

TRANSCONTINENTAL INC -CL A TCL-A.TO

July 02, 2020 - 5:02pm EST

by

andreas947

			2020	2021
Price:	15.00	EPS	0	0
Shares Out. (in M):	87	P/E	0	0
Market Cap (in \$M):	1,300	P/FCF	0	0
Net Debt (in \$M):	980	EBIT	0	0
TEV (\$):	2,280	TEV/EBIT	0	0

Description

Transcontinental, Inc. (TCL)

Summary

We focus on smaller companies with “Ft. Knox” balance sheets and large & sustainable free cash flow yields and we are typically seeking a double-digit FCF yield or higher on an unleveraged basis. The objective is for the sustainable FCF to eventually drive up the share price to a more reasonable valuation through share buybacks, debt reductions, dividends, or accretive acquisitions. Obviously, it is important we have a management team that cares about shareholder value. We focus on small-cap stocks because there is a much better chance to find an attractive investment opportunity which is under-followed or undiscovered.

Transcontinental, Inc. (TCL) is a leader in flexible packaging in North America, Canada’s largest printer, and the leading Canadian publishing group of French-language educational resources. The Company operates through three segments: Packaging, Printing, and Other. The Packaging segment engages in the extrusion, lamination, printing, and converting packaging solutions. This segment serves dairy, coffee, meat and poultry, and more. The Printing segment provides integrated services for retailers, such as premedia services, flyer and in-store marketing product printing, and door-to-door distribution. The Other segment is involved in printing and digital publishing of educational books, and specialized publications for professionals in French and English. TCL is a family-controlled business founded in 1976.

TC Transcontinental at a glance

For over 40 years, TC Transcontinental's **mission** has been to create products and services that allow businesses to attract, reach and retain their target customers.

- ▶ A leader in flexible packaging in North America
- ▶ Canada's largest printer
- ▶ The leading Canadian publishing group of French-language educational resources
- ▶ Family-controlled business founded in 1976



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TCL's shares currently trade at about C\$15 per share with about 87m fully diluted shares for a market cap of about C\$1.3b. TCL has a reasonable balance sheet with a net debt position of about C\$0.95b about 2.2x LTM adjusted EBITDA. The Company has a highly cash-generative business model. The Company's cash from operations has represented a majority percentage of adjusted EBITDA in every year since 2008. In 2019, TCL generated about C\$430m of cash from operations. TCL has an unleveraged FCF yield of close to 11%. Over the last six years, TCL has generated cumulative cash flow from operations of close to C\$2b, or about 100% of the enterprise value (EV).

For over 40 years, TC Transcontinental's mission has been to create products and services that allow businesses to attract, reach, and retain their target customers. In 2019, they generated \$3.0 billion in revenues, had about 8,500 employees, as well as 40 operating facilities. The TCL vision is to become a market leader in flexible packaging in North American while maintaining their position as Canada's largest printer and as the leading Canadian French-language educational publishing group.

TCL has a three-pronged strategy. First, they strive to grow their Packaging Sector through organic sales growth and acquisitions. Second, they want to optimize their printing platform and capture growth opportunities in promising verticals. And lastly, they want to grow their book publishing and Groupe Constructo activities through organic growth and acquisitions.

Our vision

To become a **market leader** in flexible packaging in North America while maintaining our position as Canada's largest printer and as the leading Canadian French-language educational publishing group



