The Turnaround Letter

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KNOW WHAT YOU DON'T KNOW…

And focus your efforts on what you do know – or can figure out. That may seem like obvious advice, but many investors don't follow it. They spend considerable effort on trying to predict factors and forces that are almost beyond the possibility of accurate prediction. As a result they try to get in and out of the stock market at just the right times, to predict what the economy is going to do or to forecast where interest rates are headed, among other unknowables.

Instead, we believe you are better off not trying to time the market, but choosing a level of stock market exposure with which you are comfortable and sticking with it. Then you can focus your efforts on thorough fundamental analysis of stocks that look interesting to you. While very few things about investing are known for certain, your chances of accurately predicting one company's earnings or determining the sustainability of its balance sheet are much better than forecasting major market moves or economic shifts.

That's not to say that you should completely ignore these significant unpredictable factors in your analytical process. Rather, you should consider several possible outcomes in these areas and use those outcomes to test the conclusions coming out of your focused fundamental research. For example, when you think a stock looks pretty cheap in a certain economic environment (your "base case" scenario), you should consider what will happen to it if the economy is weaker than you expect (a "worst case") or if the economy turns out to be stronger than you expect (a "best case"). You can then weigh the risk of loss in the worst case scenario against the possibility of gain in the base case and best case situations and decide if it seems like a reasonable investment given your personal tolerance for risk. This sort of stress testing can also be done with other macro forces that may be relevant to the particular stock, such as interest rates or oil prices.

An important corollary to knowing what you don't know is "Don't worry too much about what you don't know." Some investors become paralyzed by concerns about the unknown. They are so worried that they don't know which way the market (or interest rates or the economy or whatever) is going next that they don't do anything and their portfolio suffers. While you should always take reasonable steps to minimize risk – such as being diversified – there will always be risks in investing, and you just have to plow ahead regardless. As the old saying goes, "Nothing ventured, nothing gained." Moreover, in most circumstances, returns are proportional to risk over the long-term, and so the more risk you can tolerate, the higher your returns are likely to be.

IN THIS ISSUE:

Health Management Stocks..2

Utility Stocks........................ 4

RECOMMENDATIONS:

Buy: Citigroup 5

Sell: Rite Aid........................ 6

Performance…………….……..7

HEALTH MANAGEMENT STOCKS: CHEAP IN THE FACE OF UNCERTAINTY

So, how does the advice in the lead article apply to health management stocks? Basically this way: We're pretty sure that the Affordable Care Act (or ACA, also known as ObamaCare) is going to create some great investment opportunities, but we have no idea what the ultimate effects of the new government programs will be on the different individual stocks and groups of stocks in the healthcare sector. Even though we can't predict the broad trends in the sector, we can still focus on traditional valuation measures among the sectors and individual stocks. When we do that, the HMO's look pretty cheap to us almost regardless of what happens with the ACA.

One reason for the cheap valuations is that many investors have been afraid to buy HMO stocks because they don't know exactly how they will be affected by the ACA. We don't know either, but at their current low valuations, we think it is likely that the stocks will go up as the uncertainty dissipates. Also, the ACA is likely to result in more industry consolidation, which could make some of the smaller HMO companies buyout targets.

The eight health management companies discussed below represent a range of different market capitalizations, and some occupy specialized niches, but they all appear poised to achieve higher valuations in the not-too-distant future.

AETNA, whose roots date back to 1850, offers a broad range of insurance and employee benefits products. Management has used acquisitions to help reposition the company, including the purchase of Medicity in early 2011 that expanded its presence in the electronic patient records market and the 2013 acquisition of Coventry Health that better positioned Aetna in the growing Medicare Advantage market. Aetna is also well situated to grow its business outside the U.S.

CENTENE'S managed care operations span 18 states (primarily Texas, Georgia, Florida and Indiana). Government markets, including Medicare and Medicaid, account for the lion's share of revenues. As states look to private plans as a means to control quality and costs, Centene is well positioned to benefit. The company is also moving into the market for state-based health exchanges. In addition, Centene also operates related businesses, such as pharmacy benefits management, behavioral health and vision care, that provide a measure of diversification. In a consolidating industry, Centene could be an acquisition target.

