

TEMATICA INVESTING

THEMATIC COMMENTARY, EQUITY RESEARCH & INVESTING STRATEGIES



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Tematica Investing, a weekly publication by 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.

ECONOMICS & EXPECTATION

As expected, volatility has certainly returned as the number of March quarter earnings reports has picked up significantly. Adding fuel to that fire, the latest PMI readings from Markit Economics show China’s manufacturing economy contracted further in April, and ISM’s April take of domestic manufacturing shows that once again it missed the expected mark.

Slower order growth and contracting manufacturing employment here at home does not bode well for the Employment Report coming this Friday. As tends to be the case, we can expect more tinkering on April job creation figures following today’s ADP Employment Report.

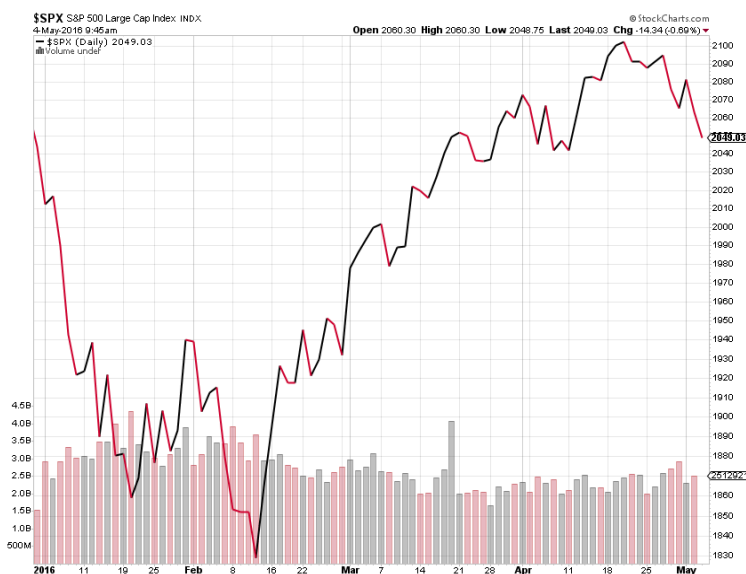
It didn’t help the global outlook yesterday when the European Central Bank trimmed its 2016 Eurozone growth forecast to 1.6 percent from 1.7 percent. Add in last week’s lack of action by the Bank of Japan, and there is a high probability we won’t see a dramatic pick up in the pace of global activity in the near-term.

In other words, we see no reason thus far for the Fed do anything until the back half of 2016 at the soonest.

The bottom line is we remain very comfortable with our existing positions on the **Tematica Select List**, especially our **ProShares Short S&P 500 (SH)** insurance position, as well as those hefty dividend payers. In the pages below we add a new company, **Petmed Express (PETS)** to the **Tematica Contender List** and we continue to put a number of other prospects under the thematic and valuation microscopes.

We intend to use the continued volatility of the market to our advantage and start to make a move on some of these contenders if and when the risk-to-reward ratio moves more in our favor.

Now, let’s get to it . . .



Adding Petmed Express to the Tematica Contender List

We are adding **Petmed Express (PETS)** to the **Tematica Contender List** — the list of companies that we’re doing more work on and in some cases we’re waiting for the risk to reward tradeoff to reach more appetizing levels.

Petmed Express, which you probably know better as 1-800-PedMeds, is an online pet pharmacy that sells prescription as well as non-prescription and health products primarily to owners of dogs and cats. From a thematic perspective, the company’s online component positions it on our **Connected Society** investment theme. We suspect some would argue over the high attach rate between the aging population and pets augurs for including it in the **Agging of the Population** theme, but we see that as a little stretched.

The drivers behind PetMed’s business include the continued growth in spending for pets as well as the growing percentage of people that have pets. According to data collected and published from the American Pet Products Association (APPA), total US pet industry expenditures have increased at a compound annual growth rate (CAGR) of 5.1 percent over the last decade, reaching \$60.28 billion in 2015.

