

A Search for Global Value ð TRAPS!

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Value Stocks: Definitive Traits

- “ Predictable, consistent cash flow
- “ Defensive and/or defensible business
- “ Not dependent on superior management
- “ Low/reasonable valuation
- “ Margin of safety using many metrics
- “ Reliable, transparent financial statements

Value Traps: Some Common Characteristics

- “ Cyclical and/or overly dependent on one product
- “ Hindsight drives expectations
- “ Marquis management and/or famous investor(s)
- “ Appears cheap using management's metric
- “ Accounting issues

Current Value Traps

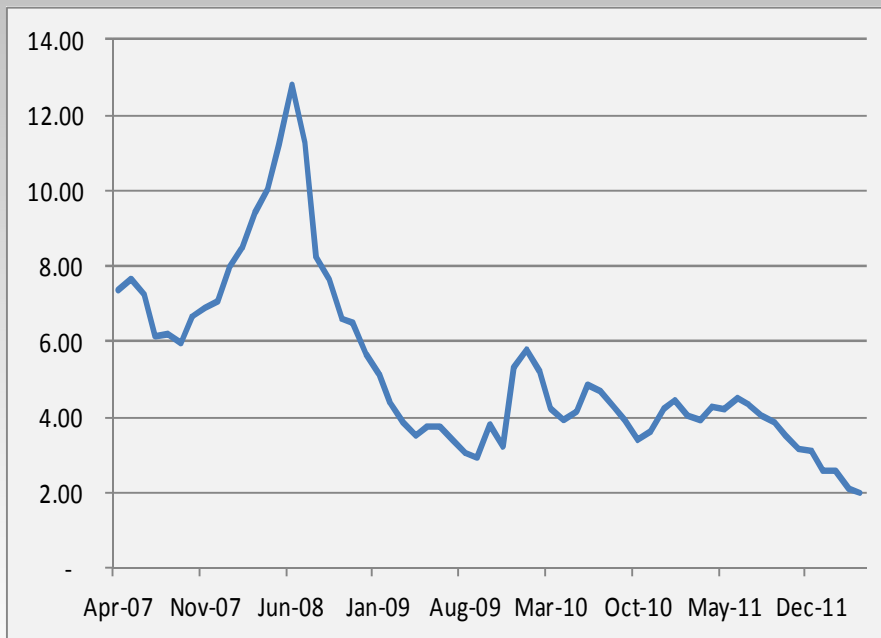
- “ U.S. Shale Explosion
 - “ National Oil Company
 - “ Mobile Computing Revolution
 - “ Digital Distribution
 - “ Troubled National Balance Sheet
 - “ Iron Ore Rush
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U.S. Shale Explosion: Cheap Gas at Coal's Expense

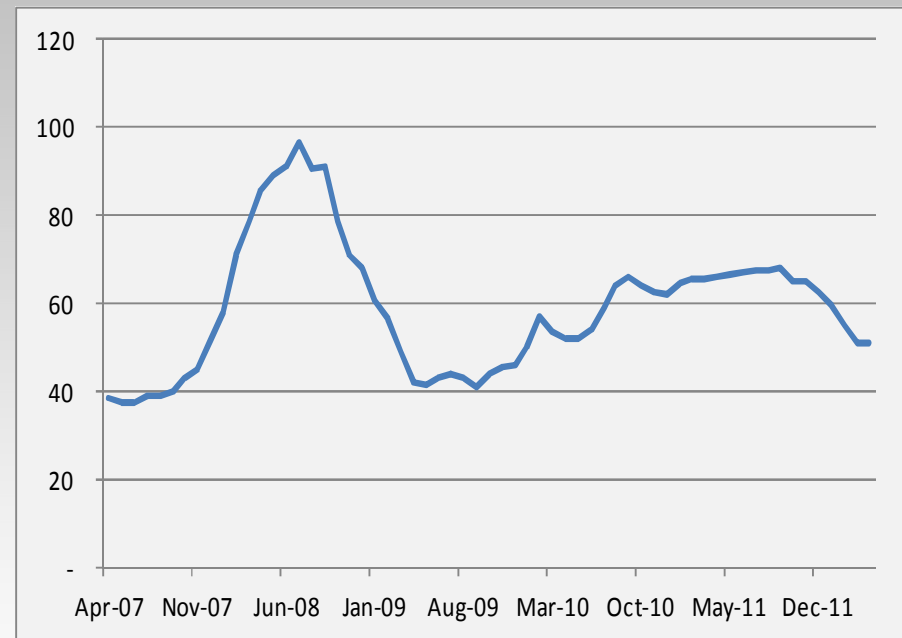
- “ Shale is a game-changer: U.S. is now 75% energy independent
- “ The rapid expansion of shale gas production capacity has led to record low prices
 - . Henry Hub natural gas price around \$2/mmBtu
 - “ Down over 50% YoY
 - “ Over 75% lower than five years ago
 - . Gas inventories are at record levels
- “ Shale production economics imply even lower natural gas prices
 - . Cash operating costs of production are extremely low (less than \$1.50/mmBtu in some cases)
 - . At current natural gas prices, there is still little incentive to cut production
- “ Cheap natural gas leading to substitution from coal-fired power generation:
 - . January 2012 coal-fired electricity was down 25% YoY
 - . January 2012 gas-fired electricity was up 23% YoY
- “ Coal industry is feeling the heat
 - . Domestic coal prices down 20-32% YoY
 - . Coal train car loads down 18% YoY

