“Calm markets”

Hubens Capital
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Make sure you read the Guidelines Newsletter and the Disclaimer Newsletter before reading this newsletter.

In the beginning of this year the financial markets have rallied and stabilized. Stocks have gone up and rates have gone down. The German Bund has ticked up considerably with the 10-year German yield approaching close to 0%. Uncertainty remains around the US China trade talks and the Brexit chaos. It makes sense to keep some cash on hand. In case of a hard Brexit and/or a bad outcome of the US China trade talks, more opportunities might arise in a downturn. Keep enough cash available to invest. I would advise against having more than 75% of your available capital invested at the moment.

In this newsletter three opportunities are being discussed:

- POSTNL (Class B)
- GME (Class C)
- MACY’s (Class B)

(Read the Guidelines Newsletter for explanations about the classes)

S&P 500

German Bund

POSTNL (PNL.AS)

"Consolidation expected"

"PostNL N.V., through its subsidiaries, provides postal and logistics services to businesses and consumers in the Netherlands, Italy, Germany, rest of Europe, and Internationally. The company operates through three segments: Mail in the Netherlands, Parcels, and International. It collects, sorts, transports, and delivers letters and parcels; and provides data and document management, direct marketing, and fulfillment services, as well as cross-border mail, parcels, and packet solutions. The company was formerly known as TNT N.V. and changed its name to PostNL N.V. in May 2011. PostNL N.V. was founded in 1946 and is headquartered in The Hague, the Netherlands" (Yahoo Finance).

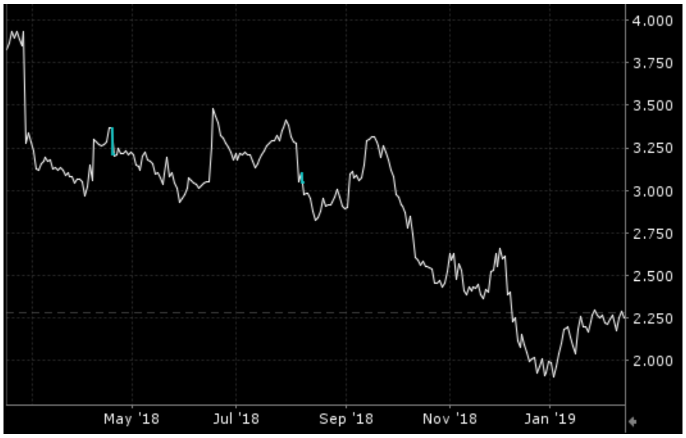
STOCK	PostNL
PRICE	€2.24
MARKET CAP	€1.05 bln
EST EPS 2019	€0.27
P/E 2019	8.3
NET DEBT / EBITDA ≈	1.0
DIVIDEND YIELD	10.2%

PostNL makes half their revenue in the parcels (total PostNL revenue 3.5 bln EUR per year). The parcel post business is doing well. People order more and more online and this is not going to change anytime soon. PostNL saw a revenue increase of 20% from Q3 2017 to Q3 2018. Next to that, parcel prices are expected to go up more than the inflation in the upcoming years. Healthy business.

The other half of the revenue is in a business that has difficulties. The post letter market is declining (>10% year on year) and there is no reason to believe that market is going to stabilize or even improve. To be honest, why would we still be sending letters in 30 years from now? Older generations might keep using the post letter incidentally but the use of it will slowly die down. The market is declining and to capture still some revenue, PostNL has been raising the stamp prices significantly last years. In the beginning of this year they raised the price with around 5%.

PostNL has close to 75% market share in the post letter market and Sandd close to 25%. Since 2 years PostNL needs to give access to the postal network to competitors. PostNL claims this is costing around €40 mln to €60 mln per year which is huge compared to the €160 to €190 mln cash operating income they are expected to make in 2018. PostNL and Sandd want to merge together, which would mean PostNL taking over Sandd. The Dutch government is behind the plan, because it will improve the working conditions of the delivery employees. They will have a chance at a better salary and maybe even more important: better work hours and less stress on the job.