Even during the Great Recession, pet spending continued to grow year over year, suggesting that come hell or high water, pet owners will continue to care for their dogs, cats, reptiles, and birds. Looking at data as far back as 1994, pet spending has never failed to grow from year to year.

Breaking the spending down in 2015:

- \$23 billion was for food
- \$14.3 billion for supplies and over-the-counter medicine
- \$15.4 billion for veterinary care
- \$2 billion for live animal purchases
- \$5.4 billion for services (grooming and boarding)

Roughly 65 percent of US households (or 79.7 million homes) have pets, with the largest percentage having either a dog (54.4 million) or a cat (42.9 million). Estimates indicate Americans own roughly 164 million cats and dogs, and, much like overall pet spending, ownership has been on the upswing. With pet ownership on the rise, overall pet spending is expected to increase in 2016 to \$62.75 billion, up 4 percent year over year, and again in 2017.

With a favorable fundamental outlook, why PetMed Express?

Quite simply, the stickiness of PetMed’s business with customers is what raises it to the top of the crowded pet segment. 85 percent of December-quarter revenue came from reorders by existing customers, which is in line with historical trends, and is expected to continue as consumers increasingly shift to online sources for prescription and non-prescription products for their cats and dogs.

Roughly half of PetMed’s business mix is prescription in nature. While the company carries over 3,000 SKUs, the core business revolves around flea, tick and heart-worm products, which speaks to the high re-order nature of the business.

Total U.S. Pet Industry Expenditures

Year	Billions of dollars
2016	\$62.75 Estimated
2015	\$60.28 Actual
2014	\$58.04
2013	\$55.72
2012	\$53.33
2011	\$50.96
2010	\$48.35
2009	\$45.53
2008	\$43.2
2007	\$41.2
2006	\$38.5
2005	\$36.3
2004	\$34.4
2003	\$32.4
2002	\$29.6
2001	\$28.5
1998	\$23
1996	\$21
1994	\$17

Turning to the balance sheet, at the end of 2015, PetMed had around \$62 million in cash, with no debt, and about \$3.05 per share in net cash. We mentioned the favorable yield earlier, and the company has a history of bumping up its dividend, but it is not a “dividend dynamo” that hikes its payout every year. That said, the current quarterly dividend of \$0.18 compares to \$0.10 in 2009, the year in which PetMed instituted a quarterly dividend.

From an earnings perspective, the company is expected to deliver flattish earnings per share this year of around \$0.98, vs. \$1.00 for the 12 months ending this past March.

PETS closed yesterday May 3 at \$18.09 per share. At current multiples, we see upside to \$20, roughly 10 percent, and even after adding the attractive 4 percent dividend yield, **we are more inclined to add the shares to the Tematica Select List between \$16-\$17. At those levels, the shares offer sufficient net upside to warrant taking a position.**

Bottomline on (PETS) PETMED EXPRESS Shares:

- **Currently trading above \$18 per share, we are more inclined to add the shares to the Tematica Select List between \$16-\$17.**
- **For now, we will add PETS shares to the Tematica Contender List.**
- **When the company reports its March quarter results on May 9, we will be listening to see if there is either upside to current 2016 earnings expectations or if the company intends to boost its quarterly dividend.**
- **Should either of these occur, we would look to revisit our \$20 price target with an upward bias.**



PetMed Express, Inc

NASDAQ: **PETS**

Theme: **Connected Society**

Price on 05/03/16: **\$18.09**

- PetMed Express, Inc. doing business as 1-800-PetMeds, operates as a pet pharmacy in the United States.
- The company markets prescription and non-prescription pet medications, health products, and supplies for dogs and cats to retail customers.
- The company also sells food, beds, crates, stairs, strollers, and other pet supplies through its Website
- It markets its products through Internet, telephone contact center, and direct mail/print through 1-800-PetMeds catalogs, brochures, and postcards
- PetMed Express, Inc. was founded in 1996 and is headquartered in Pompano Beach, Florida.

