

The Turnaround Letter

Volume 34, Number 7

December 2019

YEAR-END BRINGS THE BARGAIN HUNTING SEASON

While our focus at *The Turnaround Letter* is on long-term business fundamentals and underlying valuations, even we can be tempted to briefly set this aside for shorter-term bargains. Around year-end these bargains can appear, driven by artificial selling pressure.

One source of artificial selling pressure is tax-loss selling. With the stock market's 27% year-to-date surge (as measured by the S&P 500), not to mention its 350% increase since 2009, many investors have large capital gains embedded in their portfolios. For lucky long-time holders of Microsoft, Amazon, and Apple, most of the value of their positions may be embedded gains. When it comes time to sell, taxable investors will pay federal taxes on their profits at rates as high as 37%, not to mention the added layer of state taxes. Investors have a strong incentive to generate offsetting losses to help reduce their tax payments.

Another driver of year-end selling is behavioral – investors unload their losers to provide a fresh psychological start to the new year. Adding to the selling pressure is portfolio window-dressing by professional investors. These managers would rather not show their clients and consultants that they held some big losers, so they sell them in November and December to keep them out of year-end reports.

This year, loser stocks are scarce: only 8% of all 2,345 stocks in the Wilshire 5000 index with market caps above \$400 million have year-to-date losses greater than 25%.

However, once the selling pressure wanes toward year-end, many of the previous year's worst performing stocks bounce upwards, sometimes sharply. Nimble investors can capture some of the bounce before longer-term fundamentals and valuations take over after a month or so.

Discussed below are six stocks among the 8% mentioned above that are promising candidates for a bounce. We include only one energy company, although energy stocks comprise more than a quarter of this selected universe and many could readily rebound into the new year. This month's

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new Buy recommendation, Peabody Energy (BTU), fits the bounce criteria while also offering longer-term upside potential. Some of our current Recommended List stocks have bounce potential, as well, including Macy's, Gannett, Amplify Energy and Mosaic, all currently rated BUY. If you have not yet taken a position in these stocks, or would like to add, this could be a good time to do so.

DULUTH HOLDINGS (DLTH) – This small-cap Wisconsin company is a unique 60-store and online retailer that sells rugged yet functional outdoor clothing through a colorful marketing approach. After its IPO in 2015, the company over-expanded, pressuring its profits. In August, the CEO was re-

Tax Loss Selling							
COMPANY	SYMBOL	RECENT PRICE	52-WEEK HIGH-LOW	MARKET CAP \$ BIL	EV/EBITDA	YIELD%	
Duluth Holdings	DLTH	9.11	32.72 – 7.89	0.3	9.5	0.0	
L. Brands	LB	19.17	34.89 – 15.80	5.0	7.4	6.3	
Meredith Corporation	MDP	36.36	60.95 – 30.69	1.6	7.8	6.3	
Mylan N.V.	MYL	18.06	34.46 – 16.63	8.9	6.2	0.0	
Occidental Petroleum	OXY	39.93	72.43 – 37.60	35.4	9.9	7.9	
Resideo Technologies	REZI	10.13	26.40 – 8.60	1.2	5.7	0.0	

Closing prices on November 25, 2019. Source: CapIQ. EV/EBITDA multiple based on consensus 2019 estimates.

placed by co-founder Stephen Schlecht (owner of 60% of the company), who is slowing Duluth's growth to re-focus on asset productivity and margin expansion. The company will likely show a decent profit this year and repay most of its high but seasonal debt. Duluth shares have fallen more than 60% this year, remain below their \$12 IPO price and trade at a modest valuation. Strong holiday results and their improved priorities could lead to a rebound and perhaps a more enduring turnaround.

L BRANDS (LB) – Founded by legendary retailer Les Wexner, L Brands has failed to stay relevant to customers of Victoria's Secret (about 55% of sales), leading to an 8% decline in year-to-date same store sales. Slowing mall traffic weighs further on its prospects. Investors threw in the towel on LB shares in August following yet another weak quarter. However, the November report showed signs that the company is waking up: new leadership at PINK, strength in the Beauty line, and impressive performance in the Bath & Body Works segment. Renowned hedge fund Bridgewater Associates recently added to its sizable stake.

