MCK, OMF, SBNY, SC, SYNH, TXN, UTX, WEX, WMB

M&A. CASY, SC

Cost savings. BLD, ERI, KMT

Allocation of capital. GPS, OMF

Stocks Included and Respective Drivers

Underappreciated Revenue Opportunity

Celgene (CELG) – Mike Yee believes the market fails to appreciate the value of the pipeline and sees upcoming pipeline catalysts including mid-'18 luspatercept data in MDS and potentially best-in-class JUNO JCAR17 pivotal data

Golar LNG (GLNG) - LNG spot charter rates and FLNG production expected to boost the top line.

Goodyear Tire (GT) - After spotty results, company recently preannounced on better volumes, but '18 could be even better on reversal of share losses and net price/raw material tailwind.

Haemonetics (HAE) - New product NexSys highly value creative for customers and should result in better terms for the company.

Hologic (HOLX) - Estimates for Cynosure likely finally low enough as the salesforce has finally stabilized.

Kohl's (KSS) – Traction in proprietary brands, progress in active wear, traffic from new initiatives (accepting Amazon returns and selling Amazon smart home products in certain stores) and share gains from peer store closures should help drive the top line.

Martin Marietta (MLM) - Aggregates shipments should finally inflect in '18 on a return of public spend and efforts from state DoTs to alleviate labor constraints and get projects done.

Plains GP Holdings (PAGP) - Company has the best Permian assets in midstream and should see strong Permian volume growth in '18.

Franchise Pick **- Praxair (PX)** - Compelling late cycle stock benefitting from a better capex cycle, better merchant gas pricing and deal synergies.

Sinclair Broadcasting (SBGI) – The SBGI/TRCO combination should improve retrans growth at TRCO. 2018 midterm elections a positive for broadcasters.

Steel Dynamics (STLD) - Benefits from strength in steel prices, potential infrastructure demand and potentially from Section 232.

Franchise Pick **- Textron (TXT)** - New aviation products should drive demand even in a flattish market and various signs point to improvement in the bizjet market.

ULTA Cosmetics (ULTA) - Sales growth is settling into a sustained range, company has hinted at international expansion and the opening of additional metropolitan stores. Company showed strong growth in Tribe's most recent earned media value data.

Franchise Pick **- Under Armour (UAA)** - Stock doesn't reflect the international opportunity, category remains strong, recent management changes generally positive.

Accelerating Cash Flow/Earnings Growth

Bio-Rad (BIO) - EPS growth expected to accelerate again as the company harvests efficiencies from the new ERP.

Franchise Pick **- Casey's General Stores (CASY)** - Activist involvement could lead to a sale at a large premium and/or the company engaging in continued cost control and M&A on its own.

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C&J Energy Services (CJ) – Company expected to generate cash after losses in 2017. Margin and pricing dynamics in CJ's non-fracking IS onshore completions strong.

***Franchise Pick* - Chevron (CVX)** - Capex investments over the past several years now bearing fruit, boosting production and cash flow.

Expedia Inc. (EXPE) - Cloud investments should slow and once completed, should drive margin accretion through elimination of duplicate systems. Fundamentals are strong despite recent weak result.

First Quantum (FM CN) - Cash flow improves as Cobre comes online, capex rolls off and copper hedges reset.

Kennametal (KMT) – Steve believes the macro backdrop for machinery is as good as it's been in years but also sees a self-help story with KMT having 1000bps of margin upside over the next several years as operations are streamlined.

McKesson (MCK) - Generic price declines no longer getting worse, stock at a 5+ point discount to the S&P 500.

OneMain (OMF) – Credit has stabilized following an integration related uptick in NCOs in 2016-2017, company likely to consider a capital returns program in 2019.

***Franchise Pick*- Santander Consumer (SC)** - Company is coming off two years of declining earnings but credit stability should help drive earnings growth in '18. Potential for the parent bank to take out the remaining 30% stake.

Signature Bank (SBNY) – Exposure to taxi medallions played a part in 2017 underperformance but that issue is now largely behind the bank. Casey expects SBNY to announce a buyback and/or implement a dividend by year end '18.

Syneos (SYNH) - Stock too severely punished on the rocky start to the inVentiv deal, clinical business remains strong and Dave Windley sees a significant inflection in F19 (Mar) numbers on deal synergies.

***Franchise Pick* - Texas Instruments (TXN) –** Mark looks for 20%+ EPS growth in 2018, due partly to IoT growth and the budding US capex cycle. Mark also looks for 1000bps of margin expansion as semiconductor consolidation leads to pricing power.

Top Build (BLD) – Still room for expansion in new residential construction and margins are well below closest comp IBP, something that's being addressed with capital lease accounting and product offering.

United Technologies (UTX) – Sheila Kahyaoglu expects margins to bottom in '18 on Pratt's GTF issues, Otis pricing trends have begun to improve.

***Franchise Pick* - WEX Inc. (WEX)** – 2018 numbers should benefit from the recovery of 2017 skimming/fraud losses, new contract wins, higher fuel prices and is one of the bigger tax beneficiaries.

Williams Companies (WMB) – Company should see improved '18 results on expansion project contributions and dissipated commodity derived headwinds.

M&A

***Franchise Pick* - Casey's General Stores (CASY)** - Activist involvement could lead to a sale at a large premium and/or the company engaging in continued cost control and M&A on its own.

Franchise Pick **- Santander Consumer (SC)** - Company is coming off two years of declining earnings but credit stability should help drive earnings growth in '18. Potential for the parent bank to take out the remaining 30% stake.

Cost Savings

Top Build (BLD) – Still room for expansion in new residential construction and margins are well below closest comp IBP, something that's being addressed with capital lease accounting and product offering.

Eldorado Resorts (ERI) – Company is focusing on better managing promotional expenditures, also has the ability to monetize underutilized land.

Kennametal (KMT) – Steve believes the macro backdrop for machinery is as good as it's been in years but also sees a self-help story with KMT having 1000bps of margin upside over the next several years as operations are streamlined.

