



## Weekend Thoughts 7/16/22

Weekly collection of unstructured hypotheses for current and future research projects

- Secular vs cyclical
  - ServiceNow, Inc (NOW)
    - “the mood in uh in the headlines is a little bit worse than the reality if you look at tech automation is front and center if you have a business and you want to grow it or you want to run it more efficiently or you want to differentiate your brand you're going to have to compete with tech so automation is alive and well and i think the prospects for technology companies especially ones with very strong brands and architectures they'll do very well. . .in reality you bring in tech when you're being hurt by the economy tech is what makes it so you can still have good profits. . . these macro crosswinds are blowing strong . . .so the mood is not great but there's no way out except to innovate and drive technology in your company so you digitize your processes you move faster and you ultimately win. . .but there is one serious change that's going out there right now and that is there's a new level of prioritization in the enterprise. . .hitting a new gear where companies are first saying which platforms do we want to bet on and then how do we stack rank the priorities . . . you're going to see longer cycles in Europe. . .but this doesn't fundamentally change the narrative that tech is the only way to cut through the crosswinds”
- M&A through the cycle
  - American Outdoor Brands, Inc.(AOUT)
    - “have developed incredibly strong relationships in our industry over the past several years, and we believe those relationships will yield an increasing number of M&A opportunities in fiscal 2023, especially given the challenging consumer environment that has just begun to emerge. In fact, we have recently been approached by a number of companies with brands that are uniquely positioned to benefit from our Dock & Unlock process. And importantly, we have worked over the past 2 years to build a strong balance sheet that provides us with the flexibility to capture those opportunities when they arise.”
  - Cintas Corporation (CTAS)
    - “we are actively pursuing deals of all shapes and sizes. . .our balance sheet, we love our position and we're ready, willing and able to make deals of all shapes and sizes.”
  - Atlas Copco (ATLKY)
    - “we've been looking for this type of product that -- the industrialized pump application. We believe it's very close to home for us. . .in the coming years, we will continue to scan the market for the companies that has leading technology that we can take advantage of and sell throughout the world. So it's a start of a new growth platform for PT.”
- Sustainability of price hikes
  - PepsiCo (PEP)
    - “So I think there is nothing new that we weren't aware of, frankly, a couple of months ago. So I don't think there's any incremental information that would cause us to be concerned about the back half. Regarding your question around why is the revenue number higher, I think that the primary reason is given the unknowns

around consumer elasticity, as we came out of the first quarter, we were quite pleased with where elasticity sat. But we still had 9 months left in the year, so we adopted a certain posture about the balance of the year. The second quarter is also held up from an elasticity perspective better than we thought, and we're sort of flowing that upside through. That said, the balance of the year, we still have 6 months to go. There's still plenty of unknowns in terms of what's going to happen with consumer behavior. . .So I think – I wouldn't characterize it as conservatism. I think we go through a lot of scenario planning. And the sum of those scenarios led us to choose higher on revenue but not yet higher on EPS.

- Conagra Brands, Inc (CAG)
  - “While we expect elasticities to increase incrementally from fiscal '22 levels as more inflation-justified pricing comes to market, we believe they will remain below historical levels. . .While private label is gaining some share more broadly in food, we have not seen notable migration toward private label in the heavily branded categories in which we compete. . .The pricing power we're seeing is quite strong. Despite that strong pricing power, the elasticities remain well below historical norms. . .So to me, the positive thing here, while inflation is tough to deal with is as I've said before, it also can help liberate some of these brands from some of these legacy price thresholds where they can get stuck for a period of time.”
- Supply chain normalization
  - Fastenal Company (FAST)
    - “The supply chain picture is unchanged from the first quarter. Challenges with availability persist, but we and our customers are managing them more effectively.”
  - Conagra Brands, Inc (CAG)
    - “As we plan our '23 in terms of supply chain, we're not planning for a complete reversal of the supply chain friction that we've experienced over the last year. . .We are assuming some progress because we are seeing some progress in some green shoots in supply chain.”
- Semi/Consumer tech
  - Taiwan Semiconductor Manufacturing Company Limited (TSM)
    - “But we also expect our customers start to take action to decrease their inventory level. How far? We expect that a few quarters, at least into the first half of 2023, they will continue to do the inventory correction”
- Bullwhip
  - PriceSmart, Inc (PSMT)
    - “many months ago, we made strategic investments in inventory with the goal of remaining in-stock and capturing higher sales. Since then, the environment changed significantly. . .inflation has influenced consumer behavior by shifting the demand away from the more discretionary items and more towards the essential items. So as a result, we've been experiencing excess inventory, primarily in the area of hard life. Now in response, we have taken decisive action. We continue to do so, and we're working with the goal of swiftly selling through the excess inventory and quickly rebalancing our inventory mix. As a result, we have experienced higher-than-normal markdowns in Q3. Now our plan is to handle this quickly and efficiently in order to be well positioned for the holiday season and to sell through almost all of this, possibly by the end of Q4.”
  - American Outdoor Brands, Inc. (AOUT)
    - “So we established a strategy to build inventory over the course of the year in key

areas in an effort to mitigate the risks we face with our supply chain and shipping delays. . .we are planning for a more promotional environment in fiscal 2023 as our retail partners respond to potential shifts in consumer buying patterns and adapt to inflation and economic uncertainty. We intend to remain competitive with pricing in order to protect our market share, and as such, we expect gross margin percentage to decline for the year compared to fiscal 2022. . . However, we are seeing that retailers are taking a step back right now and closely managing their inventory levels as they anticipate or try to anticipate what the consumer is going to do.”