MEREDITH CORPORATION (MDP) – Meredith is the nation's largest publisher of print and digital magazines, with powerhouse titles such as *People*, *Travel + Leisure* and *Martha Stewart Living*. The company also owns a portfolio of 17 local television stations that have produced steadily increasing profits. Meredith is struggling with several issues: integrating its 2018 acquisition of Time, Inc., weakening advertising revenues, and the effects of a tempo-

rary blackout of its TV stations on the DISH network. However, the company is one of the few print-based companies to successfully transition to the digital world (now reaching an audience of over 182 million people, more than Comcast or Disney) and has a history of making the tactical and strategic changes necessary to remain relevant. Meredith generates considerable free cash flow which it is using to pay down its debt.

MYLAN N.V. (MYL) – Once a darling of Wall Street, Mylan shares have collapsed 80% from their peak and now trade at their 2003 price. A major problem: its core generic pharmaceutical business is facing steady volume and pricing pressure, in no small part from heightened public scrutiny. The troublesome \$13 billion debt burden (3.7x EBITDA) that financed its previous growth, including the \$7.2 billion acquisition of Sweden-based Meda in 2016, doesn't help sentiment, either. Mylan's pending combination with Pfizer's Upjohn business is meeting high skepticism, adding to the selling pressure as Pfizer shareholders head for the exits. Yet, the deal will create a new company with many cost and marketing synergies, and core Mylan's operations appear to be stabilizing. A turn of the calendar might bring a less-dour view of the company.

OCCIDENTAL PETROLEUM (OXY) – We highlighted Occidental last month as a high-risk high-yield oil stock, and now it also looks like a year-end rebound candidate. While its post-merger turnaround is an early-stage work in progress that is highly sensitive to oil prices, the shares may appeal to contrarian energy in-

vestors willing to take risks in the new year. One such investor, Berkshire Hathaway, recently bought \$300 million in common stock to accompany its \$10 billion in Occidental preferred shares. Activist Carl Icahn has sold a third of his position but continues his attack on the company's leadership for its high-priced, controversial and massive \$55 billion acquisition of Anadarko Petroleum in August.

RESIDEO TECHNOLOGIES (REZI) – Spun off from Honeywell in October 2018, Resideo has two businesses: one manufactures residential thermostats and security products, and the other, ADI Global Distribution, is the leading wholesale distributor of security and

low voltage electrical products. While the ADI business continues to post healthy revenue and profit growth, the manufacturing segment is struggling as consumers shift toward internet-connected thermostats and security devices. While Resideo also sells connected products, the volumes remain too small to offset declining sales of traditional devices, and the competition is much more robust. We are not yet convinced that Resideo has long-term turnaround potential. However, with the shares' 70% descent since the spin-off and an abrupt drop following the November earnings report, any favorable news about its credit facility refinancing or its outlook in general could prompt a quick rebound.

OPPORTUNITIES IN BUSTED IPO'S

In our August 2017 article about initial public offerings (IPOs), we wrote about the strength of the overall stock market, how this was supporting robust investor enthusiasm for IPOs, and how a large proportion of IPOs were in the healthcare/biotech and tech sectors. This past April we commented about how the (then) upcoming IPOs would test value investors' discipline, just as previous hot IPO markets reminded investors that IPO also stands for "It's Probably Overpriced."

In many ways, not much has changed. New offerings remain in high demand, raising nearly \$41 billion so far this year, according to Renaissance Capital, a firm that tracks IPOs, and is on track to match last year's strong \$47 billion total. Some debuts have produced remarkable gains: Beyond Meat (BYND), which produces plant-based meats often seen as a healthier and more environmentally-sensitive alternative to hamburger, surged 840% in the months following its May debut at \$25. Specialty insurer Palomar Holdings (PLMR) trades at triple its April pricing at \$25.

