Barron's AOSI Conference: 21 Picks From Investing Pros

The stock market looks too rich to our investment experts, but Sony, Microsoft, Whirlpool seem too cheap.

By
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Seldom has the gap between the haves and have-nots seemed so wide. We're not referring here to the economic divide, which is troublesome enough, but to a growing chasm in the stock market between overvalued shares and those that get little love. Among the former, these days, is anything with a yield, especially one that exceeds the paltry yields on Treasury bonds, and certain social-media companies whose highflying shares have slipped gravity's grasp. In the latter category? Almost everything else.

BARRON'S

THE ART OF SUCCESSFUL INVESTING CONFERENCE

No surprise, value investors find the have-nots a happy hunting ground, as some of the best in the business explained at *Barron's* 12th annual Art of Successful Investing conference, held on Oct. 15 at the Metropolitan Club in New York. Our 2016 get-together included a broad range of speakers, among them a market strategist, an energy expert, and numerous stock-picking savants. While most said the U.S. stock market averages are fully valued and possibly poised to fall, they cited plenty of individual issues that already reside in the bargain bin. In the interviews that follow, adapted from video conversations taped at AOSI, you'll get the lowdown on 21 undervalued companies, from Microsoft (ticker: MSFT) to Whirlpool (WHR) to Sony (SNE). The full videos are available at Barrons.com.

A word about our featured participants: The list includes five members of the *Barron's* Roundtable—Scott Black, Mario Gabelli, William Priest, Oscar Schafer, and Felix Zulauf—and four speakers new to the AOSI stage. Mary Ann Bartels watches markets for Merrill Lynch Wealth Management; Helima Croft is head of commodity strategy for RBC Capital Markets; Jerome Dodson, founder and president of Parnassus Investments, is a dean of ESG investing (the firm screens for environmental, social, and governance factors); and Andrew Wellington is co-founder and chief investment officer of Lyrical Asset Management, a top-performing hedge fund.

The Art of Successful Investing Participants

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It is hard to argue with the experience of these investment pros—or the beauty of New York in fall. We hope the combo will encourage you to attend AOSI next year.

FELIX ZULAUF

Barron's: *Felix, why are you so negative on the outlook for the U.S. stock market?*

Zulauf: The market is in a medium-term correction, or decline. I am looking for an interim low around the time of the election, or a bit after. If Donald Trump wins, there will be rising protectionism, which is bad for the U.S. economy. If Hillary Clinton wins and Republicans keep control of Congress, there will be gridlock in Washington. That means the U.S. won't be able to enact the structural changes needed to improve its economic situation. Either way, we are in the last inning of the bull-market cycle that started at the 2009 low. The stock market could roll over next year into a bear market.

Felix Zulauf says rising protectionism and deglobalization will favor the dollar more than other currencies. *Photo: Jenna Bascom for Barron's*

Is the bond bull market also near an end?

Bond yields around the world hit an important low in the summer and have risen since. The first step up is almost over, but after some softening, they will rise again. The yield on the 10-year Treasury bond will probably hit 2% in the first half of next year.

The stock market could peak in next year's first half and then enter a bear market lasting at least into 2018, if not 2020. It won't be as severe as the 2008 bear market, but a step-by-step decline. I see a recession in 2018; that's why bond yields will fall again. Around the middle of next year, a trader could buy U.S. Treasury bonds for a price gain into 2018.

Felix Zulauf: What's Next for Stocks, Bonds, Currencies

Speaking at Barron's Art of Successful Investing conference, the global investor sees significant losses for the S&P, but an opportunity in bonds, and a currency play.

You predict the euro-currency zone will break apart within five years. What might the impact be on other currencies?

The strongest currency will be the U.S. dollar. It is the main beneficiary of the environment into which we are moving, with rising protectionism and nationalism, and deglobalization. The U.S. is the world's largest net importer; with global trade in retreat, its external accounts will improve. The external accounts of the large export nations in Asia and Europe will deteriorate, which will hurt their currencies. I am bullish on the U.S. dollar, well into the first half of next year.

SCOTT BLACK

What do you make of the stock market's valuation?