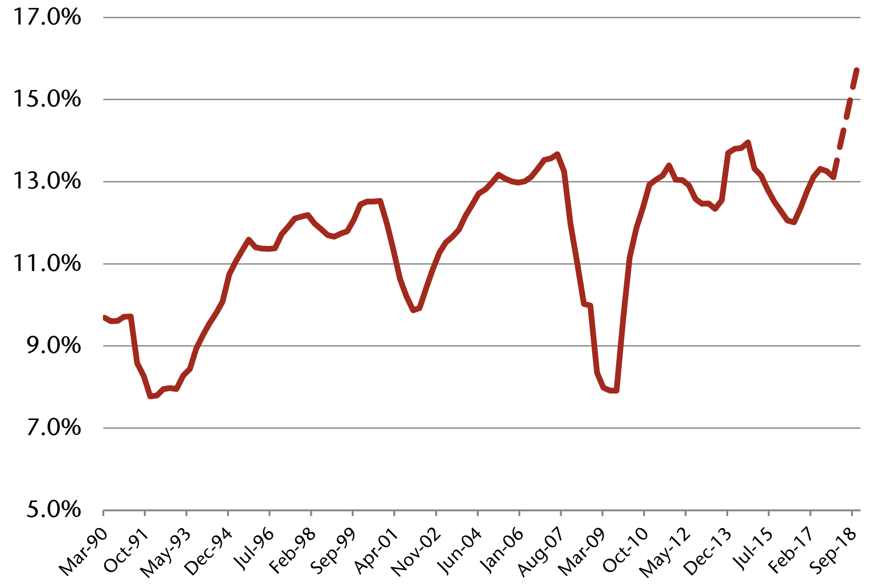
Allocation of Capital

Franchise Pick **- Gap Inc. (GPS)** - Expected to allocate toward the brands faring best, which should help drive Old Navy to 80% of company profits.

OneMain (OMF) – Credit has stabilized following an integration related uptick in NCOs in 2016-2017, company likely to consider a capital returns program in 2019.

Operating Margins Already Close to All-Time Highs, Though Street Expecting New Highs in '18

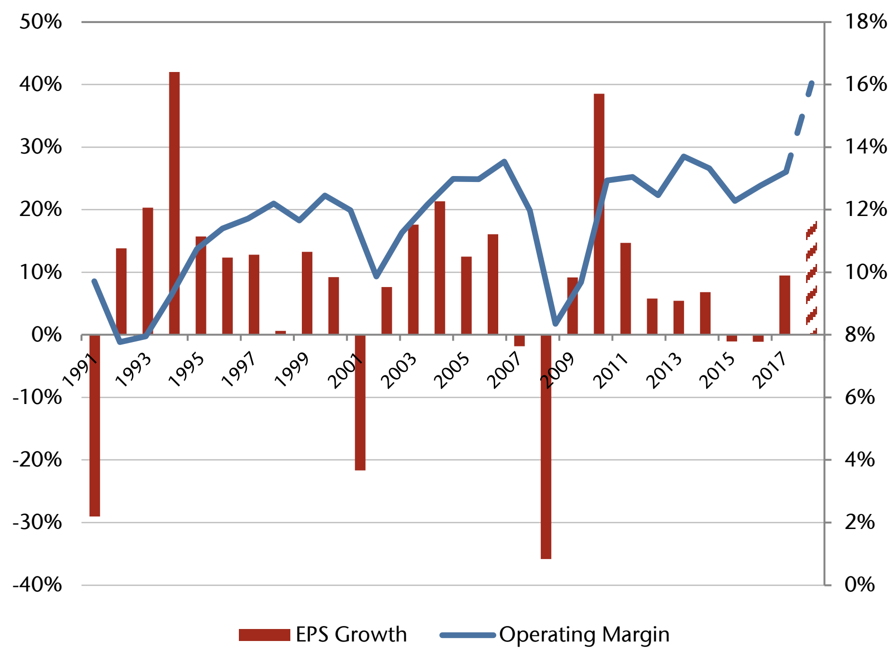
Chart 1: S&P 500 Operating Margin



Source: Bloomberg, Jefferies

'17 Growth the Best Since '11, '18 Expected to Be Better, But this Follows Years of Sub-Par Growth

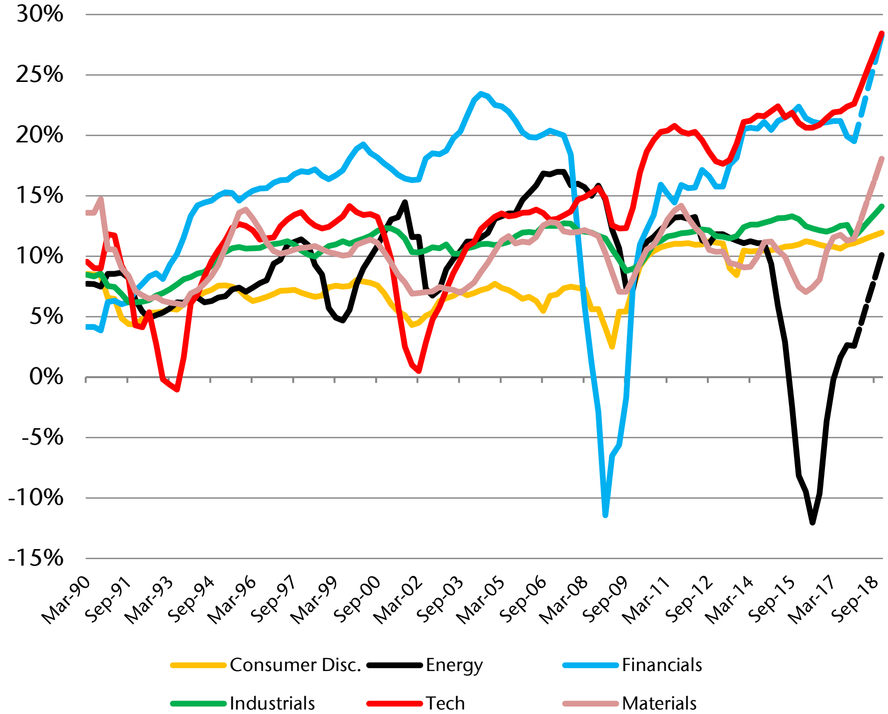
Chart 2: S&P 500 Historical Operating Margins and EPS Growth



Source: Bloomberg, Jefferies
Dotted line and hashed column indicate consensus estimates

Still, The New Highs in Margins Has Much to Do With Strong Upward Trend in Tech Margins