Yet, some things *have* changed. On one hand, investors' appetite for IPOs have become more stoked, helping to fund ever-more-speculative stocks including microcap biotech, obscure Chinese companies and special

purpose acquisition companies. The latter, known as SPACs, or "blank check companies," carry several layers of speculation: they have no operating history yet promise to acquire an as-yet-undetermined company at an unknown valuation. An expanding offering of SPACs can indicate the approaching end of an IPO boom.

On the *other* hand, investors have become more discerning, showing fading tolerance for money-losing unicorns with questionable business models. The iconic (in the wrong way) We Company, former beneficiary of a private equity echo chamber that valued it at \$47 billion, now grapples with the ignominy of a potential valuation at zero. Similarly, investors frowned at SmileDirectClub (SDC), a do-it-yourself orthodontics company that we've written about in the past, pushing its shares steadily downward by more than 60% in its eighty or so days as a public company. Notable other members of the broken unicorn stable include Uber (UBER) and Lyft (LYFT), now trading about 33% below their respective IPO prices. Silicon Valley (and perhaps the current owners of a Middle Eastern mega-cap oil company) may be unloading shares at the top of the market, but investors are becoming more assertive in saying, "no, thanks."

Opportunity in “Value IPOs”

COMPANY	SYMBOL	RECENT PRICE	PRICE CHANGE SINCE IPO	MARKET CAP \$ BIL	EV/EBITDA	YIELD%
Focus Financial	FOCS	27.92	-15%	1.3	11.7	0.0
Graf-Tech	EAF	14.13	-6%	4.2	5.6	2.4
Levi Strauss	LEVI	17.05	0%	6.7	9.3	0.9
Livent	LTHM	8.01	-53%	1.1	11.1	0.0

Closing prices on November 25, 2019 Source: CapIQ. EV/EBITDA multiple based on consensus 2019 estimates.

Listed below are four companies with worthwhile products and services, whose shares trade at or below their debut price. The term “Value IPO” may be an oxymoron, but these stocks might qualify.

FOCUS FINANCIAL (FOCS) – This company is a leading acquirer of registered investment advisor (RIA) firms. Its growth and profitability have been impressive, as it balances the benefits of centralized expertise with the operational independence of its 63 entrepreneurial partner firms. The RIA market is ripe for more mergers as generational turnover often prompts a company sale, and as scale is an increasingly important competitive advantage. Concerns over the firm’s debt (which it is now reducing), limited disclosures (which it is improving), rising competition for deals which can force up prices (Focus is staying disciplined while providing advantages over other bidders) and the sustainability of their growth model (most indications suggest it can continue) may be only temporary, offering longer-term investors the opportunity to participate at an 15% discount to its IPO price.

GRAF-TECH INTERNATIONAL (EAF) – Graf-Tech is one of the world’s largest makers of graphite electrodes, with a 24% share of the non-China-produced market. Founded in 1886, the company was public until its 2015 acquisition by the highly regarded Brookfield Asset Management. It returned to public ownership with its April 2018 IPO. Graphite electrodes are critical components in electric arc furnaces used in steel production. Graf-Tech is the only producer that is substantially vertically-integrated into petroleum needle coke, the primary raw material for graphite electrode

manufacturing, which currently is in short supply. Sluggish global steel production is contributing to the shares’ weak performance. However, the company is well-positioned for any steel recovery with its low production costs, particularly as electric arc furnaces are gaining market share over traditional blast furnaces due to the abundance of scrap steel. Its balance sheet is reasonable, with its debt partly offset by \$342 million in cash.

