THE NELSON EXCLUSIVE

Confidential

October 2016

BRIAN NELSON, CFA

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October 2016

Dear Valued Member,

In this October edition of the Exclusive, we have three new exciting ideas, covering income, capital appreciation, and a short consideration. We also archive each introductory piece at the end of the publication. Please be sure to read through the archives to capture the month-to-month developments behind the story arc of each previously-highlighted idea. In this October introduction, let's update readers on the nine ideas that have collectively been released in the three previous editions of the Exclusive from July, August, and September for developments during the month of September.

July

Income: Universal Corp (UVV)

Steady as it goes for this tobacco leaf supplier. As we had mentioned in last month's edition, fiscal first-quarter results, released August 4, were rather uneventful, and the company's $0.53 per share quarterly dividend implies a 3.6%+ annual dividend yield. We like the company's end market, rolling dividend coverage with free cash flow, and deleveraging balance sheet. The company's shares are hovering near all-time highs.

Capital Appreciation: Bloomin' Brands (BLMN)

There's a lot to like about this owner of Outback Steakhouse. Same-store trends across the restaurant space remain mixed, but we like Bloomin' Brands collection of concepts and think shares remain a long-term winner. Should the company garner interest from private equity, a buyout price double from current levels wouldn't be out of the question.

Short Consideration: Lands' End (LE)

Lands' End CEO stepped down September 26, and shares dropped 14% on the day. Not bad for our first short idea of the Exclusive, but we think there is still more bad news to come. We don't think Lands' End has the right strategy to deal with the current fickle retail environment, and while it may not be its fault (there might not be one), it doesn't matter. The worst is still ahead, in our view.

August

Income: B&G Foods (BGS)

B&G Foods is just about the savviest company that we've seen. The executive team is floating equity at lofty prices and using proceeds to scoop up valuable brands and deleverage the balance sheet. Now an owner of the *Green Giant* brand, B&G Foods purchased the spices and seasoning business of ACH Food Companies September 21. As long as management keeps its debt under control, the future is bright for income investors.

Capital Appreciation: Healthcare Services Group (HCSG)

It has been a wild month or so for holders of Healthcare Services Group's shares, with the company coming off

all-time highs on little news to speak of. We still like the demographic trends powering its business model, and its dividend track record remains in high demand in today's frothy market environment. Holders should be cognizant that because its equity has been in a solid uptrend for years, profit taking could be the reason behind any near-term share-price weakness.

Short Consideration: Vivint Solar (VSLR)

Vivint Solar has just about the worst business model, end market, and financials we've ever seen. The company still has a market capitalization north of $300 million though, even as its former suitor navigates the bankruptcy courts. We think Vivint is a $0 in coming years. Shares are now back under $3 each…again.

September

Income: Maxim Integrated Products (MXIM)

Not much has happened since we highlighted Maxim as an income idea in the September edition of the Exclusive, except that it may continue to be active on the M&A front. Reuters recently reported that it was interested in purchasing Intersil (ISIL), which was acquired by Renesas Electronics September 12. We like Maxim's free cash flow "story."

Capital Appreciation: Grupo Aeroportuario del Sureste (ASR)

We think Grupo Aeroportuario del Suraste may be one of the best long-term ideas on the market today. Operator of Cancún International Airport, the company has a long runway of future growth. Grupo Aeroportuario del Suraste's fee-based business model is not beholden to the cyclicality of commercial aircraft making or the boom and bust cycle characteristic of airlines.

Short Consideration: Lloyds Banking Group (LYG)

Goldman Sachs downgraded Lloyds to Sell September 26. Shares have been under pressure since we highlighted it as a short consideration in the September edition of the Exclusive, released September 3. We're surprised at how high its leverage is, and we think troubles are on the horizon, with or without Brexit.

I hope that you've found my brief thoughts on our previous ideas helpful, and now let's dig into the three ideas of the October edition of the Nelson Exclusive.

Sincerely,

Brian Nelson, CFA
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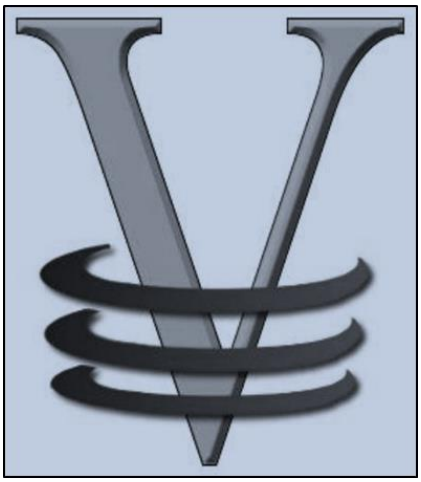


About Your Editor

Brian Nelson is the president of equity research and ETF analysis at Valuentum Securities.

He is the architect behind the company's research methodology and processes, developing the Valuentum Buying Index rating system, the Economic Castle rating, and the Dividend Cushion ratio. Mr. Nelson has acted as editor-in-chief of the firm's Best Ideas Newsletter and Dividend Growth Newsletter since their inception.

Before founding Valuentum Securities in early 2011, Brian worked as a director at Morningstar, where he was primarily responsible for training and methodology development within the firm's equity and credit research department. Prior to that position, he served as a senior industrials securities analyst covering aerospace, airlines, construction, and environmental services companies.

Before joining Morningstar, Mr. Nelson worked for a small capitalization fund covering a variety of sectors for an aggressive growth investment management firm in Chicago. He holds a Bachelor's degree in finance and a minor in mathematics, magna cum laude, from Benedictine University. Brian has an MBA from the University of Chicago Booth School of Business and also holds the Chartered Financial Analyst (CFA) designation.

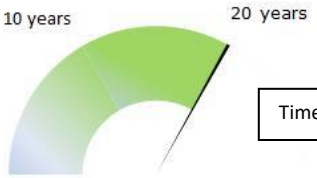
Highlights:

Brian is frequently quoted in the media and has been a frequent guest on Nightly Business Report, Bloomberg TV, CNBC, and the MoneyShow.

Mr. Nelson is very experienced valuing equities, developing discounted cash-flow models used to derive the fair value estimates for companies in the equity coverage universes of two of the largest independent investment research firms.

Brian worked on a small cap fund and a micro-cap fund that were ranked within the top 10th percentile and top 1st percentile within the Small Cap Lipper Growth Universe, respectively, in 2005.

Mr. Nelson led the charge in developing Morningstar's issuer credit ratings, creating and rolling-out one of the firm's proprietary credit metrics, the Cash Flow Cushion.



Time Horizon: Long-term

Douglas Dynamics (PLOW)

"Over the past three years, capital expenditures amounted to approximately 2.5%, 1.7%, and 1.4% of total sales in 2015, 2014, and 2013, respectively... (Douglas Dynamics) has converted more than 100% of net income to free cash flow in each year since its IPO in 2010, a trend we expect to continue… Such strong free cash flow generation is the basis for Douglas Dynamics' compelling dividend. Management has shown its commitment to paying a robust dividend and has delivered an increase in the payout an impressive eight times in six years since the IPO." -- inside this article

Thesis

If you live in an area accustomed to seeing accumulating snowfall each winter, the odds are good you've seen Douglas Dynamics' (PLOW) products hard at work. The company is a market leader in light and heavy duty snow and ice control equipment in the US and Canada, and we're big fans of its relatively broad product line up and substantial installed base. Douglas' dealer network of more than 2,100 points of sale gives it a competitive advantage against peers in terms of the breadth of its reach and its access to real-time market information. The firm is not your typical manufacturer in that it does not require significant amounts of capital to keep its business running, a significant positive for the firm as an income idea.

Corporate Profile

Douglas Dynamics produces and sells snow and ice control equipment, including products such as snowplows, sand and salt spreaders, dump bodies, replacement parts, and related parts and accessories, in the US and Canada. Its brands include Bilzzard, Fisher, SnowEx, Western, TurfEx, and SweepEx. The company is headquartered in Milwaukee, Wisconsin.

Image Source: Douglas

For residents of Canada and northern portions of the US, Douglas Dynamics' snow and ice control products, or competing products, are essential to everyday life for up to half the year. The firm offers one of the most complete products lines of snowplows and salt and sand spreaders for light trucks in the US and Canadian markets, and it also has a full range of related parts and accessories that helps generate additional revenue throughout the lifecycle of its larger products. Roughly 87% of the company's 2015 sales were generated from snow and ice control equipment sales, while the balance came from sales of parts and accessories. The recent acquisition and integration of

Key Statistics	
Last Close	$31.83
52-week range	$16.89 - $32.80
Market Cap	$706 M
Avg Daily Vol (30 wks)	148,530
Annual Dividend Yield	4.08%
Trailing Dividend Payout Ratio	46%
Trailing P/E	16.4
Net Debt (LFY)	$150 M
Net Debt/EBITDA (LFY)	1.55x

Henderson has made Douglas Dynamics a leader in the heavy-duty segment of the North American snow and ice control equipment market, as well as given it the ability to provide customized turnkey solutions to governmental agencies.

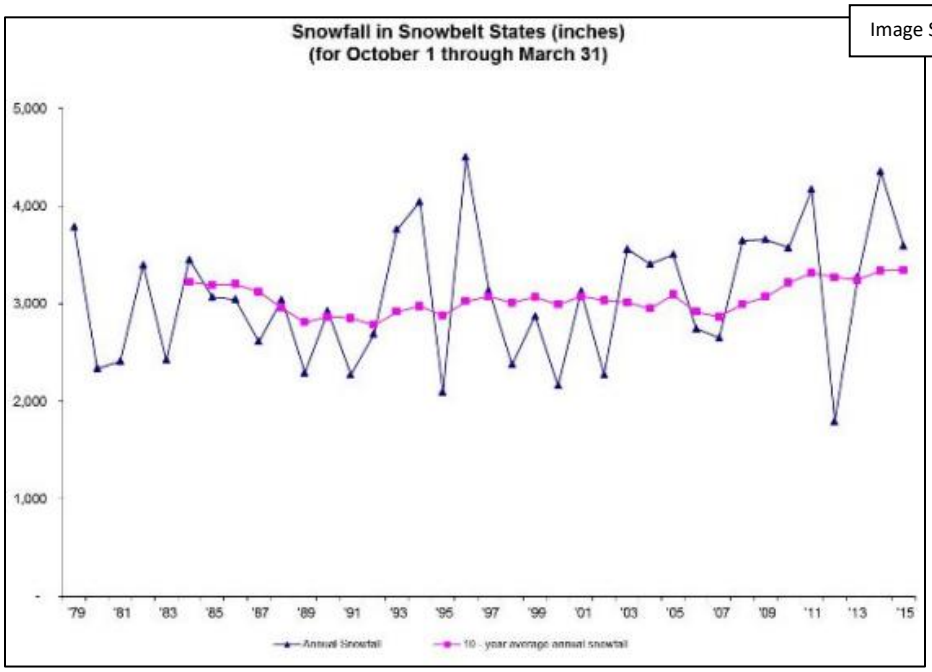
The majority of the participants in the light and heavy duty North American snow and ice control equipment market are domestic players, and demand in the industry is driven largely by the replacement cycle of the existing installed base, which is impacted by a number of factors. The average life of a snowplow or spreader is a key consideration in the length of the replacement cycle, as is the maintenance practices of the user, but the largest factor in the replacement cycle for snow and ice control equipment is the amount, timing, and location of snowfall in any given year. It is estimated that actively-used snowplows are replaced every 9-12 years, on average.