US Shale Explosion: Cheap Gas at Coal Expense

Natural Gas Price (Henry Hub \$/mmBtu)



Thermal Coal Price (Northern Appalachia \$/ton)



Source: Bloomberg

CONSOL Energy (NYSE: CNX)



Source: Bloomberg

CONSOL Energy (NYSE: CNX)

- “ The value story
 - Stock is down over 30% YoY
 - Earnings stream is diversified
 - Assets are low cost relative to peers
- “ CONSOL's businesses face headwinds
 - Thermal coal, 45% of 2011 gross profit . pressure from coal-to-gas substitution
 - Metallurgical coal, 38% of 2011 gross profit . uncertain Chinese steel demand
 - Shale gas, 17% of 2011 gross profit . ongoing domestic overinvestment
- “ High cost assets relative to international peers
 - Thermal coal exports are competing with low-cost exporters from Australia, Indonesia, South Africa, Colombia
 - Metallurgical coal exports pressured as Australia returns to normalized levels
- “ Shale gas capital allocation raises concerns: over half of 2012 growth expenditures

National Oil Company: For the Benefit of the State?

- “ From China to Brazil, quasi-public is the new model for national oil companies
 - . Step 1: Retain a majority stake
 - . Step 2: Push ambitious and costly investment strategy
 - . Step 3: Keep pump prices low to appease citizens
 - “ China shows how it's done
 - . Big three oil companies are theoretically public
 - . Overpaying for overseas reserves
 - . Downstream margins often negative
 - “ Petrobras seen as a LatAm model
 - . In Mexican election, politicians calling to IPO Pemex along similar lines
 - “ Brazil remains a troubling prospect for outside investors
 - . Chevron and Transocean face an \$11B federal lawsuit and criminal charges for a tiny 3,000 barrel spill in Nov 2011
 - . Infrastructure is ~2% of GDP . barely covering depreciation
 - . Prosperity has bred complacency and reform has slowed
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Petrobras (NYSE: PBR)