LEVI STRAUSS (LEVI) – Levi Strauss owns one of the most highly-regarded brands in the world. Its ubiquitous blue jeans are sold in over 50,000 retail locations in 110 countries, as well as through Levi’s burgeoning online business. Its shares debuted at \$17 and surged to over \$22 on the first trading day, but that enthusiasm has faded as the shares now trade at their IPO price. Levi’s otherwise sturdy revenue and profit strength is being obscured by the strong U.S. dollar and some sluggishness in the wholesale channel. The company continues to invest in its growth initiatives and expand its direct-to-consumer operations and product array. The shares are valued at a reasonable multiple, and the modest debt is nearly fully offset by cash. Investors might want to try on Levi’s for size.

LIVENT CORP (LTHM) – Spun off from FMC Corporation at \$17, Livent remains mired in a weak global pricing environment for lithium, its primary product. Industry suppliers ramped up output to meet the anticipated higher demand for batteries and electric cars, but the demand has not lived up to the hype. Many analysts expect the glut to last for another year or more. Investors might want to brush up on Livent as they wait for either a more attractive entry price (the current valuation implies some

recovery) or a reversal in the lithium market imbalance. The company will generate negative cash flow due to heightened capital spend-

ing, but it has a solid balance sheet and management appears capable and experienced.

RECOMMENDATIONS

Purchase Recommendation: Peabody Energy

PEABODY ENERGY

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ST. LOUIS, MO 63101
TEL. 314-342-3400

www.peabodyenergy.com

CATEGORY: SMALL CAP (\$880 MILLION)

SYMBOL: BTU

BUSINESS: COAL MINING

ANNUAL REVENUE: \$4.6 BILLION

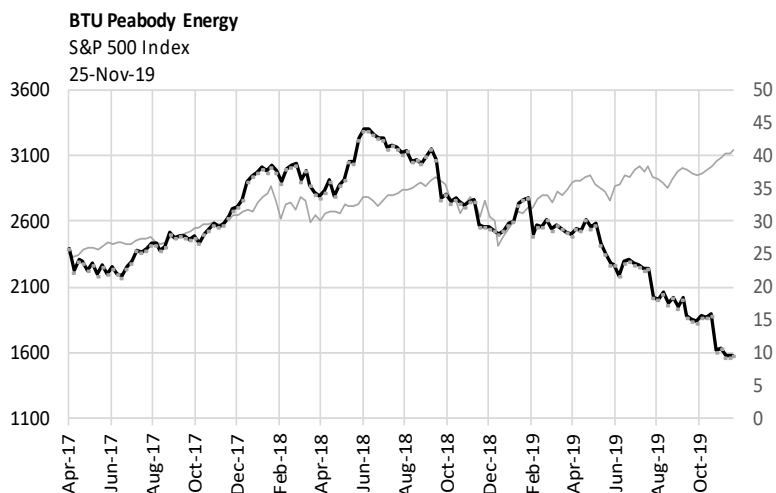
EARNINGS: (\$25) MILLION

11/25/19 PRICE: \$9.82

52-WEEK RANGE: \$37.37 - \$8.65

EST. DIVIDEND YIELD: 5.9%

PRICE TARGET: \$15



Background: Peabody Energy is one of the world's largest miners of coal. It operates 21 mines in the United States and Australia that produce thermal coal used by electric utilities and metallurgical coal ("met coal") used by steel producers. About 65% of its production is low-sulfur thermal coal mined in the Powder River Basin in Wyoming. Its Australian thermal and coal mines account for another 18% of total output.

Founded in the late 1800s by Francis Peabody, the company grew over the next century and enjoyed remarkable prosperity in the early 2000s as global coal demand and prices surged. However, an ill-timed debt-financed acquisition of Australia-based Macarthur Coal for \$5.2 billion at the top of the coal market in 2011 led to Peabody's 2016 bankruptcy. It emerged in April 2017 with a much-stronger balance sheet and new management.