Sales of Douglas Dynamics' products are most heavily influenced by the snowfall levels in the prior snow season (typically October 1 through March 31). Heavier snowfalls result in increased equipment usage, which in turn causes higher levels of wear and tear on the equipment and ultimately decreases the expected life cycle of the equipment and increases the need for replacement equipment and/or additional parts and accessories. The firm's dependence on snowfall also introduces a seasonality dynamic into its business. Distributors tend to purchase the majority of equipment in the second and third quarters of the calendar year, though this can change depending on the level of snowfall in a given year. Such dynamics can create difficult or lumpy quarter-over-quarter and year-over-year comparisons in its financial performance.

Demand for heavy-duty truck equipment is typically viewed as less elastic than that of light-duty equipment, meaning that it is less sensitive to typical influences on demand. This is a result of a large portion of heavy duty sales being to municipalities or other forms of state and local governments that require planned replacement of equipment, a dynamic Douglas now has material exposure to thanks to the Henderson acquisition.

In addition to heavy-duty truck equipment mitigating dependence on snowfall levels to a degree, investors can take some comfort in that though snowfall levels may fluctuate from year-to-year, snowfall is relatively consistent over extended periods of time. The chart on the following page shows annual snowfall and a ten-year moving average of snowfall levels in 66 cities and 26 states across the Northeast, East, Midwest, and Western US.

Image Source: Douglas



In addition to changes in demand being tied to weather, Douglas Dynamics' performance is also tied to the health of the economy as well. In weaker economic conditions, consumers may choose to attempt to increase the useful life of their equipment, which will cause an increase in sales of parts and accessories. Though sales of parts and accessories return higher margins than equipment sales, they yield materially less revenue, negatively impacting financial performance. However, snow and ice control can be viewed as a non-discretionary service in that it is necessary for public safety and continued personal and commercial transportation, so users are forced to replace equipment that has become too worn, or is unsafe or unreliable, no matter the economic conditions.

Though consumers could be forced to replace their equipment in the midst of a downturn in the economic cycle, competition arises in such a scenario from lower-quality brands that target lower price points. Such a dynamic not only can result in erosion of sales volumes, but also material pricing pressure and a lower installed base. It is important to note as well that the sale of light-duty equipment is often tied to the light truck market, as many consumers prefer to purchase new snow and ice control equipment along with the purchase a new truck.

While the geographic expansion of Douglas Dynamics' addressable market has a ceiling, barring a massive environmental shift, long-term growth in the industry is expected to continue to come via the increase in developed areas in the Snow Belt regions of North America as ongoing construction increases the aggregate area that requires snow and ice removal. Technological innovations improving effectiveness and efficiency should provide market growth as well. The sale of such technological enhancements has contributed approximately 2%-4% average unit price growth in each of the past five years.

In addition to industry-wide growth, Douglas Dynamics expects to further strengthen its position in the market via some compelling competitive advantages.

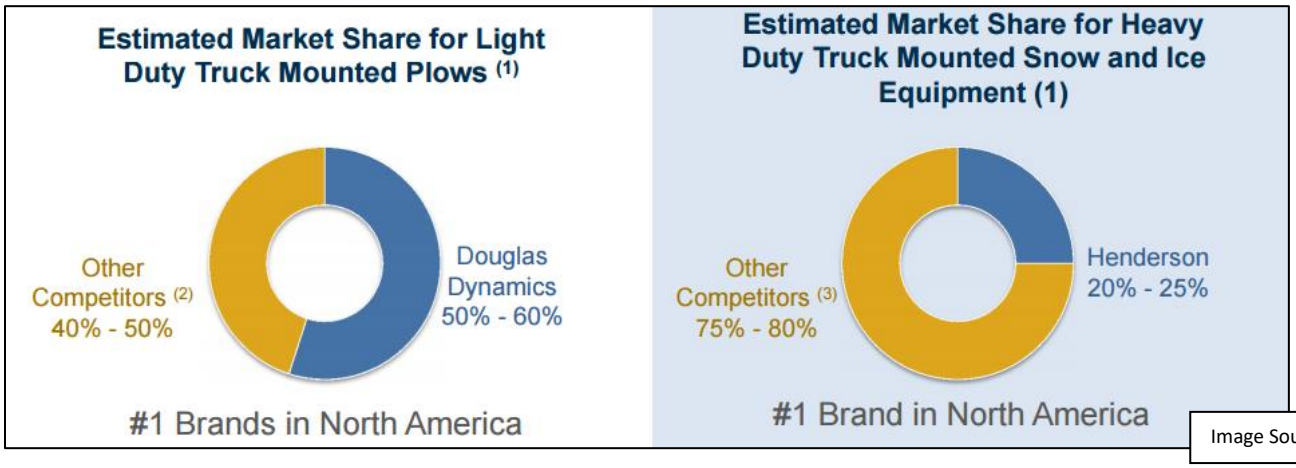


Image Source: Douglas

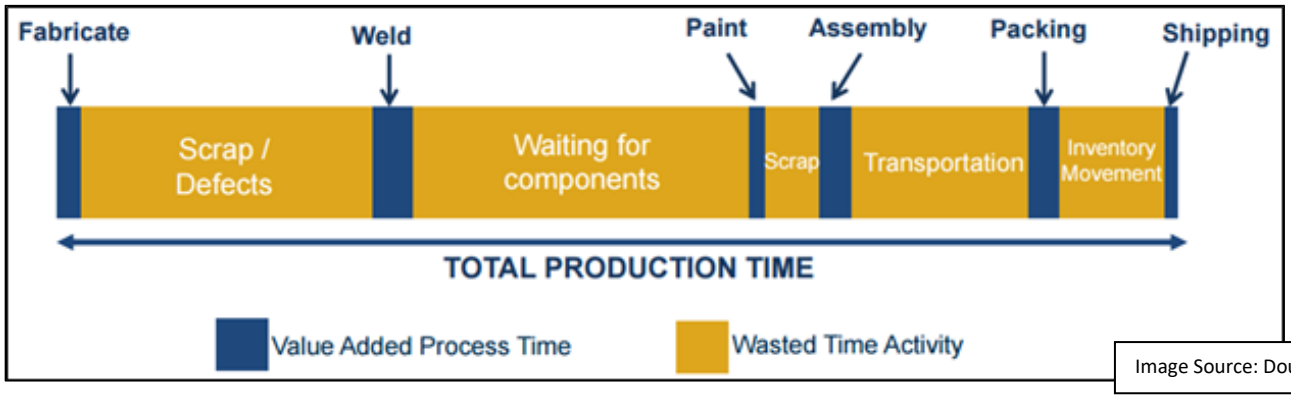
Perhaps the most important of its competitive strengths is its customer loyalty and brand equity. The firm's brands have more than 50 years' experience in developing a track record of reliability, productivity, and innovation, and past brand experience is believed to play a large role in the purchasing decisions of larger-scale equipment. Douglas is also home to the industry's broadest product lineup, and management believes it has the most advanced new product development program as it has historically introduced and redesigned several products each year. As a result of the brand loyalty built over the past several decades, management believes it has the largest installed base in the light truck market with over 500,000 snowplows and salt and

sand spreaders currently in service. Since the replacement of worn equipment is a key driver of sales, this is a form of a competitive advantage and provides a degree of visibility into future sales.

Douglas Dynamics' extensive dealer network, which management believes to be the most extensive in the industry, also provides it a competitive advantage. Its distributors are not only sales and support points, but also provide real time consumer information that is factored in to new product design and improvements and other areas of business development. As of the end of 2015, the firm had more than 2,100 points of sale across North America.

Image Source: Douglas

Management has carved out an additional advantage through its proprietary Douglas Dynamics Management System (DDMS). Unlike most lean operating initiatives, DDMS centers on creating benefits for the customer, not the manufacturer. Such a focus drives Douglas ahead of the competition, ultimately growing market share and profitability thanks to the elimination of wasted time and the maximization of operational flexibility. DDMS distinguishes itself from other lean manufacturing initiatives in that it targets the reduction of wasted time activity, not the reduction of value added process time. Increased flexibility, reduced lead times, accelerated products development cycle, and expanding margins have all been attributed to the impressive DDMS.



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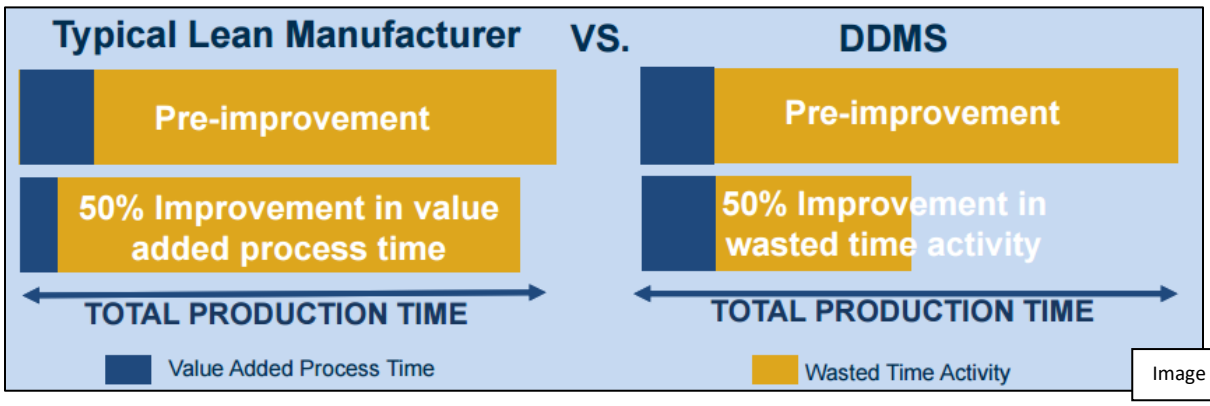

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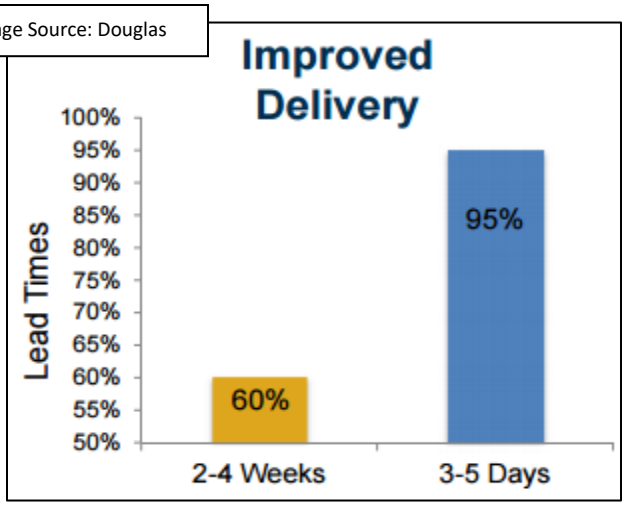

