

TEMATICA INVESTING

THEMATIC COMMENTARY, EQUITY RESEARCH & INVESTING STRATEGIES



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INSIDE THIS ISSUE

Contents

- Scaling Into International Flavors & Fragrances & AT&T3
- Adding A Helping Flavor Of McCormick & Co. Shares5
- Win A Chance To Extend Your Subscription.....8
- Tematica Select List Performance9
- Tematica Contenders.....10

Adding Scads Of Flavor As We Get Ready For Thanksgiving 2016

Given the recent weakness in the share price, we are adding to our position in **International Flavors & Fragrances (IFF)** and setting a protective stop loss at \$105.

Similarly, **AT&T (T)** shares have lagged the post-election move up in the market, and ahead of its Nov. 28 DirecTV Now event, we’re scaling into the shares at current levels. As we do that, we’ll set a protective stop loss at \$31 for T shares.

We are revisiting one of our favorite companies, extract, spice and marriage company **McCormick & Co (MKC)** with a Buy rating and a \$110 price target. We will look to scale into the position should such an opportunity present itself in the mid-to-upper \$80s. Because this is a new position, we are not issuing a recommended stop loss at this time.

From all of us here at Tematica, we wish a happy and flavorful Thanksgiving holiday. Send us your holiday shopping observations should you venture out on Black Friday, and be entered to win a free 1-year subscription to Tematica Investing — details inside.

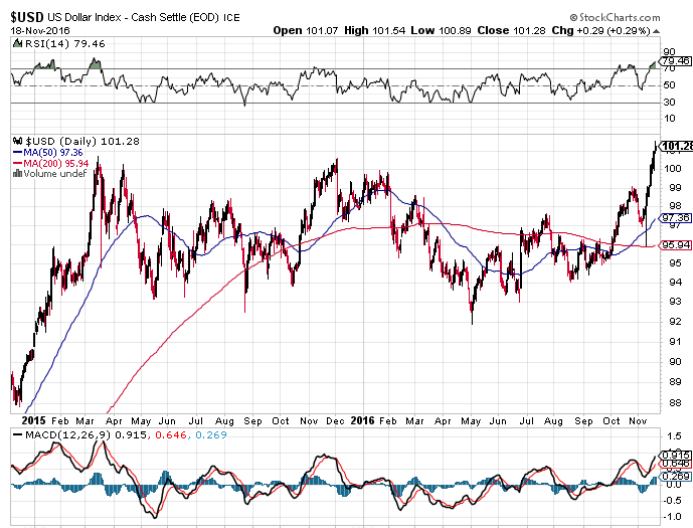
We’re coming to you a tad earlier than usual this week, given the Thanksgiving holiday that historically has led to reduced trading volumes as Wall Street essentially takes a four day weekend before the final sprint to the end of the year.



Since the Wednesday after Election Day 2016, we've seen a pronounced move higher in the domestic stock market, one that has favored growth as evidenced by the 10 percent move in the Russell 2000, compared to the 2.9 and 2.0 percent moves in the Dow Jones Industrial Average and the S&P 500 through last Friday, respectively. The **Tematica Select Investment List** has certainly benefitted with largest moves in **Dycom Industries (DY)**, **Universal Display (OLED)**, **CalAmp (CAMP)** and **United Natural Foods (UNFI)**. As we wrote last week, despite those moves each of those remains a Buy at current levels as their respective thematic tailwinds — **Connected Society**, **Disruptive Technologies** and **Foods with Integrity** — remain intact.

As you know we tend to look at the world — both investing and the one we inhabit — through our thematic lens, after all, it's hard to outperform everyone when you think like everyone else. We are certainly aware of the sector-focused view used by most investors, and from time to time we have shared some interesting observations that crop up using that perspective. In the case of the post-election rally, the sector-based perspective shows the two real winners have been Financials and Industrials, which reflect expectations President-elect Trump's will walk back financial regulations and rebuild the country's crumbling infrastructure. If we had stuck with that outdated sector-based view, we would have missed the strong moves in the positions mentioned above as well as others — rest assured, we are not reverting to that herd strategy.