Currently the Autoriteit Consument & Markt (ACM) tries to improve the competition on the postal markets. The ACM is not a fan (yet) of PostNL merging with Sandd, since this means that PostNL will have a monopoly on the letter post market. The ACM does not like this monopoly as they like to see a competitive post market. The government will together with PostNL push for the takeover and ultimately possibly overrule the ACM. PostNL is expecting that the takeover will happen somewhere in the second half of the year. Before the takeover happens, positive news will probably come out and send the stock higher.



The stock graph of PostNL (shown above). Uncertainty about the post letter market caused a bad 2018.

What will happen in the takeover scenario?

Operating income will go up with around 30% from say €170mln towards €220mln. Expected EPS for 2019 is around 25-30 cents and will improve towards 35-40 cents in case of a merger. At the same PE ratio it would mean that the PostNL share price could move north of €3. In that scenario the uncertainty about PostNLs future earnings will diminish. In combination with the dividend that is expected around €0.23 (based on 2018 income) and the fact that management at the end of 2018 repeated that they aim for a progressive dividend policy, there is far more upside to be expected in the stock. In the months after the takeover the stock can be expected to move towards €3.5-€4 euro. Meaning an upside of more than 60% from the current price.

What will happen if there is no takeover?

Currently the PostNL investor is looking at a close to 10% dividend. This dividend is not expected to get cut drastically. If 2018 earnings disappoint, management might cut it with 30%. With half of the business being very healthy and growing, a low overall net debt position (around €180 mln) and having a strong market position and brand, there is not much concern on the horizon. There is no reason to think they could get into huge problems anywhere soon. Sitting on longs at the current level seems reasonable to me.

Allocation	5%
Recommendation	Buy < €2.5
Current level	€2.24
Target level	€3.5 (+56%)
Bad case	€2 (-11%)
Class	B

<u>Execution idea:</u>
Buy 2.5% of your portfolio now and 2.5% when any positive news comes out (e.g. about possible takeover or beating earnings).

GAMESTOP (GME)

“Long term loser with limited short-term downside”

“GameStop is a family of specialty retail brands and we are a global retailer of multichannel video game, pop culture collectibles, consumer electronics and wireless services, operating more than 5,800 stores in 14 countries across Europe, Canada, Australia and the United States” (Yahoo Finance).

STOCK	GME
PRICE	$11.33
MARKET CAP	$1.17 bln
EST EPS 2019	$2.75
P/E 2019	4.6
NET DEBT / EBITDA ≈	No net debt
DIVIDEND YIELD	13.2%

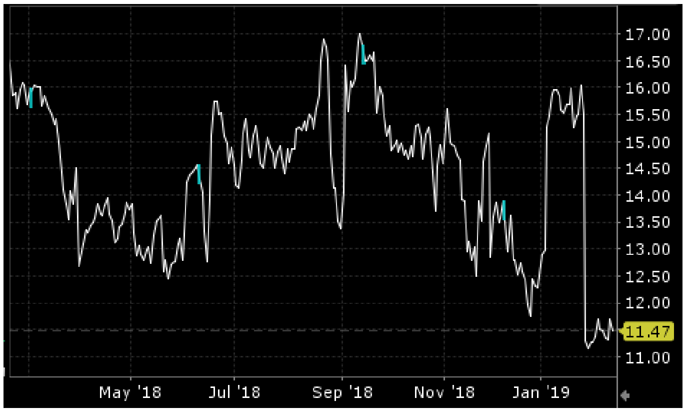
GME is a stock not really suited for the defensive investor. Volatility is high, long term prospects are uncertain and there is a lot of speculation in the stock. GME is not a stock to buy and sit on for 5 years. For that the long-term prospects are just too uncertain. GME makes money in the gaming industry. They are in the old fashion way of game trading; mostly in physical stores.