- Atlas Copco (ATLKY)
  - “...The inventories, of course, sticking out with quite a substantial increase, and that is obviously related to the buildup of component stock. . .In terms of pre-ordering, it's also difficult for us to judge, of course, what is pre-ordering and what is not. But as situation is with inflation right now, there is, of course, quite frequent announcement of price increases in all our business areas. In Power Technique specifically then, there was a very strong Q4 already. So we can see that. And that we don't normally see. And then, of course, the high demand that we have seen now. So we believe it will be a softer Q2 for Power Technique.”
- Husqvarna AB (HSQVY)
  - “higher inventories. And this is something that we will start to address working down those inventories in the second half of the year”
- Consumer health
  - Husqvarna AB (HSQVY)
    - “to date, we can't really see any slowdown in demand. We don't see it. We don't feel it at this point in time.”
    - “obviously, at some point, you reach a point where you will start to lose volumes or start to sell down. But I can't say that we are seeing that at this point in time.”
- Industrial economy
  - Fastenal Company (FAST)
    - “Demand remained generally healthy, but there were certain signs of softening that emerged in May and June in contrast to the first quarter, however, we did experience a softening intraquarter trend in the second. That softening was not particularly deep. And if the level of economic activity that we experienced exiting the second quarter were sustained, we feel good about the rest of the year. . . when I talked to our national account sales leaders and I get the tone of what they're seeing from their customers, I don't think there's a customer they talk to that doesn't have as strong a backlog as they've ever had in their business. “
  - Cintas Corporation (CTAS)
    - “we love our momentum as we've -- as you can certainly see through the quarterly growth throughout this year and a pretty good guide. And we just -- we haven't seen a change in their behavior.”
    - “we have such a broad and diverse customer base. We're up and around Main Street U.S.A. every single day and we're watching it really closely. And it seems as though demand is quite strong, demand within their business, demand for our products and services. . .I think we'd all be better off if nobody read the news or listened to the news because it seems like we're trying to talk ourselves into it. . . to date, it appears as though Main Street USA is doing just fine and we're encouraged by that.”
  - The Greenbrier Companies, Inc. (GBX)



consumer deposit customers' health indicators, including cash flow, payroll and overdraft trends are not showing elevated risk concerns. . .for certain cohorts of customers, we have seen average balances steadily decline to pre-pandemic levels. Following the final federal stimulus payments early last year and their debit card spend has also been declining. . .Overall, debit card spending was up 3% compared to a year ago when consumers receive stimulus payments and inflation appears to be impacting certain categories of spending, including a 26% increase in fuel driven by higher prices, while discretionary categories like apparel and home improvement spending were down double digits, driven by fewer transactions. Credit card spend increased 28% from a year ago. . .However, spending while still strong, started to slow in May and June. Consumer credit card utilization rates remain below pre-pandemic levels.”

- “Leading indicators such as payment rates, deposit levels, utilization and revolving debt trends do not yet indicate signs of stress. Loan demand from our commercial customers remain strong with broad-based balance and commitment growth. Our commercial customers' credit performance remained strong with exceptionally low net charge-offs and nonaccrual loans were at their lowest level in over 10 years.”
- “While we expect credit losses to increase from historically low levels, our consumer and commercial customers are not showing any meaningful signs of stress.”
- Citigroup Inc (C)
  - “Little of the data I see tells me the U.S. is on the cusp of a recession. Consumer spending remains well above pre-COVID levels with household savings providing a cushion for future stress. And as any employer will tell you, the job market remains very tight. Similarly, our corporate clients see robust demand and healthy balance sheet with revenue softness attributed to supply chain constraints so far.”
  - “The consumer and the corporate are healthy. The labor market is exceedingly tight. We are increasingly concerned about the possibility of a recession next year”
- The PNC Financial Services Group (PNC)
  - “I think you're just going to see a slow grind with credit losses increasing over time as we get into the slowdown. . .credit quality is going to deteriorate at some pace from here through the next 2 years. I just don't think it's going to be all that dramatic.”
  - “consumer spend is shifting a bit in terms of where it's occurring. It's less discretionary, certainly more nondiscretionary on food and fuel and those types of things. . .But the overall level of spend is still pretty strong. I would also say that the consumer balance sheet is strong. They still have deposit balances that are in excess of where they were pre-pandemic. I think in part, that's allowing at least on the average for that consumer to spend to continue.
  - And then they're willing to draw down on their credit card lines as well. On the business side, the way that I would characterize it as we're continuing to see inventory builds. I think that part of the loan growth that we're seeing or experiencing maybe businesses trying to get ahead of inflation a bit in

terms of acquiring inventory today as opposed to something that might have a 10%, 20%, 30% rate increase. The 1 thing I would say though, Gerard, is that I think that business owners, especially in the middle market space, are just more cautious today. And it comes back to what Andy said, it seems like a strong economy today, but the range of possibilities is very wide. And so people are trying to take that into consideration when they think about running their business.