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PACKAGING



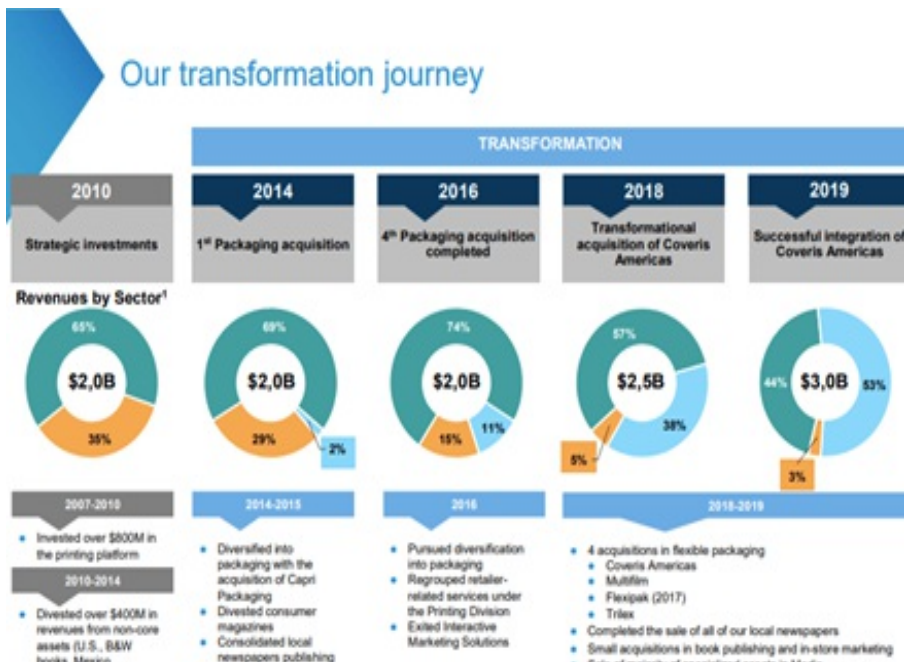
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PRINTING



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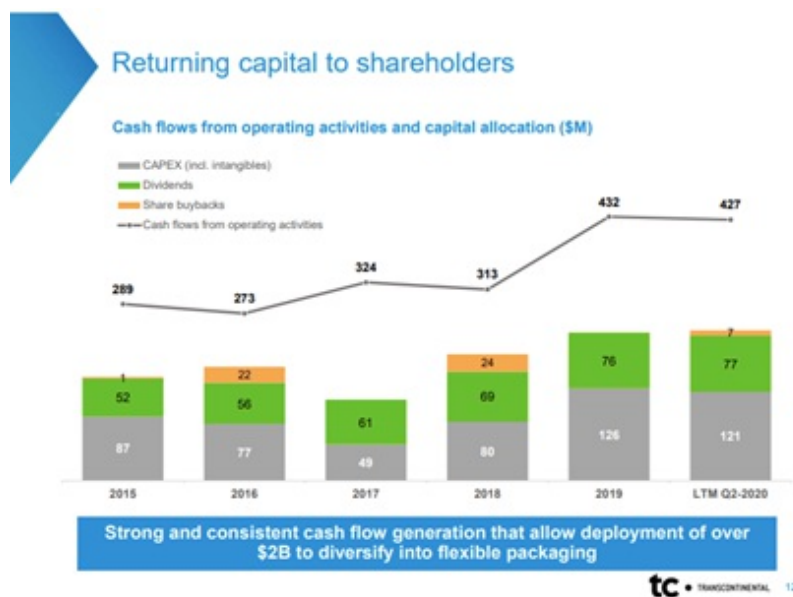
TCL has been written off as a declining printer with no growth potential and we believe the current multiple continues to reflect this sentiment. As one looks closer, it becomes evident that TCL is a major player in flexible packaging in North America and continues to grow in this segment over the next five years. TCL is using the strong and steady cash flows of its unique Print Segment to position itself as a major player in flexible packaging in North America. We believe TCL has revenue growth potential as it expands into a growing flexible packaging industry. The flexible packaging industry is expected to grow about 5% per year over the next five years.



We believe TCL is attractive at current prices trading at 0.7x revenues, 5x EBITDA, and an 11% unleveraged FCF yield. We believe its Printer Segment is a better business than most investors realize – Print Segment includes a unique business model printing flyers and in-store displays for major Canadian retailers, which has enabled industry outperformance to date.