Black: The market is overpriced. The Standard & Poor's 500 is selling for 19.4 times this year's expected earnings. Analysts were estimating earnings of $126 for this year. Now they are estimating $110. Earnings have fallen for six quarters in a row. The Russell 2000 [small-cap index] is selling for 27 times this year's estimates. The Russell 2500 [small- and mid-cap index] sells for 25 times earnings.

Nonetheless, you have found compelling values, including Carnival *[CCL]. What do you think the cruise-ship operator is doing right?*

Carnival is trading around $46, sharply below its 52-week high. Earnings are at an inflection point. The company could earn close to $3.75 a share in fiscal 2017 [ending on Nov. 30], up from this fiscal year's estimated $3.35, which puts the price/earnings multiple at 12, well below the market's P/E. Much of the boost in earnings is coming from a decline in oil prices.

4 Undervalued Stocks from Scott Black

The Boston-based value investor makes the case for Shire, Carnival, Celestica, and Lionbridge.

Carnival has promised that return on capital will exceed 10% by fiscal 2018. Bookings are up. The company generates lots of free cash, and can pay for its fleet. It is adding 17 new ships between now and 2020.

Is China a growth market for Carnival?

It is a small one. Carnival has about a 47% share of the worldwide population of cruise passengers. Its biggest markets—the Caribbean, Mediterranean, and northern Europe—account for 60% of revenue. We expect revenue to grow by 4% or 5% a year, but earnings will be up by double digits.

Shire *[SHPG] is another of your picks, and the subject of a recent positive story in Barron's ["Baxalta Could Help Boost Shire Shares More than 25%," Oct. 15]. What do you like about Shire?*

The shares are around $187. Organic growth, excluding a merger with Baxalta, is roughly 12%. Shire has some strong franchises, including Vyvanse, a follow-on to Adderall that treats attention deficit hyperactivity disorder. The company recently got a dry-eye treatment approved that could generate $1 billion in sales. The Baxalta deal brings in hemophilia treatments, another $1 billion franchise. Shire also has a new drug to treat hereditary angioedema, or HAE, a rare genetic disorder. It has the potential to be a $1.5 billion to $2 billion product.

Scott Black notes that cruise bookings are up at Carnival, one of his top picks. *Photo: Jenna Bascom for Barron's*

Shire is trading for 12.5 times next year's estimated earnings. Return on equity is around 15%, and the company generates a lot of free cash. Net debt is about five times earnings before interest, taxes, depreciation, and amortization. Management has promised to get it down to 2.8 times Ebitda by the end of 2017.

Celestica *[CLS] is a small contract manufacturer. Why do you favor the shares?*

Celestica has $6 billion in annual revenue, and is growing the top line at a 4% to 5% clip. Profit margins are rising, and we estimate earnings of $1.25 next year. The company has about $1.37 a share in net cash. If you strip the net cash and 20 cents a share out of earnings for stock-based compensation, the stock sells for 8.5 times next year's earnings. [Celestica's shares rose 10% on Friday after the company reported better-than-expected quarterly earnings. The adjusted P/E is now 7.4; net cash has risen to $1.85 a share.] Rival Sanmina 's [SANM] P/E multiple is more than 10.5. Celestica's shares could appreciate about 20% through multiple expansion. Earnings momentum has turned favorable in the past few quarters.

What is the bullish case for Lionbridge Technologies *[LIOX]?*

Lionbridge is a microcap with a market value of about $280 million. It is based in Waltham, Mass., and provides translation services of Websites, software, and other media into local languages. Microsoft accounts for 15% of sales. Google, owned by Alphabet [GOOGL], contributes 11%. Tech companies, drugmakers, and consumer-products companies also are clients.

Ebitda margins will be 8.8% this year and could top 10% in the future. Revenue is growing by the mid-single digits, and the company has good operating leverage. We expect Lionbridge to earn 67 cents a share next year, minus 11 cents in stock-based compensation. With the stock around $4.70, that's an 8.5 P/E. Return on book value is more than 30%; return on capital, 17%.

MARY ANN BARTELS

The stock market looks fully priced, but you're bullish long term. Why?

Bartels: Some say markets are overvalued. I wouldn't argue against that. In the near term, we have a more balanced view. But longer term, we are in a secular bull market. We see a number of positive long-term themes, including demographics.

The baby boomers are going to have a tremendous impact on our economy, and particularly on health-care spending. They will drive the health-care sector. In addition, the travel and leisure industry will benefit as baby boomers retire and do more traveling.