Source: Bloomberg

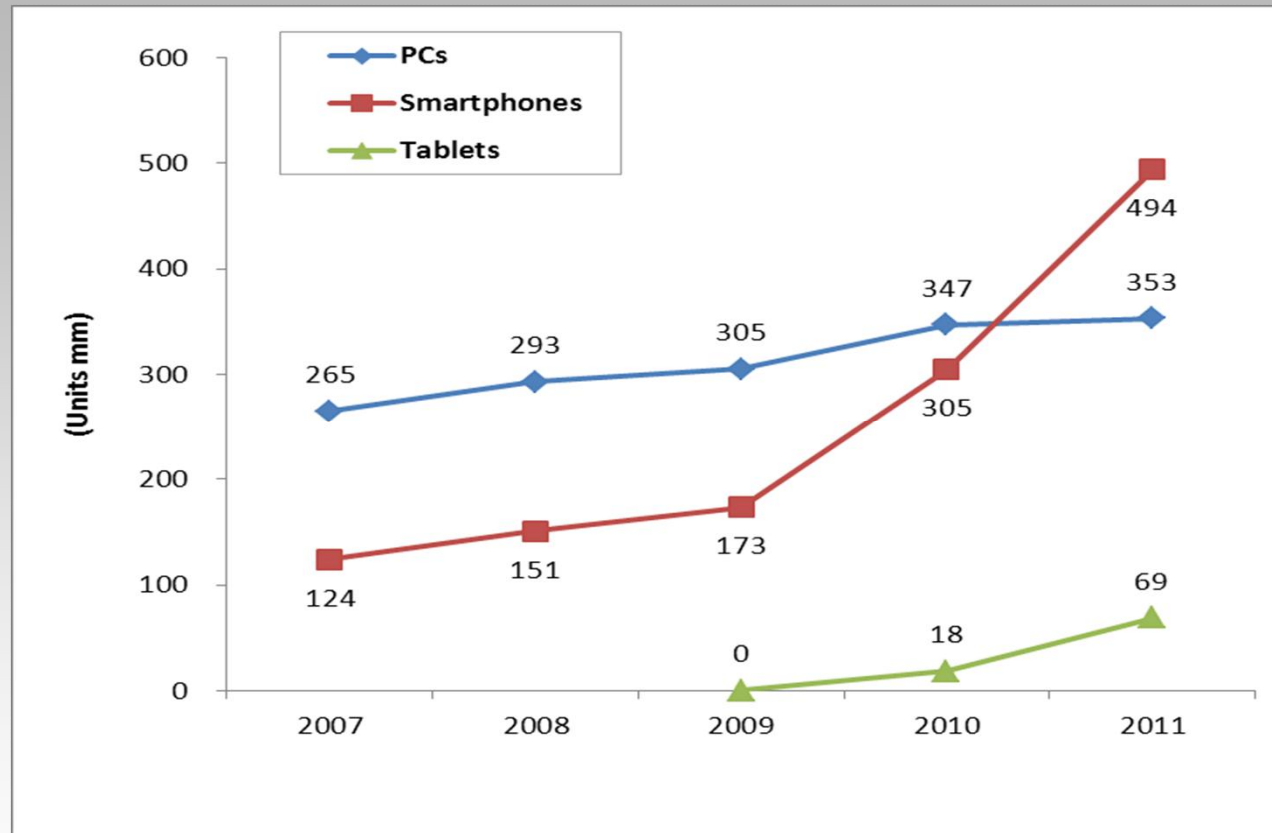
Petrobras (NYSE: PBR)

- “ The value story
 - . Forward P/E of 7.6x, forward EV/EBITDA of 5.4x
 - . Stock price is down nearly 40% over the past 2 years
 - . Pre-salt offshore oil discovery: the biggest find in Americas in a generation
- “ Huge capex program
 - . \$225B over 2011-15
 - . Requires \$14B of divestments and \$86B in additional leverage
- “ Government intervention reduces inherent value
 - . Push for local services:
 - “ PBR must incorporate 65% of content from local services industry
 - “ Brazil must construct a high-end shipbuilding industry from scratch
 - . Downstream: Domestic fuel prices capped
 - . Government domination of PBR
- “ Social engineering generates poor results
 - . Upstream: production growth of 1.4% per year from 2006-11
 - . Downstream: \$6.6B EBITDA loss in 2011
 - . \$13B FCF outflow after dividends in 2011

Mobile Computing Revolution: Death of the PC?

- “ The proliferation of mobile devices pressures PC demand
 - Mobile devices have same key capabilities as PCs
 - Apple shipped more iPads in 1Q12 than the largest vendor shipped PCs
 - Shipments of mobile products increased by 79% YoY in 2011
 - Shipments of PCs increased by 2.9%
- “ Proliferation of mobile devices pressures PC margins
 - iPad bill of materials is ~40% lower than average PC
 - Tablets/smart-phones have no hard-drives, no keyboards, and no Wintel
- “ Cloud services allow consumers to be device-agnostic
 - Eliminates need for PC as a mass storage device
 - Functionality migrating to the Cloud

Mobile Computing Revolution: Death of the PC?



