SPREE CAPITAL
ADVISERS

Weekend Thoughts 6/25/22

Weekly collection of unstructured hypotheses for current and future research projects

- Supply chain normalization
  - Lennar Corporation (LEN)
    - "Turning to the supply chain. . .Our second quarter started presenting some favorable news. There were still intermittent disruptions and an increase in construction costs. But for the first time since the disruptions began, we saw a flattening in cycle time. Over the past 4 months, cycle time has expanded by only 5 days, which we believe signals a peak. Additionally, about 25% of our markets experienced cycle time reductions in the second quarter compared to the first quarter. . .there's still disruptions but both we and our suppliers are much better positioned today. Everyone has learned a lot over the last 2 years and are able to respond very quickly to solving problems. Where at the earlier parts of the pandemic and disruptions, it sometimes could take months to solve problems. They're now being resolved in days. And the 2 areas where there are still ongoing shortages is really in electrical equipment and in flex duct."
  - KB Home (KBH)
    - "Relative to the first 5 months of the fiscal year, the second quarter marked the first time in more than a year that we did not experience an extension in our build times."
    - "With respect to the supply chain, we are seeing mixed dynamics with the availability of some materials such as paint, plumbing products, interior doors and door hardware improving sequentially. Other materials such as engineered wood products, cabinets, insulation, and concrete continue to be difficult to obtain, but have stabilized. And the third group of products, including heating and cooling materials and electrical equipment, appliances and windows remain challenged."
  - Lowe's Companies (LOW)
    - "So as we look across the global supply chain today, pressures continue to persist, but I would say largely in line with our expectations that we outlined for the year. . .We're seeing some ports around the globe continue to recover, but certainly not yet back to the 2019 levels when container ships were flowing without disruption."
    - "we have the best in-stock position that we've had since the beginning of the pandemic. . .we have no expectation that we're going to get into increased promotions. We worked really hard the last 3 years to get off of the halo pricing philosophy that Lowe's was known for."
- Consumer health
  - MGM Resorts International (MGM)
    - "The demand dynamics are strong. As we look out 90, 120 days, the group business is quite strong. In fact, this month in June of 2022, it is stronger than it might normally be because many of the groups that canceled back in January rebooked into May and June, and we're enjoying the benefits of that right now. We expect the group business to be about 90% of 2019 levels as we exit 2022. And there have been no signs on that side of the business of any reduced demand."
    - "I am concerned about the -- just the pressures that inflation and some of the cost

growth in everything from fuel prices to groceries to going out has put on customers. You can't help but be a bit concerned about that. We just haven't seen any evidence of the impact of those price increases on the visitation or spend pattern of our customers. So all I can say is that we remain vigilant. We're looking at our booking patterns. We're speaking with our customers and what they're seeing. And we just haven't seen any impact from it at this point."

- Lennar Corporation (LEN)
    - "We also managed our sales price and pace through the second quarter and increased new orders by 4% year-over-year, even though we began to see signs of weakening in the overall market. This weakening has continued into the third quarter. The housing market has cooled, as expected, in response to the Fed's aggressive and rapid reaction to inflation. The resulting very rapid, almost doubling of the 30-year fixed rate mortgage rate in 6 months has had the desired effect of slowing price appreciation and moderating demand by increasing monthly payment costs and reducing affordability. While the market has cooled, it has clearly not stopped. Demand remains reasonably strong as buyers still have down payments and have attractive credit scores and can qualify. Household formation has continued to rise. And although we have adjusted some prices in many markets, those prices remain higher on a year-over-year basis. Buyers are seeking shelter from inflationary pressures as scarce rentals drive rents higher.
    - "Supply remains limited across the country and the need for affordable workforce housing continues to be at crisis levels. Clearly, production must catch up to the growing household numbers as production of dwellings over the past decade has lagged prior decades by as many as 5 million homes. Nevertheless, the rapid increase in interest rates, together with price appreciation have created at least sticker shock and perhaps a more structural cooling of demand."
    - "Although these preliminary reflections of market conditions are not as positive of the state of the market, indicators have been building since the Fed's tightening began. And given the Fed's expressed conviction to combat inflation by the definitive statements made recently, it seems that these trends will harden as the Fed continues to tighten until inflation subsides. While we can choose to fight against the trend, the reality is that the market has been changing, and we are getting ahead of it by making all necessary adjustments."
    - "We will continue to build as prices moderate and adjust in order to fill that shortfall and provide much-needed workforce housing across markets."
    - "…So far in June, new orders, traffic, sales incentives and cancellations have worsened in many of our markets due to a rapid spike in mortgage rates and headwinds from negative economic headlines. Many markets have also slowed as we've entered a seasonably slower part of the year."
    - "To maintain sales momentum, we have offered mortgage buydown programs and normalized market incentives."
    - "traffic has slowed, and we've seen an uptick in cancellation rates. . .we've had to offer more aggressive financing programs and targeted price reductions to reduce our sales base -- to keep our sales base in line with our production schedule."
    - "We believe pricing pressure will continue until the market resets and we've been reducing pricing and offering aggressive mortgage buydown program.
    - "Seattle . . .stock market corrections, which have had a direct impact on employee stock compensation plans.

