“Super Mario”

Hubens Capital
March 2019

Biweekly Newsletter

MARCH 15th

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

The S&P is trading slightly above the level of two weeks back. Volatility picked up a bit and the situations regarding Brexit and the US China trade war remain unsolved and uncertain. Probably the most memorable event came from the ECB meeting on Thursday March 7th. Extra stimulus. Yes, again. A new TLTRO program was announced by Mario Draghi, a.k.a. Super Mario. The program intends to make sure that financing conditions for banks remain favorable. In the words of the ECB:

“Through TLTROs we provide long-term loans to banks and offer them an incentive to increase their lending to businesses and consumers in the euro area”.

Mario Draghi is likely to not have done a single rate hike during his 8 years of service as ECB president which ends at the end of October this year. The ECB lately reduced the outlook for the Euro Area economy and remains dovish on inflation expectations. For the moment this means for Europe: TINA. There Is No Alternative. No alternative for stocks as the interest rates remain close to record low levels. The German 10-year yield is again close to 0%. In general, stock valuations are not low and not cheap, but part of each portfolio probably needs to be invested in stocks to satisfy long term return ambitions.

In this newsletter two new opportunities are being discussed. 1 of them is a large cap stock, Daimler. There are a couple of other stocks that are getting into promising price areas but are not yet interesting enough to write about.

The following opportunities are being discussed in this edition:

- DATA I/O (Class C)
- DAIMLER (Class A)

(Read the Guidelines Newsletter for explanations about the classes)

This edition also contains an update on:

- GME (Class C)

S&P 500

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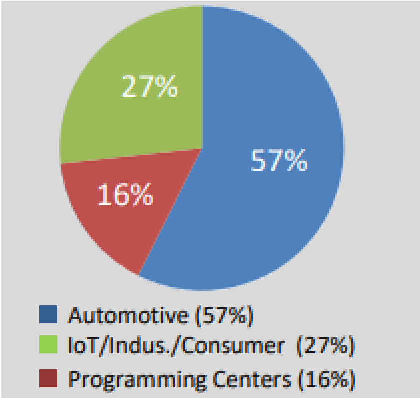
DATA I/O (DAIO)

"Huge long term potential"

"Data I/O Corporation designs, manufactures, and sells programming systems and services for electronic device manufacturers in the United States, Europe, and internationally. Its programming system products are used to program integrated circuits (ICs) with the specific data necessary for the ICs. The company provides PSV handlers off-line automated programming systems; and RoadRunner and RoadRunner3 series handlers, an in-line automated programming system. It also offers SentriX, a security provisioning system; LumenX Programmer; non-automated programming systems, such as FlashPAK III programmer; and Unifamily programmers, an off-line, low volume, and engineering non-automated system. In addition, the company provides hardware support, system installation and repair, and device programming services. Data I/O Corporation was founded in 1969 and is headquartered in Redmond, Washington" (Yahoo Finance).

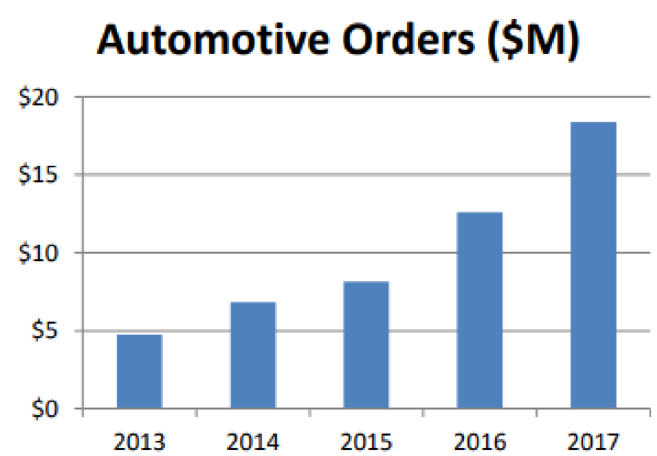
STOCK	Data I/O (DAIO)
PRICE	$5.90
MARKET CAP	$49mln
EST EPS 2019	$0.20
P/E 2019	29
NET DEBT / EBITDA ≈	0 (No debt)
DIVIDEND YIELD	0%

DAIO is a strong company making their money in the Internet of Things (IoT) market. Their long-term growth strategy is focused on the Automotive Electronics and expansion into Security Provisioning for the IoT. At the end of 2018 order revenue for the company was divided as follows:



Focus on automotive sector

It makes sense that DAIO focuses on the automotive sector. Eight out of the top nine automotive electronics companies are DAIO customers and DAIO has achieved significant growth in this automotive market in the last 5 years.



