TEMATICA INVESTING

THEMATIC COMMENTARY, EQUITY RESEARCH & INVESTING STRATEGIES

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INSIDE THIS ISSUE

We took our own advice and used the Thanksgiving holiday and the Black Friday shopping weekend to rest up and do some online shopping along the way. We even visited a couple of malls, gathering our first data point on what would end up being a record-setting online shopping weekend, given the ease of finding parking and the sparse crowds inside the stores.

As we shared in this week's Monday Morning Kickoff, digital shopping blazed the consumer spending path over the last several days, firmly cementing the shift that is driving our **Amazon (AMZN)** shares as well as lending a helping hand to our **Alphabet (GOOGL)** shares.

Despite the late day fade in the market yesterday, week over week all the major market indices are once again higher, which means a deeper step into overbought territory for the majority of the market. There are opportunities to be had, including **Facebook (FB)** shares, which we've had in our ***Connected Society*** investing theme crosshairs for some time and in today's issue we're stepping into them.

Also in the following pages, we give an overview of **AT&T's (T) DirecTV Now** service, which is available today, touch on what it means for **Dycom (DY)** and why we still think its shares are a buy. Recently added **McCormick & Co. (MKC)** made a nip and tuck acquisition, and we give you some flavor on it.

Before we let you get to the meat of the issue, over the coming weekend we have the Italian referendum vote coming up this weekend that could bring volatility back to the market next week. We'll be drilling down on it and most likely have newly added Tematica Chief Macro Strategist Lenore Hawkins share her views on it given that she lives in Italy.

Okay, let's get to it...

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.

Adding Connected Society Company Facebook to the Fold

We've long had our eye on **Facebook (FB)** as part of the ***Connected Society*** investing theme, a theme that focuses on the accelerating shift from analog to digital that is at the heart of our position in **Alphabet (GOOGL), Amazon (AMZN)** and **AT&T (T)** positions — for more on AT&T see below.

One would think we would have added Facebook earlier, but lofty price valuations have kept shares of the largest social networking player just beyond reach. Over the last few weeks, however, its shares have come under some pressure for a variety of reasons — including tough comparisons ahead, rising expenses, issues with Facebook's video metrics, the post-election malaise for tech stocks and issues surrounding "fake news".

We expect Facebook will successfully tackle the fake news issue — something that came to the forefront during the recent election cycle — as well as its video metrics problem based on the simple fact that advertising is a key revenue generator across its various platforms.

According to data from eMarketer, by the end of this year, U.S. digital ad spending will reach $72.09 billion, surpassing TV advertising spend ($71.29 billion) for the first time. This is not expected to be a blip, as digital advertising is forecasted to rise to $93 billion by 2018 vs. $74.5 billion for TV advertising.

Mobile and Video: Two key factors in that strength are critical areas for Facebook

Mobile ad spending is expected to grow 45 percent this year, reaching $45.95 billion, and by 2019 mobile ad spending is forecasted to account for more than one-third of total media spending. As we saw with the shift away from newspapers and magazines towards online and are once again seeing with the move to mobile, advertisers will go wherever the eyeballs are. Online video advertising won't be a slouch either, as it grows to $10.3 billion this year, just over 14 percent of total digital spending, before taking additional share in 2017.

As this transition is underway, Facebook continues to roll out new products and services that should help it capture incremental advertising market share. We've already seen the company bring monetization efforts across Facebook and Instagram with great success, and similar monetization efforts coming to its Messenger app in the form of sponsored messages.

The company is also expanding its services to include live video messages on Instagram to compete with Snapchat and **Twitter (TWTR)**, a free cross-platform video calling service for WhatsApp's 1 billion users and a feature that would let page administrators create job postings and receive applications from candidates — a move that could pressure **LinkedIn's (LNKD)** recruiting business, which recently agreed to be acquired by **Microsoft Corp (MSFT)**. As these and other services become available, we suspect Facebook will look at new advertising and monetization models along the way.