The other big mover over the last eight trading days has been the US dollar. As you can see in the chart to the right, the US dollar has reached its highest level in 13 years. The issue is that a strengthening dollar has negative implications for US companies that generate a significant part of their revenue from outside the US. This is nothing new as we encountered this throughout 2014 and into 2015 with company after company citing currency headwinds. Odds are this will be repeated in January and February when companies report 4Q 2016 results and offer their take on what's to come in 2017. As we pointed out in this week's Monday Morning Kickoff, consensus earnings expectations for the S&P 500 group of companies call for EPS growth of more than 12 percent in 2017 vs. 2016.



Would we love to see 12 percent EPS growth come to fruition?

Absolutely! But while our thematic lens does provide an alternative view of the landscape, it's not an alternate reality, and as of now we question how those 500 companies will deliver that 12 percent growth based on the current global economic outlook. We'll, of course, continue to watch the shifting landscape for signs that suggest that level of earnings growth could be possible — believe us, we hope we find them — but we'll also be on the lookout for signs that pour cold water on those expectations.

Scaling into International Flavors & Fragrances & AT&T ...

A few weeks ago, **International Flavors & Fragrances (IFF)** reported its September quarter results, which were hampered relative to expectations by product mix. During the quarter, IFF’s business mix was unfavorable as higher-margin businesses in both flavors (beverage) and fragrances (fine fragrances) were softer than expected, while volumes at lower-margin businesses — savory in flavors and fragrance ingredients — were better than expected.

As we mentioned previously, **Coca-Cola (KO)**, **PepsiCo (PEP)** and other beverage manufacturers are reformulating their offerings to reduce sugar content, but preserve flavor and taste. As these initiatives unfold, we see IFF’s mix swinging back, favoring higher-margin businesses in the coming quarters.

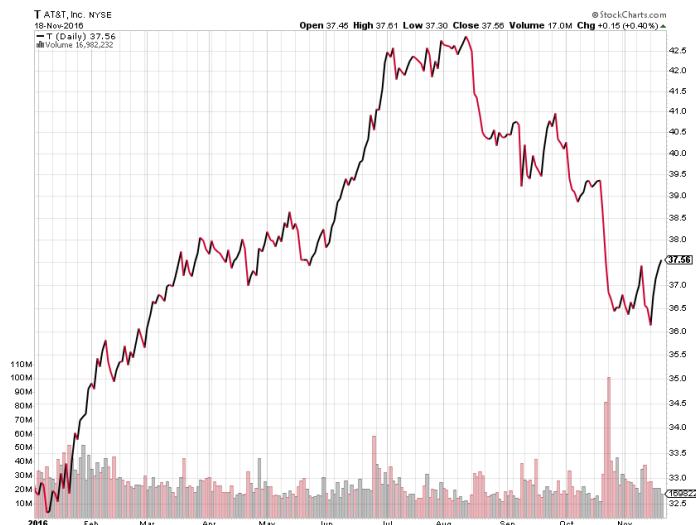
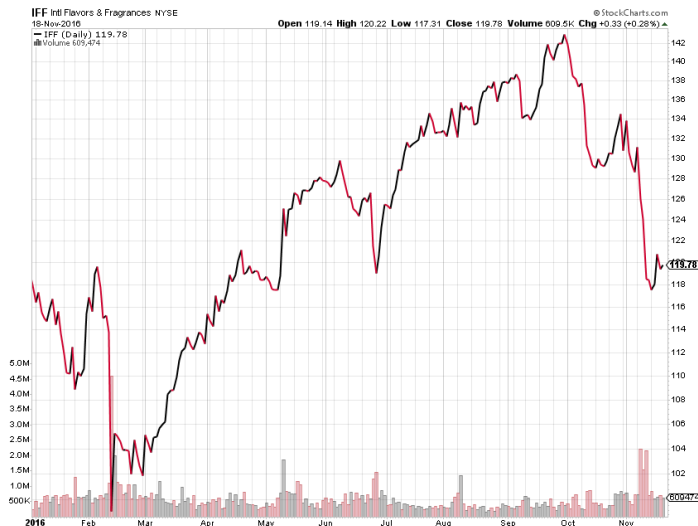
Our long-term view on IFF remains unchanged, as we see its near-oligopoly position in the flavors and fragrances industry benefiting from the **Rise & Fall of the Middle-Class** investment theme unfolding around the globe, as well as the growing consumer preference for natural and organic products that is leading IFF’s customers to reformat their products (an example of the **Foods with Integrity** theme).