Source: IDC via Bloomberg

Dell (NASDAQ: DELL)



Source: Bloomberg

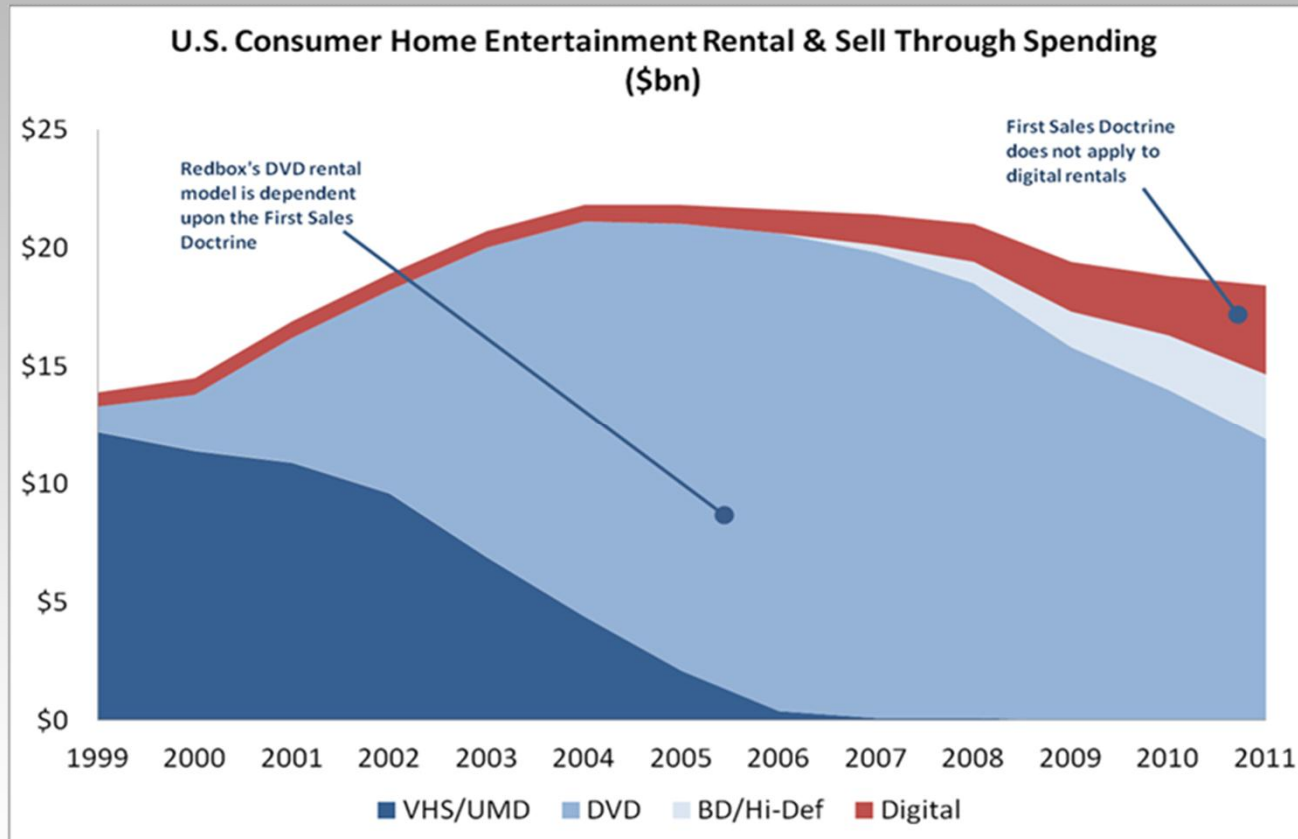
Dell (NASDAQ: DELL)