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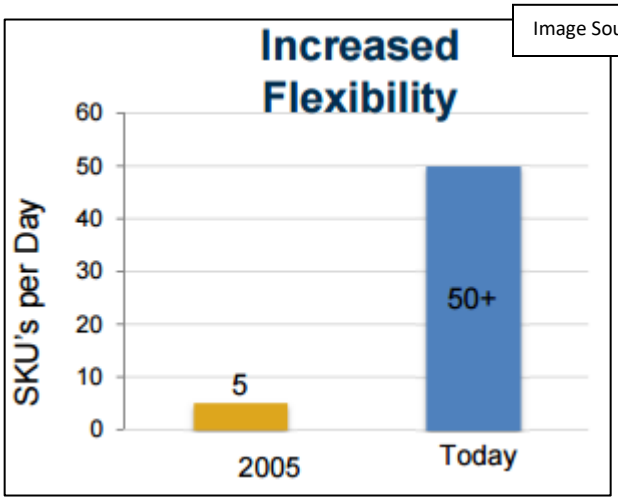
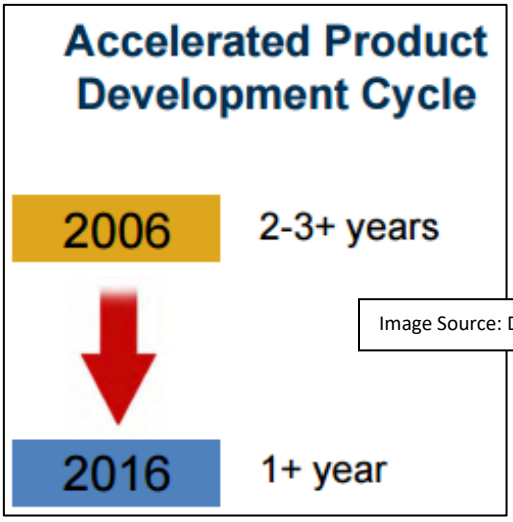


DDMS is a core part of Douglas Dynamics' margin optimization strategy. Ongoing cost reductions as a result of reduced total production time coupled with small annual price increases are expected to be the key drivers of margin expansion. The implementation of DDMS across newly acquired businesses should continue to help margin performance as well. The company has a track record of more than a decade of continuous profitability improvements as a result of DDMS, despite the fact that its largest raw material cost, steel, can be largely volatile and is out of its control.



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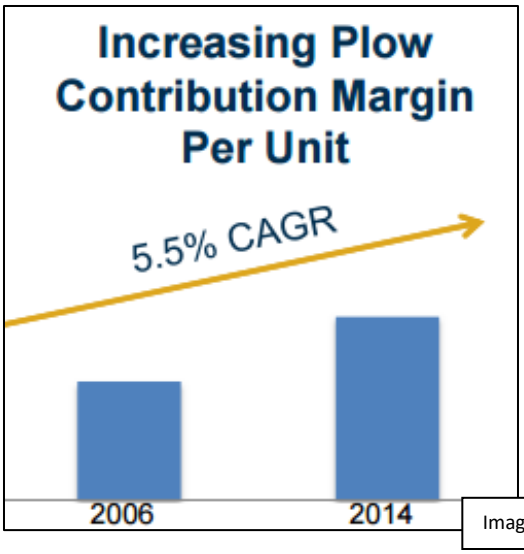


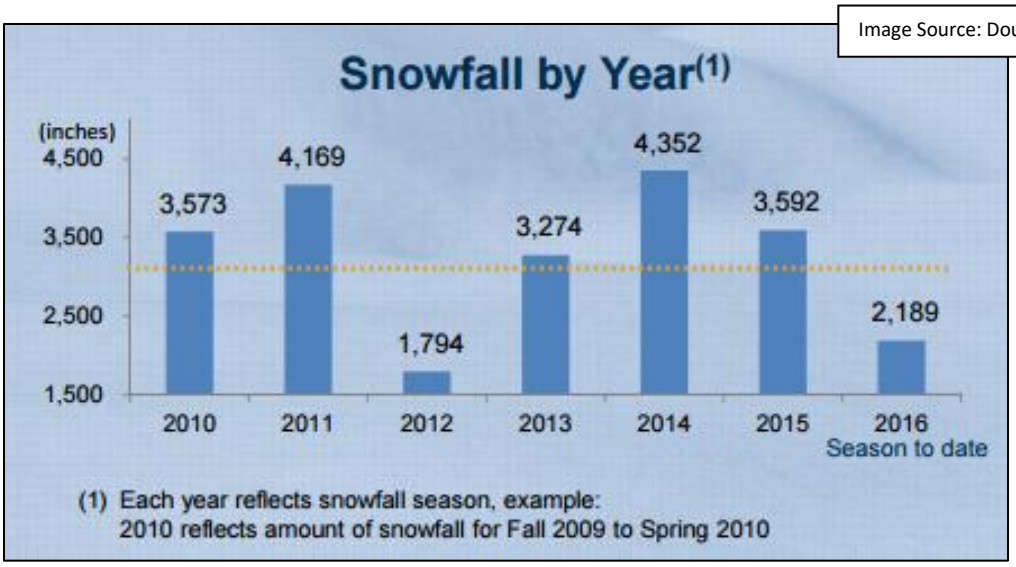
Image Source: Douglas

Strategic acquisitions and the expansion into business adjacencies will also be a part of Douglas Dynamics' growth strategy moving forward, and the implementation of DDMS into its expanding business will certainly follow. The most recent example of such expansion is the firm's acquisition of Dejana Truck and Utility Equipment for $206 million in the summer of 2016. The deal will materially strengthen Douglas' position as a premier manufacturer and up fitter of vehicle attachments and equipment and will add exposure to mid-class trucks that will round out the company's capabilities across all commercial work vehicle segments. Perhaps most importantly, the deal will further diversify Douglas' revenue and reduce the influence of weather on its financial results.

In addition to growth through acquisitions, Douglas Dynamics plan to continue fostering growth in its operations through the optimization of its product portfolio, specifically in its Henderson and SnowEx brands, the former of which was recently acquired, and the latter of which recently underwent a brand transformation following its acquisition under the TrynEx brand name in 2013. New product launches will

be ongoing, as will the evaluation of potential new market entrances and new distribution channels and points of sale. The company has begun expanding its presence in Northern Europe and Asia and will continue to do so as it feels attractive growth opportunities exist in both markets.

Image Source: Douglas

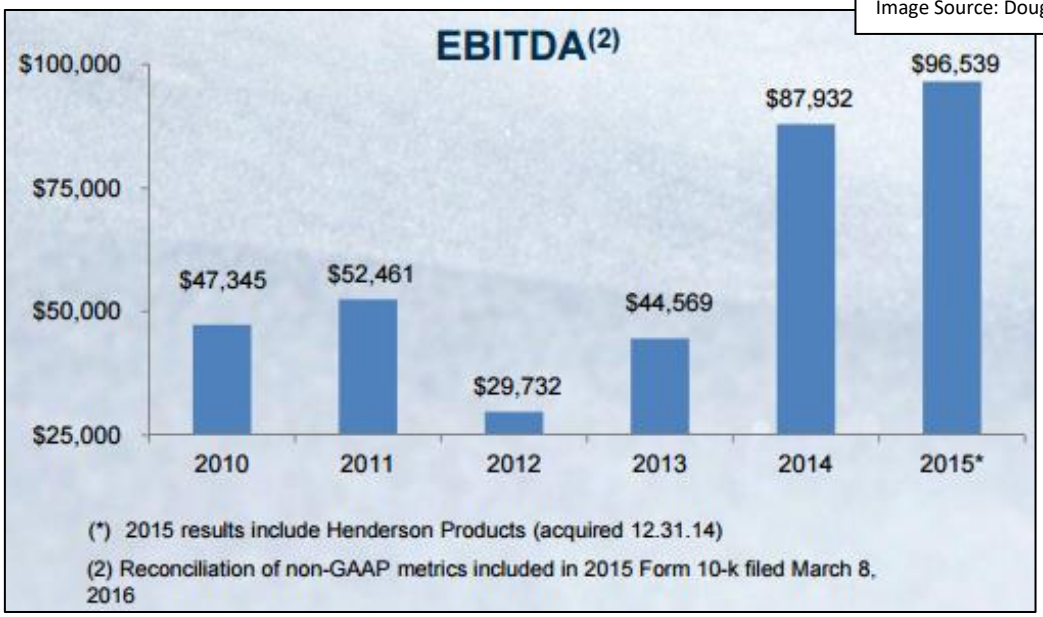


Douglas Dynamics has done extremely well in growing its business since its IPO in 2010. Revenue more than doubled from 2010 to 2015, as did EBITDA. EBITDA margins deteriorated over the same time period, though this is largely a function of increased costs related to the integration of the Henderson acquisition in 2014. As previously mentioned, DDMS is expected to improve the profitability of the business moving forward.

Image Source: Douglas

Douglas Dynamics' balance sheet has become more debt-laden over the past five years, mostly due to its acquisitions in recent years. As the firm continues to pursue strategic acquisitions, we would expect its debt levels to increase, but we have confidence in its free cash flow generation to be able to handle any such pressure on its balance sheet. As of the end of 2015, the company's net debt-to-adjusted EBITDA sat at a healthy 1.55x. The maintenance of a relatively healthy balance sheet is imperative to Douglas Dynamics' ability to continue paying a competitive dividend moving forward due to the number of seasonal and other factors impacting its business that are largely out of its control.

Image Source: Douglas



	As of December 31,				
	2011	2012	2013	2014	2015
	(in thousands)				
Selected Balance Sheet Data					
Cash and cash equivalents	$ 39,432	$ 24,136	$ 19,864	$ 24,195	$ 36,844
Total current assets	103,462	89,582	98,372	142,521	169,243
Total assets	359,017	338,371	364,339	480,443	505,503
Total current liabilities	32,611	16,670	36,098	45,694	41,733
Total debt	122,937	111,966	123,994	188,100	186,472
Total liabilities	195,628	184,639	209,018	307,154	305,007
Total shareholders' equity	163,389	153,732	155,321	173,289	200,496

Image Source: Douglas

	For the year ended December 31,				
	2011	2012	2013	2014	2015
	(in thousands, except per share data)				
Consolidated Statement of Operations Data					
Total sales	$ 208,798	$ 140,033	$ 194,320	$ 303,511	$ 400,408
Gross profit	71,817	43,963	65,650	116,326	132,863
Income from operations	40,181	18,869	27,506	72,217	77,351
Income tax expense	11,332	4,144	7,378	22,036	22,087
Net income	19,040	6,012	11,639	39,961	44,176
Net income per basic share	$ 0.87	$ 0.27	$ 0.52	$ 1.78	$ 1.95
Net income per diluted share	$ 0.85	$ 0.26	$ 0.51	$ 1.77	$ 1.94
Cash dividends paid per common share	$ 1.18	$ 0.82	$ 0.84	$ 0.87	$ 0.89

	For the year ended December 31,				
	2011	2012	2013	2014	2015
	(in thousands)				
Other Data					
Adjusted EBITDA	$ 52,461	$ 29,732	$ 44,569	$ 87,932	$ 96,536
Capital expenditures	$ 2,373	$ 1,446	$ 2,775	$ 5,254	$ 10,009

Douglas Dynamics can thank the implementation of DDMS and its capital-light business, which are inextricably linked, for its strong free cash flow generating capacity. Over the past three years, capital expenditures amounted to approximately 2.5%, 1.7%, and 1.4% of total sales in 2015, 2014, and 2013, respectively. The jump in 2015 was mostly due to a capital build of $4.8 billion (nearly doubling 2014 capital

spending) associated with facility improvements and investments in equipment. The company has converted more than 100% of net income to free cash flow in each year since its IPO in 2010, a trend we expect to continue.