- KB Home (KBH)
  - "Order rates are moderating from the exceptional levels that the industry experienced, beginning in late 2020 as higher interest rates and increased home prices, along with other inflationary pressures, are impacting current demand. . . net orders were 3,914, down 9% versus a year ago when we reported the highest second quarter net orders in the prior 14 years. While our gross orders were flat year-over-year, a higher cancellation rate created a negative net order comparison as some buyers were affected by the larger monthly payments from the increase in mortgage rates."
  - ". . .May order activity. . .consumer behavior was nothing really changed in the footage of the home. . .nothing has really changed in the dollar spend at the studio. So it stayed very consistent. . .-- the moderation in orders that we've been seeing, I think it's more the consumer digesting these higher rates and all these cost pressures where they can still afford it. They may not be comfortable making that kind of a payment or commitment or they may just be paused because of everything going on. But so far, they're picking the same homes and the same features. . . But so far, the consumer really hasn't shifted their preferences, which I find interesting.
- Lowe's Companies (LOW)
  - "we're certainly seeing some moderation for sure. . .So we've seen some slowing in housing turnover, but the flip side is that gives consumers which are mostly Lowe's consumers that they're anchored to a lower mortgage rate. They continue to invest. They continue to spend in their home, and we believe that we're well positioned for that repair remodel business and that we're prepared to capitalize on that. . .we've not seen significant discrepancies in our regional performance."
  - "historically, rising rates have not negatively impacted home improvement if the other macro indicators. . .remain strong. . . home price appreciation. . .strong balance sheets. . .employment data remaining strong, rising rates alone will not have a negative impact on home improvement. Obviously, rising rates will impact home turnover because those existing homeowners are going to pause and maybe try to wait it out before departing from a low fixed mortgage rate . . . But when those customers decide to stay in those existing homes because of higher rates then they're going to make modifications in that existing home that really benefits our business. They're going to decide rather than getting a new home maybe I put in that new kitchen. Maybe I modernize my bathroom. Maybe I finished that basement. And so those are the kinds of projects that play in our favor. But historically, rising rates alone do not have a negative impact on the home improvement sector."
  - "there are numerous tailwinds that we expect to support the home improvement demand for years. . .price appreciation, aging housing stock, disposable personal income, the extension of remote work, millennial household formation trends and baby boomers decided to age in place."
  - "I've been in this business, as you mentioned earlier, for a long time, and I have never remembered an environment where the Pro customer is more confident about what we call their book of business. . .We're hearing nothing but strength and confidence in Pros to what they are seeing from a pipeline of business and projects that they have on their schedule. So it remains really robust."
  - "trade down in some semi-durable categories, I'll mention areas like paint brushes and tools, we have seen some shift. And when we look out at the good, better, best,

continuum some shifts there from better to good. But the trade down for the most part that we've seen is quality and it's not necessarily price."

- Winnebago Industries (WGO)
  - "We are seeing Marine retail actually strengthen for our businesses from the end of April through the end of May and through the first couple of weeks of June."
  - "RV. . .year-over-year percentage stay relatively the same between each of those 3 periods. So from the end of April to the end of May, to the first week of June, we are not seeing a significant change in the comp percentage year-over-year, which means that the retail market on our brands -- from a RV brands, from a consolidated standpoint seems to kind of have stabilized at a certain percentage down versus a year ago."
  - ". . .the numbers we shared with you for calendar '22 on a shipment and a retail side are what we believe is the case today. But as we will unfortunately acknowledge, the numbers that we've stated in the past have now proven to be too optimistic. And so we just have to continue to keep an eye on, obviously, consumer sentiment and the retail environment. And if those numbers worsen and 2023 looks worse, we will obviously have to continue to adjust our plans accordingly."
  - ". . . I think we're very well aware that with consumer demand retracting in the RV industry specifically, that our ability to balance price increases and obviously, competitive market share advances is more challenged today than it ever has been. So if I were to guess Q3 would probably be the -- potentially the current peak of the pricing power that we were able to demonstrate in the last year or 2. . . with slowing retail, we need to be much more careful about when and if and how to do that. And so that will play into some of the pressure on profitability, probably facing us in the future as well."
  - ". . .there is potential for that backlog ($1.3b Towable backlog) to continue to come down as dealers revisit and if retail is different than what they're projecting in their businesses. So there probably is some risk to that."
- La-Z-Boy Incorporated (LZB)
  - "we were pleased to begin offering customers -- consumers customized product in 10 to 14 weeks versus our previously quoted 4 to 7 months."
  - "consumer sentiment, no doubt, is challenged. . .the return of seasonality. . .This is the first spring in several years that consumers were getting a regular spring and summer."
  - "furniture pricing is still quite high, right, across the industry. We're 25% to 35% higher due to all of the input costs than we were pre-pandemic."
- Darden Restaurants (DRI)
  - "the impact that inflation is having on that lower-end consumers is showing a little bit"
  - "the industry actually started to see some declines from March, April to May in same-restaurant sales. . .But some of this might be a return to normal summer seasonality that we didn't see last year. As the dining rooms reopen and people felt more comfortable, we didn't see the normal seasonal patterns that we typically do.
  - "we haven't really seen a lot of check management at any of our brands. We've seen a little bit at Cheddar's."