- “ The value story
 - . Forward P/E of 7.6x, forward EV / EBIT of 4.9x
 - . FCF yield of 16.7% using LTM FCF before share-buybacks and acquisitions
 - . \$2.7B in share-buybacks in 2011, equal to 56% of FCF, up from 23% of FCF last year
- “ Dell still a PC company
 - . Desktops and notebooks are a majority of the business (55% of revenue in FY12)
 - . PC software & peripherals are also significant part of the business (17% of revenue in FY12)
- “ Margins at near all-time highs appear unsustainable
 - . Gross margin last year was 22.3%. Average gross margin in 2005-2010 was 18.1%
 - . Margins were boosted by low component prices, moderate pricing environment, and extension of financing
 - . Recent supply chain consolidation/disruption increasing cost pressure
- “ Dell Financial Services contribution
 - . Portfolio up 7% to \$5B in FY12
 - . 68% of Dell Financial Services consumers have FICO scores of less than 660
- “ Dell using M&A to transform itself
 - . \$2.6B spent on acquisitions in FY12
 - . Announced 5 acquisitions so far this year

Digital Distribution: Physical Media an Endangered Species?

- “ Twilight of the Gatekeepers
 - “ Physical media retailers are being disaggregated
 - HMV . the last song
 - “ Unsuccessful diversification attempts to offset music declines
 - “ Shares at £0.04, down from 2005 peak of £2.73 . %cheap+throughout decline
 - Blockbuster . last of the chains
 - “ Unsuccessfully competed against DVD-by-mail service and online digital distribution
 - “ Bankruptcy filing September 2010
 - “ Continuously shrinking number of stores
 - “ Video is undergoing digital transition
 - Proliferation of digital video distribution outlets, including over-the-top video on demand and streaming services like iTunes and Netflix
 - Proliferation of internet-ready televisions and mobile devices (e.g., tablets and smart phones) are accelerating the shift to digital video consumption
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Digital Distribution: Physical Media an Endangered Species?



Source: The Digital Entertainment Group

Coinstar (NASDAQ: CSTR)



Source: Bloomberg

Coinstar (NASDAQ: CSTR)

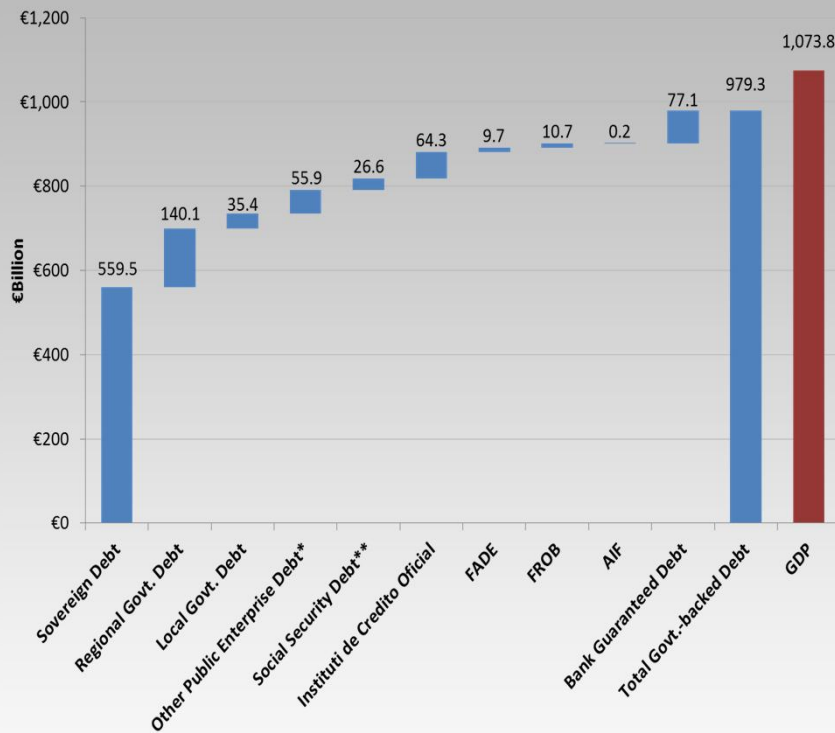
- “ The value story
 - . Forward EV/EBITDA 4.7x versus 7.0x average over last 5 years
 - . Over \$7.50 TTM FCF/share in FY11
 - . Redbox has been Coinstar's growth engine
 - “ Reaching saturation point in 4Q11
 - . Installed kiosk growth rate slowed to 2.9% QoQ, down from an average of 8.4% QoQ in the prior 10 quarters
 - . Redbox DVDs rented fell 0.7% QoQ, the first ever sequential decline
 - “ Coinstar resorts to unconventional ways to support Redbox growth
 - . Recently raised rental DVD prices by 20% to \$1.20/night
 - . Announced a digital joint venture with Verizon
 - . Pending acquisition of NCR's ~10,000 DVD kiosks
 - “ Redbox business model under pressure
 - . Movie studios have implemented more onerous distribution windows
 - . Implementation of credit card interchange fees will impact Redbox's transaction-heavy business
 - “ Coinstar is exploring creative kiosk concepts to offset potential Redbox slowdown
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Troubled National Balance Sheet: Banking on Spain