As such, we are using the 11 percent fall off in IFF shares over the last three weeks to build out the position on the Tematica Select Investment List. As we do this, we’ll set a protective stop loss at \$105.

... and doing the same with AT&T

Since the election results, **AT&T (T)** shares have lagged the overall market, climbing 1.5 percent compared to 2 percent for the S&P 500 — that’s despite the news that AT&T has bumped its annual dividend to \$1.94 per share. At current levels, that equates to an enviable dividend yield of 4.9 percent — more than double the dividend yield of 2.1 percent for the S&P 500.

Last week, **AT&T (T)** shares climbed more than 2 percent as the Wall Street community warmed to the likely passage of the **AT&T-Time Warner (TWX)** merger. Details still need to be sorted out on the regulatory front, including the potential unloading of certain Time Warner TV channels and





satellite dishes, which could eliminate a potential review by the FCC. We suspect AT&T is open to such options as it looks to transform its business to one that sits at the intersection of our **Connected Society** and **Content is King** investing themes.

On November 28, AT&T is holding an event in New York that will showcase its expected and much-discussed DirecTV Now streaming TV service. Some details have leaked already, including the \$35 per month price point for 100 channels of content that includes HBO, Discovery, NBCUniversal, Turner, Viacom, Disney (including ESPN), AMC, Scripps, Starz, and more.

Because DirecTV Now will stream to wherever you are via your smartphone, tablet, or to your TV via a streaming device like **Apple's (AAPL)** Apple TV or **Amazon's (AMZN)** Fire Stick, AT&T expects this to be its "primary TV platform" by 2020. The big savings is tied up in the lack of required equipment, as it will utilize existing devices rather than hinge on a new set-top box. This cuts out all those monthly set-top box fees that we pay to companies like **Verizon (VZ)** and **Comcast (CMCSA)**. To entice prospective customers, those who commit to three months of the service will get a free Apple TV (worth \$150), while those who pay for one month will receive an Amazon Fire TV Stick (\$35). That loud sound you are hearing is the millions of American's cutting the proverbial cable chord in unison.

We expect more details to emerge at the event next Monday, and while reality could fall short of the hype at least on launch day, as we mentioned above, we see DirecTV Now jump-starting chord cutting. We here at Tematica are crunching the numbers ourselves to see if it warrants dumping the triple-play phone/internet/tv package, to a higher speed Internet-only package, with the DirecTV Now service running over the top of that internet connection and ditching the home phone altogether. The early numbers — and the fact that the only calls we receive at home are from telemarketers — suggest it could be a smart move.

We will continue to monitor Time Warner merger-related developments, but ahead of next week's media event, we are scaling into our AT&T (T) position at current levels. As we do this we are setting a protective stop loss of \$31 on T shares. We continue to have a Buy on T shares with a price target of \$45.

Bottomline on International Flavors & Fragrances (IFF) and AT&T (T)

- **Using the 11 percent fall off in IFF shares to build out the position on the Tematica Select Investment List. As we do this, we'll set a protective stop loss at \$105.**
- **Scaling into our AT&T (T) position at current levels. As we do this we are setting a protective stop loss of \$31 on T shares. We continue to have a Buy on T shares with a price target of \$45.**

Adding A Helping Flavor Of McCormick & Co. Shares

As we get ready for the holiday season — or as we like to say it here at Tematica “season’s eatings” — the one company that we can’t help but think of is the extract, spice and marinade as well as dividend dynamo company **McCormick & Co. (MKC)**.