Shares Outstanding	20.14M
Avg. Volume	170,750
Market Cap	362.31M
EPS: '13 / '14 / '15	.77 / 1.03 / 1.27
Cash (mrq): \$US	62.74M
Debt (mrq): \$US	
Net Cash (mrq)	62.74M
Revenue (ttm)	229.29M
Enterprise Value to Revenue (ttm)	1.32
Dividend Per Share	0.72
Dividend Yield	3.93%

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 tradeoff to reach more appetizing levels.

AHS	AMN Healthcare Services	<i>Aging Population / Scarce Resources</i>
AMZN	Amazon.com	<i>Connected Society</i>
CHGG	Chegg Inc.	<i>Tooling & Retooling</i>
CMG	Chipotle Mexican Grill	<i>Foods that Are Good for You</i>
SCOR	Comscore	<i>Connected Society</i>
GLW	Corning Inc.	<i>Disruptive Technologies</i>
IMMR	Immersion Corp.	<i>Disruptive Technologies</i>
KIM	Kimco Realty	<i>Rise & Fall of the Middle Class</i>
LOCK	Lifelock	<i>Safety & Security</i>
MKC	McCormick & Co.	<i>Cashstrapped Consumer / Middle Class</i>
MRK	Merk & Co.	<i>Aging of the Population</i>
NKE	Nike Inc	<i>Affordable Luxury</i>
NLSN	Nielson NV	<i>Connected Society</i>
PANW	Palo Alto Networks	<i>Safety & Security</i>
PETS	PetMed Express, Inc	<i>Connected Society</i>
SYNA	Synaptics Inc.	<i>Disruptive Technologies</i>
SBUX	Starbucks Inc.	<i>Rise & Fall the Middle Class</i>
UNFI	United Natural Foods	<i>Foods with Integrity</i>
VZ	Verizon Communications	<i>Content is King / Connected Society</i>
XYL	Xylem, Inc	<i>Scarce Resources</i>

Regal Entertainment Group Delivers

Last week Regal Entertainment Group reported better than expected March quarter results on the top and bottom line. More specifically, Regal reported March quarter earnings of \$0.27 per share, \$0.01 better than the Capital IQ Consensus of \$0.26. Revenues for the quarter rose 13.9 percent year on year to \$787.1 million vs the \$770.62 million Capital IQ Consensus.

Given the strength of the domestic box office, this was hardly a surprise, as the company's revenue benefitted from a better mix of higher priced tickets (think IMAX and 3D). High attach rates for higher margin drinks and snacks also helped the company's revenue and profits during the quarter. With a robust slate of movies to come, including the opening of "Marvel's Captain America: Civil War" that looks to shatter box office record, we remain optimistic over box office prospects for the remainder of the year and RGC shares. **Our price target for RBC shares remains \$24.**



Ask Tematica

In the vein that there is no such thing as a bad question, we encourage subscribers to ask questions about particular investing themes, holdings on the **Tematica Select List**, the Contender List or on another topic. It's all good as far as we're concerned. This week's question centers on the recent savings rate data:

With consumers saving more and more over the last few months, should we be concerned given the influence of consumer spending on the overall economy?

We were kicking this question around ourselves the last few days, particularly after the expected, but still lackluster, 1Q 2016 GDP print of 0.5 percent. Much of the data points to the consumer being directly or indirectly responsible for roughly two-thirds of the domestic economy. This naturally means consumer spending plays a larger role in the vector (direction) and velocity (speed) of the US economy.

As we've seen over the last few months, retail sales, personal spending and other consumer led data has been weak. Viewed from the perspective of little wage growth and higher costs (healthcare, food, student loans and the like) consumers are looking to save what they can and stretch their remaining dollars.

The bottom line is a hesitant consumer will weigh on GDP and that's another reason to be skeptical about the upper end of current quarter GDP forecast we shared in this week's **Monday Morning Kickoff**. This pain point likely means consumers will turn to companies like our own **CostCo Wholesale (COST)** and similar companies, as well as seek out other value proposition in our increasingly **Connected Society**. To us, this means companies like **Amazon (AMZN)**, which we are currently putting through its paces for consideration on the **Tematica Contender List** and quite possibly the **Tematica Select List**.