Few, if any, stocks are as out-of-favor as Peabody Energy. In a year when the S&P 500 Index has returned over 27%, supported by clean companies in secular-growth industries with increasing profits and steadily-rising

stock prices, a company whose products are widely-believed to contribute to global warming, in a secularly declining industry, with falling profits, loss of a valuable mine due to fire, and a collapsing stock price, Peabody's shares have almost no appeal. Even those few investors who find the shares attractive have a motivation to sell – to capture valuable tax loss benefits. Year-to-date (and since their emergence from bankruptcy), BTU shares have tumbled over 60%. In the few weeks since their weak third quarter report, investors have thrown in the towel, cutting the share price nearly in half.

Analysis: Nevertheless, for contrarian investors Peabody shares look particularly appealing. As Warren Buffett famously says, "price is what you pay, value is what you get." Peabody's shares now trade for 2.9x estimated 2021 EBITDA, based on expectations for a continued slide in profits over the next two years. At this valuation, there is considerable upside potential if things just go "less wrong" than expected.

It is widely recognized that the U.S. thermal

coal market is in secular decline. But it isn't likely to go away anytime soon, as it will continue to provide an important source of energy for electricity production. International thermal coal demand remains healthy, driven by growing Asia Pacific economies, although near-term supply growth will dampen prices. Longer-term, falling global investment in thermal coal production will likely support higher prices. International met coal markets remain in flux near-term, but the long-term demand outlook appears solid as steel is a core component of a growing global economy. We don't believe a collapse in coal prices in either the U.S. or globally is likely. Any pricing strength would be an unexpected positive.

Recognizing shareholders' concerns about the industry's challenges, Peabody's top two financial priorities are to generate cash and maintain its financial strength. The management puts this into practice by actively managing its mine portfolio by shifting production, investments and costs to adjust to market conditions. In addition, the company has targeted \$50 million of annualized cost improvements, including a plan underway to centralize many corporate costs that now reside in its regional operations. The

fire at its North Goonyella mine, while disappointing, didn't result in any loss of life, and any return to production in future years would provide an additional boost to the bottom line. Also, a joint venture to combine Peabody's and Arch Coal's Powder River Basin operations is working its way through government and creditor approvals. If approved, the deal could produce substantial cost savings that would accrue to shareholders.

Peabody's balance sheet remains sturdy. It currently holds \$759 million in cash, with another \$600 million is available from its credit lines. The company's \$1.4 billion in debt is readily manageable at about 2.3x EBITDA, with its nearest maturity in March 2022.

Helping to keep management focused on shareholder value is activist Elliott Management, which holds nearly 30% of Peabody's shares and recently added to their position.

We believe this lump of coal makes an outstanding early holiday stocking stuffer.

We recommend the PURCHASE of shares of Peabody Energy (BTU) with a \$15 price target.

OTHER RATINGS/PRICE TARGET CHANGES:

We moved **Xerox** to Sell mid-month as the shares had only about 5% upside to our \$40 price target. Its recent offer to merge with Hewlett-Packard (or perhaps HPQ acquires Xerox?) changed the thesis to a much more complicated and higher risk "leveraged merger-integration" situation. Even if this deal doesn't move forward, the offer indicates that the company and its risk profile are moving in a direction away from our interests. We might be interested in re-purchasing Xerox shares at a much lower price.

Mid-month, we also moved **Chesapeake Energy** and **McDermott International** to Sell ratings. Both companies are under intense financial pressure due to large operating losses and high debts. For Chesapeake, the issue is chronically low natural gas prices, while for McDermott it is their debilitating and seemingly unending cash flow losses from their liquified natural gas and other projects. These companies have unacceptably high bankruptcy risk.

NEWS NOTES:

We are retaining our Buy rating on **Gannett** with a new \$9 price target to reflect its now-closed merger. Our target assumes that the company achieves less than half of the synergies expected by management, and that it

trades at a modest 4.5x EV/EBITDA multiple in 2021. If the company meets its profit targets, the shares could be worth considerably more. Gannett shares offer a likely-sustainable 11% dividend yield.

PERFORMANCE

The tables below and on the next page show the performance of all of our currently active recommendations, plus recently closed out recommendations. For additional details please visit the "Our Portfolio" pages.