To get a bit of a feel for where they make the money, see the table below:

(In millions, except %)	Q3 2018	Q3 2017	VAR. (%)
New Hardware	$349.0	$309.0	12.8
New Software	$720.7	$649.9	10.9
Pre-owned & Value Video Game products	$396.9	$458.5	-13.4
Video Game Accessories	$180.8	$136.4	32.6
Digital	$45.4	$37.2	22.0
Technology Brands	$171.1	$194.2	-11.9
Collectibles	$154.6	$138.4	11.7
Other	$65.9	$64.5	2.2
Total sales	$2,084.4	$1,988.6	4.8

The Technology Brands section has been sold in November 2018.

The stock has had a hard time last years. The market is expecting (something close to) a bankruptcy to happen somewhere in the upcoming years. The big names like Microsoft, Netflix, Apple, etc. are making plans to get rid of physical games and to make the gaming world completely digital. It will probably not go all that fast, but it makes sense that people are worried about GameStop. Next to that people are referring to the Blockbuster case. Blockbuster went out of business in the beginning of this decennium. Blockbuster was selling physical videos and games. They didn't transform the company towards online. The comparison with GME is not fair though, as Blockbuster was overloaded with debt and had no options when the financial crisis hit the fence in 2008.



GMEs stock price has been volatile last year

Last September GME decided to start a strategic and financial review of the company. They put themselves for sale. Part of the company, Spring Mobile (technology brands) got sold for $700mln. The rest of the company was still for sale but a few weeks back GME decided to end the sale process as buyers experienced a lack of available favorable financing. The stock fell from nearly $16 to just above $11. Investors had been hoping for a takeover, that takeover premium just got out of the stock price. In my opinion the stock has been sold off too aggressively.

Very solid balance sheet

GME has a very solid balance sheet since the Spring Mobile sell of $700 mln. Currently they have around $1.2bln in cash and $800mln in debt, so a net cash position of $400mln. This makes that currently GME is having around $4 per share in cash and it is expected that they are going to have an EPS of $2.5 in 2019. They are in a declining business and there are concerns about their future. In my opinion the stock is currently priced for bankruptcy within a couple of years. If GME finds a buyer, or if they can turn around the company only a little, or if the digitalization of the gaming industry takes longer than expected, GME is a bargain at the current price. I expect that at least one of these scenarios is likely to happen or likely to get decent odds priced in.

Upside scenarios

On any good news or speculations that a takeover might happen in the end (if financing conditions ease up in the market) the stock will quickly go up to $15 or higher. If bad news keeps coming in, the stock can decline more. However, the downside is limited in my opinion. With the $4 of cash and the $2.5 EPS for this year, I just do not see how this stock can go much lower than 10. If it does, there will be private equity firms or competitors ready to take it over for at least $12 or $13. Another upside scenario is one in which the company finds a highly skilled CEO who can turn the company to the modern age. But maybe the most important short term/medium term trigger for the stock can be a shareholder friendly use of the excess cash. Sticking to the dividend and/or announcing a buyback program will support the share price and likely bring it back quickly above $14. Anyway, GME seems to have very limited downside and realistic catalysts for a move above $14 and towards $17.

Allocation	5%
Recommendation	Buy < $12
Current level	$11.33
Target level	$15 (+32%)
Bad case	$10 (-12%)
Class	C

<u>Execution idea:</u>
When good news comes out, you will probably be too late to buy as this stock is very volatile. You could buy all 5% now or you could plan to buy level based on downticks.

MACY's (M)

"Turning around for long-term success"

"Macy's, Inc., an omni-channel retail organization, operates stores, Websites, and mobile applications. The company sells a range of merchandise, such as apparel and accessories for men, women, and children; cosmetics; home furnishings; and other consumer goods. As of April 4, 2018, it operated approximately 690 department stores under the Macy's and Bloomingdale's brands; 160 specialty stores under the Bloomingdale's The Outlet, Bluemercury, and Macy's Backstage brands in the District of Columbia, Guam, and Puerto Rico; and Websites, including macys.com, bloomingdales.com, and bluemercury.com" (Yahoo Finance).