DAIO is depending on demand for autonomous/self-driven cars. I think everyone can agree that we are heading into the direction of the self-driven car. Herewith lies the massive opportunity for DAIO in the upcoming years. The self-driving car market is expecting to rapidly grow.

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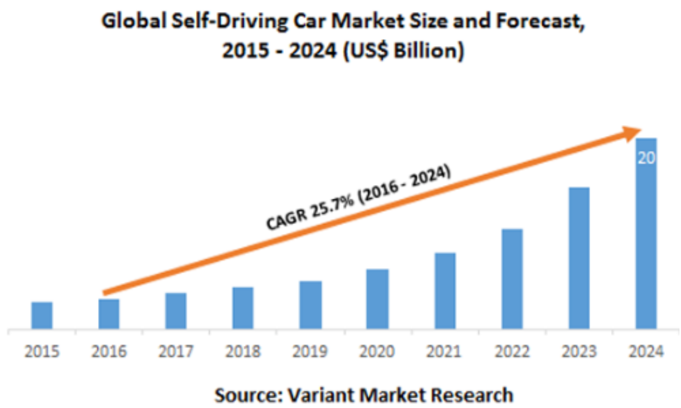
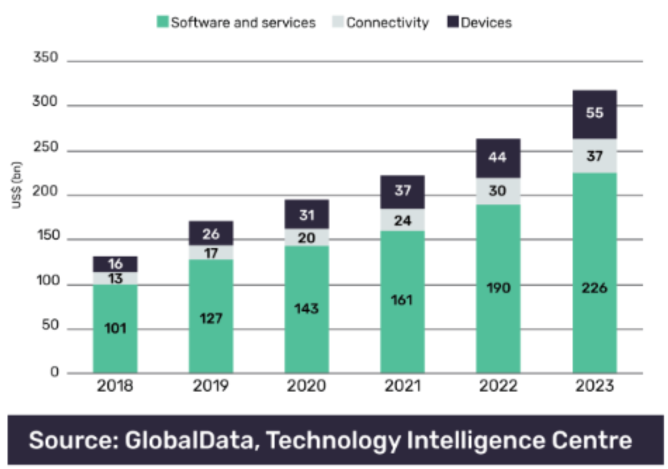


Another forecast that makes that growth development more likely is that the IoT market size is also expected to grow significantly.



The CEO of DAIO obviously understands the potential: *"We've said for many times on this call that we have a thesis for automotive electronics growth and that it will continue to grow and that view is unchanged, and we view it also very positively for us over a long period of time for Data I/O" The Data I/O programming systems are faster, have more capacity and deliver a lower total cost of ownership than competing systems available. We are also installed in 8 of the Top 9 automotive electronics suppliers" (Q4 2018 Earnings Call).*

Focus on protection

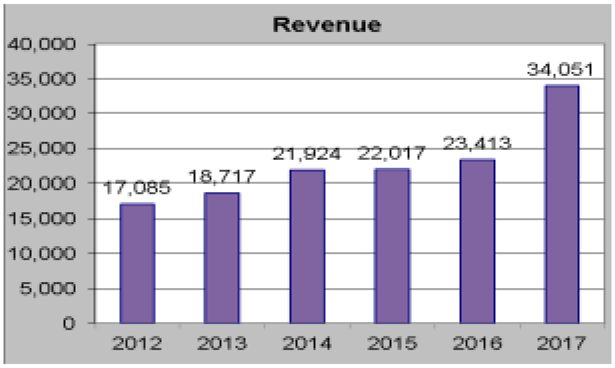
"Our second major growth initiative concerns democratizing security for IoT devices to enable a safer connected world. Again, as we've talked about on many calls, the IoT market continues to grow but is lagging in security solutions. The opportunity for Data I/O is to simplify the security provisioning process and make solutions available to customers of all sizes" (CEO in Q4 Earnings Call).

