TEMATICA INVESTING
THEMATIC COMMENTARY, EQUITY RESEARCH & INVESTING STRATEGIES

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INSIDE THIS ISSUE

Earnings Shaping Up As We Expected Means Reshaping the Tematica Select List

We all know that on its own earnings season is as busy a time as it gets. This time around, however, things have been complicated by a wave of merger and acquisition announcements, one of which involved our position in ***Connected Society*** company **AT&T (T)**. We'll speak to why we like the transaction and see it as very positive for our AT&T shares below. Outside those merger headlines and commentary, you've likely read or seen that as we get further and further into the current earnings season, we are seeing a growing number of disappointments. We'd like to say we're surprised, but as we've shared with you over the last several weeks we've been expecting something like this.

We've caught some cover fire ourselves, which led to our Special Alert yesterday in which we shed **Sherwin Williams (SHW)** and **Whirlpool Corp. (WHR)** — more on that move on page 5. We'll continue to look for thematic opportunities at better prices in the days and weeks ahead. Now let's tackle all of what's already transpired this week...

Tematica Investing Select List - Upcoming Earnings Dates

COMPANY	TICKER	DATE	THEME
Amazon.com	AMZN	27-Oct-16	*Connected Society*
Alphabet	GOOGL	27-Oct-16	*Connected Society*
Physicians Realty Trust	DOC	16-Nov	*Aging of the Population*
Starbucks	SBUX	3-Nov-16	*Guilty Pleasure*
Walt Disney	DIS	10-Nov-16	*Content is King*
Dycom Industries	DY	15-Nov-16	*Connected Society*
United Natural Foods	UNFI	5-Dec-16	*Foods with Integrity*
Costco Wholesale	COST	7-Dec-16	*Cash-strapped Consumer*

Source: Company reports and Zacks Earnings Calendar

TEMATICA RESEARCH

Tematica Investing, a weekly publication by Chief Investment Officer Chris Versace, is designed for the experienced or professional investor, providing in-depth information on real-time developing thematic strategies, economic outlook, investment trading ideas, and analysis of the most pressing developments for the market, as well as forces that drive both our thematic perspectives and thematic recommendations.

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Monday: AT&T set to acquire Time Warner

Less than 18 months after closing its DirecTV acquisition, over the weekend **AT&T (T)** announced plans to pay $107.50 per share in a mixture of cash and stock to acquire **Time Warner (TWX)** in a transaction valued at $85.4 billion. According to media reports, AT&T CEO Randall Stephenson is slated to head the combined company with Time Warner CEO Jeff Bewkes staying on as well.

The new AT&T will derive roughly 42 percent of its revenue and one-third of its operating profit from the combined entertainment businesses, with the vast majority of the remaining revenue and operating profit generated by the wireless Business Solutions and Consumer Mobility businesses.

The proposed merger between AT&T and Time Warner reflects two of our thematics: the accelerating shift toward the ***Connected Society*** —evident in the addictive nature of smartphones and tablets — and ***Content is King***, the consequence of technology providing consumers with endless news and entertainment options that are all available at the touch of a button. If we follow advertising dollars spent — and we should because those dollars follow consumer habits and behaviors, we find that for the first time ever — advertising spend on digital media will surpass broadcast TV in 2016. Per data from Standard Media Index, despite a month over month increase in overall media spending in September, the TV advertising spend fell month over month.

Where did the advertising dollars go?

Digital media, which continued its stretch of double-digit percentage gains, climbing 17 percent in September with social media, up 72 percent, and pure-play video gaining 32 percent. Pretty amazing, but not hard to fathom when we look at consumer usage habits, particularly among the demographics most coveted by advertisers. Today, consumers connect with news, entertainment and each other primarily on mobile devices that use multiple gigabytes of network data each month, and that usage is only going to increase as more of our lives move onto this connected mobile world… what we call the ***Connected Society***.