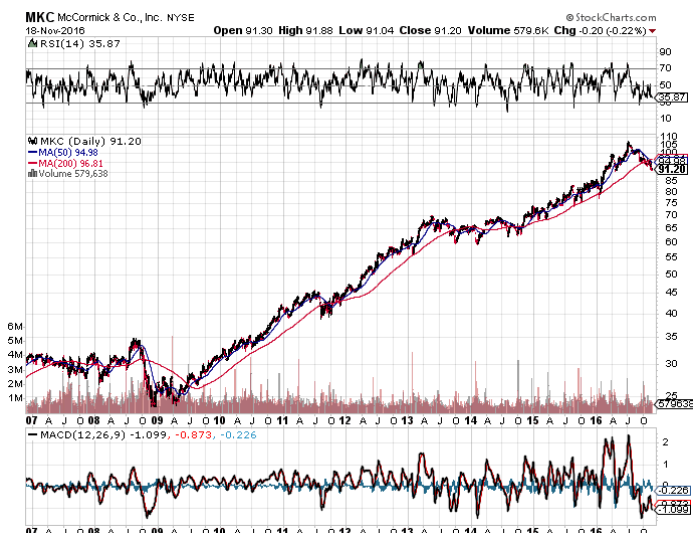
For those unfamiliarity with our “dividend dynamo” designation, it refers to a company with a pronounced track record of increasing its annual dividend. In the case of McCormick, it’s 2015 dividend increase marked its 30th and put its annual dividend at \$1.72 per share run rate this year up from \$0.66 per share in 2005.



Longtime subscribers will remember that we’ve owned shares of this company that sits at the intersection of our **Cash-strapped Consumer** and **Rise & Fall of the Middle-Class** investing themes before (August 2012 - September 2013 and January 2014 - January 2015) given the share price appreciation and steady dividend payments received.

Dividend income aside, these consistent year-over-year dividend increases tend to result in a step-like function higher in terms of the share price, even if the dividend yield metrics remain flat year over year. Historically, McCormick has announced its annual dividend increase in late November, but that is just one reason behind why we’re adding the shares.

The second reason for making the move on MKC now is the 15 percent pullback in the share price over the last several months. When we’ve seen this before in late 2014 and 2014 it proved to be a smart time to buy the shares and warrants at a minimum further investigation, especially given the continued prospects for EPS growth to \$4.45 per share in 2018, up from \$3.48 per share in 2015. If those consensus expectations are hit it means McCormick will have nearly doubled its annual EPS from the \$2.35 per share achieved in 2009, roughly a 6.5 percent compound annual earning growth rate over the 2009-2018 period.



Steady earnings growth has been a hallmark of McCormick and Co. due to its ability to augment its organic growth with strategic acquisitions, which have expanded both its product offering and its geographic footprint, primarily in the higher margin Consumer business. Historically, the Consumer segment accounts for approximately 60 percent of sales and 80 percent of operating income, and the industrial segment contributes roughly 40 percent of sales and 20 percent of operating income. From our perspective, this means the Consumer business is the one that drives the vast majority of profits, earnings and therefore the stock price.

It's that consumer-facing business that most are familiar with given the McCormick®, Lawry's®, Stubb's®, Club House®, Zatarain's®, Thai Kitchen® and Simply Asia® brands. Approximately half of the Consumer segment is spices, herbs and seasonings and for those products, the company is the category leader in what is a rather fragmented industry. For example, in the US alone, there are more than more than 250 other brands of spices, herbs and seasonings with many having less than 3 percent market share. This suggests there are ample nip and tuck acquisition opportunities to be had by McCormick.

Recent acquisitions include:

- March 2015 — Brand Aromatics, a privately held company and a supplier of natural savory flavors, marinades, and broth and stock concentrates to the packaged food industry.
- May 2015 — Drogheria & Alimentari, a privately held company based in Italy, and a leader of that country's spice and seasoning category that supplies both branded and private label products to consumers.
- August 2015 — One World Foods, Inc., owner of the Stubb's brand of barbecue products, a privately held company located in Austin, Texas. Stubb's is the leading premium barbecue sauce brand in the US. In addition to sauces, Stubb's products include marinades, rubs and skillet sauces.
- April 2016 — Botanical Food Company, owner of the Gourmet Garden brand of packaged herbs, a privately held company based in Australia. Gourmet Garden is a global market leader in chilled convenient packaged herbs.