	For the year ended December 31,		
	2013	2014	2015
	(in thousands)		
Net cash provided by operating activities	$ 32,248	$ 53,747	$ 56,465
Acquisition of property and equipment	(2,775)	(5,254)	(10,009)
Free cash flow	$ 29,473	$ 48,493	$ 46,456

Image Source: Douglas

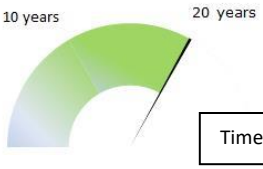
Such strong free cash flow generation is the basis for Douglas Dynamics' compelling dividend. Management has shown its commitment to paying a robust dividend and has delivered an increase in the payout an impressive eight times in six years since the IPO. Cash dividends paid totaled just over $20 million in 2015, suggesting ample free cash flow coverage. Shares currently yield ~3%.

We like the executive compensation plan in place at Douglas Dynamics as we believe it fosters a sound commitment to the improvement of key short-term operating metrics as well as keeps long-term success in clear focus. The firm's compensation plan ties its executive compensation to shareholder interests via the use of operating profit and free cash flow as the key financial metrics in determining bonus compensation. Free cash flow generation over varying periods of time is used in evaluating executive performance, ensuring that management is creating value for shareholders--as we know, free cash flow generation is what drives the intrinsic value of a stock--as it inevitably works to increase personal compensation.

We think all signs are pointing to Douglas Dynamics continuing its recent track record of strong free cash flow generation and subsequent healthy dividend payments. Aside from the potential for seasonal lumpiness, we see little imminent threats to the long-term expansion of its business, and therefore its free cash flow generating capacity. Though its growth proposition is somewhat unique, we have confidence that management will be able to adequately identify and execute appropriate growth avenues thanks to its sound compensation plan and the proven success of DDMS. We view this income idea as one that should continue to reward shareholders over the long-term and one that has the potential to build an impressive dividend track record income investors crave.

However, the firm's stock could be more attractive than current prices imply from a valuation standpoint. Shares appear extended due in part to a strong second quarter report and the ongoing dividend growth bubble that has been accentuated in recent months by the Fed's inactivity. Based on its expectations for 2016 earnings per share to be in a range of $1.39-$1.79, shares are currently changing hands at roughly 20 times forward earnings. Our current estimate of Douglas Dynamics' fair value is a range of $25-$37 per share. As a result of such an estimate, we view shares as fairly valued at recent price levels, and a more attractive entry point could present itself in the future in the form of a pullback to its previous base in the mid-$20s, near the lower bound of our fair value estimate.

Kris Rosemann contributed to this article.



Time Horizon: Long-term

Swedish Match (SWMAY)

"Much has changed since Swedish Match was listed as a publicly traded company in 1996. Back then, our smokeless tobacco business consisted of chewing tobacco and moist snuff in the US, and snus in Scandinavia. Snus and moist snuff combined were about as big as chewing tobacco in terms of sales, and together, snus and moist snuff accounted for about one-eighth of company sales. Today, Swedish Match is truly a different company with a truly different vision. Dramatically higher sales for snus and moist snuff, an emerging snus business in the US, and opportunities for the introduction and development of traditional and modern forms of smokeless tobacco worldwide are only a few of the phenomenal changes over the years." -- Lars Dahlgren, President and CEO, 2015 Annual Report

Thesis

Swedish Match isn't our typical US-based stock idea, but it may be among the most interesting thus far.

The company makes snus (a spitless alternative to cigarettes), moist snuff, other tobacco products (cigars and chewing tobacco), and lights (matches, lighters, and complementary products). It dreams of a world without cigarettes and is home to some of the most well-known brands in the tobacco industry: General, Longhorn, and Red Man, to name a few. Its shares are listed on NASDAQ Stockholm under the symbol SWMA, but a foreign domicile is not what sets it apart.

We point to five main reasons why we think Swedish Match is worthy of inclusion to this month's Exclusive.

Image Source: Swedish Match

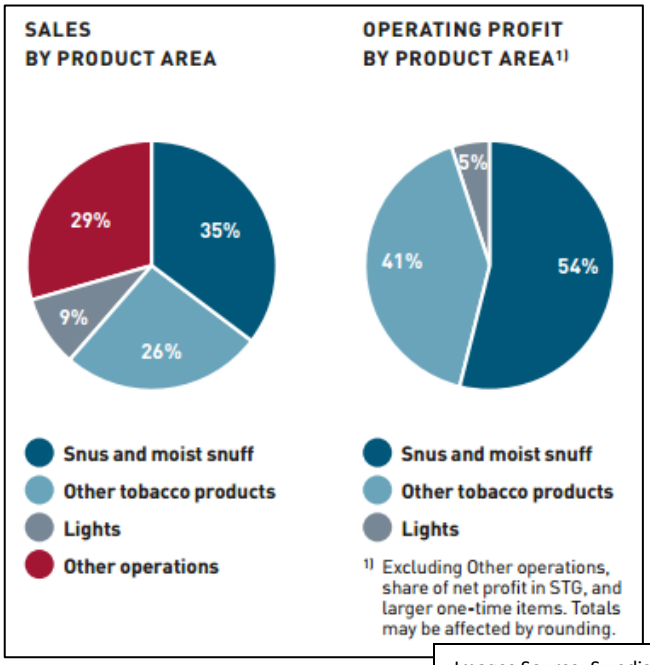
Corporate Profile

Swedish Match's vision is a world without cigarettes. The company produces snus, moist snuff, chewing tobacco, and other products. Its head office is located in Stockholm, Sweden, and shares are listed on Nasdaq Stockholm (SWMA). The company was first listed as a publicly-traded company in 1996. Swedish Match has an ownership stake in Scandinavian Tobacco Group (STG).

Key data, MSEK	2015[1]	2014	2013
Sales	14,486	13,305	12,610
Operating profit from product areas[2]	3,690	3,446	3,375
Operating profit[3]	4,008	3,780	3,855
Operating margin from product areas, %[2]	25.5	25.9	26.8
Operating margin, %[3]	27.7	28.4	29.3
EBITDA from product areas[1]	4,008	3,749	3,650
EBITDA[3]	4,368	4,083	3,968
Profit for the year	2,803	2,626	2,711
Earnings per share, basic, SEK[3]	14.48	13.23	13.63
Earnings per share, adjusted, basic, SEK[1]	14.36	13.23	12.82
Ordinary dividend per share, SEK	8.00[4]	7.50	7.30
Special dividend per share, SEK	12.00[4]	-	-

1) Full year 2015 (excluding share of STG's net profit for the fourth quarter 2015 due to changed reporting) is adjusted for a Swedish Match larger one-time item of negative 42 MSEK (negative 33 MSEK after tax) and STG reassessment of useful lives.
2) Excluding larger one-time items and share of net profit in STG.
3) Including larger one-time items and share of net profit in STG. The full year 2015 includes only the first nine months of net profit in STG due to transition to a one quarter lag reporting. Swedish Match's share of net profit in STG for the first nine months of 2015 includes an adjustment of 56 MSEK relating to 2014 due to a reassessment of useful lives of certain intangible and tangible assets.
4) Board proposal.

Image Source: Swedish Match



Images Source: Swedish Match

First, its ties to the recession-resistant, cash-flow bulging, and yield-rich tobacco space may be why we like it most, particularly in a market today that seems willing to pay almost anything for yield. We've highlighted tobacco leaf supplier Universal Corp (UVV) in a previous edition of the Exclusive, and the addition of yet another tobacco play is not just by happenstance. We like the space a lot and think it will offer relative outperformance in the years to come should any adverse event or global economic recession hit shares of more discretionary issues. Swedish Match has staying power.

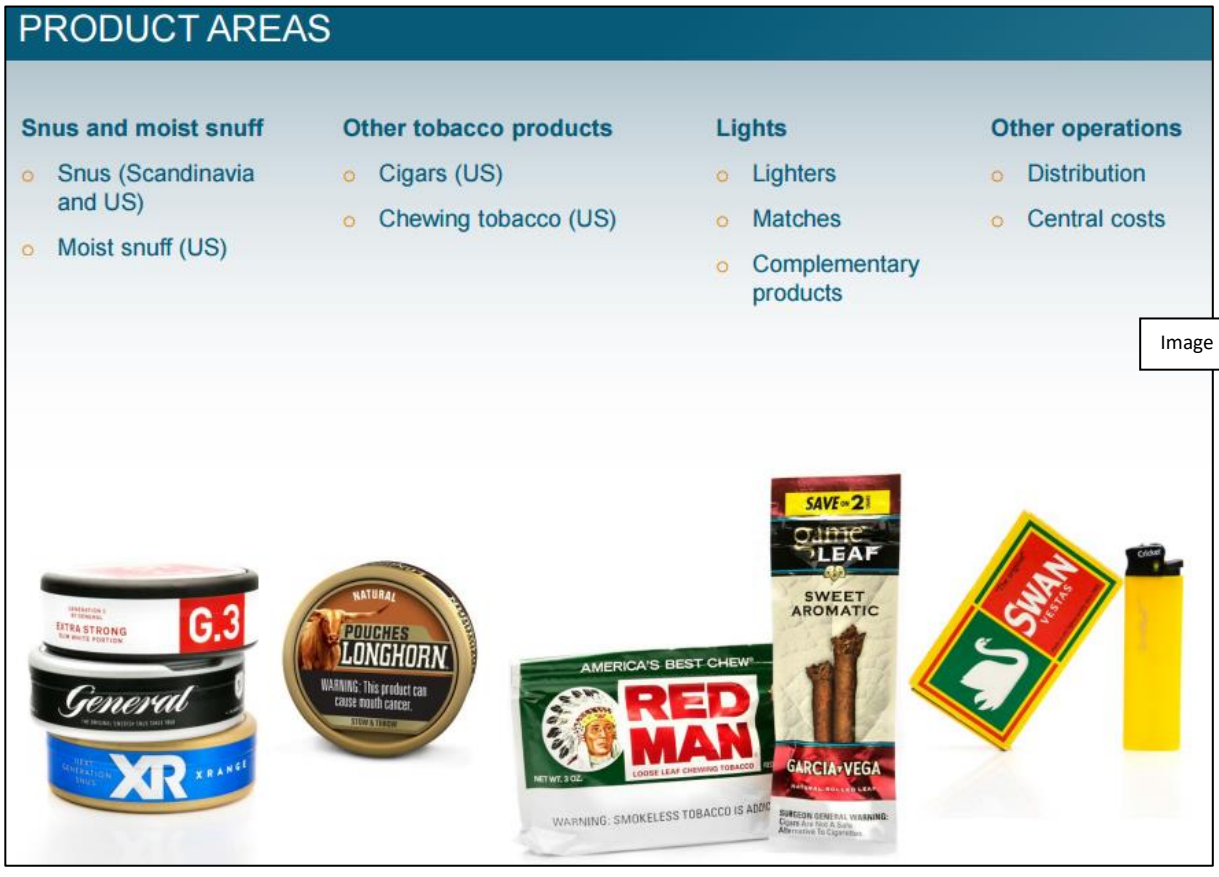


Image Source: Swedish Match

Key data	2015	2014	2013	2012	2011
Operating capital at year-end, MSEK	8,030	8,314	7,729	7,253	7,224
Net debt, MSEK	7,922	8,126	8,388	9,289	8,886
Investments in property, plant and equipment, MSEK	491	223	306	251	245
Operating margin, %	28.0	28.4	29.3	32.3	31.7
Return on operating capital, %	49.6	47.1	49.3	55.7	51.7
EBITA interest cover	8.9	7.6	7.0	7.6	7.4
Net debt/EBITA	1.9	2.1	2.3	2.3	2.4
Share data					
Share capital, MSEK	390	390	390	390	390
Ordinary dividend per share, SEK	8.00[1]	7.50	7.30	7.30	6.50
Special dividend per share, SEK	12.00[1]	–	–	–	–
Earnings per share basic, SEK					
Including larger one time items[2]	14.48	13.23	13.63	14.33	12.14
Excluding larger one time items[3]	14.36	13.23	12.82	14.18	12.14
Earnings per share diluted, SEK					
Including larger one time items[2]	14.48	13.22	13.61	14.25	12.07
Excluding larger one time items[3]	14.36	13.22	12.80	14.10	12.07

[1] Board proposal.
[2] Profit for the full year 2015 includes only the first nine months of net profit in STG due to transition to a one quarter lag reporting. Swedish Match's share of net profit in STG for 2015 includes an adjustment of 56 MSEK relating to 2014 due to a reassessment of useful lives of certain intangible and tangible assets.
[3] Profit for the full year 2015 includes only the first nine months of net profit in STG due to transition to a one quarter lag reporting. Adjusted for a Swedish Match larger one-time item of negative 42 MSEK (negative 33 MSEK after tax) and the above-mentioned STG reassessment of useful lives.