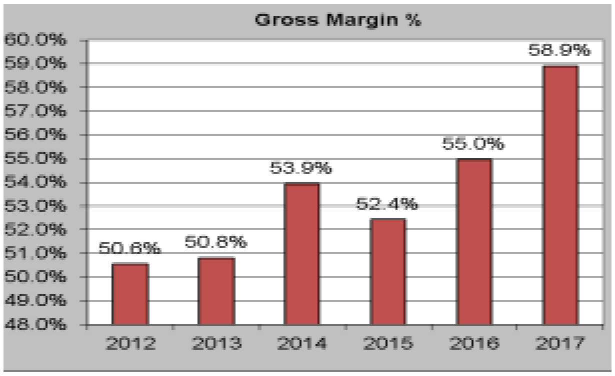
In 2017 DAIO developed Sentrix, a hardware-based security system. First small revenues were being generated last year.
"We also expanded and extended our SentriX platform for IoT security. We announced several new partnerships and deployments, and planted the seeds for the longer term industry transition to security" (CEO in Q4 Earnings Call).

DAIO thinks Sentrix can become very successful as customers in the growing IoT market will have more and more need in the future for protection against IP theft, product cloning and system hacking. I would not expect much shareholder value to be generated by Sentrix in the upcoming years yet and I would not use it too much as a reason to buy the stock. But I would keep it in the back of the mind that on the long term it could be a potential catalyst of revenues and profit. Currently it is just very difficult to assess the long-term value of Sentrix, though it certainly has optionality value.

2018

Most financials, but not all yet, regarding 2018 have been published. As we can see, revenues between 2012 and 2017 have gone up considerably and gross margins have been improving.





The company has also been making profit in each of those years. In 2017 the earnings per share (EPS) were $0.65. In 2018 they only got to $0.19 per share. This was mainly caused by revenues declining from $34mln in 2017 towards $29mln in 2018. Despite the gross margin slightly increasing to 59.4%, the operating expenses remained at similar levels. This caused the net income to drop from $5mln to $1.7mln.

See the next table on the right for a comparison between 2017 and 2018.

	Twelve Months Ended	
	December 31,	
	2018	2017
Net Sales	$29,224	$34,051
Cost of goods sold	11,868	13,992
Gross margin	17,356	20,059
Operating expenses:		
Research and development	7,361	6,896
Selling, general and administrative	8,257	8,116
Total operating expenses	15,618	15,012
Operating income	1,738	5,047

According to DAIO, results in 2018 were worse than in 2017 as they experienced 2017 as a year with very strong cyclical demands. See below the graph of the stock during the last couple of years.

2019

DAIO is careful with the prediction for 2019. They expect a similar year as 2018 with gross margins staying high in the 50s and some reductions in costs. DAIO is careful with their prediction as the US China trade war developments will significantly affect their business on the short/medium term. There are not many analysts daring to do an EPS prediction, but the expectation is that 2019 EPS will be similar to 2018 EPS, so around $0.20.

The opportunity

As mentioned, DAIO is a small cap with a strong position in the automotive electronics market. This market is expected to grow quickly. DAIO is a key player and expected to profit from this future growth. DAIO has already been profitable for over 5 years in a row. They do not have any debt on their balance sheet and have $18mln in cash representing over $2 dollar per share. With their high gross margins and the expected growth in the automotive electronics and IoT markets, the long-term profit outlook is very promising. When the bigger investors/institutions start monitoring DAIO more closely and become aware of the prospects, it is likely the stock will move much higher. Moreover, DAIO is very shareholder friendly. Currently they are executing a buyback plan of roughly 5% of the shares and they have indicated to return value to shareholders in cases of cash excesses.

In my view, the fundamental downside is not large. But remember, DAIO is a small cap. In case of bad news like an escalation of the trade war or declining revenues, algorithms or significant players might sell the stock. This will heavily affect the price. At the end of 2018 it went to $4.30, an absolute bargain, especially when thinking about the $2 in net cash. Current price around $6 is very interesting for the longer term. If you mainly invest for long term (>2 years), you can buy a full position now. In case you invest on shorter/medium (<12 months) term as well it might be interesting to buy a part now and buy a part after a decline below $5.5 and/or $5. DAIO stock has high volatility and might be less suited for a defensive (or neutral) portfolio.