Central to all of this is Facebook's growing daily active user base (1.18 billion in the third quarter of 2016, up from 1.13 in 2Q 2016 and 1.0 billion in 3Q 2015), which is increasingly mobile in nature. Of the 1.18 billion users, roughly 15 percent are located in the U.S., 22 percent in Europe, 31 percent in Asia-Pacific and the balance in the company's Rest of World category.

Now here is where it gets interesting

Roughy half of Facebook's revenue is generated in the U.S., with 16 to 22 percent derived from Europe and Asia-Pacific, each. What this tells us is that Facebook's average revenue per user outside of the U.S. lags significantly compared to what it achieves in the U.S. To us, that is one of the key growth opportunities for Facebook, and in many ways mimics Amazon bringing its Prime offering to geographies outside the U.S. The great thing about Facebook targeting international revenue growth is that it is bound to be far less capital intensive than Amazon's initiatives, and the strategy should be largely in sync with its mobile and video initiatives.

Progress by Facebook on its advertising/monetization strategies (especially video) and international revenue per user growth, and other opportunities that help grow its user base are behind the current revenue and EPS growth

facebook

FACEBOOK (FB)

Theme: ***Connected Society***

Price on 11/29/16: **$120.87**

- Facebook, Inc. operates as a mobile application and Website that enables people to connect, share, discover, and communicate each other on mobile devices and personal computers worldwide.
- Its solutions also include Instagram, Messenger, and WhatsApp Messenger. The company also develops Oculus virtual reality technology and content platform
- As of December 31, 2015, it had 1.04 billion daily active users (DAUs) and 934 million DAUs who accessed Facebook from a mobile device.
- Facebook, Inc. was founded in 2004 and is headquartered in Menlo Park, California.

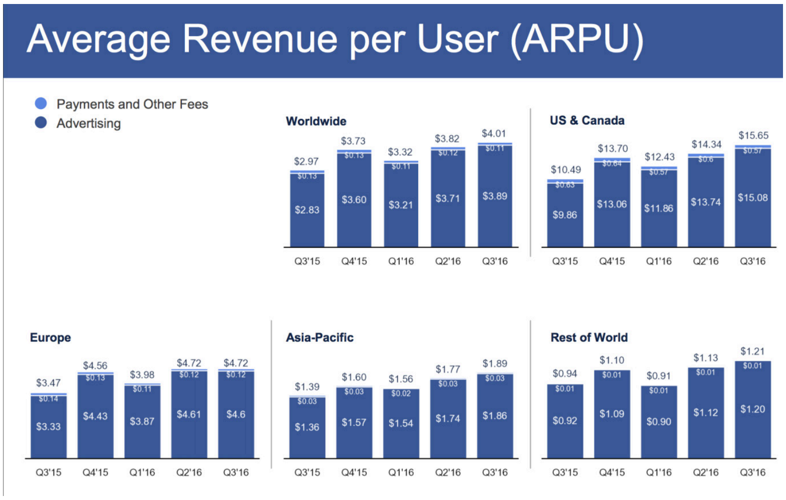
Shares Outstanding	2.34B
Avg. Volume	20.82M
Market Cap	348.37B
EPS: '15 / '16 / '17	$2.28/$4.12/$5.20
Cash (mrq): $US	26.14B
Debt (mrq): $US	N/A
Net Cash (mrq)	N/A
Revenue (ttm)	24.67B
Enterprise Value to Revenue (ttm)	13.01
Annualized Dividend Per Share	N/A
Annualized Dividend Yield	N/A