- Migration patterns that have benefited TSCO and others leading to increased competition?
  - Lowes (LOW)
    - Q: ". . .coming out of the pandemic that there has been this shift in the population to maybe more suburban, if not rural areas. . .How does that play into the real estate

footprint of Lowe's and potentially benefit the company over time?

        - A: “when we look at the overall market, U.S. home improvement market as it relates to stores, relatively mature, store footprint for big box home improvement pretty saturated. . .we're always going to look at opportunities, look at strategies, look at migration patterns, markets, where we can be strategic when adding new stores and where we see profitability opportunities. But I would say it's not going to be a meaningful part of our growth strategy going forward.”

- Inflection Points
    - Nanya Tech (4th largest DRAM maker after Samsung, SK Hynix and Micron)
        - "We see a clear slowdown in the coming [July-September] quarter, and such a slowdown could continue into the fourth quarter. There is still a lot of uncertainty. ...Demand is also weakening more than we previously thought for data center servers."
- Value with a Catalyst
    - MGM Resorts International (MGM)
        - BetMGM spin?
        - “. . .inquiries about whether we would take BetMGM public. And our view really hasn't changed, which is that job one right now is having BetMGM execute their business plan, which is to grow the business, as new jurisdictions open up, maintain or grow its market share and then continue on a road to eventual profitability of that enterprise, which we think is in 2023. We're funding that journey right now along with Entain, and that's basically the plan as it relates to BetMGM. There's a lot going on at our properties to integrate BetMGM into the business, into MGM Rewards as well. But the ultimate vision for that is that BetMGM becomes a big digital business of MGM Resorts. It becomes almost a synthetic regional network where that's how we're meeting new customers in states where we operate, where we don't operate that those customers then become entangled in our loyalty program and visit our properties in Las Vegas and so on, the typical things that we do with our other customers.”
        - “. . .Depending upon what value you ascribed to our BetMGM stake, our shares right now are trading at 5x EBITDA according to -- if you look at what most folks have modeled for us for 2023, we just sold the Gold Strike Tunica at a multiple, well in excess of that.”
    - Lennar Corporation (LEN)
        - “Finally, we will conclude our long planned spin-off by year-end. As we have continued to refine the 3 verticals of our spin company, we will spin a mature asset management company into the public markets along with billions of dollars of assets under management that we previously held on Lennar's books. The final spin of our new company, which we will call Quarterra, will trade under the stock symbol Q. And as we have noted before, will be an asset-light asset management business that will have a limited balance sheet. By finalizing the spin, we will further reduce Lennar's asset base by another estimated $2.5 billion, which will drive higher returns on our assets and equity base and will not result in a material reduction of either our bottom line or our earnings per share.”
- If mega cap tech just preempts successful enterprise software upstarts by offering it for free in a bundle, and GitHub/GitLab is democratizing software development, will AI-powered Copilots lead to the incineration of capital in startup enterprise software companies and accrue benefits to the large cap tech companies that replicate and bundle for free?
    - Microsoft-owned GitHub launched its Copilot AI tool, which helps suggest lines of code to developers inside their code editor.

        - Copilot can suggest complete methods and complex algorithms alongside boilerplate code and assistance with unit testing.
        - More than 1.2 million developers signed up to use the GitHub Copilot preview over the past 12 months, and it will remain a free tool for verified students and maintainers of popular open-source projects.
        - "Just like the rise of compilers and open source, we believe AI-assisted coding will fundamentally change the nature of software development, giving developers a new tool to write code easier and faster so they can be happier in their lives," says GitHub CEO Thomas Dohmke.
        - But until now, AI has stopped short of improving code, leaving the process of developing software almost completely manual. With GitHub Copilot<u>, for the first time in the history of software, AI can be broadly harnessed by developers to write and complete code.</u>
- Snowflake Summit 2022
    - At the Snowflake Summit, Snowflake articulated a world where developers build software directly on the Data Cloud to be run on Snowflake without the developers having access to customer data. This eliminates the overhead and security risks that come with SaaS vendors having copies of customer data in their own cloud or on-premise hosting environment. In bringing applications to the data as opposed to bringing data to the applications, this has all kinds of implications for
        - Software with heavy read workloads
        - SNOW as a software stack for data rich experiences as opposed to just storage
        - Cybersecurity
        - Will enterprises go to Snowflake and budgets go to SaaS vendors building on top of the Data Cloud?
        - Displacing duplicate data storage from SaaS providers?
        - Better unit economics for vendors?
        - Snowflake as a full application development and data storage platform?

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