We entered the digital era in 2000, and innovations continue in Big Data, cloud computing, robotics, and augmented reality. That will drive continued investment in the technology sector. There is a rebirth in semiconductor chips, too.

Mary Ann Bartels sees a rosy future for semiconductor companies. *Photo: Jenna Bascom for Barron*

What is driving the chip revival?

Every digital product, from handheld devices to smartwatches to cars, needs a brain or a chip. Drones and augmented-reality technology depend on chips. Demand will continue to rise.

Are there areas outside the U.S. that offer good value?

We recently upgraded emerging markets, which had been in a bear-type recession. They look to be bottoming.

A Bevy of Bargains

Our panelists found 21 companies with promising prospects whose shares could rally in the next few years. Many have price/earnings ratios below peers, and generate ample cash flow.

	Price 10/14/16	Comments
SCOTT BLACK		
Carnival / CCL	$46.15	Cruise operator's earnings could rise by double digits
Shire / SHPG	187.70	Baxalta acquisition adds lucrative new drugs
Celestica / CLS	10.40	Contract manufacturer's shares have at least 20% upside
Lionbridge Technologies / LIOX	4.67	Ebitda margins could top 10% at cloud-based tech outfit
WILLIAM PRIEST		
Microsoft / MSFT	$57.42	Cloud-computing leader has a 6% free-cash-flow yield
Alphabet / GOOGL	804.60	Has a 5% free-cash-flow yield
PTC / PTC	45.26	Is a leader in the Internet of Things
Visa / V	82.45	Acquisition of Visa Europe will be accretive to earnings
MARIO GABELLI		
Sony / SNE	$32.89	Virtual reality is going to be a hot product
Herc Holdings / HRI	30.18	Beneficiary of a coming surge in infrastructure spending
Harris / HRS	89.67	Beneficiary of likely rise in U.S. military outlays
Madison Square Garden / MSG	165.03	Diverse assets could be worth $210 to $275 a share
OSCAR SCHAFER		
Nomad Foods / NOMD	$12.20	Turnaround play in European frozen foods
Evertec / EVTC	15.80	As Puerto Rican economy improves, Evertec will prosper
CommScope Holding / COMM	31.12	Shares could double as free cash flow rises
ANI Pharmaceuticals / ANIP	64.78	Ebitda rising as company introduces lucrative new drugs
ANDREW WELLINGTON		
Whirlpool / WHR	$160.75	Stock is cheap and appliance sales are growing
Lincoln National /LNC	48.90	Insurer's stock wrongly punished for interest-rate sensitivity
Microsemi / MSCC	38.01	Finding new markets for its superhigh-performance chips
Goodyear Tire & Rubber / GT	31.25	Focus on high-end tires has led to record profit
JEROME DODSON		
Wells Fargo / WFC	$44.71	Wells handled its recent banking scandal "the right way"

Source: Bloomberg

WILLIAM PRIEST

Microsoft generates lots of cash. Is that why you're such a fan?

Priest: Microsoft is at the forefront of the disruptive effects of technology. Across the industrialized world, technology is being substituted for both capital and labor, which is allowing profit margins to remain high or go higher.

Microsoft is a leader in cloud computing. The company has a 6% free-cash-flow yield, based on its current market capitalization, and a nearly double-digit earnings-per-share growth rate. The stock is reasonably priced at around $57.

Do you like Google, as well?

Yes. Google is also going to benefit from the substitution of technology for capital and labor. It has a 5% free-cash-flow yield, and we are expecting a free-cash-flow growth rate in the midteens.

Bill Priest says Visa's revenue could grow by 10% a year. *Photo: Jenna Bascom for Barron's*

We also like PTC [PTC], which is a leader in the so-called Internet of Things. The company's technology platform enables manufacturers to connect equipment and devices to the cloud for uses such as predictive maintenance. PTC has a $5 billion market cap. It is changing its revenue-recognition strategy by moving to a subscription model. The stock has a lot of upside.

What's the good word on Visa [V]?

Visa just completed the acquisition of Visa Europe, which should be accretive to earnings. Visa's revenue could grow by roughly 10% a year. The company is a leader in the expansion of the digital wallet, or electronic commerce.