Chart 3: S&P 500 Cyclical Sector Operating Margins



Source: Bloomberg, Jefferies
Dotted lines are for consensus estimates

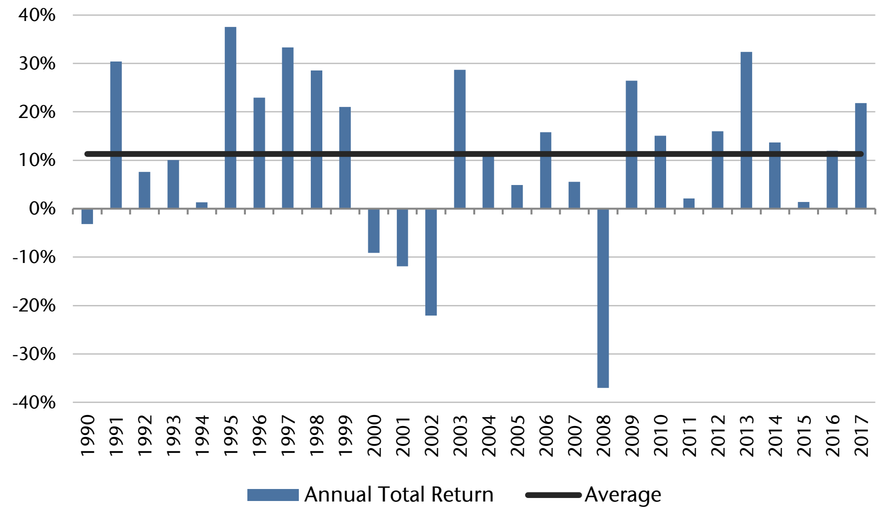
Forward P/E Highest Since Tech Bubble, but Has Compressed Recently as NTM EPS Have Risen

Chart 4: S&P 500 Forward P/E

Source: Bloomberg, Jefferies

2017 S&P Return Was Well in Excess of Average

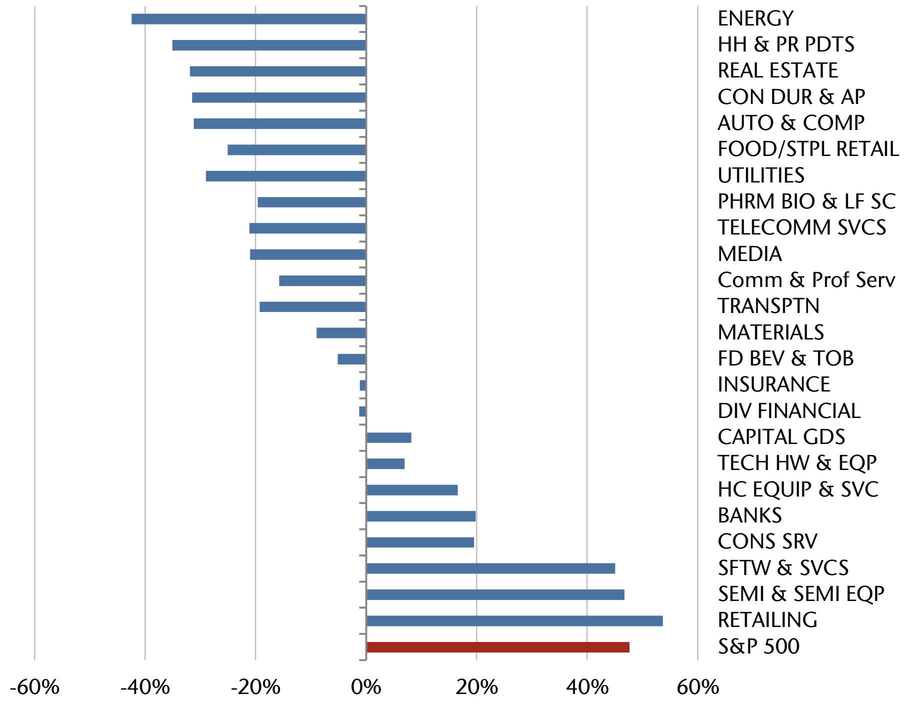
Chart 5: S&P 500 Annual Total Return



Source: Bloomberg, Jefferies

Numerous Groups Have Underperformed the S&P since '15, Namely Energy

Chart 6: Relative Total Return by S&P 500 Industry Group ('15 – Current)



Source: Bloomberg, Jefferies

Analyst Commentary on Selected Stocks

Consumer

John Janedis – Media & Entertainment

Sinclair Broadcast Group (SBGI, Buy, PT $48) – John recently initiated coverage with a Buy rating on the premise that the market materially underappreciated the benefits from the TRCO transaction. He notes that following the TRCO transaction, SBGI will reach 72% of the country, making the company the largest affiliate group for FOX, ABC and the CW. As a result, SBGI's leverage with MVPDs and networks should improve, which John thinks could drive retrans growth of 20%+ in TRCO's stations in '18E. He expects this, combined with cost savings, could contribute more than $600M in EBITDA to SBGI. His standalone SBGI estimates are ahead of consensus and he also points out that the stock trades with a ~20% FCF yield.

Randy Konik – Dept. Stores & Specialty Softlines

***Franchise Pick* - Gap (GPS, Buy, PT: $45)** – Randy expects the top-line momentum to continue, supported by additional marketing investments, while margins should continue to expand as capital is allocated towards the higher margin divisions. He believes this should drive accelerated earnings growth as management expands the Old Navy and Athleta store bases, continues to gain market share and grows the online business (which is margin accretive), while closing underperforming Gap and Banana Republic stores. His proprietary data scrapes illustrate ASP increases at Gap and Old Navy in each of the last four months, as well as decreases in discounting at Old Navy the last three months. Based on this, he expects the Gap brand should see continued gradual improvement. 3Q pointed to the turn progressing, with improvements in traffic and conversion, plus traction in key categories (denim, Gap Body). Old Navy has significantly less mall exposure and a smaller footprint relative to fast fashion peers, and will eventually increase from 70% to 80% of company profits. As a result Randy believes GPS's top-line and margins should expand ahead of expectations in FY'18 and beyond, which should result in upward EPS revisions and multiple expansion.

Kohl's (KSS, Buy, PT: $100) – Randy believes Kohl's is well-positioned in the current retail environment and shares are poised to rise significantly higher as multiple catalysts strengthen fundamentals and cause shares to rerate higher. Traction in proprietary brands, progress in active wear, share gains from peer store closures, thoughtful traffic-driving initiatives (e.g., Amazon) and a more productive new store prototype are a few aspects of the KSS story that we think are underappreciated by investors. Despite strengthened fundamentals and many catalysts ahead, valuation remains depressed vs. peak levels, comparable peers and the market. He forecasts FY'19 EPS of $6.25, FY'20 EPS of $7.50, and has a PT of $100.