From Time Warner's perspective, it wants as many people to consume its content as possible. In today's world, that means being able to reach people on multiple devices, and increasingly mobile ones as chord cutting increases, at nearly any time of the day or night. Hindsight tends to be 20/20 as they say, but in the case of Time Warner, the move to shed its capital intensive cable business, which lacked any sort of mobile component, several years ago was a smart move. Had it kept that business, Time Warner would be facing the same thematic headwinds — such as chord cutting and eyeball shrinkage due to streaming services and app content consumption as well as subsequent advertising spend issues — that are plaguing cable-centric companies like **Cablevision Systems (CVC)** and Cox Communications. Companies like **Comcast (CMCSA), Time Warner Cable (TWC)**, Cox Cable and similar providers are likely to see consumers prune Pay TV services, which will weigh on revenues.

The reality is that with mobile service today, and prospects for shrinking Pay TV revenue, the likelihood that these companies become dumb, commoditized high-speed pipe companies is higher than ever. Reaffirming that notion, last night **Alphabet (GOOGL)** announced it is going to pause its Google Fiber expansion plans and will be shrinking headcount at the business. We expect to hear more about this change later in the week when Alphabet reports its September quarter results.

Getting back to the AT&T and Time Warner deal

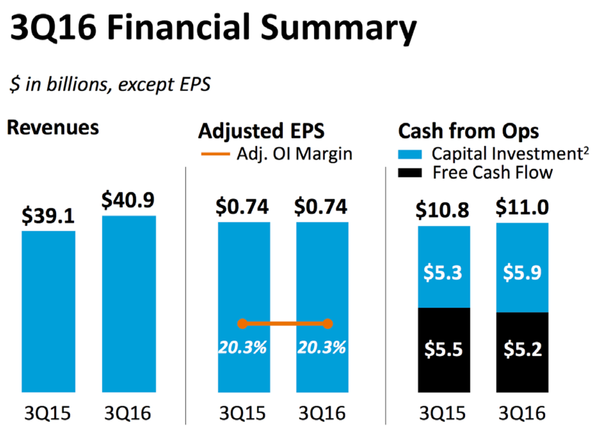
This proposed merger moves AT&T into the realm of having combined content and distribution, which creates a more competitive moat around its mobility business — much the way **Comcast (CMCSA)** did with its cable business following the acquisition of NBC Universal from **General Electric (GE)**. Given the shift in how people consume data and video — increasingly on the go with mobile devices — we like the planned AT&T-Time Warner combination, especially given the early guidance that the deal should lead to about $1 billion in cost savings within three years. We also see synergies with AT&T's soon to be launched DirecTV Now streaming service, which is expected to launch next month with a price point of around $35 per month for 100 channels of content.

Having said that, one of the potential hurdles for a transaction of this magnitude that is poised to reshape the playing field is regulatory scrutiny, which could lead to conditions that must be met to close the transaction, including potential divestitures. As such, we will continue to watch this area on the transaction's path for any hiccups

As to the "why now?" question behind the acquisition

The timing of this deal may be answered through the second announcement from AT&T over the weekend — its September-quarter results, which came three days sooner than expected. For the quarter, AT&T reported earnings per share excluding non-recurring items of $0.74, on revenue of $40.89 billion vs. expectations for EPS of $0.74 on revenue of $41.15 billion. In other words, the company reported in-line September-quarter EPS with a modest miss on the top line. Excluding DirecTV and foreign exchange, revenue was essentially flat, as growth in video and IP- based services mostly offset pressures from declines in wireless and legacy services.

During the September quarter, AT&T delivered a net increase of 1.5 million new mobile subscribers to reach 133 million, up 6.9 million year over year. We'd note one interesting data point in the subscriber data: During the quarter, AT&T added 299,000 post-paid tablet and computing devices, but lost 268,000 post-paid phone subscribers with the majority of the losses in lower-ARPU feature phones due in part to the continued ramp-down of its legacy 2G network. That network is slated to shut down around Jan. 1, 2017 and exiting 3Q 2016, AT&T still had roughly 4 million 2G subscribers vs. 6 million at the end of 2Q 2016.



