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3-SIGMA VALUE

Q3 2017 in Review

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Q3 2017 in Review

For the quarter ended September 30, 2017, 3-Sigma Value, LP (the "Partnership") had an estimated gain of 0.5% with average gross exposure of 137.6% and average net exposure of *negative* 16.0%.

3-Sigma Value, LP								
PERFORMANCE AND EXPOSURE STATISTICS								
	Monthly Performance				Average Fund Exposure			
	Gross	Net[1]	Long	Short	Long	Short	Gross	Net
2011	37.4%	29.9%	1.9%	34.8%	78.6%	89.4%	168.1%	-10.8%
2012	32.3%	25.8%	17.1%	13.1%	64.8%	79.0%	143.8%	-14.1%
2013	-12.8%	-12.8%	7.3%	-19.0%	46.7%	72.4%	119.1%	-25.7%
2014	18.1%	17.0%	-0.3%	18.4%	7.4%	54.9%	62.3%	-47.4%
2015	12.8%	10.2%	-7.0%	21.0%	22.9%	41.6%	64.5%	-18.7%
2016	12.3%	9.9%	13.0%	-1.8%	37.7%	55.6%	93.3%	-17.9%
January	-0.9%	-0.9%	1.2%	-2.1%	41.2%	64.0%	105.3%	-22.8%
February	0.9%	0.9%	0.3%	0.7%	43.8%	65.2%	109.0%	-21.3%
March	1.5%	1.2%	1.7%	-0.2%	50.2%	67.9%	118.1%	-17.8%
April	-3.7%	-3.4%	-4.0%	0.3%	51.3%	69.3%	120.5%	-18.0%
May	-1.4%	-1.4%	-1.8%	0.4%	52.7%	70.7%	123.4%	-18.0%
June	-6.2%	-6.2%	1.3%	-7.4%	56.8%	72.2%	129.1%	-15.4%
July	1.5%	1.5%	4.3%	-2.8%	66.0%	83.4%	149.5%	-17.4%
August	-1.1%	-1.1%	-0.7%	-0.4%	61.2%	79.1%	140.2%	-17.9%
September	0.2%	0.2%	0.4%	-0.2%	55.2%	67.9%	123.1%	-12.6%
2017	-9.0%	-9.0%	2.4%	-11.4%	53.2%	71.1%	124.2%	-17.9%
Cumulative	115.4%	83.6%						
Annualized	12.0%	9.4%						

(1) Net of incentive fee.

In total, 3-Sigma Value, LP is invested long in 18 companies, and short 25 companies. Our investment approach is global in scope, yet, at this time, North American equities constitute the vast majority of our gross exposure. In general, we seek overall market agnosticism in the construction of the portfolio as reflected in a target range of net exposure between negative 25% and positive 25%.

After Hurricane Irma made landfall in Florida shortly after Hurricane Harvey ravaged Texas, I pondered the beneficiaries of disaster. While reviewing my universe of building products companies, a company called **Tecnoglass (TGLS)** leapt off the spreadsheet. Tecnoglass is a leading manufacturer of hi-spec architectural glass and windows, glass that is hurricane proof. Headquartered in Barranquilla, Colombia, and operating out of a vertically-integrated, state-of-the-art manufacturing complex that provides easy access to the Americas, the Caribbean, and the Pacific, the U.S (Florida specifically) has become a bigger percentage of TGLS's business, accounting for 75% of total revenue in the second quarter of 2017, up from 60% last year. Furthermore, Tecnoglass' current stock price around $7 is down from $12 at the start of the year due to temporary factors that are reversing in the second half of 2017. Management lowered guidance, that along with selling pressure from a large shareholder (a hedge fund that shut down), caused the stock price to crater. All told, TGLS is worth ~$15 (in the Base Case), representing more than 100% upside.