In our view, McCormick is certainly one, of it not the industry consolidator of choice, given its global footprint and enviable Consumer customer base that spans grocery, mass merchandise, warehouse clubs, discount and drug stores, and e-commerce retailers. Odds are, whether you've been at a **Kroger (KR)**, **Whole Foods (WFM)**, Wegman's, Ralph's, Stop & Shop, Harris Teeter, Safeway, Piggly Wiggly or some other grocery chain, you've bought or at least seen some of McCormick's Consumer products.



MCCORMICK & CO. (MKC)

Theme: **Rise & Fall of the Middle-Class**

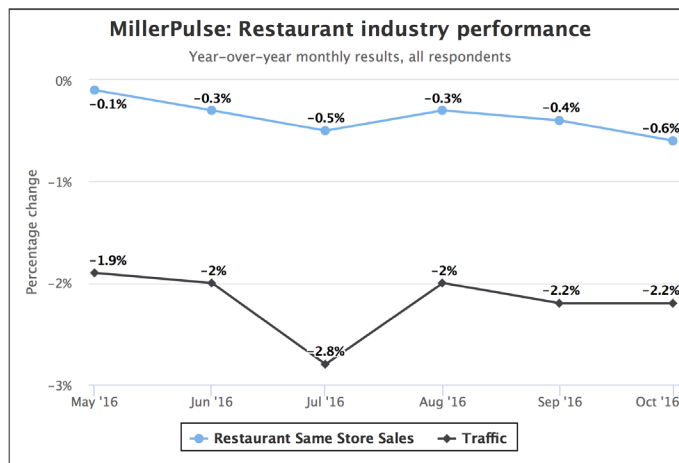
Price on 11/18/16: **\$91.20**

- McCormick & Company, Incorporated manufactures, markets, and distributes spices, seasoning mixes, condiments, and other flavorful products to the food industry.
- It operates through two segments, Consumer and Industrial. The consumer segment offers spices, herbs, seasonings, and dessert items.
- The Industrial segment offers seasoning blends, spices and herbs, condiments, coating systems, and compound and other flavors to multinational food manufacturers and foodservice customers. It serves foodservice customers directly and indirectly through distributors.
- The company was founded in 1889 and is based in Sparks, Maryland.

Shares Outstanding	114.56M
Avg. Volume	626k
Market Cap	11.62B
EPS: '15 / '16 / '17	\$3.48/\$3.79/\$4.11
Cash (mrq): \$US	139.7M
Debt (mrq): \$US	1.62B
Net Cash (mrq)	-1.48B
Revenue (ttm)	4.39B
Enterprise Value to Revenue (ttm)	13.06B
Annualized Dividend Per Share	1.72
Annualized Dividend Yield	1.87%

The big question we hear about the McCormick customer base is if **Wal-Mart (WMT)** is a customer? It's a great question given Wal-Mart's position in the overall grocery industry, and yes Wal-mart is a customer. In fact, Wal-mart has been the largest customer for McCormick's Consumer business, accounting for 11-12 percent of sales over the last several years. And for those wondering if you can order McCormick products through **Amazon (AMZN)**, the answer is yes.

While we tend to focus on McCormick's Consumer business benefitting from our **Rise & Fall of the Middle-Class** and **Cash-strapped Consumer** investing themes, it's also receiving a hefty tailwind from our **Food with Integrity** investing theme as well, as people focus on healthier food choices, which often favor natural ingredients and eating at home. The current bout of food deflation has spurred a return to consumers eating at home, and we've heard this from Kroger, Costco and others over the last few months.



We've also witnessed the falling restaurant traffic and sales trends over the last several months in the Miller Pulse Restaurant Survey data published by the Nation's Restaurant News. One of the key reasons for this weakness is the "wide price gap between grocers and restaurants remains a major factor in this year's depressed same-store sales at restaurant chains." While this is likely weighing on McCormick's lower margin Industrial business, this shift is extremely positive for McCormick as consumers increasingly look for not only healthier but more flavorful meals.