	3Q15	3Q16
Reported EPS	$0.50	$0.54
Adjustments:		
Amortization of intangibles	$0.13	$0.14
Merger, integration and other[1]	$0.11	$0.06
Adjusted EPS	$0.74	$0.74

[1]3Q16 includes merger-related items for DIRECTV ($0.02), Mexico/Other wireless ($0.01) and ($0.03) employee separation charges.
[2]3Q16 includes $87 million capital purchases in Mexico with favorable vendor payment terms.

On the existing entertainment business, total video subscribers were 25.3 million with 323,000 satellite subscriber additions in 3Q 2016, offset by a decline of 326,000 U-verse TV subscribers. With the pending launch of its over-the-top DirecTV Now streaming service, we suspect AT&T will continue to skew its focus toward that and the existing satellite business over U-verse.

All in all, it was a good quarter for AT&T, but as you probably expect all eyes are now on the transaction. Given the well-known problems with the AOL-Time Warner merger that was eventually unwound, we believe AT&T will aim to be as clear as possible in the coming days and weeks in describing the benefits, expected strategies and synergies of a combined entity as well as the post-deal capital structure. We're also curious to learn about any potential impact on investment spending in existing 4G and looming 5G networks that would impact our shares of **Dycom (DY)**. With the increasing emphasis on mobile video, we are not expecting any major disruptions.

Finally, AT&T's board of directors has approved a 2.1 percent increase in the quarterly dividend to $0.49 per share from $0.48 per share payable on Feb. 1, 2017 to holders of record on Jan. 10, 2017. We believe this reflects the underlying strength of the core business as well as the company's confidence, not only in the proposed transaction but in its ability to fund it.

The Tematica bottom line is we see the combined AT&T-Time Warner benefitting from two powerful thematic tailwinds — ***Connect Society*** and ***Content is King*** — that also has a rich history of dividend increases that are expected to continue.

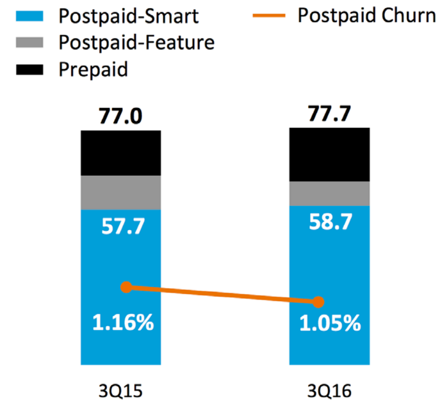
For now, our $44 price target remains intact, and over the coming months as we move toward the transaction closing we will look to revisit that target as necessary.

3Q16 Results: U.S. Wireless

Wireless Trends *($ in billions)*

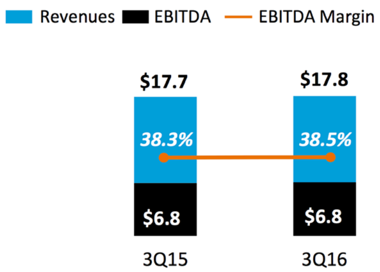
	3Q15	3Q16	Δ
Service Rev.	15.1	15.0	(0.1)
Equipment Rev.	3.2	3.2	0.0
Total Revenues	**18.3**	**18.2**	**(0.1)**
Cash Opex	**10.9**	**10.7**	**(0.2)**
EBITDA	**7.5**	**7.5**	**0.0**
EBITDA Margin	*40.7%*	*41.2%*	*50 bps*
EBITDA Svc. Mgn.	*49.4%*	*50.1%*	*70 bps*

Branded Phone Subscribers
(in thousands)

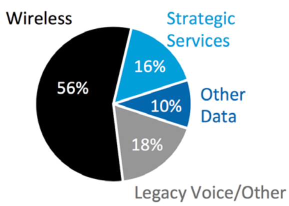


3Q16 Results: Business Solutions

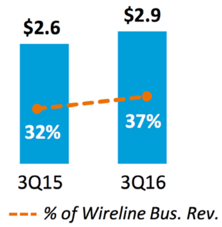
Financial Results
($ in billions)