- “ Spain’s fiscal house is in disarray
 - Unemployment rate at 23% continues to rise (youth unemployment at 50.5%)
 - Fiscal debt greater than consensus view
 - Austerity won’t solve Spain’s on-going economic woes
 - “ Over-reliance on LTRO and ECB funding kicks can down the road
 - ” 152B in ECB funding as of February 2012 (47% of total ECB lending)
 - Spanish banks purchased at least ” 68B in Spanish debt since November 2011
 - Regional government borrowings continue to climb (” 140B at year-end 2011)
 - “ Caja collapse adds to problem
 - Problematic loans forcing industry consolidation
 - Government guarantees and incentives required to complete consolidations
 - “ Spanish real estate bubble still on the books
 - ” 323B of commercial and property developer loans still outstanding
 - ” 50B of increased provisions only 15% of total required coverage
-

Troubled National Balance Sheet: Banking on Spain

Spain's Debt/GDP +90%, all in – not 60%



* Other central, regional and local public enterprises

** Other public enterprise debt as of 3Q11; govt.-backed bank debt as of April 10, 2012

Note: FADE = Fondo de Amortizacion del Deficit Electrico;

FROB = Fondo de Reestructuracion Ordenada Bancaria;

AIF = Administrador de Infraestructuras

Source: Bank of Spain, Bloomberg

Spain 5-Y CDS: Back at pre-LTRO levels



Source: Bloomberg

Banco Santander (SAN SM)



Source: Bloomberg

Banco Santander (SAN SM)

“ The value story

- Trading at P/TBV of 0.9x, P/E of 7.2x
- Attractive exposure to Brazil

“ Significant real estate exposure in Spain

- Equates to 172% of TBV
- 29% of commercial real estate loans are classified as NPLs as of year-end 2011
- Residential mortgage NPLs at 2.7% of portfolio and rising

“ Brazil exposure a headwind, not a panacea

- Increasing lending, even as local competitors pull back
- Credit quality a question mark

“ Capital remains an issue

- Core Tier 1 capital ratio of 10% doesn't reflect leverage of 26x TBV
- Listed local bank structure traps capital

