ANALYST QUICK NOTES

New products, M&A announcements, management shakeups, earnings surprises. Whatever the news, you want to know what Argus thinks. Our Quick Notes fill this need by providing real-time analysis of current news about Argus-covered companies or other market-moving events. Please check back regularly for new Quick Notes. Important disclaimer information is on the last page of this document.

Small-Cap Stocks
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Five Small-Cap Stocks

- Small- and mid-cap stocks have been market leaders for the past year, and have shown exceptionally strong momentum over the trailing three months. Small- and mid-caps are likely benefiting from expectations of improving US economic growth, as they tend to be more focused on growth than income and they often lack the global diversification of large-caps.
- Below is a list of five BUY-rated companies followed by Argus analysts and that are in the small- and mid-cap group.
  - Colfax Corp. (NYSE: CFX). We recently raised our rating on the CFX shares to BUY from HOLD, as the company is making progress on both revenue and margins. Over the long term, we see Colfax, a mid-cap company with a focus on power generation, energy and infrastructure, as an emerging leader in the Industrial sector. Colfax has a history of growing via M&A, and management integrates acquired businesses through the 'Colfax Business System,' which focuses on the continuous improvement of acquired companies and is modeled on the highly successful Danaher Business System. In recent quarters, earnings have been weak due to the company's exposure to the energy and mining industries, and to unfavorable currency effects. But the 3Q results may indicate an inflection point, as margins have begun to rise and orders are improving.
  - Hawaiian Holdings Inc. (NGS: HA). This mid-cap airline company reported solid EPS in 4Q16, reflecting strong demand for flights to Hawaii and low fuel costs. Looking ahead, we expect it to benefit from limited capacity growth on Hawaii-to-West Coast flights, which should help it to maintain ticket prices, as well as from expanded service to Japan and the purchase of new fuel-efficient aircraft. In addition, it continues to pay down debt and buy back stock, and should benefit from diminishing currency headwinds in the coming quarters. Our target price is $64.

- Wendy's Co. (NYSE: WEN). We recently upgraded this mid-cap restaurant company to BUY from HOLD. We believe that Wendy's has revitalized its brand over the last three years by selling more than 800 company-owned restaurants. By the end of the third quarter, it had sold 85% of the company-owned restaurants it had planned to sell to franchisees - well above its 60% target. By the end of the year, franchisees will own 95% of all Wendy's restaurants and only 5% will be company-owned. Meanwhile, Wendy's is on track to remodel 500 restaurants and build 100 new restaurants in North America. The company and its franchisees have already remodeled 30% of restaurants, and the remodeled restaurants are generating significantly greater revenue on average than older locations. The company is also working to strengthen its brand through new product launches and stepped-up marketing.
- Cracker Barrel Old Country Store Inc. (NGS: CBRL). This is another recent upgrade. The company has reported higher comp sales for ten consecutive quarters, and we expect its 'barbell strategy,' with a dual focus on more expensive menu items and value meals, to result in low single-digit comp growth in FY17. In addition, we look for cost savings from restaurant-level operating efficiencies, which should offset higher labor expense. We also expect a 4% decline in commodity costs in FY17, reflecting the impact of lower beef and egg prices. Over the long term, we believe that management can improve sales at Cracker Barrel restaurants through more-efficient labor scheduling, faster service, radio and television ads, and roadside billboards. We also expect management to use the proceeds from sale-leaseback transactions to decrease debt, boost the dividend, and buy back shares.
- Arista Networks Inc. (NYSE: ANET). The ANET shares sold off by about 12%, or $12, after the company suffered a legal setback in its ongoing battle with Cisco over patent infringing technology. We think the sell-off is a buying opportunity. On 1/13/17, the U.S. International Trade Commission (ITC) revoked a U.S. Customs and Border Protection ruling that was favorable to Arista. The ITC has ruled that Arista's 'workaround' in fact continues to infringe on Cisco's technology and thus may not be imported into the United States. The reversal in the original ruling will be appealed by Arista. But the timing of such an appeal, not to mention prospects for success or failure, could impact Arista's earnings over time. We note, however, that Arista has on-shored some production, and thus can meet near-term demand with products produced in the U.S. And while mindful of the risks related to the recent ITC ruling, we continue to view ANET's prospects favorably. We expect more and more businesses to shift to cloud-based technology in the coming years.

For more information on these companies, please see our Analyst Reports on the website.

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