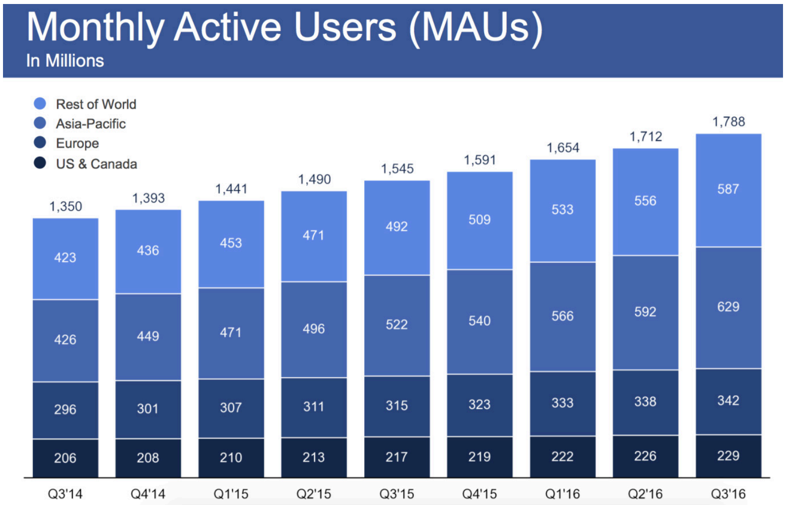
expectations, calling for continued revenue growth over the coming years. Consensus expectations have Facebook earning $4.12 per share this year, up from $2.28 per share in 2015. But the valuation story and bullish demeanor across the investment community for FB shares is really a 2017 to 2018 story. As Facebook continues to grow and improve its global monetization efforts, earnings expectations rise to $5.20 per share in 2017 and $6.55 per share in 2018.

Some quick math infers that over the 2015 to 2018 period, Facebook will grow its EPS to the tune of 42 percent on a compound annual growth rate basis. Even if we handicap those earnings expectations somewhat so that the compound annual growth rate is more like 25 percent to 30 percent, our $150 price target equates to a PEG ratio between 0.9 and 1.2 on 2017 EPS expectations, and a far more compelling 0.75 to 0.9 when looking at 2018.

To be fair, there are others with higher price targets for Facebook, like **Goldman Sachs (GS)** that has published a $162 price target for the stock, but we'd prefer to see international advertising revenue growth in the coming quarters before getting a tad more aggressive in our valuation assumptions. As it is, Facebook's recently announced $6 billion share repurchase that begins in 1Q 2017 has the potential to shrink the share count by around 2 percent near current share price levels, which should lend a helping hand when it comes to meeting those earnings expectations.

For subscribers looking for an ETF play for Facebook, we would suggest the **First Trust Dow Jones Internet Index Fund (FDN)**. Three of its top four holdings are Amazon (9.88 percent), Facebook (9.32) and Alphabet (9.95 across two share classes).





Bottomline on Facebook (FB)

- **We are adding Facebook shares to the Tematica Select Investment List with a $150 price target, which offers 24 percent upside from current levels.**
- **Because this is a new position, we are inclined to use any pullback near $105-$110 to scale into the position and improve our cost basis.**
- **As such, we are holding off adding a protective stop loss recommendation at this time.**
- **For subscribers looking for an ETF play for Facebook, we would suggest the First Trust Dow Jones Internet Index Fund (FDN)**

Details Emerge on AT&T's DirecTV Now Service and We Like It

Earlier this week ***Connected Society*** investment theme company **AT&T (T)** took the wraps off its much-discussed DirecTV Now video streaming service, which was first unveiled back in October. In many respects, it was a non-event event, given the prior unveiling. AT&T did, however, fill in a number of the missing pieces, including programming packages and the launch date.

With the previously missing details in hand, we have a better feel for the overall offering, which in our view should be rather attractive to potential cord-cutters that want to consume video where and when they want on whichever device they choose. This is something AT&T is counting on as it shores up its competitive offering (mobile, streaming) against **Verizon (VZ), T-Mobile USA (TMUS)** and **Sprint (S)**, as well as potential mobile entrant **Comcast (CMCSA)** in an increasingly competitive mobile smartphone marketplace. In our view, this makes AT&T even more of a ***Connected Society*** company than before.

Over the coming months, investors such as ourselves will be watching DirecTV Now customer metrics to gauge not only the overall success of the services but what the potential impact could be on wireless capital spending in the coming quarters. Initial estimates call for AT&T to add 1.0 million subscribers in the first year, with others forecasting 3.0 million users by 2020. Helping spur initial demand, AT&T is making what appears to be a compelling promotional offering: 100 channels for $35/month, but only for a limited time (more on that below), which is likely to pull forward demand. This also means we'll need to closely watch cancellations and churn metrics as well as new adds to gauge the true success of the offering.