Image Source: Swedish Match

Second, Swedish Match's economic returns are phenomenal. We measure the operating prowess of a business on the basis of return on invested capital, which is a better measure than traditional return on assets or return on equity considerations that may result in skewed analysis as a result of cash on the books or the application of leverage, specifically. For a company that has been around for a long time like Swedish Match, one might have expected that economic returns would have been much lower (teens or less). That's not the case. Return on operating capital has hovered around 50% during the past 5 years, a measure that is remarkable in light of industry trends. Not all firms generate returns above capital costs, but Swedish Match is doing so 5 times over!

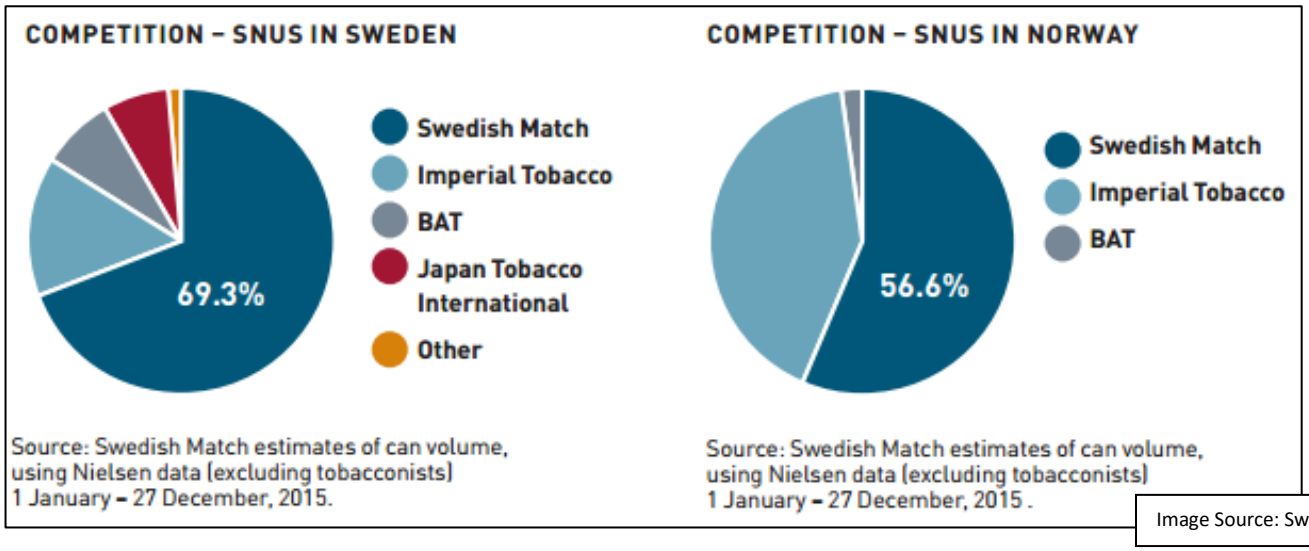
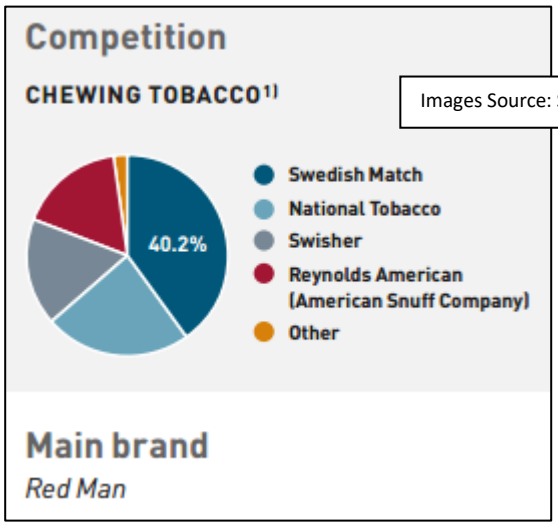
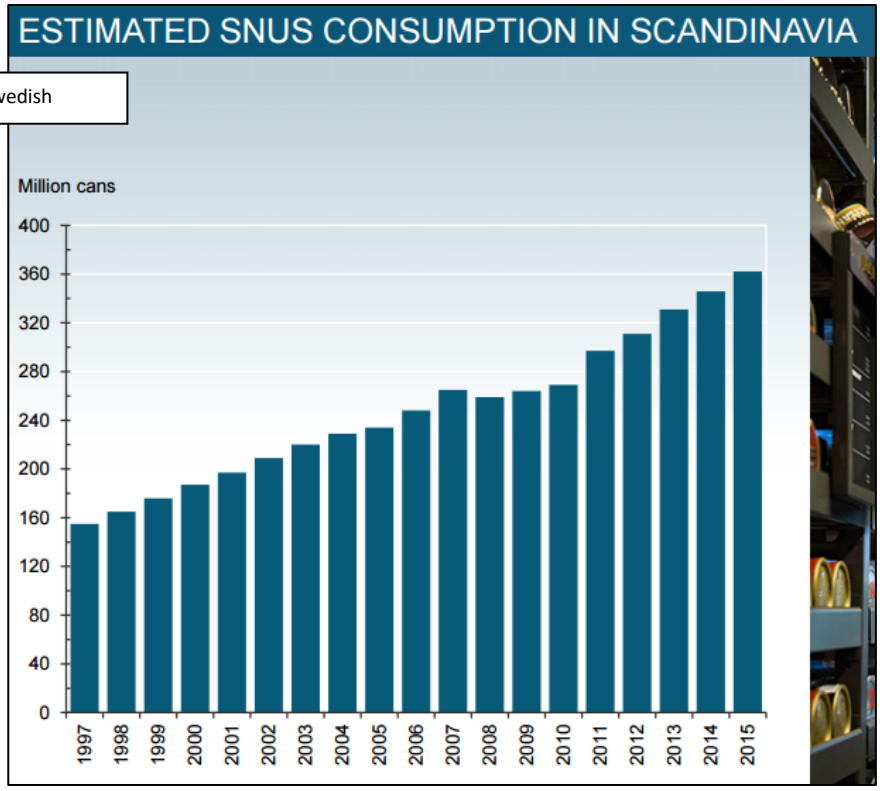


Image Source: Swedish Match

What excess economic-profit generation means is that the company is about as "moaty" as it gets. (Warren Buffett classifies a company that has substantial competitive advantages as having a "wide" moat to protect its business, the castle itself.) It's easy to understand the source of Swedish Match's "moaty" financial performance. The company is the top player in snus in Sweden and Norway, outpacing all others by a long shot when it comes to share, and while trends in chewing tobacco (distinct from snus or snuff) have not been great, the company owns one of the most prominent brands, Red Man – a staple for die-hard chewers on and off the field. Scale, brand strength, customer loyalty, and recurring sales (given the addictive nature of its product) translates into solid ongoing economic returns. The company's EBITDA margin in 2015 was north of 30%!

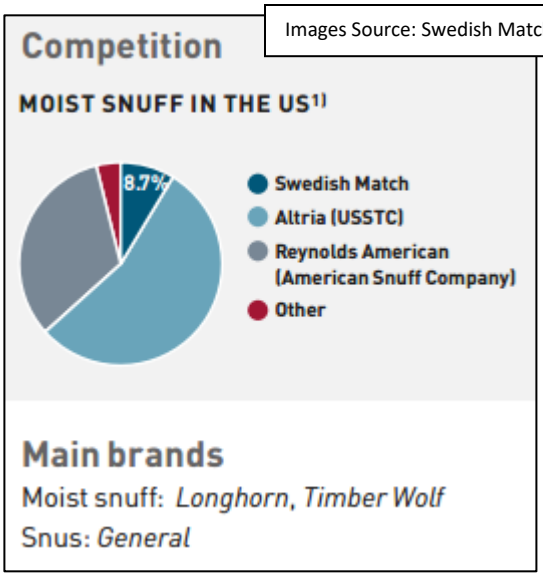


Images Source: Swedish

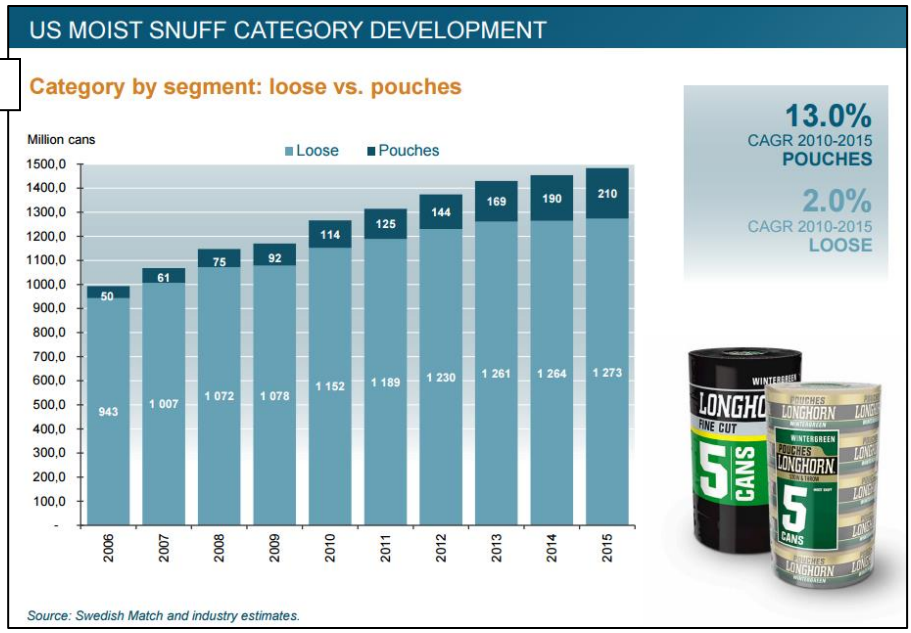


Third, while cigarette consumption is facing considerable pressure in most of the developed world, snus and moist snuff continue to experience unit growth, as measured in cans. The Scandinavian snus market, for one, is growing at a mid-single-digit annual pace, with approximately one million consumers in Sweden alone (incredible stat: roughly 20% of Swedish men use snus regularly). The moist snuff market in the US, where most volumes are concentrated in the southern and mid-Atlantic states, is growing at a respectable 2-3% per annum, with sales of the pouch variety expanding at a 13% yearly clip the past few years. Swedish Match's brands (Longhorn and Timber Wolf in moist snuff, and General in snus) are well positioned to capture market growth, and the "less messy" pouch option has significantly broadened consumer appeal, by our observation.