Allocation	5% (7.5%<$5.0)
Recommendation	Buy < $6.50
Current level	$5.90
Target level	$10 (+69%)
Bad case	$4.50 (-24%)
Class	C

Execution idea:
Buy 2.5% of your portfolio now, an extra 2.5%<$5.5 and an extra 2.5%<$5.0.

DAIMLER (DAI. DE)

“Dividend play”

“Daimler AG, together its subsidiaries, develops and manufactures passenger cars, trucks, vans, and buses in Germany and internationally. It operates through Mercedes-Benz Cars, Daimler Trucks, Mercedes-Benz Vans, Daimler Buses, and Daimler Financial Services divisions. The company also sells vehicle related spare parts and accessories. Daimler AG was founded in 1886 and is headquartered in Stuttgart, Germany” (Yahoo Finance).

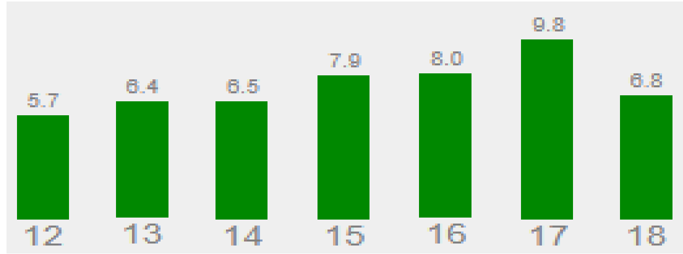
STOCK	Daimler (DAI.DE)
PRICE	€51.00
MARKET CAP	€54.7bln
EST EPS 2019	€7
P/E 2019	7.3
DEBT / EQUITY ≈	1.35 (Debt/EBITDA = 4.8)
DIVIDEND YIELD	6.4%

Daimler is the world’s leading premium car brand with most revenues generating from the Mercedes-Benz car.

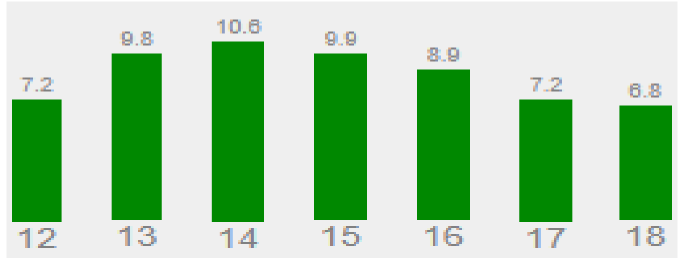
Revenue by division

in billion euros	2017*	2018
Daimler Group	164.2	**167.4**
of which		
Mercedes-Benz Cars	94.4	**93.1**
Daimler Trucks	35.8	**38.3**
Mercedes-Benz Vans	13.2	**13.6**
Daimler Buses	4.5	**4.5**
Daimler Financial Services	24.5**	**26.3**

Daimler is a long term very profitable company that has been very friendly to shareholders.

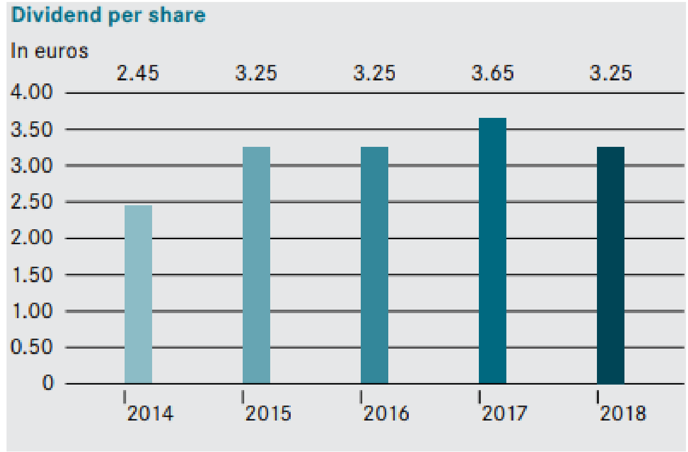


EPS Daimler



P/E Daimler

Daimler currently has a low P/E multiple of around 7. As one can see, the dividend is easily supported by the earnings per share (EPS). The dividend policy is aiming at a pay-out ratio between 40 and 50%.