Health Management Stocks

COMPANY	SYMBOL	RECENT PRICE	52– WEEK RANGE	MARKET CAP. $BIL.	PRICE TO SALES	FORWARD P/E
Aetna	AET	70.46	76.71 – 56.05	25.56	0.49	10.0
Centene	CNC	65.51	68.26 – 45.25	3.78	0.33	14.9
Cigna	CI	77.85	65.18 – 90.63	21.30	0.66	10.1
Humana	HUM	109.05	119.93 – 72.13	16.80	0.41	12.7
Magellan Health Services	MGLN	57.51	62.00 – 49.67	1.58	0.43	19.3
Molina Healthcare	MOH	37.09	40.90 – 31.10	1.71	0.26	13.6
UnitedHealth Group	UNH	75.20	83.32 – 58.87	74.90	0.61	12.5
WellCare Health Plans	WCG	66.69	75.31 – 50.41	2.92	0.31	14.2
WellPoint	WLP	95.39	102.56 – 71.65	26.94	0.38	11.0

CIGNA is a large diversified provider of employee benefits that range from commercial and government health programs to group disability and life insurance. The company also has a large international presence that offers good growth opportunities. Management has used acquisitions to take advantage of growth sectors such as Medicare Advantage that are being driven by the aging population. Recent results have been a bit light relative to expectations, but Cigna's diversification, international opportunities and strong financials bode well for long-term gains.

HUMANA, with over 12 million medical coverage memberships, is one of the nation's largest managed care companies. The bottom line has been challenged recently because of the costs of implementing the ACA and other federal programs, but top-line growth remains impressive. This revenue growth should eventually boost profits and the stock price. Humana is also diversifying into new markets, as evidenced by its acquisition of Concentra, an urgent/occupational care provider.

MAGELLAN HEALTH SERVICES has historically been a significant provider of behavioral healthcare services, but it is now morphing into a company with a broader focus and an emphasis on special population management. In August 2013, Magellan acquired AlphaCare Holdings, a New York based HMO; also in 2013, Magellan began operating as a general Medicaid HMO. Just recently, management announced an agreement to acquire CDMI, a privately-held company that provides a range of clinical consulting programs and negotiates and administers drug rebates for managed care organizations. Earnings may be soft as the company digests these acquisitions, but the changing business mix should position the company well for the future.

MOLINA HEALTHCARE has carved out a niche providing government-funded health programs to low-income families and individuals; it also helps states administer their Medicaid programs. With this expertise, the company is in a good position to capitalize on the trend toward privatizing government managed health care. Also, being focused and relatively small might make Molina an attractive acquisition target.

UNITEDHEALTH GROUP, by revenues, is the largest publicly-traded managed care company. Its operations are well diversified across the health management spectrum, which creates both short-term challenges and long-term opportunities. In the short-term, the company is dealing with new regulations and competitive forces across many of its business lines. Longer-term, however, its size and breadth of offerings give the company market clout that should be very valuable.

WELLCARE HEALTH PLANS is a regional provider of managed-care products that target government markets, including Medicare Advantage and Medicaid. The bulk of its business is in Florida, Georgia, Kentucky, New York and Illinois, and roughly two-thirds of revenues are from Medicaid. With its expertise in these markets and the demographic opportunities from the aging population, WellCare could be another acquisition candidate.

WELLPOINT, with north of 35 million members, is one of the nation's largest health benefits companies. It operates Blue Cross and Blue Shield plans throughout 14 states. It is also a large player in government markets where it is aggressively embracing the opportunities being triggered by healthcare exchanges. Management has also used acquisitions to build out the company's presence in Medicaid and Medicare Advantage. Overall, the company's size and geographic/product diversification, along with a strong balance sheet, bode well for its long-term performance once the current industry headwinds subside.

UTILITY STOCKS: PUT A LITTLE ELECTRICITY IN YOUR PORTFOLIO

Utility stocks have significantly lagged the market over the last year or so. The electric utility sector is only up about 4.6% over the past 12 months, compared to about 18% for the S&P 500. The utility stocks have done better in 2014, but according to at least one analyst, they remain "the most-hated group on the Street."

Maybe utilities are not as sexy as tech stocks, but they tend to be steady earners and pay relatively high dividends. The half dozen utility stocks discussed below have not run up as much this year as some of their peers, and so they look like good long-term values.