Business Solutions Revenue Mix



Wireline Strategic Services Revenues



Tuesday: Cutting Sherwin Williams and Whirlpool

Yesterday was one of our less fun ones given earnings reports from **Sherwin Williams (SHW), Whirlpool Corp. (WHR)** and **Under Armour (UA)**. Following those results we issued a special alert in which we:

- **Closed out of our position in both Sherwin Williams at $250.05 (a combined 13 percent loss between our two positions) and Whirlpool Corp. at $150.24 (a combined 14 percent loss on our two positions) from the Tematica Investing Select List.**
- **Cut our price target on UA shares to $40 from $55, but we've kept our Buy rating on the shares.**

The move to remove both Sherwin Williams and Whirlpool shares from the ***Tematica Investing Select List*** was the result of a combination of weaker than expected September quarter results and downside guidance for the balance of 2016. Included in the reset outlook are weaker than expected revenue growth that will translate into reduced EPS expectations near-term. The share reaction in the shares yesterday — SHW down more than 9 percent and WHR down over 10 percent — mean the shares are likely to remain range bound if not fall further as Wall Street recasts its earnings expectations for the coming quarters.

While we could have been patient with SHW and WHR shares, we suspect there will be other better-positioned opportunities to move our capital to, rather than endure a potentially slow crawl to our breakeven points with these two positions.

In short, we decided to fold and move on to the next hand.

2016 THIRD-QUARTER RESULTS

Whirlpool CORPORATION

	Net Sales	Net Sales (Excluding Currency)	Diluted EPS (GAAP)	Ongoing Business Diluted EPS[1]	Free Cash Flow[2]
2016	$5.2B	$5.3B	$3.10	$3.66	$(466)M
2015	$5.3B	$5.3B	$2.95	$3.45	$(492)M
Change	$(0.1)B (0.5)%	$0.0B 0.2%	$0.15 5%	$0.21 6%	$26M

Tuesday: Adjusted Our Under Armour Price Target

Yesterday morning **Under Armour (UA)** reported better than expected September quarter results and re-affirmed its 2016 revenue forecast. For the quarter, UA delivered EPS of $0.29 per share on revenue of $1.47 billion vs. expectations of $0.25 per share in earnings on revenue of $1.45 billion. Ticking through the company's earnings report reveals double-digit growth across all revenue categories (wholesale, direct to consumer, North America, International, apparel, footwear and accessories), with total revenue up 22.5 percent on a year-over-year basis.

So why were UA shares down as the market opened yesterday?

On the earnings conference call, UA management shared it will step up the level of investment to drive growth and it will weigh on margins and bottom line performance over the coming several quarters. Even though UA reiterated its 2018 revenue target of $7.5 billion, this increased level of investment in most aspects of the company's business to achieve its revenue targets means resetting margin and EPS expectations.

Under Armour, Inc.
For the Quarter Ended and Nine Months Ended September 30, 2016 and 2015
(Unaudited; in thousands, except per share amounts)

CONSOLIDATED STATEMENTS OF INCOME

	Quarter Ended September 30,			
	2016	% of Net Revenues	2015	% of Net Revenues
Net revenues	$ 1,471,573	100.0 %	$ 1,204,109	100.0 %
Cost of goods sold	772,949	52.5 %	616,949	51.2 %
Gross profit	**698,624**	**47.5 %**	**587,160**	**48.8 %**
Selling, general and administrative expenses	499,314	34.0 %	415,763	34.6 %
Income from operations	**199,310**	**13.5 %**	**171,397**	**14.2 %**
Interest expense, net	(8,189)	(0.5) %	(4,100)	(0.3) %
Other expense, net	(772)	(0.1) %	(3,239)	(0.3) %
Income before income taxes	**190,349**	**12.9 %**	**164,058**	**13.6 %**
Provision for income taxes	62,124	4.2 %	63,581	5.3 %
Net income	**$ 128,225**	**8.7 %**	**$ 100,477**	**8.3 %**
Adjustment payment to Class C capital stockholders	–		–	
Net income available to all stockholders	128,225		100,477	
Basic net income per share of Class A and B common stock	$ 0.29		$ 0.23	
Basic net income per share of Class C common stock	$ 0.29		$ 0.23	
Diluted net income per share of Class A and B common stock	$ 0.29		$ 0.23	
Diluted net income per share of Class C common stock	$ 0.29		$ 0.23	