- Loan growth/tightening liquidity
  - JPMorgan Chase & Co. (JPM)
    - “certain loan growth is discretionary and portfolio-based, think of mortgages, and there's a good chance we're going to drive it down substantially.
    - “we're going to scrutinize even more aggressively than we always do, elements of our lending which are either low-returning or have a low client nexus or both. We do that all the time anyway. But of course, in this moment, we're going to turn up the heat on that a little bit.”
    - “we'll originate (mortgages), but the balances in the books will probably come down. . .And if it doesn't make sense to own mortgage, then we're not going to own them.”
    - “if you look at what we do, our bridge book is way down. That was managing certain exposures.”
- Digital Ad spend
  - IAC/InterActiveCorp (IAC)
    - "Dotdash Meredith June Digital revenue was impacted by softening advertiser demand”
- Catalyst
  - Titan International, Inc. (TWI)
    - Acquiring Heartland Ag Systems
    - Heartland is the largest Case IH Application Equipment distributorship in North America
    - Heartland provides TWI access to the commercial application segment of the market, which previously TWI wasn't able to participate in due to OEM distribution agreements.
  - Dufry AG (DUFY)
    - Combining with Autogrill
    - “As part of this travel experience, we don't see duty-free, travel convenience and F&B as 3 separate segments of business anymore. We see those as one integrated offering. . .How we're going to do that? First, on the physical space, reimagine our stores with better extended brand partnerships. Pushing, as I said, for the digital enhancement and with more dynamic sales force.”
    - “Let me start with 2 important metrics. Today, passenger conversion, people who actually stop and buy something in travel retail, is between 15% and 20%. It's significantly higher in F&B, 30%. Also, the time spent in a travel retail store could be between 5 and 10 minutes, more than double, 20 to 25 in the F&B. That's why we think that combining these 2 offerings will give us additional opportunities through cross-selling, mixed store formats and increase digital engagement.”
  - Fastenal Company (FAST)
    - “I believe there is a structural change in demand. COVID -- I mean, COVID-19 hiring

environment is part of it. I think awareness part of it, too. If you go back 15 years ago, there wasn't a structural demand for vending in industrial world, industrial distribution. It didn't exist. It was a one-off novelty that had been around for 20 years, but it really didn't have a presence. Even internally, when we first started talking about it, most -- a lot of reaction was we want to put what in a stack machine? And it's a better means to distribute that type of product. And we've expanded that footprint now into our FastFin offering, our Fasstock offering. And what's changed is our awareness of the solution, but as of equal importance, the customers' awareness of the solution. The one thing that is nice about an event like our customers show is customers get to come to that event, and they see firsthand examples. They talk to other customers that are doing it. And all of a sudden, the awareness changed of what the Onsite is about Fastenal model. . . I believe structurally, there's a better environment for it, and that's why we're signing 100 versus 80 or 85 or 90, if I go back even prepandemic. That's enhanced by the fact that maybe some folks look at that as, "Geez, it's really difficult to hire, especially for an expertise that isn't inherent in my business." We make widgets. We don't source product. And so it's an expertise and a hiring element. . . But the premise of your question is, structurally, there are a better environment today than there would have been in the past? Yes. Part of that's COVID. Part of that is a hiring environment. But I think the most important element is awareness. And that gives us sustainability past the next 6 to 12 months. That gives us sustainability for years into the future because it's a thing. . . over the last 3 to 5 months, a lot of the feedback that's come back from the Regional Vice Presidents in their commentary to me that they give me each month, each quarter, there's been many of them that have said that the lessons that were learned from the period you just came out of was that -- our customers are not supply chain managers, and they're looking for someone to bring that expertise into them. . . On top of that, supply chains have just gotten more expensive in the current environment. And I think that our customers are looking for more assistance in that, and I think they're conveying that to the to the field sales force based on the commentary that I'm getting back."

- Husqvarna AB (HSQVY)
  - "Pro robotics, I mean, where we are doubling sales basically so far this year."
- Federal Reserve telegraphing intentions
  - FED'S WALLER: FOR ME 75 BPS HIKE AT THIS MEETING GETS US TO NEUTRAL
  - BULLARD: AM AN ADVOCATE OF FRONTLOADING RATE HIKES
  - BOSTIC: 75 BPS WAS A "BIG MOVE" IN POLICY, FED WANTS POLICY TRANSITION TO BE ORDERLY
  - BOSTIC: MOVING "TOO DRAMATICALLY" COULD UNDERMINE POSITIVE ASPECTS OF THE ECONOMY, ADD TO UNCERTAINTY

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