We believe if TCL grows its Packaging Segment and Print Segment results remain relatively stable, investor perception could further improve. We believe TCL could achieve C\$500m in adjusted EBITDA by 2022 and trade for 6x adjusted EBITDA or an EV of about C\$3b, with net debt of about C\$800m for a market cap of about C\$2.2b. Based on 87m diluted shares outstanding, we believe TCL stock could trade for about C\$25 per share, or close to 70% higher than the current price of C\$15 per share.



TCL is the largest printer in Canada and has a state-of-the-art network of printing plants and one of the lowest cost structures in the industry. TCL cost structure and modern equipment and geographic locations enable it to provide unique service capabilities to its customers that other prints find difficult to match. Major retailers in Canada depend heavily on flyers to drive customers into their stores and these retailers have long-term relationships with TCL. TCL also provides unique in-store printing capabilities for these retailer customers.

Business Description

Transcontinental Inc. engages in the flexible packaging business in Canada, the United States, Latin America, the United Kingdom, Australia, and New Zealand. It operates through three segments: Packaging, Printing, and Other. The Packaging segment engages in the extrusion, lamination, printing, and converting packaging solutions; and manufacturing flexible plastic and paper products, including roll stock, bags and pouches, coextruded films, shrink films and bags, and advanced coatings. This segment serves dairy, coffee, meat and poultry, pet food, agriculture, beverage, confectionery, industrial, and consumer product markets, as well as supermarkets. The Printing segment provides integrated services for retailers, such as premedia services, flyer and in-store marketing product printing, and door-to-door distribution, as well as print solutions for magazines, four-color books, and personalized and mass marketing products. The Other segment is involved in printing and digital publishing of educational books, and specialized publications for professionals in French and English. Transcontinental Inc. was founded in 1976 and is headquartered in Montreal, Canada.

TC Transcontinental Packaging

The vision for the Packaging sector is to become a market leader in flexible packaging in North America. The strategy for the Packaging sector is to grow the sector through organic sales growth and acquisitions. They have 25 production plants worldwide, mainly in the United States, Canada, and Latin America.

TCL packaging has significant traction in growing profitability. Adjusted EBITDA margins grew from 11.9% in FY2018 to 12.8% in FY2019, a 90bps improvement. Additional cost synergies are expected in FY2020 from internalization of film and plates, on plan to exceed the initial cost synergy target of \$20 million US. TCL is striving to establish leadership in sustainability and the circular economy for plastics.

The Packaging sector serves a variety of core markets. This includes agriculture, beverage, candy, dairy, coffee, home and personal, pet food, and meat and poultry. TCL invests in innovative and eco-responsible products to become the market leader in core markets.

Serving a variety of industries

Core markets among our portfolio of products



Investing in innovative and ecoresponsible products to become the market leader in core markets

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Flexible Packaging Serves an Important Purpose

The key function of a package is to contain and protect the product. Packaging also extends shelf life. Packaging accounts for about 10% of the carbon footprint of a product. About 1/3 of all food produced is disposed of before it is consumed so packaging is identified as one of the solutions to reduce food waste. The benefits of flexible packaging include that it is lightweight, optimizes transportation, and offers significant improvement in shelf life.

Flexible packaging serves an important purpose

- The key function of a package is to contain and protect the product
- Packaging extend shelf life
 - Rule of thumb: packaging accounts for about 10% of carbon footprint of product¹
 - 1/3 of all food produced is disposed of before it is consumed²
 - Packaging is identified as one of the solutions to reduce food waste³
- Benefits of flexible packaging:
 - Flexible packaging is lightweight
 - Flexible packaging optimizes transportation
 - Flexible packaging offers significant improvement in shelf life



The challenge of flexible packaging is the end-of-life management

¹ Source: Sustainable Packaging Coalition

² Source: U.S. Department of Agriculture. In the United States, over one-third of all available food goes uneaten through loss or waste.