With that mention, let's take a look at McCormick's Industrial business, which provides a wide range of products, including seasoning blends, spices and herbs, condiments, coating systems and compound flavors. The key customer for this business is **PepsiCo (PEP)**, which accounted for roughly 11 percent of sales over the last few years. Much like the Consumer business, McCormick's Industrial business is benefitting from its customer base focusing on meeting growing consumer demand for organic flavors, non-GMO products, and "on-trend" flavors, as well as healthier snacking foods. We've mentioned this as a positive for **International Flavors & Fragrances (IFF)** and the same holds for McCormick's business as well.

Several years ago, MKC management targeted expanding the company's presence in the emerging markets to capitalize on rising disposable incomes. This has led to continued growth in the non-US business, which has come to account for 40-45 percent of sales depending on the quarter. What this means is, aside from the overall business dynamics that tend to focus on shifting consumer preferences and the benefits associated with rising incomes in the emerging markets, we have to be mindful of US dollar strength and the impact of foreign currency translation. Much as we do with **Costco Wholesale (COST)**, we'll focus on metrics adjusted for currency in order to better gauge volume demand.

We are issuing a Buy on MKC shares with a \$110 price target, which offers upside of just over 21 percent before factoring in the company's dividend yield that has ranged between 1.8 to 2.2 percent on a consistent basis over the last few years. Based on a "high" dividend yield that coincides with annual stock price lows over the last few years, we see potential downside in the shares to \$83, roughly 9 percent below the current share price.

With \$600 million left on the company's current share repurchase authorization, we suspect the likelihood of seeing the shares fall to that level on a sustained basis to be rather low. Year to date, McCormick has generated \$322 million on operating cash flow, which should help fund that repurchase program as well as another dividend boost in our view.

Bottomline on McCormick & Co. (MKC)

- **Given that likelihood combined with several thematic tailwinds at the company's back and the simple fact that we are in the sweet spot of the core Consumer business at a time when more people are opting to eat at home, we are adding MKC shares to the Tematica Select Stock & ETF List.**
- **We will look to scale into the position should such an opportunity present itself in the mid-to-upper \$80s.**
- **Because this is a new position, we are not issuing a recommended stop loss at this time.**

An ETF Option for MKC Exposure

For subscribers looking for an ETF with meaningful exposure to MKC shares, **the PowerShares DWA Consumer Staples Momentum Portfolio (PSL)** has the greatest exposure at 3.6 percent of its assets. That position puts MKC share behind **Altria Group (MO), Church & Dwight (CHD), Reynolds America (RAI)** and several other positions.

To us, that stake falls short of really influencing the ETF as the top six holdings account for more than 25 percent of PSL's assets. As such, we are not adding PSL shares to the **Tematica Select Investment List**.

In a perfect world, we would have an ETF that contained both MKC and IFF shares, but alas at least for now there isn't one.

Win a chance to extend your subscription

From all of us here at Tematica, we wish a happy and flavorful Thanksgiving holiday. If you're inclined to venture forth during Black Friday, be sure to let us know what you're seeing out there. What stores are heavy with traffic? Which shopping bags are you seeing? We'll be making our own store and mall walks, but we'd love to hear from you. So much so that, we're having our first Tematica contest.

All subscribers that email in their holiday shopping observations to customerservice@tematicaresearch.com will be eligible to win a free 1-year addition to their **Tematica Investing** subscription.

Send us an email with the details of what you're seeing — the packed stores as well as the empty ones — along with a photo or two and we'll choose one lucky winner at random.

Our tip, follow the money and bags.