2018

2018 was a difficult year for Daimler and especially for its stock price. The year was specifically difficult for car shares, due to the diesel gates and tariffs, and therefore also for the DAX. The DAX lost around 18% of value in

2018. Whereas the S&P lost 'only' 6.6% in the year 2018. Below the stock graph of Daimler.

Why was 2018 difficult?

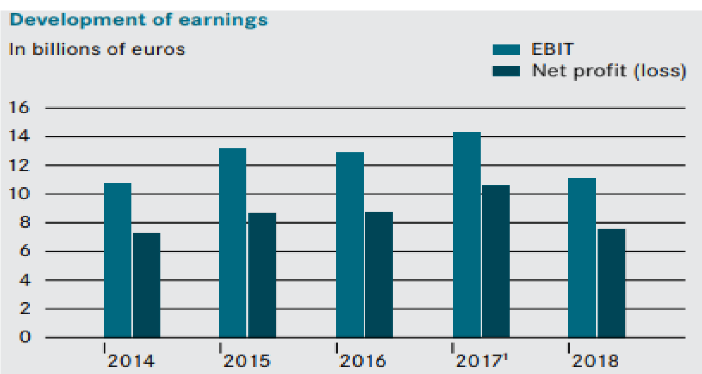
- *Diesel scandals in car sector and air pollution*

  Daimler makes most of the revenues from the Mercedes-Benz cars of which a large part is diesel driven. Daimler is investing heavily in improving the diesel engines to make sure the NOx and CO2 emissions will be reduced much more. They also had to improve their testing methods in connection with ongoing government proceedings.

- *Global tariff dispute*

  The China tariffs for imported cars hit profitability and increased the costs for preparing for future scenarios regarding the trade dispute. China (including Hong Kong) is the biggest market for Mercedes-Benz cars.

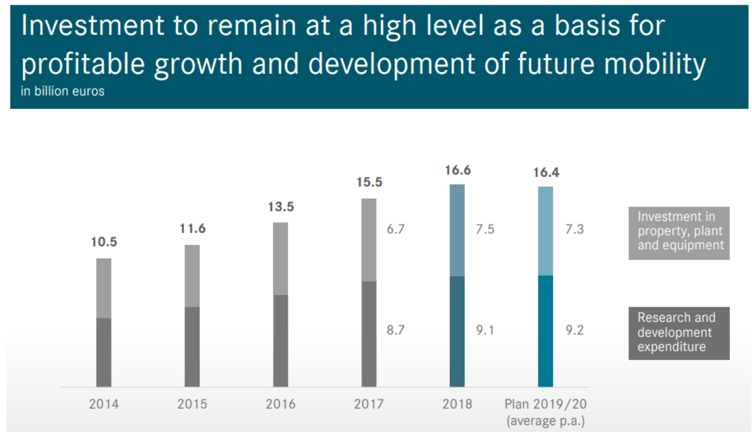
The above two reasons were impacting the results of Daimler significantly in 2018. Total revenues increased a bit, but due to the higher costs, the net profit tumbled.



Innovation

Daimler is not just generating profit. They invest heavily in R&D and are not falling behind in innovation.

Next to the improvements they make in the diesel engines, they are focusing a lot on the development of electrical cars. One of their goals is to offer 130 electrified Mercedes-Benz Cars variants by 2022. Moreover, for their truck divisions, they are investing heavily to remain one of the pioneers regarding developing the electrical truck of the future.



Outlook 2019

Daimler is expecting the EBIT and net income to be around or slightly above the 2018 level. Uncertainty remains around the trade dispute. Daimler is looking to further increase the share of locally manufactured cars in China to protect the profitability. They already increased this share from around 50% in 2013 towards nearly 72% in 2018.

Why owning Daimler?

