

BerkeleyHaas

Haas School of Business
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Allocations:



MULE, NRG, JNCE, KAR, SFS

Team: CALiforniaflation

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NRG Energy Inc (NYSE: NRG)

NRG Energy (NRG) is a leading integrated power company. NRG engages in wholesale power generation, energy retail services, and the investment in and development of renewable energy.

In February 2017, NRG entered into cooperation agreements with activist investors Elliott and Bluescape. After a five-month review process, NRG announced a transformation plan focused on achieving the following: \$1.1B in recurring cost and margin improvements, \$2.5-\$4B in targeted asset sales, and \$13B total debt removal from balance sheet.

The stock is up over 50% since its transformation plan was revealed. Assuming NRG can achieve even 70% of its plan, the stock is still undervalued.

Our investment thesis is predicated on the core belief that NRG will execute (within 85% of management guidance) on its plans for cost cutting, asset sales, and deleveraging. With these achievements, NRG's share price could reach \$35 (based on hitting its cost targets) and \$45 (based on hitting its divestiture targets) within the next 12 months, compared to \$25 as of October 31st. We are confident in the Company's abilities to achieve its goals given: (i) it has hit its milestones since the July announcement; (ii) sales of the renewables and generation assets seem achievable based on comps; (iii) Bluescape Chairman John Wilder (former CEO of TXU who pulled TXU from the brink of insolvency into a phenomenal sale to a group of PE buyers, including KKR) has joined the Board of NRG and is highly focused on ensuring a successful exit.

KAR Auction Services, Inc. (NYSE: KAR)

KAR Auction Services (KAR) is a leading provider of whole vehicle auction, salvage vehicle auction, and automotive financing services operating in North America and the U.K.

Our investment thesis is predicated on the core belief that the Company is expected to benefit from positive cyclical trends that offer strong mid-term visibility in volume and pricing growth. Within the whole car market segment, there is strong visibility due to a significant flow of off-lease vehicles returning to the market over the next several years. Lease vehicles represent the second largest source of transaction volume in the market. Accordingly, our analysis indicated that pent-up off-lease volumes are expected to drive increased volume in the whole auction space (expected CAGR of 16% through 2019). Such growth in leased vehicle volumes should drive pricing upward as commercial customers tend to leverage more ancillary services. Within the salvage car market segment, moderate near-term growth is expected to be facilitated by an increase in car miles driven, higher repair costs, and tailwinds from catastrophic events (e.g. Hurricane Harvey).

Other near-term catalysts include (i) favorable competitive dynamics and (ii) a strong deleveraging profile supported by high free cash flow. The whole and salvage car markets are highly defensible, characterized as oligopolies. As a result, KAR should be able to benefit from positive near and mid-term tailwinds. Finally, KAR maintains leverage above 4.5x EBITDA. Positive growth trends and strong margin and cash flow metrics should drive equity value as the Company continues to de-lever.

Jounce Therapeutics (NASDAQ: JNCE)

Jounce Therapeutics (JNCE) is a clinical-stage immunotherapy company dedicated to revolutionizing the treatment of cancer. Put simply, immunotherapies look to harness the power of the body's own immune system to fight back against cancerous tumors.

We believe Jounce represents an attractive investment opportunity given: (i) the upcoming release of Phase-2 data on its lead product candidate, (ii) its unique contract with Celgene (NASDAQ: CELG), and (iii) a suppressed stock price trading near its 52-week low.

The company's primary asset, JTX-2011, is a monoclonal antibody that binds to certain proteins on the surface of T Cells believed to stimulate an immune response. JTX-2011 is currently in its Phase-2 trial on humans, which is expected to conclude in early 2017 with results released shortly thereafter. Positive results could yield significant upward movement in the stock.

In July 2016, the company entered into a \$2.6B contract with Celgene, including options on JTX-2011. This type of collaboration with a well-established immunotherapy company is a strong vote of confidence in the smaller, lesser-known, Jounce. The deal also includes a \$225M upfront payment and a \$35M equity injection for additional preclinical assets, which provides flexibility to the Jounce team to pursue additional targets.

Jounce held its IPO in January 2017 and traded as high as \$29.29/share in early May. Since then, the stock has traded down, reaching \$11.05/share in mid-August. At \$14.00/share as of October 31st (\$450.66 million market cap), we believe Jounce represents a strong buying opportunity with promising near-term catalysts.

Smart and Final Stores, Inc. (NYSE: SFS)

Bruised and battered, Smart and Final Stores (SFS) presents a buying opportunity in an underappreciated and differentiated segment of the grocery market. The California-centric grocer was affected drastically by the Amazon (NASDAQ: AMZN) Whole Foods (formerly NASDAQ: WFM) merger announcement in June. This event, paired with recent tepid short-term financial performance, pushed SFS to a 52-week low (\$6.00) on

10/31/17. This created a strong entry point for CALiforniaflation, which allocated the following day.

Our investment thesis is predicated on SFS's ability to differentiate itself from WFT/AMZN behemoth in near-term horizon due to SFS's differentiated offerings and customer base. Firstly, SFS operates in a substantially different segment than "mega-grocers" and upscale online retailers. Membership-fee free, it touts highly discounted consumables geared for households and small restaurants. Its bulk off-label products are sold at smaller footprint, urban, and more convenient locations than its big box rivals. Further, SFS has strong penetration within markets less vulnerable to click-based grocers. This includes governmental-assistance consumers and the California Hispanic population, which has growing spending power and historically higher tendencies to shop at brick and mortar. Thus, SFS's loyal customers will be slower to switch to AMZN's, and other discount, grocery offerings.

The management team is well suited to combat the recent decline. The team has been successful in other Southern California grocers at all ends of the value-consciousness spectrum. Finally, management enjoys strong support and expertise from Ares Management, the company's majority investor. Ares has a long history of generating strong returns for its own investors: we expect the same will be true for its SFS.