MARIO GABELLI

Mario, why is Sony one of your current picks?

Gabelli: The company's entertainment side—videogames, movies, TV shows, music—generates half of Sony's $5 billion in annual Ebitda. As Bob Dylan, the Nobel Prize winner, sang, "The times, they are a-changin'."

Meaning what, exactly?

No matter what device they are using, millennials have a passion for live events. The world of entertainment is changing all the time. Sony is involved in the world that is changing. It is active in robots, artificial intelligence, and sensors for self-driving cars. The company recently started selling a virtual-reality headset for use with its PlayStation 4. Virtual reality is going to be a hot product.

Sony has 1.3 billion shares and trades for $33. The market cap is $40 billion. In the next 12 months Sony could be a pretty interesting stock.

Herc Holdings [HRI], the former Hertz Equipment Rental, is another of your favorites. Why?

Whether Hillary Clinton or Donald Trump becomes president, there is going to be more infrastructure spending. This country has real problems—25% of our 600,000-plus bridges are in need of significant repair. Our roads are challenged, as are our airports. Equipment rental, Herc's specialty, is a play on infrastructure investment. There are several public companies in the business. Herc has a about a 3% market share. The company was spun out of Hertz Global Holdings [HTZ]. It sells for $30, and there are 28 million shares outstanding.

Herc is an early-stage turnaround. The company's Ebitda margin is 35%, compared with competitors' 48%. Herc has to improve. The company has an economic tail wind, plus it is a fixer-upper. The stock has a shot at doubling. There are air pockets in the short term, with the cost of being public and Hertz-related legal issues.

Greater military spending is another of your themes. How powerful will that tail wind be for stocks?

President Obama drew a red line, threatening retaliation if Syria's president used chemical weapons. Syria crossed it, and the U.S. did nothing. The Russians annexed Crimea. North Korea and Iran remain rogues. The Sunnis and Shiites have been fighting for centuries. The Chinese are heating things up in the South China Sea. The Australian navy is buying submarines. Other countries are getting agitated. The U.S. has underspent on its military, and that has to change.

We are interested in avionics communications; Harris [HRS], based in Melbourne, Fla., is one of our picks. The stock is selling for $90, and there are about 125 million shares.

Mario Gabelli says Madison Square Garden's assets could be worth as much as $275 a share; the shares traded on Friday at $166. *Photo: Jenna Bascom for Barron's*

Let's bring it back home to Madison Square Garden *[MSG]. What's the score?*

Madison Square Garden has been involved in a lot of financial engineering. It was spun out of Cablevision Systems. Madison Square Garden has 24 million shares outstanding. The stock is $165, and the market cap is around $4 billion. The company has about $1.5 billion of net cash, and you get the air rights over the Garden, which could be sold for $400 million to $600 million. There are ways to structure a deal to reduce the tax impact.

MSG also gives you exposure to e-sports and e-gaming. Plus, the company owns numerous entertainment venues in addition to the Garden. Throw in the New York Rangers hockey franchise, which is worth about $900 million, and you get the New York Knicks for free. They are probably worth more than $1 billion. Add up these assets, and the company is worth between $210 and $275 a share and growing. The Dolan family, which controls the company, has run it well and is sensitive to other shareholders.

OSCAR SCHAFER

You're finding bargains among small-cap stocks. What is alluring about Nomad Foods *[NOMD]?*

Schafer: Nomad Foods distributes Iglo and BirdsEye frozen foods in Europe. The stock went public at $10 a share, rallied to $22, and then fell to single digits. Nomad is a platform company; it acquires companies in the packaged-foods arena to add to its platform. Hedge fund manager Bill Ackman, who also owns Valeant Pharmaceuticals International [VRX], is a big holder.

Problems at Valeant and other platform companies hurt Ackman and his followers. The company also had a few marketing hiccups. Nomad could earn $1.25 a share in the next several years. If it does so, the stock could trade closer to $20 than $12.

Oscar Schafer expects Evertec to benefit from rising credit-card and ATM use in Puerto Rico. *Photo: Jenna Bascom for Barron's*

How does Nomad's P/E multiple compare with the rest of the food group's?

Nomad trades for 11 times next year's estimated earnings. Pinnacle Foods [PF], in the U.S., is similarly sized, yet trades for 2.5 times the enterprise value of Nomad.