We'll watch these metrics with an eye to what it may mean for incremental network deployments to fill in capacity needs over the coming quarters as well as the next evolution in mobile technology that is 5G. As a quick reminder, 5G should not only offer far greater data speeds vs. 4G LTE networks but also bring improved network capacity as well. In our view, any such incremental deployments would bode well for our ***Dycom (DY)*** shares given that AT&T is its largest customer.

Stepping back, the DirecTV Now service is but one step (granted, a medium-to-large one) in AT&T's larger transformation. With the pending acquisition of ***Time Warner (TWX)*** still in motion — a transaction that we think will help transform AT&T into a connected content company, putting it in the same room as **Disney (DIS)** — **we continue to have a $44 price target on T shares.**

Here are the details that were shared at the DirecTV Now event this past Monday:

DirecTV Now will debut on Wednesday, November 30, 2016, at prices ranging from $35 a month for over 60 channels to $70 for over 120 channels. The four programming packages include:

For a limited time, more than 100 channels will be available for $35 and anyone who signs up at this promotional price will be able to keep paying it until they cancel.

In addition to those packages, DirecTV Now users can also:

- Add premium services such as HBO and Cinemax for $5 per month.
- For $6 a month, viewers can also sign up for Fullscreen, a video service owned by Otter Media, a joint venture between AT&T and media company the Chernin Group. We'd note that AT&T is giving its wireless subscribers free access to Fullscreen for a year.
- AT&T is also rolling out FreeView, an ad-supported video service that gives viewers a taste of some on-demand DirecTV Now content for free.

Turning to the content, DirecTV Now will include content from Disney and ESPN, AMC Networks, Turner, Viacom, NBCUniversal, Fox, Discovery and Bloomberg, and continues to negotiate with CBS Corp. A better sense as to which channels are bundled into the different DirecTV Now packages can be seen in the below graphic.

Once the service goes live, potential users will be able to sign up for a 7-day free trial and download the app from either **Apple's (AAPL)** App Store or **Alphabet's (GOOGL)** Google Play. As previously announced, anyone who signs up for one month of prepaid access to DirecTV Now will receive a free **Amazon (AMZN)** Fire TV Stick with Alexa Voice Remote, while customers who pay for three months up front will get an Apple TV. Here's a list of all the devices that will support DirecTV Now at launch:

- Amazon Fire TV and Fire TV Stick
- Android mobile devices and tablets
- iPhone, iPad and Apple TV
- Chromecast (Android at launch; iOS in 2017)
- Google Cast-enabled LeEco ecotvs and VIZIO SmartCast Displays
- Internet Explorer, Chrome and Safari web browsers

In 2017, the service is expected to expand to include Roku devices, Amazon Fire tablets and Samsung Smart TVs. From a device perspective, AT&T's promotional activity could spur some upside unit demand this holiday season, but even so, those units are not likely to sway overall results at Amazon, Apple or Alphabet.

Even a new service such as this is bound to launch with some shortcomings and in this case, they include a total lack of a DVR feature, pausing of live video and access to local major networks like ABC, NBC and Fox outside of big cities. We expect new features and services over the coming months, much the way Amazon eventually allowed Amazon Prime subscribers to either stream or download video content for later viewing from its Prime Video service.

We'll have more on DirecTV Now as Chris Versace is planning to beta the service as he contemplates removing not only the Verizon FiOS TV service to his home but becoming a true cord-cutter by axing his Verizon landline telephony service in exchange for increasing Internet speed and streaming services.

Mr. Versace could be running with scissors!

Still Bullish on Dycom (DY) Shares Following the Ground Hog Like Move Lower

Last Monday (Nov. 21) **Dycom Industries (DY)** reported better-than-expected bottom line results for its October quarter, but also offered several revisions to forward-looking expectations. Those revisions included the second cut to expected revenue from its Goodman acquisition and another customer, (which was not named but we suspect to be Google Fiber) that had "modified its plans" such that it would hit Dycom's revenue over the coming quarters by $80 million.