STOCK	Macy's (M)
PRICE	$25.14
MARKET CAP	$7.76 bln
EST EPS 2019	$3.65
P/E 2019	6.9
NET DEBT / EBITDA ≈	3.1
DIVIDEND YIELD	6.0%

Macy's has had a couple of difficult years. Revenue had been shrinking around 3 to 4% per year for the last years. Macy's has been hurt by the strong competition from online retailers and was initially slow in keeping the company innovative. The good news is that Macy's has been able to (finally) start turning around the company, improve the balance sheet, repurchase stock and keep paying a solid dividend (6%).

Last year went with ups and downs for Macy's

Turnaround & Balance sheet

Macy's has an EBITDA around $1.5bln. In 2014 the company had a debt level of $7.3bln. They have repaid a significant amount of debt and currently have $4.7bln debt on the balance sheet. At the end of 2019 this is expected to be below $4bln. They are deleveraging significantly which will give them comfort in case the economy weakens. Last couple of years the sales have been declining but this seemed to have stopped now. In the second half of 2018 comparable sales have been positive compared to 2017. A very interesting part of the future of Macy's is their luxury beauty products and spa retailer named Bluemercury. The brand is expected to grow revenues with 19% over the next five years and to become one of the most essential parts of Macy's. With the huge free cash flow that Macy's generates, they will be able to let Bluemercury grow rapidly.

Repurchase stock & solid dividend

Over 2018 management expects to make around $3.95 EPS. For 2019 analysts expected EPS is going to be around $3.65. More than enough to reward the shareholders. Macy's bought back 27% of their stock between 2011 and 2016. In 2016 when the EBITDA stumbled, Macy's had to abandon the stock repurchase program. Currently Macy's has the option to start the repurchases again AND keep paying the dividends. It is fair to say that the dividend is safe at Macy's. Currently the dividend yield is 6%. Very shareholder friendly for a considerably safe stock for the future.

Upside

It seems reasonable to buy a first clip of the stock around $25 and to add on further declines. We have seen the stock going below $20 at the end of 2017. Because of the much stronger financial state Macy's is in currently I would expect the chance of going below $20 to be very slim. Currently the stock is trading around a forward (2019) PE of 7. When looking at competitors, for example Kohl's, a forward PE of 10 to 12 seems standard for the healthy companies in the retail industry. Macy's priced at a forward PE of 10 would mean a stock price of around $37. That would be a reasonable target. Meanwhile, shareholders eceive the safe 6% dividend while they are waiting. Macy's reports full year 2018 earnings on the 26th of Feb.

Allocation	7.5%
Recommendation	Buy < $27
Current level	$25.14
Target level	$37 (+47%)
Bad case	$20 (-20%)
Class	B

<u>Execution idea:</u>
Buy 3.75% now and the rest leveled down till $20.

COMBINED PORTFOLIO

Stock	Allocation
GameStop (GME)	5.0%
Macy's (M)	7.5%
PostNL (PNL.AS)	5.0%

OFFENSIVE PORTFOLIO (Deep value/Distressed)

Stock
GameStop (GME)

DEFENSIVE/NEUTRAL PORTFOLIO (Safe and Quality)

Stock
Macy's (M)
PostNL (PNL.AS)

AUTHOR

Sven Hubens, owner of Hubens Capital. Traded nearly 8 years successfully for Optiver as an option trader. Experienced the different ways in which markets can behave. Expert in assessing risk rewards. With this newsletter I want to show you some insight in favorable risk reward trades for your personal portfolio. Especially in the smaller stocks, huge opportunities now and then arise. Because of algoritms causing it, or illiquidity, tax loss selling, short sellers, etc.

TRADING LESSON

"Take losses in the same way as you take your profits"

Do not hope your losses come back and do not take profit just because you make profit. Be rational. When you do not rationally believe anymore in an investment, sell it! When you still rationally believe in your profitable longs, hold it! Use the blank sheet approach: if you had no position in the stock, would you buy or sell it now? Ask this to yourself for every investment and it will do the magic for you!