SMALL CAP¹ (under \$1 billion) CURRENT RECOMMENDATIONS

RECOMMENDATION	SYMBOL	REC. ISSUE	PRICE AT REC. ⁽⁴⁾	11/25/19 PRICE	TOTAL % RETURN ^(3,4)	CURRENT YIELD	CURRENT STATUS ⁽²⁾
Consolidated Communications	CNSL	July 11	12.90	4.11	-44	0%	Buy (22)
Gannett Company	GCI	Aug 17	9.22	6.59	+24	11.5%	Buy (9)
Amplify Energy	AMPY	Feb 18	16.88	5.91	-64	13.8%	Buy (9.50)
Blue Apron Holdings	APRN	July 18	48.75	6.97	-86	0%	Buy (30)
Oaktree Specialty Lending Corp.	OCSL	Aug 18	4.91	5.23	+16	7.3%	Buy (7)
Signet Jewelers Limited	SIG	Oct 19	17.47	17.09	0	8.7%	Buy (29)

MID CAP¹ (\$1 billion - \$10 billion) CURRENT RECOMMENDATIONS

RECOMMENDATION	SYMBOL	REC. ISSUE	PRICE AT REC. ⁽⁴⁾	11/25/19 PRICE	TOTAL % RETURN ^(3,4)	CURRENT YIELD	CURRENT STATUS ⁽²⁾
Janus Henderson Group plc	JHG	Aug 05	32.36	25.39	+3	5.7%	Buy (44.50)
Allscripts Healthcare Solutions	MDRX	Feb 14	16.43	11.03	-33	0%	Buy (24)
Globalstar	GSAT	Nov 14	2.16	0.37	-83	0%	Hold
Mattel, Inc.	MAT	May 15	28.43	11.74	-46	0%	Buy (38)
SeaWorld Entertainment	SEAS	Apr 16	21.45	29.94	+41	0%	Buy (35)
BorgWarner	BWA	Aug 16	33.18	43.47	+37	1.6%	Buy (58)
Washington Prime Group	WPG	Dec 16	10.02	4.30	-30	23.3%	Buy (17)
Conduent	CNDT	Feb 17	14.96	6.40	-57	0%	Buy (20)
AMC Entertainment Holdings	AMC	Jan 18	14.40	8.38	-23	9.6%	Buy (25)
Brookdale Senior Living	BKD	Sept 18	9.74	7.19	-26	0%	Buy (16)
Adient, plc	ADNT	Oct 18	39.77	22.06	-44	0%	Buy (64)
JELD-WEN	JELD	Nov 18	16.20	21.97	+36	0%	Buy (25)
GameStop Corp.	GME	Apr 19	10.29	6.03	-41	0%	Buy (16)
Trinity Industries	TRN	Sept 19	17.47	21.50	+24	3.2%	Buy (26)
Thor Industries	THO	Nov 19	67.60	65.79	-3	2.4%	Buy (98)

- KEY:**
- (1) Based on market capitalization at original recommendation date.
 - (2) Price target in parentheses.
 - (3) Total return includes price changes and dividends.
 - (4) Prices and returns are adjusted for stock splits.
 - SP Given their higher risk, we consider these stocks to be speculative.
 - * Mid-month recommendation change .

Disclosure: One or more employees of the Publisher own shares in every Turnaround Letter Recommended stock.