TGLS Capitalization as of 9/30/17					
Share Price as of 11/15/17					$7.02
x FD Shares Out.					34.8
= Market Capitalization					244.3
- Cash					36.2
+ Total Debt					253.1
= Enterprise Value (EV)					461.2
Annual dividend - 85% of 3Q17 div elected to be paid in ordinary shares					0.56
Yield					8.0%
	2015	2016	2017	2018	2019
Revenue	242,239	305,016	323,611	404,880	448,482
EV / Revenue	1.9x	1.5x	1.4x	1.1x	1.0x
EBITDA	52,056	63,370	59,771	80,534	90,564
% Margin	21.5%	20.8%	18.5%	19.9%	20.2%
EV / EBITDA	8.9x	7.3x	7.7x	5.7x	5.1x
EPS	0.55	0.63	0.38	0.79	1.00
P/E	12.6x	11.1x	18.5x	8.8x	7.0x
Base case estimates.					

Company Background

TGLS was originally formed under the name “Andina Acquisition Corporation”, a SPAC. On March 22, 2012, the SPAC consummated its initial public offering at $10 per share, and on December 20, 2013, consummated its initial business combination (reverse merger) with Tecnoglass Holding. In connection with the merger, the SPAC changed its name to Tecnoglass.

In addition to glass, Tecnoglass produces aluminum products such as profiles, rods, bars, plates and other hardware used in the manufacture of windows. In 2007, Tecnoglass established its Alutions plant in Barranquilla, Colombia, which contributes all of the raw materials needed for production of Tecnoglass products. In December 2016, as part of its vertical-integration strategy, Tecnoglas acquired ESW LLC, its U.S. distributor, for a total purchase price of $13.5 million. Vertical integration – from the purchase of raw materials, to the manufacture of glass and aluminum products and the subsequent production and distribution of customized glass and windows for architectural and industrial settings – guarantees high quality and enables operating leverage.

Glass Magazine ranked Tecnoglass as the second largest glass fabricator serving the U.S. market in 2016 (behind Apogee Enterprises (APOG)). Other competitors include PGT (PGTI), WinDoor, Guardian, Oldcastle, and Trulite.

CEO Jose Daes, COO Christian Daes and others have ownership interests in Energy Holding Corporation, a Boca Raton FL company owning 21,813,685 shares (6/30/17), equal to a 64.5% stake in TGLS.

Long Thesis

Tecnoglass was supply-constrained (operating at 100% utilization) until 2016 when it added new manufacturing lines to its plant, effectively doubling capacity from ~$250 million in 2016 to ~$500 million. At 12/31/16, backlog was $396 million while 2017 revenue guidance was $360-$390 million. However, events at the beginning of 2017 created short-lived challenges:

1. A long awaited peace treaty between the Colombian government and the Revolutionary Armed Forces of Colombia – People’s Army (FARC), ending more than half a century of internal conflict, was finalized in January 2017. While this represents a significant positive over the medium and long term, in the very short term the negotiation created a vacuum that limited invoicing in early 2017.

2. Similarly, comprehensive tax reform was ratified in early 2017, creating a temporary bought of uncertainty. However, this too represents a structural positive as Tecnoglass' corporate tax rate will decline from 40% in 2017 to 37% in 2018, and then 33% in 2019.

In consequence, Colombian revenues plummeted 45% in the first half of 2017 (despite an increase in Colombian market share from 40% to 45%) and revenue guidance for 2017 was lowered to $320-$330 million (down 13.3% at the midpoint).

The upshot is that these revenues are not lost, but merely pushed into 2018, and according to CFO Santiago Giraldo, the pent-up activity is already showing up in a rapidly expanding backlog. As of 6/30/17, backlog had risen to $487 million, and is expected to surpass $500 million by year end, representing revenue that will be realized in 2018.

In short, a fundamental recovery has already taken hold without a corresponding recovery in the stock price, providing a window of opportunity for investors to buy in advance of the news.