Fourth, Swedish Match has one of the most promising dividend policies around. Though the company at times rewards its shareholders with special dividends (as it did in 2015), Swedish Match's dividend policy is to pay out 40-60% of earnings per share each year. While we have not highlighted the company as a potential dividend



Images Source: Swedish Match



growth play in this edition of the Exclusive, the payout still has tremendous potential for expansion. Including its special dividend, Swedish Match had an effective dividend yield of ~6.7% in 2015, and the company generates a yield of 3-3.5% on a more normalized basis. Importantly, while companies such as cigarette-maker Altria boast yields in this range, they are doing so while paying out 80% or more of adjusted earnings. Swedish Match is doing so at half the payout ratio. This is incredible, and something the market hasn't got around to fully recognizing, in our view. Shares could double on the basis of yield-equivalent analysis in the event global interest rates remain ultra-low for the foreseeable future.

Share data	2015	2014	2013	2012	2011
Earnings per share, basic, SEK					
Including larger one time items[1]	14.48	13.23	13.63	14.33	12.14
Excluding larger one time items[2]	14.36	13.23	12.82	14.18	12.14
Earnings per share, diluted, SEK					
Including larger one time items[1]	14.48	13.22	13.61	14.25	12.07
Excluding larger one time items[2]	14.36	13.22	12.80	14.10	12.07
Dividend per share, SEK	20.00[3]	7.50	7.30	7.30	6.50
Dividend yield at year-end, %	6.66[3]	3.06	3.53	3.35	2.66
Dividend pay-out ratio, excluding larger one time items, %	139[3]	57	57	51	54
Market price at year-end, SEK	300.20	244.80	206.70	218.20	244.30
Market capitalization at year-end, billion SEK[4]	56.7	47.9	41.1	43.5	49.9
P/E ratio	20.7	18.5	15.2	15.3	20.2
EBIT multiple	16.1	14.8	12.8	13.0	15.9
Total return, %	26.2	22.4	–2.3	–8.5	28.8
Average number of shares, basic	193,506,546	198,475,824	198,930,422	202,888,955	209,001,190
Average number of shares, diluted	193,530,266	198,583,328	199,274,054	203,995,039	210,296,918
Number of shareholders	49,806	47,952	49,405	51,244	51,646

1) Profit for the full year 2015 includes only the first nine months of net profit in STG due to transition to a one quarter lag reporting. Swedish Match's share of net profit in STG for 2015 includes an adjustment of 56 MSEK relating to 2014 due to a reassessment of useful lives of certain intangible and tangible assets.
2) Profit for the full year 2015 includes only the first nine months of net profit in STG due to transition to a one quarter lag reporting. Adjusted for a Swedish Match larger one-time item of negative 42 MSEK (negative 33 MSEK after tax) and the above-mentioned STG reassessment of useful lives.
3) Board proposal. Dividend includes ordinary dividend of 8.00 SEK and a special dividend of 12.00 SEK.
4) Excluding shares held by Swedish Match.

Image Source: Swedish Match

Finally, Swedish Match's financial leverage, while elevated, is conducive to a firm that must continue to exercise discipline, even as it pursues a very shareholder-friendly nature – we like this a lot. The board is adamant that net debt will not exceed 3 times EBITDA, a comparatively low measure considering a fully-maxed effective dividend yield close to 5% (14.36/300.20). Most entities can't come close to this potential income stream today without levering up 5-6 times and using the capital markets as a funding source as in the case of most energy master limited partnerships, for example. A commitment to maintaining an investment grade credit rating is also reassuring. Buybacks have also bolstered per-share earnings performance in recent years.

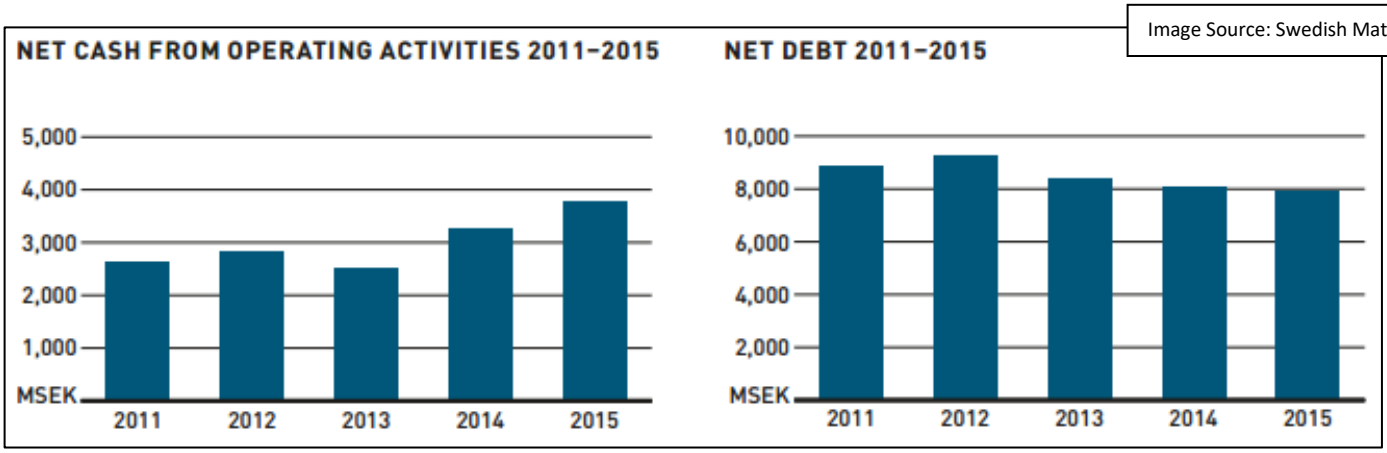
Transfer of capital to Swedish Match's shareholders

MSEK	2015	2014	2013	2012	2011	Total
Dividend paid	1,464	1,453	1,459	1,334	1,152	6,862
Repurchase of own shares, net	1,854	836	164	1,532	2,304	6,690
Total	**3,318**	**2,289**	**1,623**	**2,866**	**3,456**	**13,552**

Dividend proposed for calendar year 2015 to be paid in 2016 is 3,778 MSEK.

Image Source: Swedish Match

Image Source: Swedish Match



That said, there are four primary risks to our thesis.

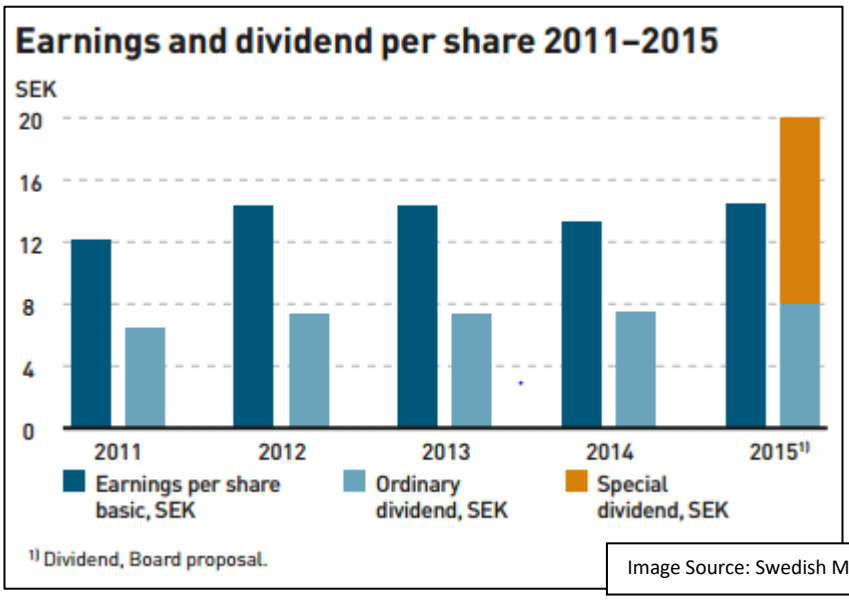
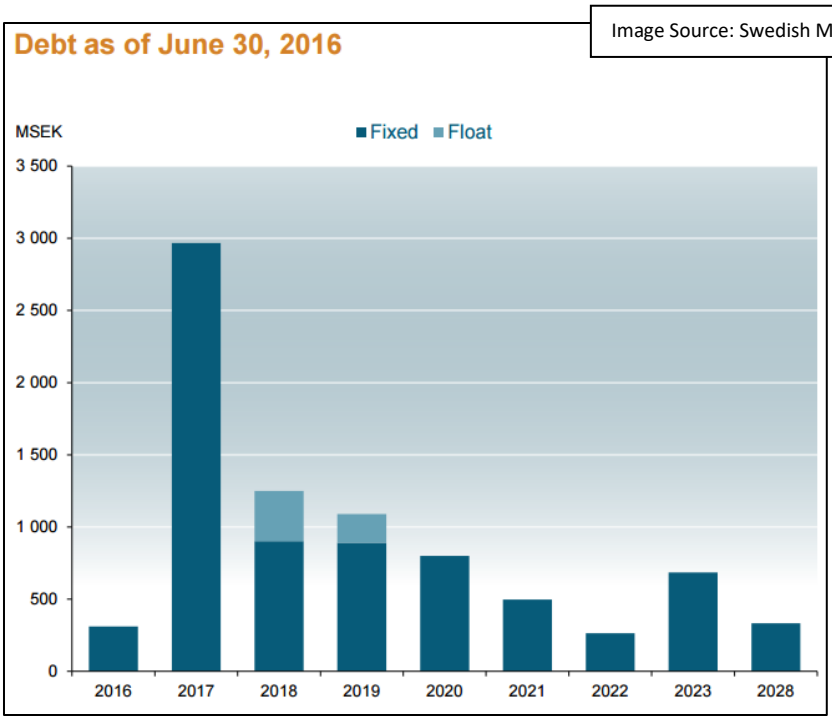


Image Source: Swedish Match

First, the growing public opposition to tobacco products and the ever-changing regulatory environment comes immediately to mind. What we've found, however, after evaluating studies of some of the best-performing stocks in history, namely Altria, is that the presence of such risks have counter-intuitively acted as an artificial return-enhancing dynamic. Stated differently, with many investors concerned about an adverse regulatory shock, holders of tobacco-related equities have been able to reinvest ever-growing dividends at depressed prices over time to augment the total return proposition. Swedish Match is positioned to do the same, in our view.