(In addition to the stocks mentioned below, distressed debt investors should keep an eye on Energy Future Holdings [formerly known as Texas Utilities or TXU] which filed for Chapter 11 on April 29. The company was the largest leveraged buyout in history in 2007, which left it saddled with more than $46 billion in debt spread over several different entities.)

ENTERGY operates both electric-distribution and power-production businesses in Arkansas, Louisiana, Mississippi and Texas. The company's power-production capabilities include the nation's second largest collection of nuclear generators. Management is optimistic due to a rebound of industrial activity in its service areas and the opportunity for rate increases.

EXELON conducts energy generating and delivery operations in 47 states and Canada. As the nation's largest operator of nuclear facilities, Exelon offers its customers some of the nation's lowest-cost energy options. Rising natural gas prices might cause regulators to allow rate increases which would be beneficial for Exelon.

FIRSTENERGY'S utility customers are found in Ohio, Pennsylvania, New Jersey, New York, Maryland and West Virginia. Coal currently fuels about 60% of its generating capacity with 20% from nuclear. To shore up its financials in preparation for more investment in its transmission business, FirstEnergy deactivated several facilities and sold some hydro units. In addition, the dividend was cut by 35%, but the stock still yields more than 4%.

GREAT PLAINS ENERGY supplies electricity to customers in Missouri and Kansas. The company generates approximately 80% of its output with coal, but it is building out its renewable base with wind and hydro power that are expected to account for 10% of output by 2022. The company's service region is showing signs of economic recovery, and its regulatory environment is seen as generally positive.

Utilities: Can They Spark Portfolio Returns?

Company	Symbol	Recent Price	6– Year Range	Market Cap. $Bil.	Dividend Yield	Price to Sales
Entergy	ETR	72.89	123.27 – 57.60	13.02	4.7	1.14
Exelon	EXC	36.18	92.13 – 26.45	31.02	3.4	1.26
FirstEnergy	FE	34.26	84.00 – 30.10	14.35	4.3	0.99
Great Plains Energy	GXP	26.83	27.52 – 10.20	4.12	3.5	1.71
Portland General*	POR	32.90	33.36 – 13.45	2.57	3.3	1.43
TECO Energy	TE	18.24	21.99 – 8.41	3.98	4.9	1.40

** Previous TL recommendation*

Great Plains could be an acquisition target for one of the larger utitilites.

PORTLAND GENERAL provides electric service to over 40% of Oregon. We first recommended it when it was spun out of the Enron debacle. Generating capacity is roughly 27% natural gas, 17% coal, 11% hydro and 10% wind, making Portland General one of the "greener" utilities. The stock has been creeping up toward our maximum buying price, but we think it will go higher, and we're raising the ceiling to 36.

TECO ENERGY owns Tampa Electric, an electric service provider to the Tampa Bay region of Florida, and Peoples Gas Systems, which serves some 345,000 Floridians with natural gas. It also owns coal-mining operations that have been a drag on results. TECO is expanding its gas operations with the planned $950 million acquisition of New Mexico Gas. The balance sheet is a bit on the leveraged side but still quite capable of supporting capital expenditures and the attractive dividend.

RECOMMENDATIONS:
Purchase Recommendation: Citigroup, Inc.

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NEW YORK, NY 10022
212-559-1000
www.citigroup.com

CATEGORY: LARGE-CAP ($146 BIL.)

SYMBOL: C EXCHANGE: NY

BUSINESS: MONEY CENTER BANK

ANNUAL REVENUE: $76.4 BIL. (12/31/13)