If you have a question on something you just read as it concerns one of our live positions, a contender or even something that may be burning your ears and eyes as it relates to one of our investing themes, drop us a line at **customerservice@tematicagroup.com**.

What We're Enjoying



In an effort to bring a more personal feel to Tematica Insights, we're reviving a feature that hardens back to my very first newsletter: "What We're Enjoying." Each week, it will feature a service, product or equivalent that we here at the Tematica offices are enjoying. It could be something new —or just new to us. Of course, if you have something you think we should check out, be sure to email us and let us know.

With Cinco de Mayo quickly approaching and before long Memorial Day Weekend, it will soon be time for back yard grilling, swimming and other warm weather recreational activities. We were recently invited to a get together that featured food that was prepared not a charcoal or a gas powered grill, but rather in the Big Green Egg.

This was a rather new and interesting contraption that seals the food in a large ceramic container and pulls heat throughout from a wood fire at the bottom via a few vents. Not only did it cut the cooking time in half, but the food coming out of the Big Green Egg was simply delicious. We may have a few years left with our current Weber gas grille, but the Big Green Egg will certainly be a contender for the official Tematica Grill....

Now the question is which beverages should we stock? Email us your suggestions at customerservice@tematicagroup.com and we'll share some in an upcoming issue.

Thematic Signals: Ripped from the Headlines

Amid the frenzy of earnings reports this week we've cobbled together a number of Ripped from the Headlines data points that reinforce a number of our investing thematics.



Affordable Luxury

China is by far the world's largest online retail market with sales of \$630 billion in 2015, according to estimates by McKinsey. Directing traffic to local websites therefore forms no small part of the government's goal to drive domestic consumption.

China's latest move to increase taxes on products bought from online overseas websites — or so-called cross-border e-commerce — can be viewed in the context of government intervention that ultimately proves a negative for the jewelry industry. The policy, effective April 8, saw the tax on jewelry raised from 10 percent to 15 percent, and watches from 30 percent to 60 percent.

Asset-Lite Business Models

"According to GSMA, LTE [highspeed data for mobile phones] penetration worldwide is still only at 14 percent. In emerging market, 3G and LTE penetration combined is only 40 percent. Of the 7.3 billion cellular subscriber in the world, 51 percent still own 2G feature phone. The slow penetration rate of 3G and LTE smartphone present a sizable opportunity for us for which we can leverage on our diverse product line and experienced customer base."

CEVA, Inc. (CEVA) CEO Gideon Wertheizer

Cash Strapped Consumer

"We are consumer oriented company, and I mean we are the basically the worldwide economy is flattening. There is a lot of stuff out there. And we are just being a lit bit of cautious. And obviously I mean, we all know there is a few tenants out there that may or may not go bankrupt may or may not close the bunch of stores."

Simon Property Group (SPG) CEO David Simon (Mall REIT)

Cashless Consumption

PayPal's (PYPL) key metric of total payment volume, or the value of payments completed through PayPal, came in at \$81.06 billion for the first quarter, up 29 percent from the same period last year. Its active customer accounts, defined as an account that had completed a transaction on PayPal in the last 12 months, were up to 184 million, an increase of 11 percent from the first three months of 2015.

On his company's earnings call, CEO Dan Schulman reiterated PayPal's focus on mobile development and said it processed \$21 billion in payment volume on phones and tablets, up 54 percent from the same period last year.

Connected Society

"Microsoft announced Azure contracts with BMW and Toyota, to assist in making their cars smarter and more connected. This is in addition to contracts Microsoft has with Volvo and Nissan. BMW is using Azure to power its open mobility cloud for their new BMW connected app. Toyota will use Azure to run Toyota Connected to support in-car services, telematics, Internet of Things, home connectivity and smart city integration."

DuPont Fabros (DFT) CEO Christopher Eldredge

"This whole focus on total system innovation going forward, combining hardware with sensors, instrumentation, and software controls, this is the way of the future for the industry."