Image Source: Swedish Match



Second, holders of the company's equity should be cognizant of its refinancing risk. Swedish Match's net debt position is not small, by any measure, and while it does have a sizable maturity coming due in 2017, Swedish Match's brand strength, return on operating capital performance, margin profile, and customer loyalty are things creditors love. The company's free cash flow generating prowess alone may be enough for bond holders to sleep well at night, and an investment grade credit rating is a tangible mitigation of this concern. Frankly, we'd be surprised if rolling over debt ever becomes an issue as the firm is not beholden to capital raises to fund growth.

Third, competition remains intense, particularly in the US. Altria and Reynolds American dominate the moist snuff market in the States, but growth in this geography for Swedish Match can in some ways be considered icing on the cake. Its bread and butter chewing tobacco brand, Red Man, and its position in Scandinavia offer a firm foundation on which to continue to expand in foreign domiciles, even if the average net selling price per can faces some pressure. As with its peers, Swedish Match has been competing with cigarettes for years, and the exponential adoption of snus puts it at the forefront of the growth curve.

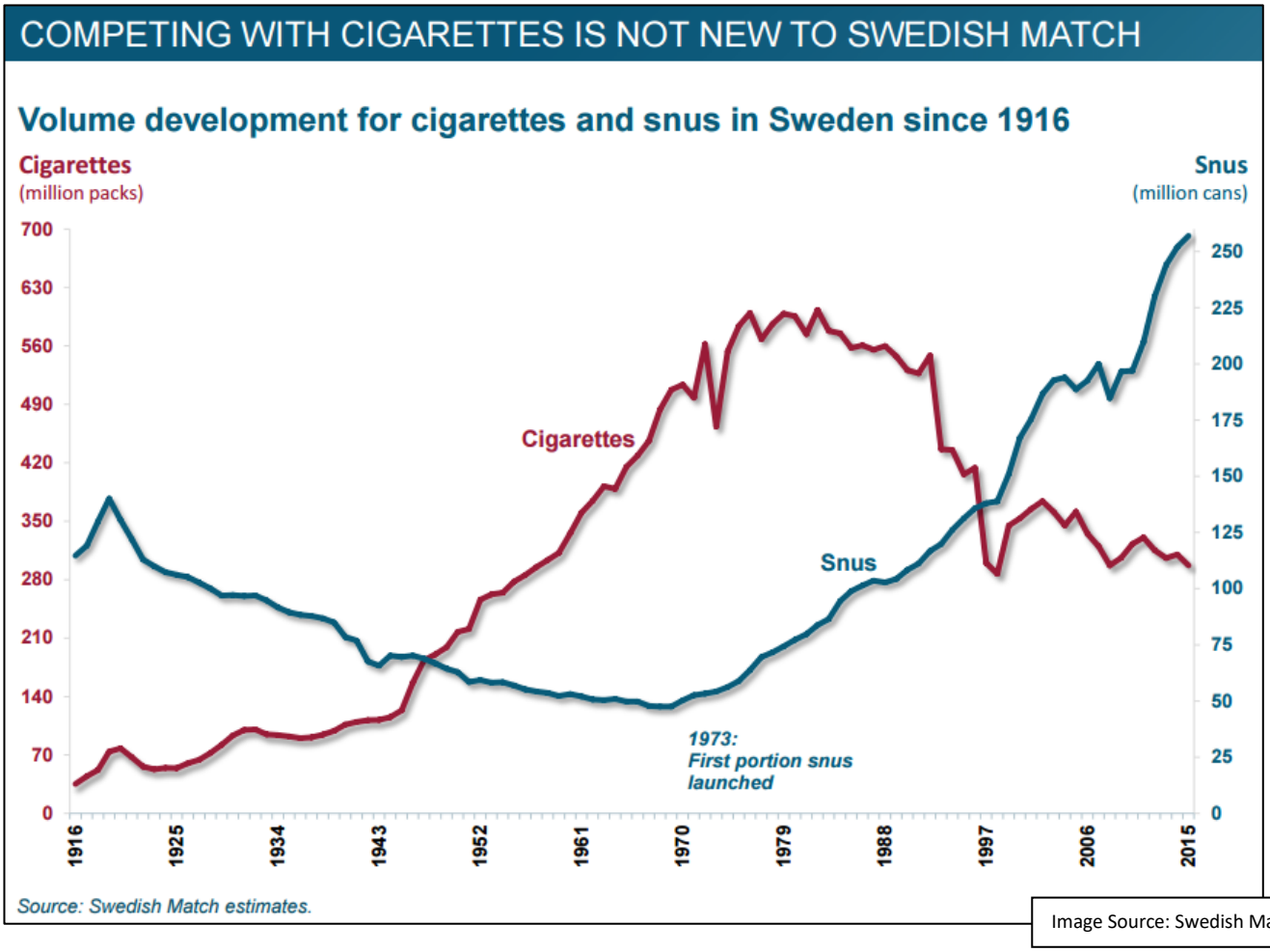
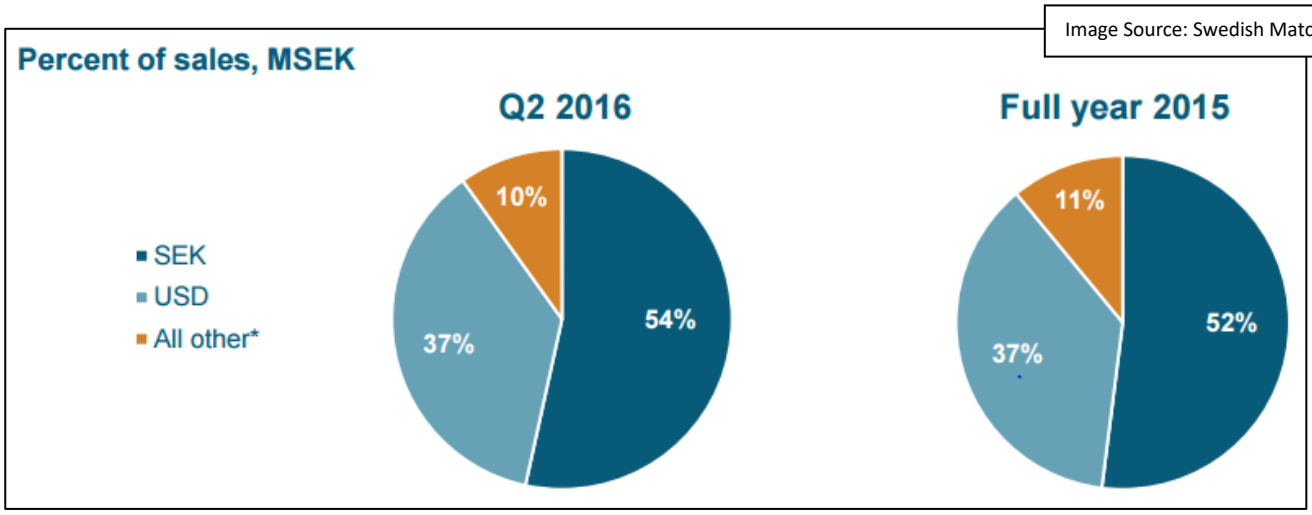


Image Source: Swedish Match

Finally, with any multinational, there is some currency risk. Still, it's hard to find anything wrong with Swedish Match's most recently-reported second-quarter results, released July 22, which showed sales and operating profit advancing at a double-digit pace in local currencies. Importantly, reported performance, including currency fluctuations, leapt both 8% on the top and operating lines during the period. Roughly 50% of its sales are Swedish Krona-based, while nearly 40% are US-dollar-based, a good mix. Production is spread across 6 countries, too, with snus production in Sweden, moist snuff and chewing tobacco made in Kentucky, and other tobacco products sourced in the Dominican Republic and Alabama. The company matches sales and its cost structure well, though a stronger US dollar has often been a net-positive to performance.

As it relates to corporate governance, we have no reason to believe that the company is not in good hands, with Lars Dahlgren at the helm, CEO since 2008. Short- and long-term incentive compensation should keep the team aligned with shareholder interests, too, with the predominant performance criterion on a short-term variable basis being group operating profit (excluding share of net profit in STG, Scandinavian Tobacco

Image Source: Swedish Match



Group), a good fundamental financial measure and one we like much better than share-price performance that could cause risky-dealings.

The executive long-term incentive performance assessment is based on accumulated group operating profit, and interestingly, no payout is given related to this criterion unless comparable improvement "from product areas" is achieved over a multi-year period (2015-2017). We like this a lot. Seven members made up the board at the end of 2015, and we believe Swedish Match has a deep bench of executive talent to fill any leadership roles that may surface. Standard Life is the largest institutional owner at ~3.3% as of June 2016.

Swedish Match is a hidden multinational gem that could see shares nearly double on a yield-equivalent basis relative to US-listed peers. We believe the company is a long-term winner with a strong end market to mitigate downside risk in the current overheated US equity market.