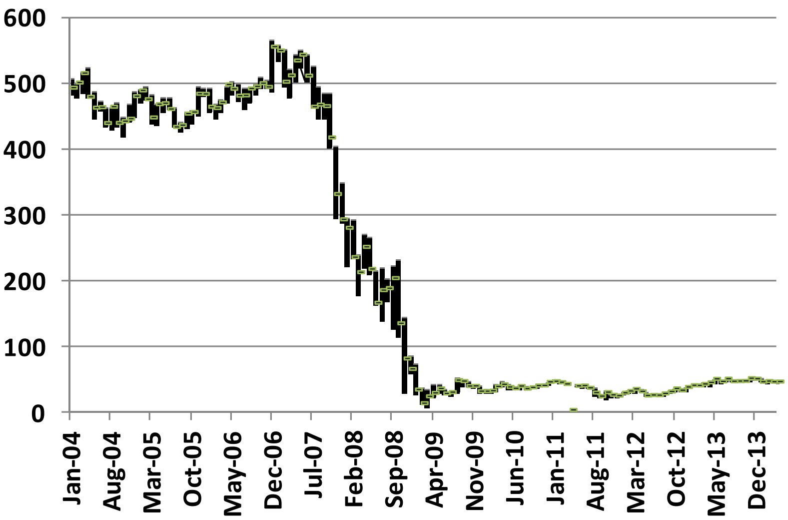
EARNINGS: $13.7 BIL.

4/29/14 PRICE: 48.16

12 MONTH RANGE: 55.28—45.06

MAX. REC PRICE: 65

EST. DIVIDEND YIELD: 0.1%



Background: Citigroup traces its roots back to 1812 with the formation of the City Bank of New York. Through ups and downs over the next two centuries, Citi grew into one of the world's largest financial institutions. One of the most significant steps along the way was the merger with Travelers Group in 1998. Travelers had previously acquired the iconic Wall Street firms of Salomon Brothers and Smith Barney, and so the merger created a commercial and investment banking goliath.

However, Citigroup never fully realized the expected synergies from its different parts, and during the financial meltdown in 2008 the leverage in various divisions almost brought the whole company down. The U.S. government was forced to inject about $475 billion in cash and guarantees to keep Citi afloat. The stock, which had traded as high as 570 (adjusted for a 1-for-10 reverse split) in late 2006, fell as low as 10 in early 2009. When markets recovered later in 2009, the stock jumped back to the 40's, and it has traded basically between 30 and 50 ever since.

Analysis: When Citigroup began to stabilize in 2009, it split into two business units: Citi-corp, which contains most of the company's core retail and institutional client businesses, and Citi Holdings, which includes the asset management and brokerage businesses as well as other assets that it planned to sell off. In 2012, former CEO Vikram Pandit, who came from the hedge fund world, was replaced by company veteran Michael Corbat. Corbat has focused on strengthening Citi's core businesses and divesting non-core and unprofitable assets, and the company is making good progress on both fronts.

On the core business front, Citi retains a strong global presence and a powerful brand name. More than half of its business comes from outside North America, with an increasing portion from high growth emerging markets. Moreover, management is actively working to improve efficiency by reducing expenses and reallocating resources. In this regard, it is continuing to streamline products and services, as well as consolidating platforms and processes.

On the non-core front, management has reduced the assets in Citi Holdings by almost 50% from 2011 through 2013 and brought the unit's bottom line up to break-even. Most of the remaining assets in Holdings are mortgages, and the company plans to sell them opportunistically as the mortgage market continues to improve.

From a valuation perspective, Citi looks cheap, both historically and compared to its peers. It currently trades at 0.85 times Tangible Book Value (TBV) compared to 1.7 times for other large banks. During the period 1993-2007, Citi traded at an average of 3.5 times TBV. Moreover, Citi's TBV should grow as the company continues to re-focus its businesses. On an earnings basis, Citi currently trades at 10 times estimated 2014 earnings, compared to more than 15 times historically. It is also worth noting that rising interest rates would give a nice boost to the company's earnings.

While the Fed recently denied Citi's request to increase its dividend and share repurchase program, we believe that Citi will be able to get the Fed's blessing in the not-too-distant future. In the meantime, the denial gives investors a good opportunity to buy the stock cheaply. <u>We recommend buying Citigroup up to 65.</u>

<u>For Aggressive Investors:</u> There are Citigroup warrants trading that are remnants of the government's TARP program in 2008-09. These warrants, currently priced around 0.61, have a strike price of 106.10 and an expiration date of January 2019. While the warrants are still well out of the money, they have a lot of upside leverage if the stock can get above the strike price before 2019.

<u>Disclosure Note:</u> Accounts managed by an affiliate of the Publisher hold Citigroup warrants.