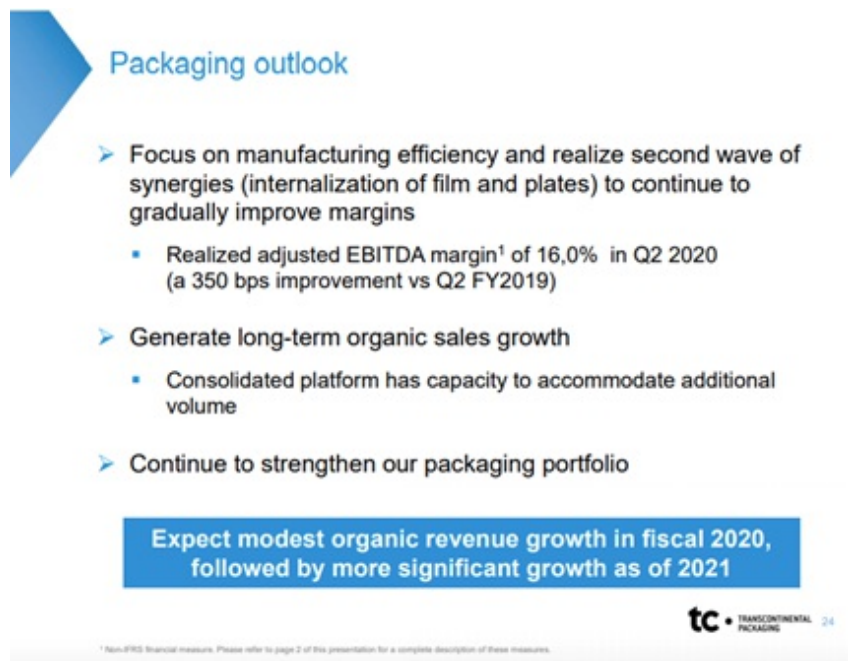
³ Source: According to ReFED, a non-profit organization committed to reducing U.S. food waste.

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Impact of COVID-19 on Packaging Activities

While not immune to economic downturn or crisis, the Packaging sector typically performs well in these occasions. This sector plays a crucial role in food, beverage, and other essential consumer staples. These products are more important than ever and essentially all of our products and packaging are for home consumption. Their focus is to manage the strong order uptake and ensure they can support their customers by optimizing capacity and keeping their employees healthy and safe. Over the last few months, the sales team has been operating remotely, but in close contact with customers. This is a strong opportunity for the Company to demonstrate the resilience of the packaging business.

TCL is focused on manufacturing efficiency and realizing a second wave of synergies (internalization of film and plates) to continue to gradually improve margins. TCL realized adjusted EBITDA margin of 16.0% in Q2 2020. TCL seeks to generate long-term organic sales growth. Their consolidated platform has the capacity to accommodate additional volume. They also want to continue to strengthen their packaging portfolio. TCL expects modest organic revenue growth in fiscal 2020, followed by more significant growth as of 2021.



Packaging outlook

- Focus on manufacturing efficiency and realize second wave of synergies (internalization of film and plates) to continue to gradually improve margins
 - Realized adjusted EBITDA margin¹ of 16,0% in Q2 2020 (a 350 bps improvement vs Q2 FY2019)
- Generate long-term organic sales growth
 - Consolidated platform has capacity to accommodate additional volume
- Continue to strengthen our packaging portfolio

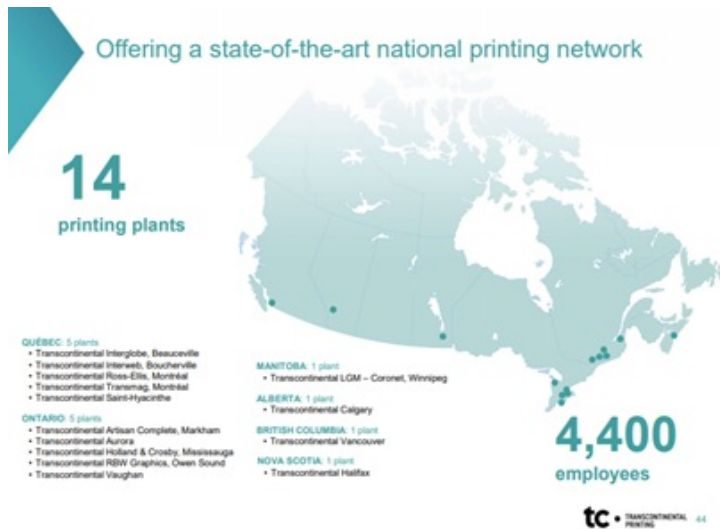
Expect modest organic revenue growth in fiscal 2020, followed by more significant growth as of 2021

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¹ Non-IFRS financial measure. Please refer to page 2 of this presentation for a complete description of these measures.