As such, UA backed away from its 2018 operating income target of $800 million and while it did not offer a specific revision it painted the picture of mid-teens operating income growth over the next two years, which suggests operating income more like $580-600 million by 2018 compared to $440-$445 million this year. Compounding these investments is the likely prospect that gross margins improvement will be the continued expansion of the company's footwear margins, which are in the low-to-mid 30 percent range today.

Ahead of the company's earnings call, UA shares were up 2 percent on the better than expected September quarter results. During the call, however, as we and other investors digested the updated guidance the shares dropped more than 14 percent pre-market, where it essentially remained for the rest of the trading day yesterday. What we are seeing is a major re-set in expectations for both the company's financial performance and the corresponding valuation for its shares. That reset, which paints 2018 earnings more like $0.75-$0.80 than the current $1.00 per share consensus, has us cutting our price target on UA shares to $40 from $55.

After adjusting for the sharp falloff in UA shares yesterday, which is likely to be overdone in the short-term as Wall Street revises its earnings and price target expectations as we have done, our revised price target offers 23 percent upside. **As such we will continue to keep a Buy rating on UA shares.**

We expect UA will be in the penalty box with investors, a position that takes a company time to work its way out of. The silver lining is that while its growth rate has been reset, UA is still poised to continue to grow its revenue and operating income in the coming quarters as its initiatives take hold. **As the shares settle out in the coming days and cool off from today's news, and we would look to be opportunistic.**

Here's what's coming next this week

Today represents a bit of a break from the earnings onslaught for the Tematica Select List, but it's back in full swing tomorrow (Thursday) when **Alphabet (GOOGL), Amazon (AMZN)** and **Regal Entertainment Group (RGC)** issue their respective results and outlooks. As of last night's market close, we're up nicely in these two Connected Society and ***Content is King*** positions, but as we saw with Under Armour we will remain vigilant during these as well as others positions when they report their quarterly results. In today's market climate, we are taking nothing for granted.

Tematica Contenders

As we roll up our sleeves each week we add companies and discard others to our list of ***Tematica Select Contenders***. These are companies that we're doing more work on and in some cases we're waiting for the risk to reward trade-off to reach more appetizing levels.

AWK	American Water Works	***Scarce Resources***
WTR	Aqua America	***Scare Resources***
CHGG	Chegg Inc.	***Tooling & Retooling***
CMG	Chipotle Mexican Grill	***Foods with Integrity***
SCOR	Comscore	***Connected Society***
GLW	Corning Inc.	***Disruptive Technologies***
EPR	EPR Properties	***Content is King***
IMMR	Immersion Corp.	***Disruptive Technologies***
KIM	Kimco Realty	***Rise & Fall of the Middle Class***
LOCK	Lifelock	***Safety & Security***
MKC	McCormick & Co.	***Cashstrapped Consumer / Middle Class***
MRK	Merk & Co.	***Aging of the Population***
NLSN	Nielson NV	***Connected Society***
OME	Omega Protein Corp.	***Fountain of Youth***
PANW	Palo Alto Networks	***Safety & Security***
SYNA	Synaptics Inc.	***Disruptive Technologies***
VZ	Verizon Communications	***Content is King / Connected Society***
XYL	Xylem, Inc	***Scare Resources***