Sale Recommendation: Rite Aid Corporation

Over the last year Rite Aid has done a good job of both growing revenues and improving margins, and the stock price has responded nicely. However, we think it may take a while for the valuation metrics to grow into the current stock price. It's been a year since we first recommended Rite Aid, and so if you bought it shortly after our recommendation, you should now have a long-term gain in the stock. <u>For those who have held the stock for at least a year, we recommend selling it now; if you haven't yet held it for a year, wait for the gain to go long-term before selling.</u>

PERFORMANCE

The tables below and on the next page show the performance of all of our currently active recommendations, plus recently closed out recommendations. The categories are based on market capitalization on the recommendation date, except that recommendations made prior to August 2004 are categorized by their 8/20/04 market cap.

SMALL CAP (under $1 billion) CURRENT RECOMMENDATIONS

RECOMMENDATION	SYMBOL/ EXCHANGE (1)	REC. ISSUE	PRICE AT REC.	4/29/14 PRICE	TOTAL % RETURN (3)	CURRENT STATUS (2)
Bristow Group	BRS/NY	Nov 86	0.75	76.03	+10,264	Hold
Electro Scientific Ind.	ESIO/NQ	Feb 07	21.24	8.56	-57	Buy (20)
Wet Seal	WTSL/NQ	Oct 09	3.93	1.15	-71	Buy (6)
ACCO Brands	ACCO/NY	Mar 10	7.17	5.88	-18	Buy (12)
Superior Industries	SUP/NY	Sept 10	14.75	20.84	+56	Buy (30)
Kemet	KEM/NY	Feb 11	14.75	5.01	-66	Buy (11)
Drew Industries	DW/NY	Mar 11	23.13	49.53	+131	Hold
Fairpoint Communications	FRP/NQ	July 11	9.42	13.61	+44	Buy (14)
Builders FirstSource, Inc.	BLDR/NQ	May 12	4.17	7.85	+88	Buy (12)
Felcor Lodging Trust, Inc.	FCH/NY	Nov 12	4.39	9.11	+108	Buy (11)
Chiquita Brands	CQB/NY	Apr 13	7.76	11.56	+49	Buy (15)
Stewart Information Services Corp.	STC/NY	June 13	29.34	30.37	+4	Buy (37)
Accuride Corporation	ACW/NY	Oct 13	5.14	5.36	+4	Buy (8)
Layne Christensen Co.	LAYN/NQ	Nov 13	19.59	16.99	-13	Buy (26)
Ply Gem Holdings, Inc.	PGEM/NY	Apr 14	12.63	12.79	+1	Buy (20)

MID CAP ($1 billion - $10 billion) CURRENT RECOMMENDATIONS

RECOMMENDATION	SYMBOL/ EXCHANGE (1)	REC. ISSUE	PRICE AT REC.	4/29/14 PRICE	TOTAL % RETURN (3)	CURRENT STATUS (2)
Newell Rubbermaid	NWL/NY	June 04	23.24	30.14	+53	Buy (33)
Janus Capital Group	JNS/NY	Aug 05	15.27	12.04	-13	Buy (17)
Portland General	POR/NY	Nov 06	25.70	32.90	+57	Buy (36)
Interpublic Group	IPG/NY	Dec 06	11.94	17.14	+49	Buy (18)
Tellabs	TLAB/NQ	Feb 08	6.66	2.44	-60	Hold
Federal-Mogul	FDML/NQ	May 08	21.00	16.91	-19	Buy (23)
Old Republic	ORI/NY	June 08	14.64	16.44	+42	Buy (18)
Boston Scientific	BSX/NY	Aug 10	5.60	12.73	+127	Buy (15)
MGIC	MTG/NY	Jan 11	10.11	8.31	-18	Buy (11)
Wendy’s	WEN/NQ	Mar 12	5.18	8.30	+63	Buy (13)
Veolia Environnement S.A.	VE/NY	Oct 12	10.82	18.69	+90	Buy (22)
Cypress Semiconductor	CY/NQ	Jan 13	10.63	9.58	-6	Buy (16)
New York Times	NYT/NY	Mar 13	9.64	16.14	+69	Hold
Rite Aid Corporation	RAD/NY	May 13	2.61	7.09	+172	Sell
PennyMac Mortgage Investment Trust	PMT/NY	Sept 13	21.40	23.12	+16	Buy (26)
Allscripts Healthcare Solutions	MDRX/NQ	Feb 14	16.43	15.17	-8	Buy (24)
Staples	SPLS/NQ	Mar 14	13.60	12.40	-8	Buy (18)

KEY: (1) Exchanges: NY= New York; NQ= NASDAQ; (2) Maximum recommended buy prices in parentheses; (3) Total return includes dividends as well as price changes.