TC Transcontinental Printing

The vision in the Printing sector is to maintain their position as Canada's largest printer. Their strategy is to optimize their printing platform and capture growth opportunities in promising verticals. They have 16 state-of-the-art printing plants, from coast to coast.



The Printing sector provides a broad range of printing solutions for many industries. This includes marketing products, publishing, retail, and premedia and distribution.



In 2019, TCL announced the closure of Brampton and PEI plants, providing more than \$12 million in annual cost savings. FY2019 Adjusted EBITDA was \$268 million. TCL simplified overhead structure to reduce indirect costs. They did an acquisition of Holland & Crosby to increase their presence in a growth vertical. TCL states they will continue to take action to ensure they generate strong free cash flow in the printing sector.



2019 Achievements in Printing

- Optimizing our manufacturing platform
 - Announced the closure of Brampton and PEI plants, providing more than \$12 million in annual cost savings
 - FY2019 Adjusted EBITDA margin of \$268 million (20,2%)
- Simplifying overhead structure to reduce indirect costs
- Proactive defense of the Publisac
- Acquisition of Holland & Crosby to increase our presence in a growth vertical (In-Store Marketing).
 - Combined with the acquisition of Artisan complete in January 2020, the annual revenues run-rate for this vertical stands at ~\$140 million
- Sale of Fremont building to Hearst (\$75M US)

We will continue to take action to ensure we generate strong free cash flow in our Printing sector

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Impact of COVID-19 on Printing Activities

TCL has been communicating closely with customers and monitoring market developments. Following the government decisions related to non-essential services, they have significantly reduced their operation with about 1,600 temporary layoffs. They will recall employees as volume recovers.

The competitive landscape will be impacted in the long term as some players may not survive the crisis, such as customers and competitors. However, the printing sector is expected to continue generating positive free cash flows through the crisis.

In the printing sector, TCL will monitor volume trends and proactively adjust cost structure to protect profitability. TCL wants to grow their market share in verticals with significant growth potential like in-store marketing products, book printing, and pre-media services. TCL wants to ensure rigorous management of their long-term contracts and invest in automation to improve manufacturing efficiency. The Printing outlook will continue to generate significant cash flow.



Printing outlook

- Monitor volume trends and proactively adjust cost structure to protect profitability
- Grow our market share in verticals with significant growth potential like in-store marketing product, book printing and premedia services
- Ensure rigorous management of our long-term contracts
- Invest in automation to improve our manufacturing efficiency
- Continue to generate significant cash flow



TC Media

The Media segment of TC Transcontinental is the smallest sector. This segment is now focused on Educational Material and Groupe Constructo. They completed the transformation in the Media sector with the sale of the majority of their specialty media assets and event planning activities. In 2010, the Media sector had close to \$700 million in revenues while it now represents less than \$70 million annually or about 2% of their consolidated revenues. They maintained solid financial performance in FY2019 and expect continued good performance in FY2020. TCL is committed to growing their activities of TC Media Books, which includes educational material publishing and distribution, and Groupe Constructo. Their vision is to maintain their position as the leading Canadian French-language educational publishing group.

Segment now focused on Educational Material and Groupe Constructo

- Completed the transformation in Media Sector with the sale of the majority of our specialty media assets and event planning activities.
- With close to \$700 million in revenues in 2010, the Media Sector now represents less than \$70 million annually or ~2% of our consolidated revenues.
- Solid financial performance in FY2019 and expect continued good performance in FY2020 with limited impact from COVID-19.
- Committed to growing our activities of TC Media Books (educational material publishing and distribution) and Groupe Constructo.