The net effect of these two factors led Dycom's backlog to fall to $5.2 billion at the end of October vs. $6 billion at the end of July. In after-market trading after the news, it was rather apparent Dycom shares were going to get hit and get hit hard when the market opened on Tuesday (Nov. 22), and that is exactly what happened. DY shares opened and fell to bottom at $70.60 in early market trading the next day.

All of that spun out of the company's earnings press release as Dycom's earnings conference got underway at 9 AM ET on Nov. 22. As usual, Dycom was rather forthcoming in breaking down its business during the quarter. Telco was 68.8 percent of revenue, cable 23 percent, facility locating 5.5 percent and electro and others 2.7 percent.

The key message was revenue from its top five customers — **AT&T (T), CenturyLink (CTL), Comcast (CMCSA), Verizon (VZ)**, Windstream — which accounted for 75 percent of revenue in the quarter, rose 40 percent year over year. That does mean revenue contracted at other customers, which includes the revised expectation at Goodman as well as the now well- known issues at Google Fiber. We would note however during the quarter Dycom continued to win new mandates from its top customers

To put the impact of Google Fiber and Goodman into perspective, on a combined basis, they accounted for roughly 5 percent of expected revenue — not a small amount, but also not one that should drive a 20 percent pullback in the share price. Moreover, with multiyear capital spending plans to deploy gigabit fiber, expand cable footprints, enhance existing 4G LTE networks and deploy 5G ones being announced by key Dycom customers like CenturyLink, AT&T, and Comcast, we suspect the near-term is likely to be a bump in the road amid robust network spending over the next several years.

Added to all of this is the recent FCC approval by Verizon to take over XO Communications, which brings 20,000 route miles of intercity network crossing the U.S and Canada and 13,000 route miles of metro fiber to the company. For Verizon, the deal yields infrastructure for power future 5G gigabit wireless networks as well as incremental wireline expansion, both of which bode well for Dycom.

The bottom line is the move in DY shares last week was an over-reaction, given the size of the revenue adjustment and the longer-term opportunities to be had with its core customer base.

While it may be somewhat simplistic, over the coming quarters telecom and cable companies are going to expand existing networks and deploy new technologies to bring new revenue generation services to market. Perhaps the best example is AT&T's DirectTV Now, which we covered above.

As we've seen in the past with new services like this as well as 3G and 4G networks, it all comes down to the quality and reliability of the network. Over the next few years, odds are some projects will speed up and others will get pushed back, but over the medium to longer-term, the buildout of those networks bodes very well for Dycom and its shares. There is also potential for incremental business with Google once it resumes its network buildout, be it with fiber or wireless technologies, which as we discussed in our initial piece on Dycom require wireline backhaul deployments.

During the conference call, we were reminded that Dycom has $100 million to repurchase shares under its current authorization, and the buyback window opens two days after earnings are released. We suspect the company will be putting that authorization to work near-term, and we would not be surprised to see another authorization emerge should Dycom exhaust the current one. Over the last 11 years, the company has bought back roughly 40 percent of the outstanding shares.

We've seen EPS expectations lowered and subsequently price targets as well from more than $120 to in-line $100-$110 range, but we are also seeing DY shares defended, given its industry position and the expected network spending over the coming years. We certainly agree with the sentiment, but we too will trim our price target back to $105 from $115, which still offers substantial upside to be had over the coming quarters.

McCormick Snaps Up An Italian Play

This week recently added **McCormick & Co. (MKC)** announced it was acquiring Florence, Italy-based Italian flavor manufacturer Enrico Giotti for $127 million in cash. Annual sales of the company's beverage, sweet, savory and dairy flavor applications that include natural flavors, aromatic herbal extracts, and concentrated juices tally $56 million. That portfolio of products should be additive to McCormick's Industrial food business and help expand its presence Europe.

This is a great example of the nip and tuck acquisitions that McCormick has been doing over the last several years as it strategically consolidates the fragmented flavor and spice industry. Granted the Enrico acquisition is not likely to move the McCormick needle dramatically, but over time it should be a solid contributor and McCormick leverages its products across its global platform.