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Franchise Pick **- Under Armour (UAA, Buy, PT: $24)** – In 2017, Randy underestimated the difficulties of management transition, bloated cost structure, slowing sales and rising competition from Adidas. However, he remains bullish on UAA for 2018 believing the brand is not broken, management direction is improving and numbers are finally bottoming. He believes the current market cap does not reflect the large global TAM and growth ahead for UAA. Executive turnover is stabilizing, product misses are improving and the company is lapping the TSA bankruptcy. Randy thinks their issues can be fixed with better product, inventory control and more direct distribution. He likes UAA's positioning in a strong category that has limited competition (UA, Adidas, Nike), and points out that the brand is not over-distributed, with only ~half as many doors in NA vs. NKE. He continues to believe UAA is one of three brands that matters in athletic, which is a good LT category, and continues to see asymmetric risk/reward.

David Katz – Gaming

Eldorado Resorts (ERI, Buy, PT: $41) – The company has created value thus far by acquiring under-managed companies and improving profitability. At the moment, it is progressing on integrating ISLE, which it acquired in '17, where David believes there is considerable value to capture. At a time when the industry is focusing on managing promotional expenditures more effectively, ERI is a leader, which he thinks offers a 250-500bps opportunity over the next two to three years. The near-term catalysts involve the monetization strategies for three large parcels of land, in Pompano, Columbus and West Virginia, which David believes should increase the value of the company. David thinks the current valuation does not reflect both the ownership of real estate, as well as operations.

Ashik Kurian – Autos/Auto Parts

Goodyear (GT, Buy, PT: $42) – Ashik recently raised his '18 estimates ~5% following pre-announced better Q4 results. The beat, amidst a challenging backdrop and modest guidance, was driven primarily by volume growth. His new 2018 SOI estimate of $1.8B is at the low end of GT's guidance, which seems conservative as it does not factor in reversal of share losses in '17, nor any net price/raw material tailwind. Numbers should also benefit from the weak dollar and Ashik sees limited inventory risk for the industry too as we start the year. GT's implied >6% FCF yield, off of his $550M FCF forecast, should support further re-rating of shares.

Chris Mandeville – Grocery and Convenience Retail

Franchise Pick **- Casey's General Stores (CASY, Buy, PT: $143) –** Although CASY underperformed the broader market in 2017 (-16%), Chris views the company favorably over the next 12-24 months. As a result of management's newfound cost control religion, food costs locked in at favorable pricing through C2018 and assuming modestly better comps (vs. easing compares), Chris expects EBITDA/EPS growth to rebound strongly in 2H18 with further improvement in F2019 (9%/7% ex-tax reform vs. 3%/-9%). Additionally, while Chris already appreciated CASY's growth story as a premier food-focused c-store operator and consolidator of the industry, this is now a win/win situation for investors as an activist has gotten involved and is pushing for a sale, which Chris thinks could bring a significant premium to the current share price (+25-50% upside based on historical transactions and our view of the quality of CASY's assets) if investors grow impatient. On the flipside of being acquired, CASY can also continue to pursue M&A of its own. Chris likes the idea of CASY buying a portion of KR's c-stores (165 of 784 found within CASY's distribution centers' radii), which could provide low-to-mid teens accretion. CASY is also the largest benefactor from tax reform across his coverage.

Brent Thill – Internet

Expedia (EXPE, Buy, PT: $170) – Expedia is a market share leader (by gross bookings) that continues returning capital to shareholders through regular dividends and opportunistic stock repurchases. So far in 2018, EXPE is trading in line with the market and Brent expects continued double-digit revenue growth and margin improvement to drive outperformance, most likely in 2H18. While competition remains tough, he doesn't think a tougher recent (late October) print reflects a change in EXPE fundamentals, or a behavioral consumer shift to direct bookings or a meaningful impact from alternative accommodations. Over the last couple of years, EXPE has built a solid portfolio of travel assets, and now that they are integrated on a common base, platform efficiencies are starting to show up in operating results. Brent also expects incremental efficiencies from the migration of EXPE's global brands to the Cloud. Over the near term, this move is putting pressure on margins (over $150M in Cloud expenses in 2018) but once transition is over, eliminating duplicate systems would drive further margin accretion. Brent models 150bps Operating Margin improvement in 2018 (more upside in the 2H) and ~20% EPS growth, with further improvement in 2019. On top of that, EXPE remains one of the cheapest stocks in our coverage universe – trading at over 30% discount to large cap Internet names on forward EV/EBITDA and over 70% discount on forward EV/Sales.

Stephanie Wissink – Cosmetics, Household & Personal Care

Ulta Beauty (ULTA, Buy, PT: $300) – Steph remains positive on ULTA and forecasts 20%+ earnings growth over the near-medium term. She believes sales rates are settling into a sustained range and forecasts meaningful margin expansion in the near-term. Steph also notes that the acceleration in cash flow adds capital allocation optionality and company management has hinted at international expansion and the opening of additional metropolitan stores. Assuming ULTA continues to take share in beauty, with improved cost leverage and share buybacks, Steph sees $14+ of potential annual EPS. ULTA shares currently trade at 23x FY19 earnings and Steph's $300 PT implies shares trade at 30x.

Energy

Jason Gammel – Integrated Oil

***Franchise Pick* - Chevron (CVX, Buy, PT: $152) –** Jason believes the Chevron portfolio is the most strategically advantaged in the super-major sector, with visible growth and an industry-leading Permian position. Chevron now begins to harvest the yield from a major expansion in capital expenditures that began in 2011 and Jason expects an organic production CAGR of 5.6% through 2020, including 10% in 2018. Capital expenditures are falling, and he believes the company has considerable potential for free cash generation and assumes that the company will increase the dividend by 5% annually. Jason also estimates the company would have sufficient free cash flow to fund a $32B share repurchase through 2020.

Randy Giveans – Maritime Group

Golar (GLNG, Buy, PT: $40) – Randy sees plenty of upside despite the recent run for three reasons: 1) LNG spot charter rates are at four-year highs of $80,000 per day (the last time they were at this level, the stock was trading near $40 per share); 2) LNG production from Golar's first FLNG project, the Hilli, is expected in the coming weeks as the vessel is already hooked-up to the subsea anchor system in Cameroon; and 3) Golar is expected to make a positive final investment decision on its second FLNG project, the Fortuna, in the first quarter of 2018. The last hurdle to FID is finalizing the terms of the financing package, which is likely contingent upon first production from the Hilli.