Schlumberger (SLB) CEO Paal Kibsgaard

“Today, we’ve got 400,000 connected assets and growing. By this summer, every one of our machines will come off the line being able to be connected and provide some kind of feedback in operational productivity to the owner, to the dealer and to us.”

Caterpillar (CAT) CEO Doug Oberhelman

New technologies are creeping into cars from all sides—image sensors from Sony, graphics chips from Nvidia, processors from NXP, artificial intelligence from Google and Tesla—but at the heart of recent advances are wireless networks. Connectivity has not only enabled drivers to access their smartphones on dashboard displays, but also cleared the way for vehicles to communicate with each other and infrastructure.

Content is King

NBCUniversal, a unit of **Comcast Corp. (CMCSA)**, acquired **DreamWorks Animation (DWA)**, the studio started by former Disney exec Jeffrey Katzenberg, for \$3.8 billion. The acquisition gives Universal the rights to the “Shrek” franchise — the highest-grossing animated film series ever — as well as “Kung Fu Panda,” “Madagascar” and plenty more characters that are kid-tested, parent-approved and commercially proven. Universal’s theme parks have always been little brothers to those of Disney, which invented them, but the gap is closing lately. Universal’s Wizarding World of Harry Potter, based on the “Harry Potter” franchise, is now one of the most popular theme park attractions ever.

Economic Acceleration/Deceleration

“Orders during the quarter sequentially got better as we saw January going through March...we saw a number of markets move from accelerating declined to decelerating decline.”

Parker Hannifin (PH) CEO Tom Williams

“We continue to see declines in our premium luxury business...our premium luxury profits declined 13 percent year-over-year...Industry inventories were elevated with retail day supply outstanding at approximately 80 days. As we indicated earlier this year, the new vehicle market is plateauing”

AutoNation (AN) COO Bill Berman

“The US new vehicle inventories stood at 31,400 units which equates to an 85 day supply compared to a 69 day supply for the first quarter of 2015. Luxury brand inventories drove much of the year-over-year increase.”

*Group 1 Automotive (GPI) CEO Earl Hesterberg
(Auto Dealership)*

Food with Integrity

“We begin to see sales recover in the second half of the first quarter as our transaction trends reversed course from the lows we saw in January. Since the beginning of February, we have seen an 18-point improvement in comp transactions compared to the full month of January.”

Chipotle Mexican Grill (CMG) CEO Steve Ells

Dannon says it will use only non-GMO ingredients in its three flagship brands – Dannon, Oikos and Danimals – by summer 2016 (when Vermont’s new GMO labeling law comes into effect), but has also pledged to transition these brands to using milk from cows fed non-GMO feed within three years.

Rise & Fall of the Middle Class

“We saw private label shares flat to down in nearly every category that we’re in, which is again another sign of health of the consumer for us, and are probably maybe more bullish on the outlook in North America at this point in time than maybe we would have been even at the beginning of the year.”

Kimberly Clark (KMB) CEO Tom Falk

“Passenger traffic is off to its strongest start in eight years, with traffic growing 8 percent in early 2016. Over the past three years, we have seen passenger traffic growth consistently outpace global GDP and airline capacity growth”

Boeing (BA) CEO Dennis Muilenburg

Shopping destination remains a key element of the travel decision for Chinese tourists. According to McKinsey, more than 100 million overseas trips are made from China each year and about a third of those travelers choose the location based on where it’s best to shop.

Tooling & Re-tooling

“In prior cycles, late stage has been indicated by this white hot hyper demand where permanent placement grows at very high double-digit rates. That hasn’t happened...we still don’t see that type of hyper demand that we would typically see late cycle, but instead we continue to slug it out in this relatively sluggish macro environment.”