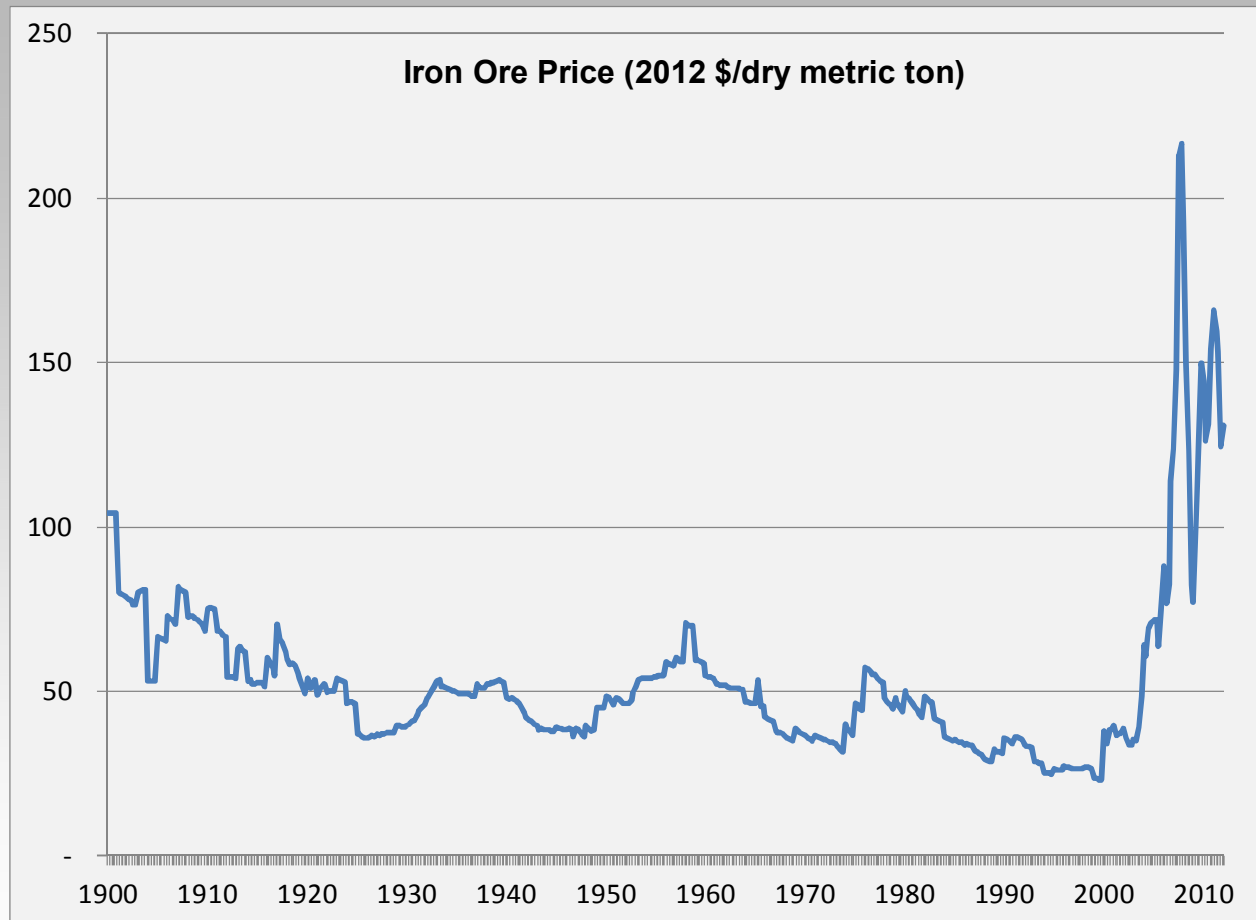
Iron Ore Rush: Fuel for China's Bubble

- “ Leveraged to Chinese growth
 - Growth in iron ore demand is driven by China's fixed asset investment boom
 - China's share of global iron ore consumption is 66% (2011) up from 51% (2007) ¹
- “ China's credit-driven fixed-asset economy not sustainable
 - Recent signs of a slow down
 - Negative implications for Chinese steel consumption
 - Recent BHP comments consistent: %Steel growth rates will flatten and they have flattened.+ *Ian Ashby, President of BHP Iron Ore, March 20, 2012* ²
- “ Iron ore extraction becoming more costly
 - Enormous investment in rail, port and energy facilities required
 - Steel, energy and labor cost inflation in key mining regions
 - Governments targeting the industry as a source of revenue and taxes