Our vision is to maintain our position as the leading Canadian French-language educational publishing group

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Strong Cash Generative Business Model and Attractive FCF yield

TCL has a highly cash-generative business model. The Company's cash from operations has represented a majority percentage of adjusted EBITDA in every year since 2008. In 2019, TCL generated about C\$430m of cash from operations. TCL has an unleveraged FCF yield of close to 11%. Over the last six years, TCL has generated cumulative cash flow from operations of close to C\$2b, or almost 100% of the enterprise value (EV).

Revenue Growth Potential Through Flexible Packaging Segment

We believe TCL has revenue growth potential as it expands into a growing flexible packaging industry. The flexible packaging industry is expected to grow about 5% per year over the next five years.

Solid Competitive Position in Canada Printing Industry

TCL is the largest printer in Canada and has a state-of-the-art network of printing plants and one of

the lowest cost structures in the industry. TCL cost structure and modern equipment and geographic locations enable it to provide unique service capabilities to its customers that other printers find difficult to match. Major retailers in Canada depend heavily on flyers to drive customers into their stores and these retailers have long-term relationships with TCL. TCL also provides unique in-store printing capabilities for these retailer customers.

Solid Results for Quarter Ended April 2020 Despite Pandemic

Importantly, TCL achieved a strong quarter for April 2020 with both Packaging and Printing segments showing resilient performance amid the corona pandemic. Packaging segment expects organic growth in H2 of 2020 and Printing segment is recovering with the reopening of Canada's economy. TCL's Print segment is a stronger business than the market is giving it credit for as its flyers are an essential tool for major retailers to drive sales. We expect Print segment to maintain profitability and cash flows as it consolidates its plant network in Canada (currently 16 plants, down from 38 plants in 2010). Management will aggressively consolidate printing plants as needed and has done this very skillfully.

"Mr. Market" Mis-Prices Valuation

We believe current TCL's valuation misprices the resiliency in both its Packaging and Print segments. Packaging companies trade at much higher multiples and as Packaging becomes a larger part of TCL we expect its multiple to move up accordingly.

Attractive 7% Dividend Yield

TCL currently pays an annual dividend of about C\$0.87 per share for a 7%+ dividend yield and we believe the dividend is likely sustainable based on TCL strong free cash flow generation and its improving balance sheet.

Attractive Upside Potential

TCL in 2019 generated C\$3b in revenues and C\$465m in adjusted EBITDA. We believe TCL can achieve stable adjusted EBITDA in its Print Segment and its Packaging Segment can grow. The flexible packaging industry in North America is expected to grow about 5% per annum over the next five years. We believe TCL could achieve adjusted EBITDA of C\$500m by 2022 and reduce net debt to about C\$0.8b. As Packaging Segment becomes a larger share of total adjusted EBITDA, we believe TCL could trade for 6x adjusted EBITDA or more and have an enterprise value (EV) of about C\$3b and an equity market cap of about C\$2.2b. Based on 87m total common shares outstanding, TCL would have a share price of about C\$25 per share (close to 70% higher than current price).

Balance Sheet Can Further Deleverage

TCL has a reasonable balance sheet with a net debt position of about C\$0.95b about 2.2x LTM adjusted EBITDA. We expect TCL to use its strong free cash flow to reduce net debt. We believe TCL could generate close to C\$250m of FCF (defined as cash from operations less maintenance capital expenditures) per annum, which it can use to reduce its net debt. We think TCL could end 2022 with C\$0.8b of net debt and probably less.

Conclusion and Target Price

Based on 6x our estimate of adjusted EBITDA of C\$500m for 2022 with about C\$800b net debt and about 87m diluted shares outstanding, we believe TCL could have a market cap close to C\$2.2b or C\$25 per share or more versus C\$15 per share today (+70%). If TCL continues to execute and its flexible packaging and printing segments perform as we expect, we think our target price can be achieved.