Evertec *[EVTC] also has had some hard knocks. What is the attraction?*

Evertec is a transaction-processing company in Puerto Rico. Investors have fled because of Puerto Rico's financial problems, leaving the stock at 10 times 2016 estimated earnings. Comparable companies have been acquired for 30 times earnings. Puerto Rico is much less banked than the U.S. More people there use cash than credit cards. As credit-card use, and the use of ATMs, grows in Puerto Rico, the company will see gains.

Additionally, President Obama recently signed a law that will help the commonwealth restructure its debt. That should help the local economy improve. Evertec is planning to make acquisitions in South and Central America, which also will lead to growth.

What does CommScope Holding [COMM] do, and why do you like it?

CommScope is a provider of tower-top antennas and cabling for data centers. The chairman, Frank Drendel, has made three acquisitions. The end markets for CommScope's products are the big telecommunications carriers. Business is lumpy from quarter to quarter, or even year to year. But acquisition-related synergies are increasing, and in several years, CommScope could generate $4.20 a share in free cash flow. Apply a multiple of 15 to that, and the stock could trade at $60. The shares are now around $30.

ANI Pharmaceuticals [ANIP] has long been a top pick of yours. What is the company's specialty?

ANI sells generic and branded drugs to fight cancer, infections, and other conditions. Ebitda has grown by 79% a year since 2010. The company's short- to medium-term goal is to generate $100 million a year in Ebitda. If it does so, it could be worth eight times Ebitda, or $800 million. Divide that by 11 million shares, and you get a $75 to $80 stock price, versus $65 a share today.

ANI owns a product for infantile spasms that has already been approved by the Food and Drug Administration. It will compete in a $1.5 billion market owned by Mallinckrodt [MNK]. In the next few years, that will add $300 million to $400 million of sales, and maybe $200 million of Ebitda. It is a call option, for which you are paying nothing.

ANDREW WELLINGTON

You describe this as a stock market of haves and have-nots. What caused the split?

Wellington: The overall market looks a bit expensive, driven by just half the market that is very expensive. Within that half, we see three types of stocks: high-dividend stocks; stocks that investors perceive as supersafe, such as consumer staples; and supergrowth stocks. Those include shares of companies that people think will grow forever: Facebook [FB], Amazon.com [AMZN], Netflix [NFLX], Alphabet. The expensive half is lifting the valuation of the broad market and masking the fact that the other half of the market is really cheap.

We take it that you shop among the have-nots.

We pride ourselves on getting exciting returns from boring stocks. Whirlpool, a manufacturer of washing machines and dryers and ovens, isn't in the sexiest business. But the stock is attractively valued, and valuation ultimately drives returns. Paying a fair price for a good business doesn't give you a good return. You have to pay an unfair price—a really cheap price.

Whirpool is trading for about 10 times earnings. Although earnings have rebounded since the housing crisis and are reaching new highs, the industry hasn't fully recovered. Appliance sales today are still below trend, which means the company should grow at an above-average rate for the next several years. Also, Whirlpool has improved dramatically in the past five to 10 years. It merged with Maytag and eliminated a lot of costs. It is making more money overseas than ever before and isn't getting full credit for it.

Lincoln National [LNC] sells for eight times earnings. Surely, this insurer is worth more.

Life insurance and annuities might be even more boring than appliances, but the low valuation is what makes the stock exciting. Lincoln sold for 12 times earnings in the not-so-distant past. The industry and the company have been wrongly criticized for their sensitivity to interest rates. The common view is that low rates are bad for life-insurance companies, which own lots of bonds. But to compensate for reduced interest income, they are charging higher premiums.

There are a lot of levers that management can pull to manage the business through different environments. Lincoln's profit has grown at a steady, stable rate for the past seven or eight years.

Andrew Wellington praises Whirlpool's makeover in the past decade, including its merger with Maytag, which led to substantial cost savings. *Jenna Bascom for Barron's*

Investors are rediscovering chip stocks, but Microsemi *[MSCC] remains somewhat obscure. What is its claim to fame?*

We weren't familiar with Microsemi until it popped up in our investment-screening process. Chip makers all have different businesses; Microsemi is in a niche business, making superhigh-performance chips. They aren't used in everyday household items, but in airplanes, missiles, communications equipment, and the like. Volume isn't huge, but the company has great profit margins and return on capital. It keeps finding new markets for its chips. Revenue is growing by 7% to 8% a year. Annual earnings growth is more like 10% to 15%. The company trades for a modest 10 times earnings.