As mentioned, Daimler has a very strong presence with their Mercedes-Benz cars and the Daimler trucks. They are driven and on the way to make the electrical car era a success. Daimler stock is attractively priced at around 7 times the yearly net profit. And they are paying a 'safe' dividend of above 6%. The car sector in generally is attractively priced with quite some car manufacturers having a PE below 10. I think Daimler is one of the best car companies to own. Although Daimler has a reasonable amount of debt (4.8 times EBITDA), this is not uncommon in the car business and partly due to the business unit Daimler Financial Services. Financial Services offers loans to customers to pay for the car. Looking at the debt/equity ratio of 1.35, there is not much need for concerns. When it gets close to 2, the story will change. Currently the main concern on the medium term is the outcome of the trade dispute. Because of this uncertainty, I would not yet take a large position in Daimler. Daimler is attractively priced but not yet a huge opportunity, which it might become in an economic or further sector downturn. Currently it is a longer-term opportunity where you get paid a solid 6%+ dividend. Daimler is suited for an initial position in any portfolio. On further developments regarding the trade dispute or Daimler itself, I will update you and hopefully we will get a situation to expand the position at a favorable price.

Allocation	3.75% (7.5%<€47)
Recommendation	Buy < €55
Current level	€51.00
Target level	€65(+27%)
Bad case	€45(-12%)
Class	A

<u>Execution idea:</u>
Buy 3.75% of your portfolio now and an extra 3.75%<€47.

UPDATE GAMESTOP (GME)

"Share buybacks and downgrade"

GME had some volatility in the last couple of weeks. Initially there was some optimism based on the announcement on March 4th from GME that they authorized a new $300M share repurchase program to replace the previous share repurchase authorization which had $170M remaining. GME also announced to retire $350M worth of debt and to stick to the $0.38 per share quarterly dividend payout rate. The stock went up above $12. I expected these kind of announcements as mentioned in the newsletter of Feb 15th. Last step GME has to take now is to find a skillful experienced CEO. Anyway, a couple of days later, GME was downgraded by Bank of America Merrill Lynch (BAML) and dipped below $11.

BAML expects a deterioration in fundamentals amid multiple structural headwinds and a diminishing opportunity for a GameStop turnaround. Everyone agrees on the deterioration in fundamentals and that a turnaround will be difficult. Though, at the current price I see the risk reward as very favorable and I have not seen any indications in the last weeks to change the stand on GME at the current stock price. Target remains $15. By the way, the stock went ex-dividend ($0.38) yesterday.

COMBINED PORTFOLIO

Stock	Class	Allocation	Execution idea
GameStop (GME)	C	<5%	<5%
Macy's (M)	B	<7.5%	<7.5%
PostNL (PNL.AS)	B	<5%	<5%
ETM (ETM)	C	<2.5%	<5%
Vastned (VASTN.AS)	A	<3.75%	<3.75%
Data I/O (DAIO)	C	<5%	<2.5%
Daimler (DAI.DE)	A	<3.75%	<3.75%

The execution idea column represents the allocation if you would follow the execution idea for the stock which often means buying stocks based on the price development.

OFFENSIVE PORTFOLIO (Deep value/Distressed)

Stock
GameStop (GME)
Entercom (ETM)
Data I/O (DAIO)

DEFENSIVE/NEUTRAL PORTFOLIO (Safe and Quality)

Stock
Macy's (M)
PostNL (PNL.AS)
Vastned (VASTN.AS)
Daimler (DAI.DE)

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 algorithms causing it, or illiquidity, tax loss selling, short sellers, etc.

TRADING LESSON

"Avoid any hindsight reasoning!"

On hindsight we are all billionaires. We all went long Apple before they came up with the iPod and we all knew Amazon was going to take over the world. What if we would have invested our well-deserved capital into one of these stars. Yes, you would have been rich. And yes, you would have probably been just lucky. Same holds for the crypto boom. Of course, there are some, maybe just more than a handful of people, who know what they were doing and reaping massive profits. But most have just been lucky, and pretending they invested wisely. You never hear people telling you on family parties or working dinners that they put all their money in Imtech or Lehman Brothers. "It was so cheap at the start of the financial crisis, put all my money in it and got paid back zero!". Luck should not affect you, neither should successful lucky stories. Go back to the moment at which you made a decision and ask yourself if it was a sound one. Do some proper analysis on the information that was available at that point. Only then you can become a better and fair investor!