Brad Handler – Oilfield Services & Equipment

C&J Energy Services (CJ, Buy, PT: $40) - Brad likes CJ's diversified set of NAM completions-related offerings, because he sees some of the best pricing and margin dynamics in US onshore in CJ's non-fracking completions segments (~30% of 2018E revenue) and believes there is multiple expansion potential for the company as investors come to appreciate that. At the same time, Brad feels generally comfortable that CJ's fracking business (50% of 2018E revenues) is better than some may fear and supportive of pumping industry fundamentals through 2019. As a result, he projects FCF will inflect in '18 as CJ generates $150M, following losses in '17. Finally, Brad is encouraged by management's efforts to divest/rationalize non-core/less-profitable businesses and sees attractive earnings and asset-based valuation.

Chris Sighinolfi – MLPs

Plains GP Holdings (PAGP, Buy, PT: $26) – Despite warehousing the most enviable Permian assets in the broader midstream group, PAGP is currently trading at a ~2.0x discount to the 2019 peer average (EV/EBITDA). Two dividend reductions, large capital raises (common and preferred) and guidance missteps over the last two years caused the shares to weaken vs. the group, underperforming the AMZ Index by ~23% in 2017. However, Chris believes volume growth, particularly in the Permian, as well as a strengthening balance sheet and execution of its financial targets will prompt investors to return to Plains All American in '18. Chris expects Permian transportation volumes to grow 11% YoY in 2018 to 3,159 MBbld. Moreover, there exists a wide chasm between the value of private Permian asset transactions and the value currently embedded in Plains shares, indicating other avenues of potential investor support.

Williams Companies (WMB, Buy, PT: $37) – Trading at a ~1.2x discount to the peer average EV/2019 EBITDA and a ~2.7x discount to the premium-priced peers, Chris believes WMB offers an opportunity for improved 2018 returns given expansion project contributions and dissipated commodity-derived headwinds. He sees ROE expanding to ~11% by 2019 from just ~5% in 2017 and the dividend rising to $1.35 in 2018 (~4.1% implied yield). In the last 18 months, WMB has streamlined its asset profile (selling its Canadian and petrochemical assets), reconstituted its Board (10 of 11 directors are now independent), reduced leverage by nearly 1.0x of EBITDA, simplified its corporate structure with the eradication of its MLP's IDRs and solidly executed on organic expansions. Chris expects WMB DCF to grow ~6% YoY in '18, following continued strength from Transco, Atlantic Sunrise in-service and declines in ethane rejection providing an immediate-term tailwind for its Keep-whole and POP-oriented processing business. The stock trades at a material discount to the group and he notes that every 1.0x of 2019E EBITDA is $6/share or 18% of current price.

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Financials

Casey Haire – Regional Banks

Signature Bank (SBNY, Buy, PT: $178) – Casey expects SBNY to rebound in 2018 after underperforming meaningfully in '17. SBNY's exposure to taxi medallions, which suffered outsized losses, played a big part in SBNY's underperformance last year. However, he feels the overhang is removed given the magnitude of write-downs and the fact that it makes up only 1% of total loans. Further, recent steepening of the yield curve bodes well for the NIM outlook, which Casey believes can stabilize after getting squeezed last year. Lastly, SBNY is a big tax reform winner (tax rate goes to 27% from 40%), which will dramatically improve profitability and open the door for capital return opportunities, given that equity is poised to outrun asset growth. Casey expects SBNY to announce a share buyback and/or implement a dividend by year-end '18, while still maintaining an above average growth profile relative to peers. Valuation is attractive at 12.9x 2018 EPS, which is a 10% discount vs. peers; the historical relative average has been a 13% premium.

John Hecht – Consumer Finance

OneMain (OMF, Buy, PT: $48) – OMF is a top pick of John's for 2018 following the removal of technical pressures, improving fundamentals and the ongoing discount versus peers. John notes that credit has stabilized following an integration-related uptick in NCOs in 2016-2017. As a result, he expects the growing focus on secured lending should diminish loss variability as well. He believes the competitive environment remains balanced and that OMF will continue to be able to grow its book through the online/store combination while the company is preparing for more online originations going forward. Given the evident optimization of the capital structure, the decrease of the D/TCE ratio to 9.5x from 11.5x, high capital returns and current reserve levels, John thinks management will consider a capital returns program in '19. The company has diversified its funding sources, reducing reliance on capital markets and enabling growth even in periods of capital market dislocation. Given improving credit trends, strong loan growth opportunities and balance sheet bolstering, John remains favorable on OMF, especially as shares trade at a substantial discount to peers at just 7x his '18 EPS estimate.

***Franchise Pick* - Santander Consumer (SC, Buy, PT: $23)** – John believes SC has reached an inflection point for credit which should buttress both EPS growth and returns on capital going forward. He expects the improving credit quality and the plateauing of TDR migration will support growing EPS into FY18 and FY19, which should be an ongoing positive catalyst for the stock. In addition, he also likes the increased flexibility provided by recent positive regulatory developments, including capital returns on the back of strong TBV growth and a relatively strong ROE. Tangible book value has appreciated over 55% since 12/2014, a pace of nearly 16% per year on average. John forecasts TBV growing to nearly ~$18.20 by FYE18. He believes 2017 marks the tail end of trough returns as credit stabilizes, and forecasts the ROE improving in 2018. Finally, he highlights the potential for the parent bank to take out the remaining 30% public stake.

Healthcare

Brandon Couillard – Life Sciences & Diagnostic Tools

Bio-Rad (BIO, Buy, PT: $300) – Post the recent completion of its new global ERP system, 2018 marks a key inflection year for BIO as it begins to harvest efficiencies, eliminate redundant costs and optimize its supply chain. Brandon sees '18 as the start of a multi-year period of accelerating revenue growth, outsized margin expansion and industry-leading EPS growth. He forecasts 270bps of EBITDA margin (>3x peers) and nearly 50% EPS growth in '18 (4-5x peers). Tax reform & accelerated capital deployment are both likely sources of earnings upside going forward, as well. BIO remains Brandon's top idea and he sees room for more upside as it executes on its self-help opportunities in '18.