Major shareholders			
Jarislowsky		8,003	10.9%
Foyston Gordon		7,643	10.4%
Dimensional Fund		2,941	4.0%
Caisse de Depot		2,887	3.9%
BlackRock, Inc.		2,608	3.6%
Royal Bank		2,300	3.1%
		Avg Daily Volume	
		335,000	

Price per share		\$15.00	
Shares outstanding		84	
Market value		\$1,260	
52 week range		\$9.50	\$17.60

Income statements						6 mos.	6 mos.
FYE 10/31	2016	2017	2018	2019	2019	2020	
Sales	\$2,020	\$2,007	\$2,521	\$3,039	\$1,519	\$1,331	
Gross Profit	\$414	\$420	\$552	\$480			
Adjusted EBITDA (1)	\$390	\$397	\$459	\$475	\$224	\$213	
Adjusted EBIT (1)	\$283	\$293	\$357	\$348	\$97	\$85	
Net income	\$196	\$202	\$239	\$166	\$50	\$32	
EPS - continuing ops	\$2.53	\$2.61	\$2.91	\$2.52	\$1.12	\$0.99	

Cash flow statements						6 mos.	6 mos.
FYE 10/31		2016	2017	2018	2019	2019	2020
Net income		\$146	\$212	\$213	\$166	\$50	\$32
Dep & amort		\$133	\$128	\$194	\$224	\$111	\$119
Non cash adjust		\$115	\$71	\$130	\$22	\$6	\$25
Working capital chgs		(\$121)	(\$87)	(\$225)	\$20	\$16	\$2
Cash fr operations		\$273	\$324	\$312	\$432	\$183	\$178
Capital expenditures		(\$59)	(\$33)	(\$59)	(\$125)	(\$53)	(\$50)
Dividends		(\$56)	(\$61)	(\$69)	(\$76)	(\$38)	(\$39)
Share repurchases		(\$22)	\$0	\$275	\$0	\$0	\$0
Acquisitions		(\$86)	\$16	(\$1,573)	(\$19)	\$0	\$232
Est. free cash flow		\$214	\$291	\$253	\$307	\$130	\$128

Balance sheets

FYE 10/31		2016	2017	2018	2019	4/26/20
Cash		\$17	\$247	\$41	\$214	\$105
Total assets		\$2,062	\$2,137	\$3,782	\$3,781	\$3,623
Total debt		\$348	\$348	\$1,461	\$1,382	\$1,089
Shareholder equity		\$1,069	\$1,219	\$1,634	\$1,687	\$1,725
Net debt		\$331	\$101	\$1,420	\$1,168	\$984

	<u>Transcontinental Inc (TCL)</u>	<u>Sealed Air Corporation (SEE)</u>	<u>Berry Global Group, Inc. (BERY)</u>	<u>Win-Pak Ltd. (WPK)</u>
	Engages in print, flexible packaging, publishing, and digital media operations in Canada and the United States. Operates through three main segments: Printing, Packaging, and Media.	Provides food safety and security, and product protection solutions worldwide. The company operates through Food Care and Product Care segments.	Manufactures and distributes engineered materials, nonwoven specialty materials, and consumer packaging products.	Manufactures and distributes packaging materials and related packaging machines in the United States, Canada, and internationally
Cash	\$105m	\$275m	\$953m	\$417m
LTD	C\$1050m	\$3,960m	\$12,010m	\$0m
Price	C\$15	\$32.42	\$44.06	\$41.51
Shares	87m	156m	133m	65m
Market Cap	C\$1.2b	\$4.8b	\$5.5b	\$2.7b
Enter. Value (EV)	C\$2.2b	\$8.5b	\$16.2b	\$2.1b
Rev - LTM	C\$2.9b	\$4.9b	\$10.8b	\$0.9b
Adj. EBITDA – LTM	C\$460m	\$900m	\$1.8b	\$195m
Adj. EBITDA margin	16%	18%	17%	21%
EV to Adj. EBITDA	4.7x	9.3x	9.1x	10.8x
EV to LTM Revenues	0.7x	1.7x	1.5x	2.3x
LTM Cash from Operations	C\$427m	\$487m	\$1,400m	\$151m
EV to LTM Cash from Ops	5.1x	17x	11.7x	13.9x