Financial Analysis

3-Sigma Value identifies 8 significant assumptions (factors) that underlie our analysis of TGLS:

1. Capacity – assumes flat capacity of $500 million per annum in all cases; although the Alutions plant has material room for expansion.
2. Utilization – guidance for the second half of 2017 is 70%-75%; thereafter we assume utilization ranges between 70% and 100%.
3. Cost of goods sold – assumes fixed costs equal 25% of sales plus inflation, per guidance. Gross margin target is low 30s.
4. Selling expense – assumes range of 9.5%-10% of sales, per guidance.
5. General and administrative expense (G&A) – assumes $8 million per quarter, per guidance.
6. Capital expenditures – assumes maintenance capex equals $3-$5 million per guidance. Additional capex in 2017 and 2018 is for solar panel project.
7. Tax rate – 40% in 2017, 37% in 2018, 33% thereafter.
8. Capital structure – assumes no change to capital structure; on January 23, 2017 the Company sold $210 million of 5-year unsecured notes at a coupon rate of 8.2%.

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TGLS Financial Summary - Base Case Operating Scenario 1							
	Year Ended:						
$ in thousands, unless per share	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017	12/31/2018	12/31/2019
Backlog	120,000	280,000	375,200	396,000	503,492	548,804	548,804
Sequential Increase		133%	34%	6%	27%	9%	0%
% of NTM Revenue		116%	123%	122%	122%	122%	122%
Revenue	**183,294**	**197,452**	**242,239**	**305,016**	**323,611**	**404,880**	**448,482**
% Growth		**7.7%**	**22.7%**	**25.9%**	**6.1%**	**25.1%**	**10.8%**
COGS:							
Fixed					53,599	56,200	56,200
Variable					166,878	219,315	242,933
COGS	127,875	136,021	151,381	192,369	220,477	275,515	299,133
% of Revenues	69.8%	68.9%	62.5%	63.1%	68.1%	68.0%	66.7%
Gross Profit	55,419	61,431	90,858	112,647	103,134	129,365	149,349
% Margin	30.2%	31.1%	37.5%	36.9%	31.9%	32.0%	33.3%
Operating Expenses:							
Selling	17,287	17,872	27,603	32,267	31,720	39,476	43,727
% of Revenues	9.4%	9.1%	11.4%	10.6%	9.8%	9.8%	9.8%
G&A	10,862	16,327	22,186	27,846	30,952	32,000	32,000
% of Revenues	5.9%	8.3%	9.2%	9.1%	9.6%	7.9%	7.1%
Provision for Bad Debts and Write Offs			1,477	4,686	2,739	0	0
Total Operating Expenses	28,149	34,199	51,266	64,799	65,411	71,476	75,727
% of Revenues	15.4%	17.3%	21.2%	21.2%	20.2%	17.7%	16.9%
Operating Income (EBIT)	**27,270**	**27,232**	**39,592**	**47,848**	**37,723**	**57,889**	**73,622**
% Margin	**14.9%**	**13.8%**	**16.3%**	**15.7%**	**11.7%**	**14.3%**	**16.4%**
Non-Operating Revenues, net	3,998	12,235	5,054	4,155	3,605	4,000	4,000
Change in fair value of warrant liabilit	7,626	-12,518	-35,759	5,450	0	0	0
FX Transaction Gains (Losses)			10,059	-1,387	-894	0	0
Interest Expense	-7,886	-8,900	-9,274	-16,814	-20,065	-20,700	-20,700
Pre-tax Income, ex. Warrant & FX	23,382	30,567	35,372	35,189	21,263	41,189	56,922
Taxes	8,696	8,538	20,691	16,072	8,505	15,240	18,784
% Tax Rate	37%	28%	58%	46%	40%	37%	33%
Net Income	14,686	22,029	14,681	19,117	12,758	25,949	38,138
FD Shares Out	20,714	27,738	26,454	30,253	32,648	34,801	34,801
EPS	**0.71**	**0.79**	**0.55**	**0.63**	**0.39**	**0.75**	**1.10**
D&A	7,238	8,542	12,464	15,522	21,048	21,725	21,975
EBITDA	**34,508**	**35,774**	**52,056**	**63,370**	**58,771**	**79,614**	**95,597**
% Margin	**18.8%**	**18.1%**	**21.5%**	**20.8%**	**18.2%**	**19.7%**	**21.3%**
NOPAT	17,128	19,626	39,592	25,994	22,634	36,470	49,327
D&A	7,238	8,542	12,464	15,522	21,048	21,725	21,975
Change in A/R	-20,891	-5,002	-29,394	-25,979	6,460	0	0
Change in Invy	-6,143	-10,696	-29,185	-4,305	-8,923	0	0
Change in Prepaid Expenses	646	-761	-1,503	799	248	0	0
Change in Other Current Assets	1,002	1,852	-12,203	-6,425	-5,814	0	0
Change in A/P & Taxes Payable	-11,216	11,846	15,423	1,574	-12,176	0	0
Change in Advances from Customers	18,141	-18,461	14,055	-2,299	2,497	0	0
Change in Related Parties, net	375	-19,132	295	2,259	3,097	0	0
Change in Other Current Liabilites	-598	-352	6,323	-6,846	0	0	0
Capital Expenditures, net	-20,001	-28,457	-14,901	-22,906	-9,107	-9,624	-5,000
Unlevered Free Cash Flow	-14,319	-40,995	966	-22,612	19,964	48,571	66,302
Cash Interest	-7,303	-7,451	-6,916	-8,696	-15,769	-17,810	-17,810
Cash Taxes	-4,183	-3,101	-13,212	-25,825	-19,599	-15,240	-18,784
Free Cash Flow to Common	**-25,805**	**-51,547**	**-19,162**	**-57,133**	**-15,404**	**15,521**	**29,708**