Raj Denhoy – Medical Supplies & Devices

Hologic (HOLX, Buy, PT: $52) – Raj's Buy thesis is predicated on the totality of HOLX's portfolio (Breast Health, Diagnostics, Surgical, Aesthetics) being well positioned to drive sustained top-line growth at the upper end of peers (5-7%). The HOLX story has started to move beyond the self-inflicted wounds from trading the blood-screening business for Cynosure. Roughly half of CYNO's salesforce has turned over since the acquisition was announced in February. Since then, all senior sales positions have been filled with legacy HOLX executives, and most sales positions have been filled. Quarterly revenues seem to have bottomed and forecasts look low enough. The reality is that Cynosure is less than 12% of HOLX revenue and the other 88% of the business is doing very well. This, paired against an industry high op margin profile, 32%+ and upside from US tax reform sets HOLX up to be a low-teens EPS growth story for the next several years.

Anthony Petrone – Medical Supplies & Devices

Haemonics (HAE, Buy, PT: $75) – Anthony's Buy thesis is predicated on HAE maintaining 75-80% share of the global plasma collection market with its next gen platform, the NexSys System. His bottoms-up model on NexSys points to $18 per donor in potential economic value creation for collectors/processors (HAE's end customers) on a combination of faster throughput, higher plasma yields and reduced error. Should this prove accurate in ongoing trials, HAE will be positioned for favorable terms later this year. Assuming HAE can capture 20-30% of the $18 EVA from NexSys would drive a $4-$6 ASP benefit per kit. Looking ahead to F2021, the first full roll-out year, this would drive $144-$234M in revenue upside and EPS to $6.50+, nearly double that of current consensus. When applying the 5-yr historical PE of 21x, Anthony sees visibility to share upside in the $125-150 range.

Brian Tanquilut– Healthcare Services

MCK (Tanquilut, Buy, PT: $205) Brian recently upgraded the stock to Buy on the back of his analysis of generic pricing, which highlighted an emerging stabilization trend. Brian expects this trend to persist throughout '18, which he believes will drive improved earnings and LT margins for MCK, resulting in multiple expansion. He thinks MCK's exposure to AMZN risk is fairly limited given that med supplies account for only ~5% of EBITDA. In addition, Brian believes Street EPS estimates are too low as few analysts have adjusted for the ~$200M in estimated tax reform benefits. Shares currently trade at a 5.5 turn discount to the S&P vs. the 10Y historical average discount of 1.5 turns. His $205 PT implies 20% upside from current levels.

Dave Windley – Pharmaceutical Svcs.

Syneos (SYNH, Buy, PT: $55) – Investors have reacted negatively to a rocky early start to the INC Research/inVentiv Health merger. Importantly, that rocky start really only applies to 30% of revenue and 25% of EBITDA. Further, Dave has been hearing investors express concern that the business may "go away." In his experience, that has been an overreaction for some time. Conversely, order trends for the clinical business (75% of EBITDA) have been industry leading. Dave views that as a very positive sign of customers' attitudes toward the merger. His EPS estimates for '18 are above consensus, but he thinks the '19 ramp is more important as synergies drive outsized EPS growth.

Mike Yee – Biotechnology

Celgene (CELG, Buy, PT: $125) – Mike continues to expect a rebound for shares in '18 as the market gains better appreciation for the pipeline. He believes this could be largely driven by upcoming catalysts that include: 1) mid-'18 luspatercept data in MDS, which could be a $1B+ drug and reinforce management's business development strategy; 2) upcoming, potentially best-in-class JUNO JCAR17 pivotal data, which would show the ability to drive leadership in cell therapy; 3) bb2121 pivotal data potentially by YE; and 4) a potential settlement with Dr. Reddy's on IP. In addition, Mike would expect the company to return to executing through earnings, particularly with Otezla and Revlimid, and expand margins to highlight the power of inherent operational leverage. Lastly, he expects the company to continue to engage in opportunistic M&A.

Industrials

Sheila Kahyaoglu – Aerospace & Defense Electronics

United Technologies (UTX, Buy, PT: $157) – Sheila highlights that It appears Pratt is making headway on the GTF with its improved engine receiving greater acceptance from airlines. We estimate negative engine mix headwind was ~$650M in 2016, increasing to $850M in '17 and expect $1.15B in '18. This translates into ~$350MM mix headwind for 2018 earnings across Pratt's large engine platforms. Operating margins should bottom in 2018 and steadily improve in 2019 and 2020, particularly as volume grows across Commercial, PWC and Military franchises. In addition, price has impacted Otis for the past several years, but trends have begun to improve. Within CC&S, price has been favorable thus far; however, the Middle East and China continue to be areas to watch. In total, Sheila forecasts segment earnings growth of 3% in 2018, accelerating to 10% in 2019. Her survey work has shown support in the aftermarket for the deal with COL, which she expects to be accretive in '19.

Franchise Pick **- Textron (TXT, Buy, PT: $68) –** Sheila highlights that TXT has the potential for significant organic growth given its new product pipeline. New products in Aviation should drive demand in a flattish market, while margin dynamics should improve. Sheila estimates that R&D investment and mix resulted in $105M or $0.25 of earnings headwind in 2017. Improved market dynamics and some investment holiday should lead to higher earnings growth in 2018/19. Looking further out, contributions from Bell's V-280 program, which are not expected until 2023, could drive an additional $1.50 in EPS, but non this this appears to be priced in at all. She thinks this growth outlook is not reflected in the current 10-20% valuation discount to peers.

Phil Ng – Building Products

TopBuild (BLD, Buy, PT: $89) BLD has had strong stock performance over the past year, but Phil continues to believe it can sustain strong top-line and earnings growth through end market improvements, pricing, M&A and margin improvement. New residential construction (~80% of sales) still sits ~20% below normalized levels and is expected to continue to grow given the resurgence of the first time homebuyer, household formations, healthy consumer balance sheets and relatively low interest rates. This should drive high single digit top-line growth (both volume and price) and operating margin improvement. BLD's margins also lag IBP, its best public comp, but Phil expects the gap to close as: 1) BLD switches from operating lease accounting to capital lease accounting, which should yield ~120 bps of margin improvement over the next two to three years; 2) they optimize the product offering, reducing services and products to correct its margin profile; and 3) business leverage improves as the larger footprint is better suited to operate at higher levels of new residential construction activity. Additionally, the company should see a robust improvement in after-tax earnings and cash flow given the new tax bill with its strictly domestic earnings profile, which should enhance its FCF and allow the company to continue to consolidate a fragmented installation and distribution industry at multiples roughly half of where it currently trades.

