SN VALUATION
SN CAPITAL SN CONSULTING SN ENGLISH

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SPLS and DGIT

Staples piggybacked the stock appreciation in the office supplies space, with the recent merger talks between Office Max and Office Depot driving up the comp stock prices across the board. They are essentially in the same sector domestically, as Staples. We picked up Staples 2 weeks ago, and we are happy to have coincidentally participated in the 13% **pricing** jump. As we have stated before, we are happy with pricing adjustments, but we are in this business for uncovering value. Value is primarily created with 1) operational efficiency, 2) market share retention and market expansion, and 3) capital efficiency, which is driven by management, and the reason why we are proponents of the PE, direct control model versus passive portfolio management. These secular growth stories provide a spot light to stir interest in a name, where analysts will start to uncover these growth catalysts, or undisclosed risk, thereby unlocking the hidden value for the market investors. However, spot light alone doesn't create value, which is why we are happy with the jump, which will trigger our Sell recommendation for now, but we want to focus more on management improving margins, increasing growth, sustaining strong cash flow, and reinvesting cash at a higher IRR than cost of capital. As the stock market continues its upward trend, we have to catch ourselves from including a stock in the portfolio because of the recent run up and technical indicators, while dismissing weak fundamentals because as quickly as the market rallied in 2012 and YTD, the rally may reverse into a plunge in a short time period, and we will face palm ourselves over the ill-advised stock picks. Staples, as highlighted in our valuation report, is generating healthy cash, with a strong balance sheet, and selling at a low valuation to net tangible asset and cash flow. So, although we will sell, it is really a long term hold, in our view.

Digital Generation was picked up by us in late 2011. The co.'s stock plunged shortly thereafter, amidst co. specific news and Europe related impact on the market. Then in Aug. 2012, the co. announced a strategic committee which was advised by none other than, Goldman Sachs, would look into marketing the firm for strategic alternatives, such as a sale, merger, etc. The co., just yesterday, announced the committee has not found a willing buyer, which made the stock plunge 28% to $6.45. We believe the market is overreacting. Even with a 3% growth forecast over the next 5 years, the co. will still generate $80 MM in operating cash flow, leaving $50MM in extra cash annually, after accounting for maintenance capex. We loathe the $380MM goodwill balance, indicating mismanagement of cash by management. Granted the co. has a negative tangible asset of -$3.30, but the co. will generate $2/year, so we believe there is a value play at stake. Negative book value of -$60MM, but the cash flow will suffice, over the next 5 years, to justify a new batch of purchase in the ensuing week.