TEMATICA SELECT LIST PERFORMANCE

POSITION	DATE ADDED	ADD PRICE	CURRENT PRICE	DIV. PAID	STOP PRICE	RETURN (%)	TARGET	RATING
ALPHABET, INC. (GOOGL) <i>Asset-Lite</i>	6/15/16	\$733.94	\$775.97	--	--	5.73%	\$900.00	(BUY)
AMAZON.COM (AMZN) <i>Connected Society</i>	5/24/16	\$709.53	\$760.16	--	--	7.14%	\$950.00	(BUY)
	10/28/16	\$781.59	\$760.16	--	--	-2.74%	\$950.00	(BUY)
AMN HEALTHCARE SERV. (AMN) <i>Scarce Res. / Aging of Population</i>	8/17/16	\$33.80	\$33.40	--	--	-1.18%	\$47.00	(BUY)
	10/5/16	\$31.18	\$33.40	--	--	7.12%	\$47.00	(BUY)
AT&T (T) <i>Connected Society</i>	10/12/16	\$39.29	\$37.56	--	--	-4.16%	\$45.00	(HOLD)
CALAMP CORP (CAMP) <i>Connected Society</i>	8/09/16	\$15.37	\$15.10	--	--	-1.76%	\$21.00	(BUY)
	10/05/16	\$13.70	\$15.10	--	--	10.22%	\$21.00	(BUY)
COSTCO WHOLESALE (COST) <i>Cash-strapped Consumer</i>	9/28/16	\$149.67	\$150.36	--	--	0.76%	\$170.00	(BUY)
WALT DISNEY CO. (DIS) <i>Content is King</i>	4/20/16	\$102.16	\$98.24	\$0.71	\$87.00	-3.14%	\$125.00	(BUY)
	5/11/16	\$101.78	\$98.24	\$0.71	\$87.00	-2.78%	\$125.00	(BUY)
DYCOM INDUSTRIES (DY) <i>Connected Society</i>	9/14/16	\$80.47	\$91.81	--	--	14.09%	\$115.00	(BUY)
	10/29/16	\$72.89	\$91.81	--	--	25.96%	\$115.00	(BUY)
INTER. FLAVORS & FRAGRANCES (IFF) <i>Rise & Fall of the Middle Class</i>	10/19/16	\$129.23	\$119.78	--	--	-7.31%	\$145.00	(BUY)
PROSHARES SHORT S&P 500 (SH)	1/14/16	\$45.10	\$37.65	--	--	-16.52%	\$24.00	(BUY)
	3/23/16	\$41.12	\$37.65	--	--	-8.44%	\$24.00	(BUY)
POWERSHARES NASDAQ INTERNET PORTFOLIO ETF (PNQI) <i>Connected Society</i>	11/16/16	\$83.67	\$84.13	--	--	0.54%	\$90.00	(BUY)
STARBUCKS (SBUX) <i>Guilty Pleasures</i>	6/01/16	\$54.90	\$55.77	\$0.20	--	1.96%	\$74.00	(BUY)
UNDER ARMOUR (UA) <i>Rise & Fall of Middle Class</i>	7/27/16	\$39.26	\$30.95	--	--	-21.17%	\$55.00	(BUY)
	11/2/16	\$30.74	\$30.95	--	--	0.68%	\$55.00	(BUY)
UNITED NATURAL FOODS (UNFI) <i>Foods with Integrity</i>	8/31/16	\$47.00	\$48.11	--	--	2.36%	\$232.00	(BUY)
	9/14/16	\$38.91	\$48.11	--	--	23.64%	\$232.00	(BUY)
UNIVERSAL DISPLAY (OLED) <i>Disruptive Technology / Connected Society</i>	10/5/16	\$53.09	\$58.10	--	--	9.44%	\$68.00	(BUY)

as of market close November 18, 2016

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	Scarce 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
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	Scarce Resources

STOCKS / FUNDS MENTIONED

- Amazon (AMZN)
- AT&T (T)
- CalAmp (CAMP)
- Coca-Cola (KO)
- Comcast (CMCSA)
- Costco Wholesale (COST)
- Dycom Industries (DY)
- Kroger (KR)
- McCormick & Co (MKC)
- PepsiCo (PEP)
- Time Warner (TWX)
- United Natural Foods (UNFI)
- Universal Display (OLED)
- Wal-Mart (WMT)
- Whole Foods (WFM)

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.

IMPORTANT DISCLOSURES AND CERTIFICATIONS

Analyst Certification - The author certifies that this research report accurately states his/her personal views about the subject securities, which are reflected in the ratings as well as in the substance of this report. The author certifies that no part of his/ her compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in this research report.

Investment opinions are based on each stock's 6-12 month return potential. Our ratings are not based on formal price targets, however our analysts will discuss fair value and/or target price ranges in research reports. Decisions to buy or sell a stock should be based on the investor's investment objectives and risk tolerance and should not rely solely on the rating. Investors should read carefully the entire research report, which provides a more complete discussion of the analyst's views.

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