Martin Marietta (MLM, Buy, PT: $265) MLM saw weak stock price performance in 2017 with declining public spending on highways and streets weighing on aggregates shipments. However, Phil believes aggregates shipments will inflect in 2018 and sees a multi-year recovery with federal (FAST Act) and state level funding finally starting to come through, and State DoTs alleviating labor constraints to get projects out the door. Improvements in volumes should drive solid margin expansion with incremental gross margins historically being in the 60% range. The company should also benefit from a lower U.S. federal tax rate given its U.S. centric earnings providing management with additional capital to deploy in M&A and internal investment. Phil also likes the recent Blue Grass acquisition, which should close soon and provide upside to Street estimates.

Steve Volkmann – Machinery

KMT (Volkmann, Buy, PT: $60) – Steve thinks the current macro environment indicates the best fundamental setup he has seen in years for the machinery group. That being said, with valuations across the space stretched, and with potential for longer term momentum to fade, Steve would remain selective and finds self-help story KMT attractive. At present KMT stands out for three reasons, in his view: 1) it is highly levered to short cycle manufacturing operating expenditures and should be early to see any signs of recovery; 2) the company appears to have 1,000+ bps of margin upside as operations are streamlined over the next two to three years; and 3) valuation is relatively attractive, trading at 10x Steve's '19 EV/EBITDA, below the upper end of the historical range of 13x. While Steve's '18 EPS estimate $2.55 in in line with the current consensus, he sees room for upside driven by margin expansion and any uptick in short cycle expenditures.

Information Technology

Ramsey El-Assal – Payments, Processors & IT Services

***Franchise Pick* - WEX (WEX, Buy, PT: $202) –** Ramsey continues to view WEX as an attractive asset with high margins, a healthy top-and bottom-line growth profile, and a defensive moat in the core fleet card segment. He further believes WEX is well-positioned in 2018 due to: 1) high (mid-to-high-teens) EPS impact from tax reform; 2) the recovery of 2017 skimming/fraud losses; 3) new contract wins (Verizon, GSA, Chevron); 4) anniversarying the Expedia contract renewal; and 5) a meaningful tailwind from higher YoY fuel prices. The stock currently trades at ~19.5x 2019 EPS, but when normalized for these factors, he finds 2019 price/earnings is closer to 16x-17x.

Mark Lipacis – Semiconductors

***Franchise Pick* – Texas Instruments (TXN, Buy, PT: $150)** – Mark recently added TXN to the Franchise Pick list as he believes the company is uniquely positioned to benefit from several secular drivers as the industry shifts towards the next phase of growth--the Internet of Things--and cyclical demand from industrial capex picks up. He notes that the Auto and Industrial businesses grew by 18-21% in '17. Further, he expects the company to expand GMs by 1,000bps as consolidation in semis drives further pricing power. His new target assumes 23x our 2019 EPS of $6.51, a number that's well ahead of consensus, though accounts for some tax reform benefits. His '18 EPS estimate of $5.35 is 7% ahead of consensus.

Materials

Laurence Alexander – Chemicals

***Franchise Pick* - Praxair (PX, Buy, PT: $186) –** Stars finally appear be aligning given a combination of favorable industrial production trends, evidence that merchant gas pricing trends have turned the corner, a broader set of indicators and anecdotes supporting the idea that the capex cycle has troughed and should become a tailwind to industrial gas earnings later in the decade, progress on the merger with Linde and the prospect of an extended cycle of portfolio optimization and capital returns that lift the EPS CAGR into the low-to-mid teens.

Chris LaFemina – Metals & Mining

First Quantum (FM CN, Buy, PT: C$27) – 2018 marks a key inflection year for First Quantum as Cobre Panama comes online in a phased commissioning starting in 2H18 (with commercial production starting in 2019). In addition, the company's copper hedges reset at higher levels, roll off completely, or are replaced by zero cost collars that offer downside protection with upside leverage. Chris expects First Quantum's free cash flow to increase from *negative* $1.36/sh in 2017 to positive $3.56/sh (24.4% FCF yield) in 2020 as the company benefits from higher realized prices, higher volumes and lower capex. The conversion of debt to equity with FCF starting in 2H18 should also be a positive for FM shares.

Seth Rosenfeld – Steel

Steel Dynamics (STLD, Buy, PT: $54) – STLD remains one of Seth's top picks in the US steel sector as a high-quality play on the gradually tightening domestic steel market and supported by bullish global trends led by Chinese supply-side reform. In the near-term, STLD should benefit from greatly improving margins as steel prices continue to move sharply higher following several rounds of price hikes launched in October. While scrap input costs have also risen, flat steel margins have widened by 39%, driving bullish expectations for STLD's 1H18 earnings performance. Though US flat steel prices have already rallied +$120/st since October, Seth believes prices may continue to increase through 1H18 as the pre-existing inventory overhang is worked down, imports remain uncompetitive and cede share to domestic steelmakers and demand seasonally improves into spring. Imports may be structurally pushed out of the US through new trade protections now under consideration through Section 232, which is expected to be confirmed in the coming three months; however, Seth is hopeful that STLD's long products business should benefit from Section 232. Further, in the medium-term STLD is leveraged to rising domestic demand across diversified end markets (infrastructure, machinery, autos), which should allow STLD to better optimize its existing excess capacity with notable fixed cost leverage as volumes rise. In addition, Seth views STLD as a key winner from new US federal tax policy and management has noted they expect the effective tax rate to fall to 24-25% from 36%. Although STLD trades at 7.7x CY18E EV/EBITDA, a premium to its historical average of 5.7x and the US steel sector at 6.7x, Seth believes a premium is merited.

Jefferies Equity Research, Equity Analyst, (888) JEFFERIES, research_support@jefferies.com