We continue to rate MKC shares a Buy with a $110 price target.

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	$789.44	--	--	7.56%	$900.00	(BUY)
AMAZON.COM (AMZN) *Connected Society*	5/24/16	$709.53	$762.52	--	--	7.47%	$950.00	(BUY)
	10/28/16	$781.59	$762.52	--	--	-2.44%	$950.00	(BUY)
AMN HEALTHCARE SERV. (AMN) *Scarce Res. / Aging of Population*	8/17/16	$33.80	$33.85	--	--	0.15%	$47.00	(BUY)
	10/5/16	$31.18	$33.85	--	--	8.56%	$47.00	(BUY)
AT&T (T) *Connected Society*	10/12/16	$39.29	$39.48	--	$31.00	0.74%	$45.00	(HOLD)
	11/21/16	$37.63	$39.48	--	$31.00	4.92%	$45.00	(HOLD)
CALAMP CORP (CAMP) *Connected Society*	8/09/16	$15.37	$14.95	--	--	-2.73%	$21.00	(BUY)
	10/05/16	$13.70	$14.95	--	--	9.12%	$21.00	(BUY)
COSTCO WHOLESALE (COST) *Cash-strapped Consumer*	9/28/16	$149.67	$151.48	--	--	1.51%	$170.00	(BUY)
WALT DISNEY CO. (DIS) *Content is King*	4/20/16	$102.16	$99.67	$0.71	$87.00	-1.74%	$125.00	(BUY)
	5/11/16	$101.78	$99.67	$0.71	$87.00	-1.38%	$125.00	(BUY)
DYCOM INDUSTRIES (DY) *Connected Society*	9/14/16	$80.47	$72.27	--	--	-10.19%	$115.00	(BUY)
	10/29/16	$72.89	$72.27	--	--	-0.85%	$115.00	(BUY)
INTER. FLAVORS & FRAGRANCES (IFF) *Rise & Fall of the Middle Class*	10/19/16	$129.23	$121.25	--	$105	-6.18%	$145.00	(BUY)
	11/21/16	$120.06	$121.25	--	$105	0.99%	$145.00	(BUY)
MCCORMICK & CO. *Cash-strapped Consumer*	11/21/16	$91.80	$93.13	--	--	1.45%	$170.00	(BUY)
PROSHARES SHORT S&P 500 (SH)	1/14/16	$45.10	$37.23	--	--	-17.45%	$24.00	(BUY)
	3/23/16	$41.12	$37.23	--	--	-9.46%	$24.00	(BUY)
POWERSHARES NASDAQ INTERNET PORTFOLIO ETF (PNQI) *Connected Society*	11/16/16	$83.68	$85.32	--	--	1.97%	$90.00	(BUY)
STARBUCKS (SBUX) *Guilty Pleasures*	6/01/16	$54.90	$58.17	$0.20	--	6.33%	$74.00	(BUY)
UNDER ARMOUR (UA) *Rise & Fall of Middle Class*	7/27/16	$39.26	$30.90	--	$25.00	-21.29%	$55.00	(BUY)
	11/2/16	$30.74	$30.90	--	$25.00	0.52%	$55.00	(BUY)
UNITED NATURAL FOODS (UNFI) *Foods with Integrity*	8/31/16	$47.00	$46.96	--	--	-0.09%	$232.00	(BUY)
	9/14/16	$38.91	$46.96	--	--	20.69%	$232.00	(BUY)
UNIVERSAL DISPLAY (OLED) *Disruptive Technology / Connected Society*	10/5/16	$53.09	$53.75	--	--	1.24%	$68.00	(BUY)

as of market close November 29, 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

Alphabet (GOOGL)
Amazon (AMZN)
Apple (AAPL)
AT&T (T)
CenturyLink (CTL)
Comcast (CMCSA)
Dycom Industries (DY)
Facebook (FB)
Goldman Sachs (GS)
McCormick & Co. (MKC)
Sprint (S)
T-Mobile USA (TMUS)
The Walt Disney Co (DIS)
Time Warner (TWX)
Twitter (TWTR)
Verizon (VZ)

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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