Valuation

Applying a terminal value multiple range of 8.0x to 9.8x, with 9.8x representing the trading multiple of Apogee Enterprises (APOG), TGLS's best comp, we derive a probability-weighted target price of $13.06 (up 86.1%).

Probability-weighted DCF-based Target Price Calculation			
Base (8.9x, WACC)	$13.55	60.0%	$8.13
Upside (9.7x, WACC)	$20.33	20.0%	$4.07
Downside (8x, WACC)	$4.33	20.0%	$0.87
Probability-weighted Target Price			**$13.06**
			86.1%

We sanity check the DCF with a P/E analysis.

P/E Sanity Check					
Base - 17.8x	$1.10	17.8x	$19.46	60.0%	$11.68
Upside - 19.5x	$1.50	19.5x	$29.21	20.0%	$5.84
Downside - 16x	$0.36	16.0x	$5.76	20.0%	$1.15
Probability-weighted Target Price					**$18.67**
Average of DCF and P/E-based Valuation Methodologies					**$15.87**
					126.0%

With a downside valuation ~$5 supported by both DCF and P/E, the risk/reward is very attractive. At a current price ~$7, there are 2-points to the downside versus 13-points to an upside valuation ~$20.

Risks

Beyond the standard risks associated with competition, supply and demand, and raw material costs, two prominent risks must be considered:

1. Since Tecnoglass' operations are in Colombia, there is political, economic, and FX risk. Colombia is the fourth biggest economy in Latin America and has been growing at an average rate ~2%. However, growth is projected to strengthen to ~2.5% in the second half of 2017 and 3.0%+ in 2018, driven by tax reform and the peace accord.

2. Energy Holding Corporation, a Boca Raton, FL-based company, is the majority and controlling shareholder.

Other Considerations

TGLS pays a $0.56 per share annual dividend (8% yield) that is payable in cash or stock at the option of the shareholder. The Company has an agreement with its majority shareholder (64.5% stake) to pay the dividend in stock, limiting the cash outlay to ~$3 million per annum. We assume a flat dividend and no change to the structure.

Conclusion

Buy Tecnoglass up to $10, with a target price of $15, upside to $20 and downside to $5. In August 2017, the stock price traded below $6 for three consecutive days due to technical factors. We will update this analysis upon receipt of any new information that causes us to change the underlying assumptions.

Thank you for your confidence.

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