LARGE CAP¹ (over \$10 billion) CURRENT RECOMMENDATIONS

RECOMMENDATION	SYMBOL	REC. ISSUE	PRICE AT REC. (4)	11/25/19 PRICE	TOTAL % RETURN ^(3,4)	CURRENT YIELD	CURRENT STATUS ⁽²⁾
General Electric	GE	July 07	38.12	11.58	-46	0.4%	Buy (20)
General Motors	GM	May 11	32.09	35.81	+37	4.2%	Buy (45)
Weyerhaeuser Company	WY	Apr 12	21.89	29.41	+72	4.6%	Buy (40)
BP plc	BP	July 13	41.78	38.63	+30	6.4%	Buy (55)
Freeport-McMoRan	FCX	Aug 13	28.21	11.66	-50	1.7%	Buy (20)
Citigroup	C	May 14	48.16	75.68	+68	2.7%	Buy (85)
Royal Dutch Shell plc	RDS-B	Jan 15	69.95	59.14	+11	6.4%	Buy (85)
Nokia Corporation	NOK	Mar 15	8.02	3.47	-45	0%	Buy (12)
The Mosaic Company	MOS	Sept 15	40.55	18.64	-48	1.1%	Buy (50)
Rolls-Royce Hldgs plc	RYCEY	Mar 16	9.25	9.68	+11	1.6%	Buy (14)
Macy's	M	July 16	33.61	15.56	-39	9.7%	Buy (48)
Viacom	VIAB	Jan 17	35.52	23.91	-26	3.4%	Buy (54)
Volkswagen AG	VWAGY	May 17	15.91	19.44	+30	2.8%	Buy (24.50)
Credit Suisse Group AG	CS	June 17	14.48	13.33	0	2.0%	Buy (24)
Toshiba Corporation	TOSYY	Nov 17	14.49	16.10	+12	1.2%	Buy (28)
LafargeHolcim Ltd.	HCMLY	Apr 18	10.92	10.37	+2	4.0%	Buy (16)
Newell Brands	NWL	June 18	24.78	19.28	-18	4.8%	Buy (39)
Vodafone Group plc	VOD	Dec 18	21.24	20.23	-3	4.5%	Buy (32)
Barrick Gold	GOLD	Feb 19	13.05	16.43	+27	1.2%	Buy (20)
Mohawk Industries	MHK	Mar 19	138.60	141.43	+2	0%	Buy (220)
Gilead Sciences	GILD	May 19	64.92	67.22	+5	3.8%	Buy (105)
Kraft Heinz	KHC	Jun 19	28.68	31.06	+12	5.2%	Buy (45)
Molson Coors	TAP	July 19	54.96	52.42	-4	4.4%	Buy (82)
Biogen	BIIB	Aug 19	241.51	302.61	+25	0%	Buy (360)

RECENTLY CLOSED OUT RECOMMENDATIONS (ALL CATEGORIES)

RECOMMENDATION	SYMBOL	CATEGORY	BUY ISSUE	PRICE AT BUY	SELL ISSUE	PRICE AT SELL	TOTAL % RETURN ^(3,4)
Ally Financial	ALLY	Large	Sept 14	24.95	May 19	29.98	+26
Weatherford Intl.	WFT	Mid	Mar 17	5.66	*Jun 19	0.05	-99
NII Holdings	NIHD	Small	Nov 15	7.00	Aug 19	1.70	-76
Bank of America	BAC	Large	Oct 08	35.00	Aug 19	30.89	-5
Hovnanian Enterprises	HOV	Small	May 18	50.25	*Oct 19	18.42	-50
Ford Motor Company	F	Large	Dec 03	13.00	Nov 19	8.61	+10
McDermott Int'l	MDR	Small	Apr 15	11.19	*Nov 19	1.49	-87
Chesapeake Energy	CHK	Mid	June 15	14.11	*Nov 19	0.91	-94
Xerox Corporation	XRX	Large	Aug 11	38.32	*Nov 19	38.85	+53

The Turnaround Letter is published monthly by **New Generation Research, Inc.**, 88 Broad Street, 2nd Floor, Boston, MA 02110.

Editor: George Putnam, III; Associate Editor: Bruce Kaser. The subscription rate is \$340 per year. Other publications from New Generation Research: **Bankruptcy Week**, a weekly summary of key bankruptcy events and data; **The Bankruptcy Yearbook and Almanac**, an annual compendium of bankruptcy information; **The Distressed Company Alert**, a weekly service identifying troubled companies; and **BankruptcyData**, providing detailed information on current and past bankruptcies. For more information on these publications, call (617) 573-9550.

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