Robert Half International (RHI) CEO Max Messmer

“Generally speaking the catalyst behind this cycle is pretty powerful, which is this deflationary trend. And M&A becomes an important tool for boards and companies to have in their toolbox to address difficulties or challenges around organic growth and challenges around driving earnings through additional efficiencies in the business”

Lazard Ltd. (LAZ) CEO Ken Jacobs

“I think corporates are back and looking and how they can improve their business. It’s a very low growth environment out there, they still have to look at M&A as a way to either take out cost or increase growth.”

Moelis and Co. (MC) CEO Ken Moelis

TEMATICA SELECT LIST PERFORMANCE

as of market close May 3, 2017

(AGNC) AMERICAN CAPITAL AGENCY CORP

DATE ADDED	ADD PRICE	CURRENT PRICE	DIVIDENDS	STOP PRICE	RETURN (%)	TARGET	RATING
7/17/15	\$18.98	\$18.15	\$1.60	\$17.00	4.06%	\$23.00	(BUY)

(XLY) CONSUMER DISCRETIONARY SPDR (ETF)

Content is King

DATE ADDED	ADD PRICE	CURRENT PRICE	DIVIDENDS	STOP PRICE	RETURN (%)	TARGET	RATING
4/20/16	\$79.57	\$79.57	--	--	0.0%	--	(BUY)

(COST) COSTCO WHOLESALE CORPORATION

Cashstrapped Consumer

DATE ADDED	ADD PRICE	CURRENT PRICE	DIVIDENDS	STOP PRICE	RETURN (%)	TARGET	RATING
4/13/16	\$152.83	\$151.41	--	\$140.00	-0.93%	\$170.00	(BUY)

(DIS) THE WALT DISNEY CO.

Content is King

DATE ADDED	ADD PRICE	CURRENT PRICE	DIVIDENDS	STOP PRICE	RETURN (%)	TARGET	RATING
4/20/16	\$102.16	\$103.82	--	\$87.00	1.62%	\$125.00	(BUY)

(DOC) PHYSICIANS REALTY TRUST

Aging of Population

DATE ADDED	ADD PRICE	CURRENT PRICE	DIVIDENDS	STOP PRICE	RETURN (%)	TARGET	RATING
6/27/14	\$14.33	\$18.40	\$1.80	\$16.00	40.96%	\$18.00	(HOLD)

(SH) PROSHARES SHORT S&P 500 (ETF)

DATE ADDED	ADD PRICE	CURRENT PRICE	DIVIDENDS	STOP PRICE	RETURN (%)	TARGET	RATING
1/14/16	\$22.55	\$20.35	--	--	-9.75%	\$24.00	(BUY)
3/23/16	\$20.56	\$20.35	--	--	-1.02%	\$24.00	(BUY)

(RGC) REGAL ENTERTAINMENT GROUP

Content is King

DATE ADDED	ADD PRICE	CURRENT PRICE	DIVIDENDS	STOP PRICE	RETURN (%)	TARGET	RATING
11/23/15	\$18.51	\$21.09	\$0.44	\$19.00	16.32%	\$24.00	(BUY)

(T) AT&T, INC.

Connected Society

DATE ADDED	ADD PRICE	CURRENT PRICE	DIVIDENDS	STOP PRICE	RETURN (%)	TARGET	RATING
7/21/15	\$34.67	\$38.91	\$0.95	\$36.00	14.97%	\$42.00	(BUY)

Companies Mentioned

Amazon (AMZN)
AutoNation (AN)
Boeing (BA) CEO Dennis Muilenburg
Caterpillar (CAT) CEO
CEVA, Inc. (CEVA)
Chipotle Mexican Grill (CMG)
Comcast Corp. (CMCSA)
CostCo Wholesale (COST)
DreamWorks Animation (DWA)
DuPont Fabros (DFT)
Group 1 Automotive (GPI)
Kimberly Clark (KMB)
Lazard Ltd. (LAZ)
Moelis and Co. (MC)
Parker Hannifin (PH)
PayPal's (PYPL)
Petmed Express (PETS)
ProShares Short S&P 500 (SH)
Regal Entertainment (RGC)
Robert Half International (RHI)
Schlumberger (SLB)
Simon Property Group (SPG)

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

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