TEMATICA SELECT LIST PERFORMANCE

POSITION	DATE ADDED	ADD PRICE	CURRENT PRICE	DIV. PAID	STOP PRICE	RETURN (%)	TARGET	RATING
ALPHABET, INC. (GOOGL) *Asset-Lite*	6/15/16	$733.94	$828.55	--	--	12.89%	$900.00	(BUY)
AMAZON.COM (AMZN) *Connected Society*	5/24/16	$709.53	$826.18	--	--	16.45%	$900.00	(BUY)
AMN HEALTHCARE SERV. (AHS) *Scarce Res. / Aging of Population*	8/17/16	$33.80	$33.46	--	--	-1.01%	$47.00	(BUY)
	10/5/16	$31.18	$33.46	--	--	7.31%	$47.00	(BUY)
AT&T (T) *Connected Society*	10/12/16	$39.29	$36.70	--	--	0.43%	$45.00	(HOLD)
Consumer Disc. SPDR (XLY) *Content is King*	4/20/16	$79.57	$79.22	--	--	-1.02%	--	(HOLD)
CALAMP CORP (CAMP) *Connected Society*	8/09/16	$15.37	$13.35	--	--	-13.14%	$21.00	(BUY)
	10/05/16	$13.70	$13.35	--	--	-2.55%	$21.00	(BUY)
COSTCO WHOLESALE (COST) *Cash-strapped Consumer*	9/28/16	$149.67	$150.99	--	--	0.88%	$170.00	(BUY)
WALT DISNEY CO. (DIS) *Content is King*	4/20/16	$102.16	$92.75	--	$87.00	-8.52%	$125.00	(BUY)
	5/11/16	$101.78	$92.75	--	$87.00	-8.17%	$125.00	(BUY)
DYCOM INDUSTRIES (DY) *Connected Society*	9/14/16	$80.47	$84.71	--	--	5.27%	$115.00	(BUY)
INTER. FLAVORS & FRAGRANCES (IFF) *Rise & Fall of the Middle Class*	10/19/16	$129.23	$36.70	--	--	0.43%	$145.00	(BUY)
NIKE INC. (NKE) *Rise & Fall of the Middle Class*	5/18/16	$56.10	$51.05	$0.16	--	-8.43%	$66.00	(BUY)
PETMEDS EXPRESS (PETS) *Connected Society*	5/4/16	$17.80	$20.03	$0.57	--	14.66%	$23.00	(HOLD)
PHYSICIANS REALTY TRUST (DOC) *Aging of the Population*	6/27/14	$14.33	$20.52	$2.03	$18.00	57.33%	$25.00	(HOLD)
PROSHARES SHORT S&P 500 (SH)	1/14/16	$45.10	$38.43	--	--	-14.79%	$24.00	(BUY)
	3/23/16	$41.12	$38.43	--	--	-6.54%	$24.00	(BUY)
REGAL ENTERTAINMENT (RGC) *Content is King*	11/23/15	$18.51	$22.80	$0.66	$19.00	27.23%	$24.00	(HOLD)
STARBUCKS (SBUX) *Guilty Pleasures*	6/01/16	$54.90	$53.67	$0.20	--	-1.87%	$74.00	(BUY)
UNDER ARMOUR (UA) *Rise & Fall of Middle Class*	7/27/16	$39.26	$32.89	--	--	-16.23%	$55.00	(BUY)
UNITED NATURAL FOODS (UNFI) *Foods with Integrity*	8/31/16	$47.00	$41.57	--	--	-11.55%	$232.00	(BUY)
	9/14/16	$38.91	$41.57	--	--	6.84%	$232.00	(BUY)
UNIVERSAL DISPLAY (OLED) *Disruptive Technology / Connected Society*	10/5/16	$53.09	$49.70	--	--	-5.41%	$68.00	(BUY)

as of market close October 25, 2016

STOCKS / FUNDS MENTIONED

AT&T (T)
Alphabet (GOOGL)
Amazon (AMZN)
Cablevision Systems (CVC)
Comcast (CMCSA)
Dycom (DY)
General Electric (GE
Regal Entertainment Group (RGC)
Sherwin Williams (SHW)
Time Warner (TWX)
Time Warner Cable (TWC)
Under Armour (UA)
Whirlpool Corp. (WHR)

ANALYST POSITIONS

At the time of publication, Mr. Versace, Chief Investment Officer of Tematica Research had no positions in the shares of companies mentioned in this issue.

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