Table 1: Stocks Selected by Jefferies Research

Ticker	Name	Analyst	Rating	Price Target ($)	Last Price ($)	GICS Sector	Last FY EPS Growth	Est. '18 EPS Growth	Est. Rel. OM Exp. (bps)	Sector OM Exp. (bps)	Rel. '17 Perf.
BIO	BIO-RAD	BRANDON COUILLARD	BUY	300	263.41	Healthcare	-34%	59%	260	89	10.9%
BLD	TOPBUILD COR	PHILIP NG	BUY	89	76.36	Cons. Disc.	22%	38%	64	40	91.5%
CASY*	CASEY'S GENER	CHRISTOPHER MANDEVILLE	BUY	143	124.25	Cons. Staples	-21%	-4%	-110	57	-16.3%
CELG	CELGENE CORP	MICHAEL J YEE	BUY	125	103.26	Healthcare	47%	45%	1963	89	-29.8%
CJ	C&J ENERGY	BRADLEY PHILIP HANDLER	BUY	40	31.81	Energy	-	6692%	479	423	-10.6%
CVX*	CHEVRON	JASON GAMMEL	BUY	152	128.48	Energy	-67%	47%	-105	423	10.2%
ERI	ELDORADO RES	DAVID KATZ	BUY	41	32.00	Cons. Disc.	-66%	786%	440	40	74.3%
EXPE	EXPEDIA INC	BRENT THILL	BUY	170	130.40	Cons. Disc.	30%	17%	-155	40	-15.5%
FM CN	FIRST QUANTU	CHRISTOPHER LAFEMINA	BUY	27	18.50	Materials	160%	1215%	1859	162	10.5%
GLNG	GOLAR LNG	RANDY GIVEANS	BUY	40	28.27	Energy	34%	97%	10668	423	33.8%
GPS*	GAP INC/THE	RANDAL KONIK	BUY	45	35.08	Cons. Disc.	-17%	4%	83	40	30.6%
GT	GOODYEAR	ASHIK KURIAN	BUY	42	35.66	Cons. Disc.	18%	30%	154	40	-16.6%
HAE	HAEMONETICS	ANTHONY PETRONE	BUY	75	65.92	Healthcare	-5%	25%	1417	89	24.5%
HOLX	HOLOGIC INC	RAJ DENHOY	BUY	52	43.75	Healthcare	6%	77%	-1482	89	-13.4%
KMT	KENNAMETAL	STEPHEN VOLKMANN	BUY	60	49.57	Industrials	38%	69%	675	65	36.3%
KSS	KOHLS CORP	RANDAL KONIK	BUY	100	67.95	Cons. Disc.	-14%	17%	52	40	-11.4%
MCK	MCKESSON	BRIAN GIL TANQUILUT	BUY	205	176.33	Healthcare	7%	13%	-275	89	-9.0%
MLM	MARTIN MAR	PHILIP NG	BUY	265	236.91	Materials	44%	30%	182	162	-21.6%
OMF	ONEMAIN	JOHN HECHT	BUY	48	33.48	Financials	199%	34%	211	97	-2.6%
PAGP	PLAINS GP	CHRISTOPHER SIGHINOLFI	BUY	26	22.23	Energy	-35%	57%	-298	423	-32.9%
PX*	PRAXAIR INC	LAURENCE ALEXANDER	BUY	186	162.83	Materials	8%	13%	-64	162	10.6%
SBGI	SINCLAIR BROA	JOHN JANEDIS	BUY	48	38.85	Cons. Disc.	52%	72%	329	40	-7.7%
SBNY	SIGNATURE BA	CASEY HAIRE	BUY	178	154.20	Financials	21%	25%	1411	97	-28.6%
SC*	SANTANDER C	JOHN HECHT	BUY	23	18.62	Financials	-8%	19%	219	97	17.9%
STLD	STEEL DYNAMI	SETH ROSENFELD	BUY	54	47.32	Materials	37%	44%	1	162	-0.2%
SYNH	SYNEOS HEALT	DAVID WINDLEY	BUY	55	40.75	Healthcare	33%	7%	-517	89	-37.1%
TXN*	TEXAS INSTRU	MARK LIPACIS	BUY	150	112.65	Technology	18%	20%	-154	223	6.2%
TXT*	TEXTRON INC	SHEILA KAHYAOGLU	BUY	68	61.22	Industrials	5%	30%	16	65	-2.0%
UAA*	UNDER ARMOU	RANDAL KONIK	BUY	24	14.53	Cons. Disc.	-9%	13%	18	40	-71.6%
ULTA	ULTA BEAUTY	STEPHANIE WISSINK	BUY	300	229.15	Cons. Disc.	32%	26%	-26	40	-33.5%
UTX	UNITED TECH	SHEILA KAHYAOGLU	BUY	157	136.67	Industrials	1%	6%	-136	65	-2.2%
WEX*	WEX INC	RAMSEY EL-ASSAL	BUY	202	156.00	Technology	-43%	27%	209	223	-10.4%
WMB	WILLIAMS COS	CHRISTOPHER SIGHINOLFI	BUY	37	31.98	Energy	-41%	65%	370	423	1.7%
						Median:	**8%**	**30%**	**82.5**	**Avg:**	**-0.5%**

Source: Bloomberg, Jefferies
***Denotes Franchise Pick**

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Other Companies Mentioned in This Report

- Bio-Rad Laboratories (BIO: $263.41, BUY)
- C&J Energy Services, Inc. (CJ: $31.81, BUY)
- Casey's General Stores, Inc. (CASY: $124.25, BUY)
- Celgene Corporation (CELG: $103.26, BUY)
- Chevron (CVX: $128.48, BUY)
- Eldorado Resorts Inc (ERI: $32.00, BUY)
- Expedia, Inc (EXPE: $130.40, BUY)
- First Quantum (FM CN: C$18.50, BUY)
- Golar LNG Limited (GLNG: $28.27, BUY)
- Goodyear Tire & Rubber Co/The (GT: $35.66, BUY)
- Haemonetics Corporation (HAE: $65.92, BUY)
- Hologic, Inc. (HOLX: $43.75, BUY)
- Kennametal Inc. (KMT: $49.57, BUY)
- Kohl's Corporation (KSS: $67.95, BUY)
- Martin Marietta Materials (MLM: $236.91, BUY)
- McKesson Corporation (MCK: $176.33, BUY)
- OneMain Holdings, Inc. (OMF: $33.48, BUY)
- Plains GP Holdings, L.P. (PAGP: $22.23, BUY)
- Praxair (PX: $162.83, BUY)
- Santander Consumer USA Holdings (SC: $18.62, BUY)
- Signature Bank (SBNY: $154.20, BUY)
- Sinclair Broadcast Group (SBGI: $38.85, BUY)
- Steel Dynamics, Inc. (STLD: $47.32, BUY)
- Syneos Health (SYNH: $40.75, BUY)
- Texas Instruments Incorporated (TXN: $112.65, BUY)
- Textron Inc. (TXT: $61.22, BUY)
- The Gap, Inc. (GPS: $35.08, BUY)
- The Williams Companies, Inc. (WMB: $31.98, BUY)
- TopBuild Corp. (BLD: $76.36, BUY)
- Ulta Beauty (ULTA: $229.15, BUY)
- Under Armour (UAA: $14.53, BUY)
- United Technologies Corp. (UTX: $136.67, BUY)
- WEX, Inc. (WEX: $156.00, BUY)

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