¹ Macquarie

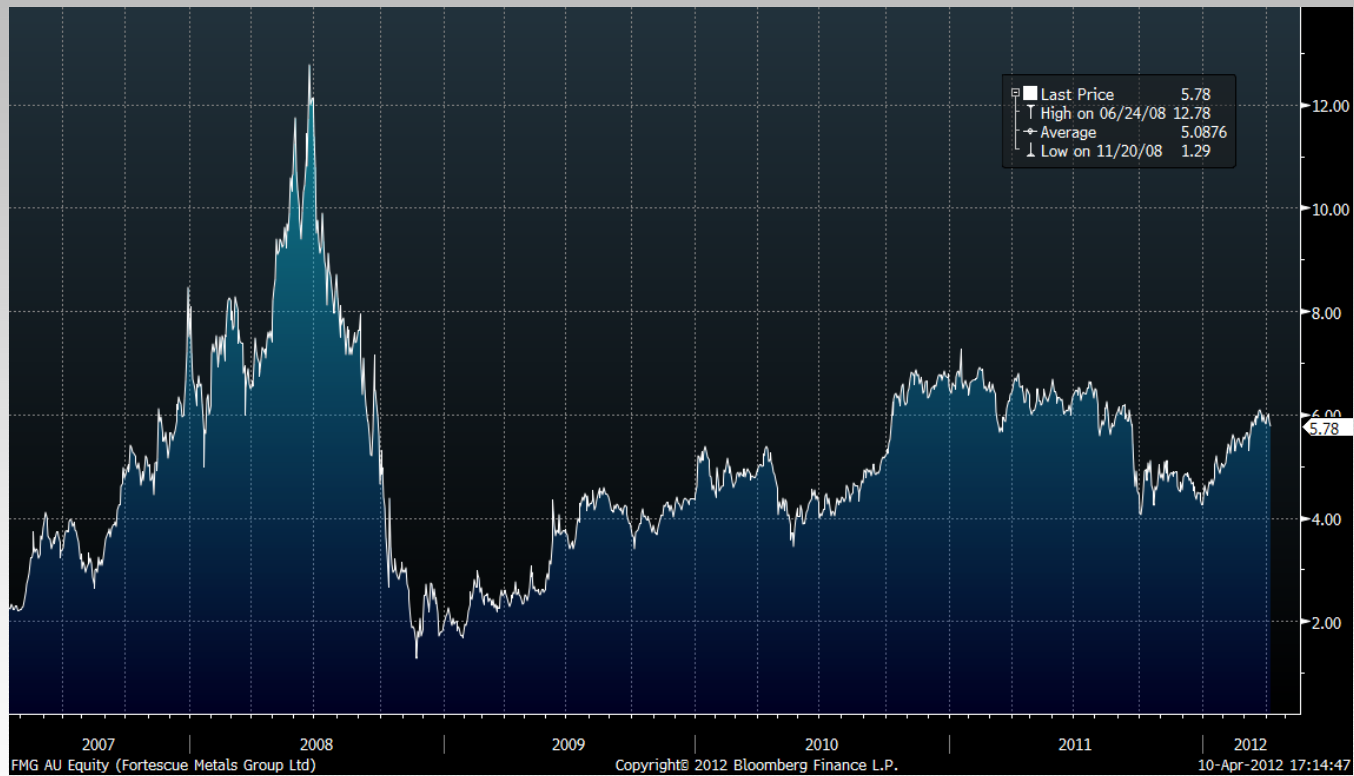
² AJM Global Iron Ore & Steel Conference (March 20, 2012)

Iron Ore Rush: Fuel for China's Bubble



Source: Global Financial Data

Fortescue (ASX: FMG)



Source: Bloomberg

Fortescue (ASX: FMG)

- “ The value story
 - High operating cash flow margins (38% in 2011)
 - Key assets near the bottom of the industry cost curve
 - Plans to increase production capacity to 155Mtpa from 55Mtpa by June 2013
- “ A highly leveraged bet on continued fixed asset investment growth in China
 - 98% of sales from China
 - High level of debt (\$6.4B) exposes company to iron ore price declines
- “ Cost inflation endemic in Western Australia's Pilbara region
 - Shortages in labor, accommodation and transportation driving up costs
 - Increasing overburden removal required at existing mines
 - Cost inflation in dollar terms exacerbated by strong AUD currency
- “ Significant planned volume growth may create oversupply in the iron ore market
 - The four major iron ore producers are all pursuing significant expansions at a time when Chinese demand growth is flattening
 - Increases risk to Fortescue debt-financed expansion

**Thank You to the
Grant's Spring 2012 Conference**

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