LARGE CAP (over $10 billion) CURRENT RECOMMENDATIONS

RECOMMENDATION	SYMBOL/ EXCHANGE (1)	REC. ISSUE	PRICE AT REC.	4/29/14 PRICE	TOTAL % RETURN (3)	CURRENT STATUS (2)
Carnival Corporation	CCL/NY	Jan 01	30.50	39.54	+63	Buy (45)
AT&T Inc.	T/NY	May 03	23.05	35.42	+127	Buy (44)
Ford	F/NY	Dec 03	13.00	16.12	+36	Buy (20)
Pfizer	PFE/NY	Mar 07	25.84	31.76	+47	Buy (35)
General Electric	GE/NY	July 07	38.12	26.76	-17	Buy (30)
Motorola Solutions	MSI/NY	Aug 07	68.52	63.43	-3	Buy (70)
DuPont	DD/NY	Jan 08	45.07	67.18	+70	Buy (70)
Bank of America	BAC/NY	Oct 08	35.00	15.24	-55	Buy (20)
Fifth Third	FITB/NQ	Nov 10	12.56	20.48	+71	Hold
Coca-Cola	KO/NY	Apr 11	32.86	40.57	+36	Buy (45)
General Motors	GM/NY	May 11	32.09	33.99	+7	Buy (45)
Xerox	XRX/NY	Aug 11	9.58	12.11	+31	Buy (14)
Sony	SNE/NY	Sept 11	22.01	17.96	-18	Buy (32)
Johnson & Johnson	JNJ/NY	Jan 12	65.45	101.03	+62	Buy (106)
Corning, Inc.	GLW/NY	Feb 12	12.61	20.86	+69	Buy (24)
Weyerhaeuser Co.	WY/NY	Apr 12	21.89	29.92	+40	Buy (35)
Hewlett-Packard	HPQ/NY	June 12	22.74	32.96	+50	Buy (36)
Cisco Systems, Inc.	CSCO/NQ	Sept 12	19.18	23.16	+26	Buy (26)
MetLife	MET/NY	Feb 13	37.20	51.84	+43	Buy (60)
BP plc	BP/NY	July 13	41.78	50.29	+24	Buy (55)
Freeport-McMoRan Copper & Gold	FCX/NY	Aug 13	28.21	34.44	+25	Buy (40)
EMC Corporation	EMC/NY	Dec 13	23.72	25.41	+8	Buy (34)
Dow Chemical Company	DOW/NY	Jan 14	44.60	48.70	+10	Buy (55)

RECENTLY CLOSED OUT RECOMMENDATIONS (ALL CATEGORIES)

RECOMMENDATION	SYMBOL	REC. CAT.	BUY ISSUE	PRICE AT BUY	SELL ISSUE	PRICE AT SELL	TOTAL % RETURN (3)
Time Warner	TWX	Large	Dec 04	53.46	Aug 13	62.07	+40
Goodyear Tire	GT	Mid	July 04	9.14	Sept 13	20.31	+122
CTS Corporation	CTS	Small	Nov 07	12.54	Oct 13	15.77	+31
Delta	DAL	Mid	Oct 11	8.11	Nov 13	26.48	+227
Schwab	SCHW	Large	Mar 04	12.20	Dec 13	24.83	+127
E*Trade Financial	ETFC	Mid	Aug 12	7.53	Dec 13	17.92	+138
Sprint	S	Large	Mar 08	8.09	Jan 14	10.58	+31
Sysco	SYY	Large	Nov 09	27.01	Jan 14	36.28	+50
United Continental	UAL	Mid	Dec 12	20.22	Feb 14	45.43	+125
Marsh & McLennan	MMC	Large	Feb 10	21.71	Mar 14	47.59	+136
Microsoft	MSFT	Large	Oct 06	27.94	Apr 14	40.99	+64
Applied Materials	AMAT	Large	Apr 10	13.45	Apr 14	20.42	+62

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