	<u>Transcontinental Inc (TCL)</u>	<u>R.R. Donnelley & Sons Company (RRD)</u>	<u>Quad/Graphics, Inc. (QUAD)</u>
	Engages in print, flexible packaging, publishing, and digital media operations in Canada and the United States. Operates through three main segments: Printing, Packaging, and Media.	R.R. Donnelley & Sons Company, an integrated communications company that operates through Variable Print, Strategic Services, and International segments.	Quad/Graphics, Inc. provides marketing solutions worldwide. It offers printing services, marketing, and media planning.
Cash	\$105m	\$451m	\$208m
LTD	C\$1050m	\$2,400m	\$1,300m
Price	C\$15	\$1.18	\$3.45
Shares	87m	71m	40m
Market Cap	C\$1.3b	\$79m	\$174m
Enter. Value (EV)	C\$2.2b	\$2b	\$1.3b
Rev - LTM	C\$2.9b	\$6.2b	\$3.8b
Adj. EBITDA – LTM	C\$460m	\$392m	\$320m
Adj. EBITDA margin	16%	6%	8%
EV to Adj. EBITDA	4.7x	5x	4x
EV to LTM Revenues	0.7x	0.3x	0.3x
LTM Cash from Operations	C\$427m	\$190m	\$259m
EV to LTM Cash from Ops	5.1x	10.5x	5x

Catalysts

1. Modest valuation with an 11% unleveraged FCF yield and 5x adjusted EBITDA and 0.7x revenue for a resilient business with growth potential.
2. Projected adjusted EBITDA of C\$500m in fiscal year 2022.
3. Growth of Packaging Segment revenues and adjusted EBITDA over next few years.
4. Continued stabilize performance and strong cash generation in Print Segment due to strong competitive position, long-term contracts, and unique flyer distribution business for major retailers.
5. Increased recognition of Packaging Segment's major contribution to financial results.
6. Increased analyst recognition of TCL's unique and strengthening business model.

Risks

1. The Canadian and /or U.S. economies decline which impacts TCL's print and packaging businesses.
2. The printing business is in secular decline although TCL's unique competitive position in Canada and cost competitive network have enabled TCL to post stable results in revenues and profits to date.
3. TCL recovers from Covid-19 impact more slowly than we expect.
4. TCL is unable to improve its adjusted EBITDA margins and/or grow its revenues as we expect.
5. Trading relationship between the U.S. and Canada deteriorates and impacts TCL's business model.
6. Misallocation of capital into a poor acquisition.
7. We are defining FCF as cash from operations less maintenance capital expenditures and including non-cash stock comp and some other add-backs which some investors would not want to include.

I do not hold a position with the issuer such as employment, directorship, or consultancy.
I and/or others I advise do not hold a material investment in the issuer's securities.

Catalyst

See above.

Messages

Subject Questions
Entry 07/13/2020 09:18 AM
Member iseaid

andreas947, thank you for the idea.

How do you expect each division do grow organically and how much of that is driven by pricing?

Is there any potential hard catalyst, for instance, the sale of a business unit?

And why has the share price halved in the past 2 years? I am not very familiar with the company / history.

Subject Re: Questions
Entry 07/13/2020 01:18 PM
Member andreas947

iseaid,

thanks for the questions.

we expect packaging to grow low single digits organically in H2 of 2020 as it is least impacted by corona.

we expect printing to be down in 2020 but be stable to down low single digits on revenue in 2021 but we expect printing adjusted EBITDA to be stable in 2021 onward as they will aggressively close plants to match any revenue decline.

we dont think there is any hard catalyst, just continued growth of packaging funded by print cash flows and also further debt paydown.

share price halved as they purchased Covaris Americas at a relatively high price and it has taken some time to stabilize and begin to grow. If packaging continues to perform and becomes a larger part of total company we believe share price can recover to prior levels.

hope that helps.

best,

Andreas