Goodyear Tire & Rubber *[GT] is far better known. How has the company beaten back cheap competition from Asia?*

Low-cost Asian tire imports nearly killed Goodyear 15 years ago. The company got out of the low end of the business and now focuses on high-end tires. The low-cost manufacturers can't compete in that business. They don't have the technology or factories.

Goodyear's business is better today than at any time in its history. The company is generating record profits and still has room to improve margins. Before the financial crisis, it was earning about $1.60 a share. Today, it is earning $4 a share. Yet, the market seems skeptical; as a result, you can buy Goodyear for only eight times this year's estimated earnings.

JEROME DODSON

As a manager of ESG funds—funds that pay particular attention to environmental, social, and governance issues—you're confronted with an awkward question. One of your top holdings, Wells Fargo *[WFC], has been enmeshed in scandal after the bank opened more than two million customer accounts without authorization. Do you sell the stock?*

Dodson: We thought long and hard, and decided to hold on to the stock.

Here's why: Individual customers didn't suffer significant damage. The average fee charged to these accounts was $25, and all the money has been refunded. The problem was caused by the actions of individual bankers, who weren't authorized by the company.

Jerome Dodson is hanging on to Parnassus' Wells Fargo shares, which he considers undervalued. He thinks the bank's management handled a recent scandal correctly. *Photo: Jenna Bascom for Barron's*

The problematic question is: Did Wells Fargo put too much pressure on its bankers to meet sales quotas? The answer is probably yes, but this has stopped.

We still like the company from an ESG standpoint. It is the third-largest corporate contributor in the country to charitable organizations. Fifty percent of officers and managers are women. Wells has gone out of its way to be friendly to the LGBT community and gay employees.

What Wells did was wrong, but it has corrected the problem. The CEO is gone, and he gave up $41 million in compensation. The head of the division that ran the retail bank gave up about $19 million, and is also gone. Wells handled the problem the right way.

Given what's happened, does the stock have much upside?

Wells Fargo is trading around $45 a share. It could rise into the $70s over three years. This is an opportunity to buy Wells at a low price and P/E multiple. Its return on equity is almost 13%, whereas most banks are in the single digits. If you can overcome your emotions, you can buy the stock at a bargain.

HELIMA CROFT

Oil is trading around $50 a barrel. Where does the price go from here? It seems as if Saudi Arabia's plan to weaken marginal U.S. producers and keep prices high has backfired.

Croft: Oil prices fell lower than the Saudis anticipated. They didn't expect to be sitting in January 2016 on $26-a-barrel oil. They probably thought that by not cutting production at last November's OPEC meeting, oil would bottom in the low $70s and U.S. production would start to roll over. They didn't figure that the capital markets would remain open to U.S. shale producers—although, to be fair to the Saudis, shale production has dropped significantly

Helima Croft figures that Saudi Arabia wants to keep oil prices around $50 a barrel ahead of the IPO of its national oil company. *Photo: Jenna Bascom for Barron's*

Are supply and demand more balanced today?

Low prices have caused a rebalancing of the market in terms of daily supply and demand. But inventories remain bloated. Thus, rebalancing is a two-step process. Bloated inventories must be worked off, which means oil prices will grind upward, but not gallop higher.

Here's Where the Price of Gas Is Headed

Helima Croft, head of commodities strategy at RBC Capital Markets, explains why the Saudis will ensure oil stays in a very specific range. She spoke at Barron's Art of Successful Investing conference.

Saudi Arabia plans to bring its national oil company public, probably in 2018. How might that influence oil prices?

Saudi Arabia needs oil prices to be around $50 a barrel to make the initial public offering work. They don't want oil to trade for $70 or $80 a barrel. They are OK with some shale production coming back, but they don't want to resurrect the entire U.S. shale complex.

Oil at $50 relieves some pressure on foreign exchange reserves. It allows the IPO to get off the ground, and it helps Saudi Arabia avoid a debt-rating downgrade, allowing it to borrow. That is the Goldilocks price, for now.

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