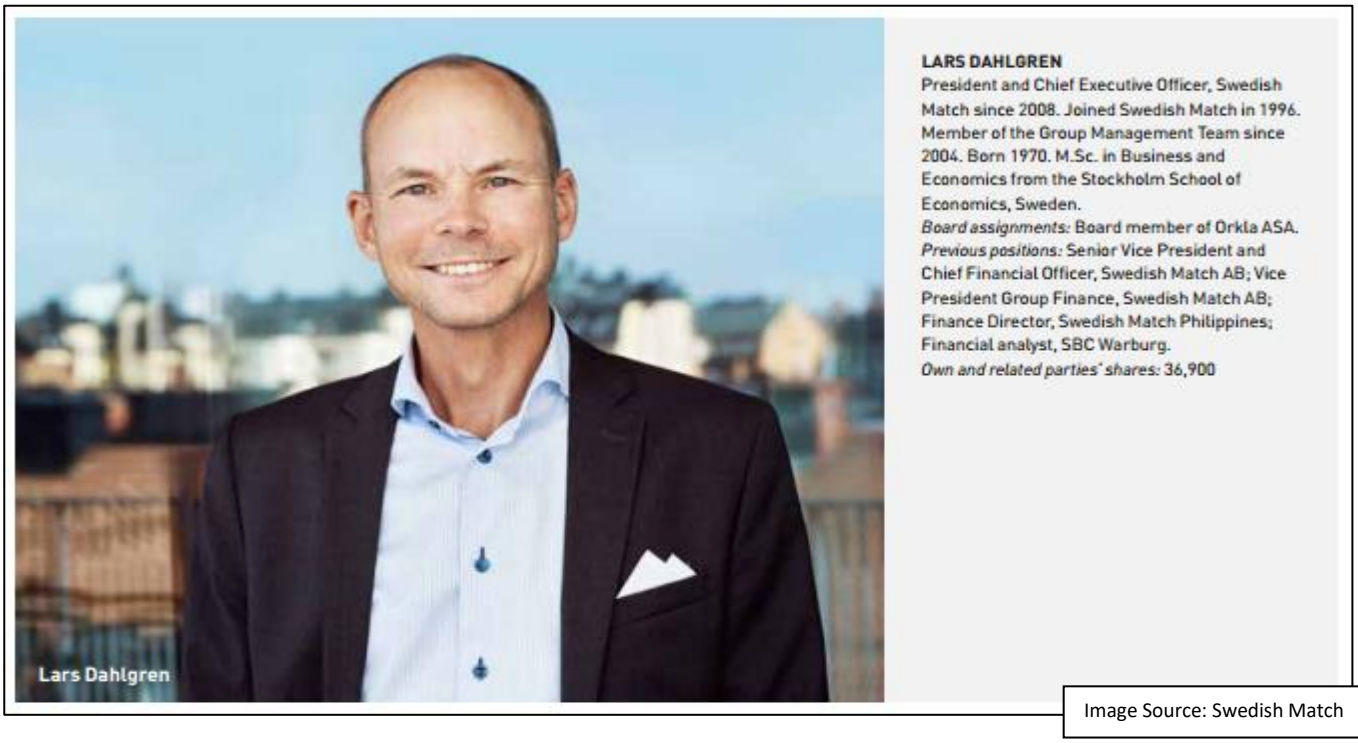


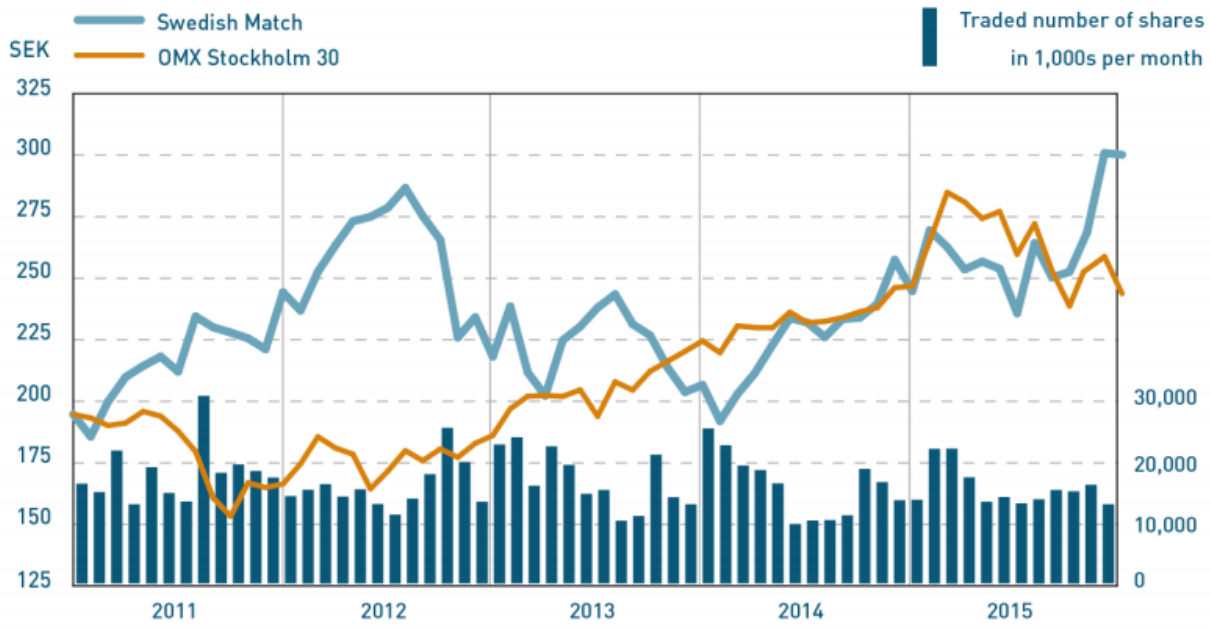
Image Source: Swedish Match

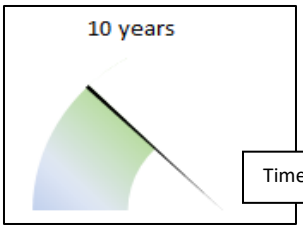
Image Source: Swedish Match

As of June 30, 2016

10 largest shareholders	
Standard Life Investment Funds	3.3%
Nordea Funds	2.2%
Second Swedish National Pension Fund	2.2%
First Swedish National Pension Fund	2.0%
Invesco Funds	1.7%
SEB Funds	1.2%
Vanguard Funds	1.0%
UBS Funds	1.0%
Swedbank Robur Funds	0.9%
Third Swedish National Pension Fund	0.9%
	16.5%

Image Source: Swedish Match





Time Horizon: Intermediate-term

GoPro (GPRO)

Thesis

We expect the smartphone market to eat GoPro's (GPRO) lunch, much like the convergence trends in the past that have brought almost every gadget to everyday handheld devices. In our opinion, GoPro will not be able to differentiate enough to capture the everyday consumer, which is already enjoying camera technology on advanced smartphones like never before. Revenue is expected to plummet in 2016 due in part to the lack of excitement surrounding its new product lineup.

Corporate Profile

GoPro develops, produces, and sells mountable and wearable action capture devices. It was formerly known as Woodman Labs before changing its name to GoPro in February 2014. The company was founded in 2004 and is headquartered in San Mateo, California.

GoPro (GPRO) got its start in 2004, creating mountable and wearable action cameras with various accessories designed to capture images and video in every imaginable situation. The firm's products have become increasingly mainstream in recent years, and consumers are likely to recognize various first person viewing experiences of extreme sports, drivers in a variety of motorsports, as well as a growing number of more general population targeted scenarios that are captured with its products. The company was an early mover in the action camera market, and as a result, its name is now synonymous with extreme footage capturing. From GoPro's 2015 Annual Report:

Image Source: GoPro

> *"What began as an idea to help athletes self-document themselves engaged in their sport, GoPro has become a standard for how people capture themselves engaged in their interests, whatever they may be. From extreme to mainstream, professional to consumer, GoPro enables the world to capture and share its passions in the form of immersive and engaging content."*

GoPro currently offers four new products, three action cameras and one drone, with previous iterations of its action cameras still available. The Hero 5 Black is the firm's flagship product, offering 4k resolution along with all the staple technologies of high-level GoPro products such as video stabilization. While the Hero 5 Black currently sells for $399.99, GoPro has two products at lower price points of $299.99 and $199.99 in the Hero 5 Session and Hero Session, respectively; both of the cheaper models are designed and priced to be more consumer friendly. The company's lone drone product, Karma, is offered with or without one of its aforementioned action cameras, though a discount is offered with the packaging of a drone and an action camera.

Key Statistics	
Last Close	$17.15
52-week range	$8.62 - $32.15
Market Cap	$2.34 B
Avg Daily Volume (30 wks)	7,683,730
Shares Outstanding	102.94 M
Float	85.54 M
Shares Short	30.85 M
Short Ratio	4.56
Short % of Float	30.9%
Shares short (prior month)	30.54 M

Image Source: GoPro

Each of GoPro's products is subject to significant competition. Like many other technologies, the market for cameras is characterized by frequent product introductions and rapid technological advances. Winning in areas such as quality, reliability and user experience, price and performance, design innovation, brand recognition, marketing and distribution capability, service and support, and corporate reputation are keys to success in such a competitive landscape. Additional pressure in the cameras market has come from the proliferation of smartphones and tablets with high-quality photo and video functionalities. GoPro competes against well-established camera makers, diversified electronics companies, and specialty firms alike, many of which have an advantage over GoPro in the form of scale and resources that could allow them to compete more effectively in a rapidly changing environment.

In addition to material competition, which was intensified recently as rival DJI revealed its drone offering with numerous additional smart features at a similar price point, the drone market offers a variety of unique challenges. It is still an emerging market, and many players continue to jostle for market positioning. GoPro's long-term success in the market remains up in the air, as is the regulatory environment surrounding the consumer drone market. Consumer drone registration laws were put into effect in the US late 2015, and further regulations in the US or other international markets could further restrict the use of recreational drones or require specific certifications or product modifications that could impact the attractiveness of the market. Material uncertainty in the drone market exists on the liability front as well.

Though GoPro remains confident in the distinction of its products through differentiated use cases, it is important to note that all of its revenue is derived from products that can almost exclusively be classified as discretionary.

Image Source: GoPro

Selected Financial Data

($ in millions)

	2011	2012	2013	2014	2015
Revenue	$ 234	$ 526	$ 986	$ 1,394	$ 1,620
Gross Profit	123	227	362	627	673
Gross Margin %	52.3	43.2	36.7	45.0	41.6
Net Income	25	32	61	128	36
Adjusted EBITDA	53	75	134	293	179
Cash and Investments	29	36	101	422	474
Total Assets	104	247	440	918	1,103
Working Capital	$ 44	$ 70	$ 57	$ 564	$ 538

While GoPro's top-line growth has been nothing short of incredible in recent years, the same cannot be said of the remainder of its financial performance. The firm's gross margin has been volatile, and net income continues to feel pressure. Revenue is expected to fall to a range of $1.35-$1.5 billion in 2016, while gross margin pressure is projected to persist in what's left of the year (guidance of ~40% for the second half of the year). Recent marketing efforts have helped improve sell-through, and management is committed to brand and product marking moving forward, which is expected to grow revenue on a quarterly sequential basis but will inevitably pressure operating margins.

Image Source: GoPro

(dollars in thousands)	Year ended December 31,					
	2015		2014		2013	
	Dollars	% of Revenue	Dollars	% of Revenue	Dollars	% of Revenue
Revenue	$ 1,619,971	100%	$ 1,394,205	100%	$ 985,737	100%
Cost of revenue[1]	946,757	58	766,970	55	623,953	63
Gross profit	673,214	42	627,235	45	361,784	37
Operating expenses:						
Research and development[1]	241,694	15	151,852	11	73,737	7
Sales and marketing[1]	268,939	17	194,377	14	157,771	16
General and administrative[1]	107,833	7	93,971	7	31,573	4
Total operating expenses	618,466	38	440,200	32	263,081	27
Operating income	54,748	3	187,035	13	98,703	10
Other expense, net	(2,163)	—	(6,060)	—	(7,374)	(1)
Income before income taxes	52,585	3	180,975	13	91,329	9
Income tax expense	16,454	1	52,887	4	30,751	3
Net income	$ 36,131	2%	$ 128,088	9%	$ 60,578	6%

GoPro's need to increase sales via aggressive brand promotion deflates the notion that demand for its products is enhanced by a virtuous cycle in the creation and sharing of content created with its products. If such a cycle truly existed, sales and marketing costs would not be accounting for the majority of the growth in operating expenses in 2016. The company has not turned a profit through two quarters in 2016 but is expected to return to profitability in the fourth quarter of the year. Though a material portion of the increased costs thus far in 2016 have been attributed to research and development, such spending levels are not healthy and certainly not sustainable.

After generating ~$111 million in the first half of 2015, GoPro's free cash flow generation in the first half of 2016 came in at roughly negative $91 million. As a result, its net cash position deteriorated to ~$279 million from more than $474 million at the beginning of the year. Such a cash burn is ominous, and if management is unable to right the ship with respect to profitability and positive free cash flow generation, GoPro shareholders may be feeling a material pinch sooner rather than later.

Perhaps the largest long-term barrier to GoPro's success is the challenge it faces in driving demand for its products from average consumers. The company continues to work to find ways to bridge the gap between the extreme and the mainstream, including via the offering of products at lower price points. However, such products have had a hard time catching on, as more than 50% of units shipped in the second quarter of 2016 were of the $399 and higher variety.

One of the most important factors behind potential long-term challenges in demand for GoPro is the vast improvements smartphone cameras have seen in recent years. The ready availability of an on-the-go, high-quality camera substantially cuts into the market in which GoPro is working to infiltrate. The company has yet to prove its ability to up sell customers to new product iterations. This will go hand-in-hand with product innovation in the future, but we have a difficult time envisioning where the differentiation will

come from that the everyday consumer will 'need' to have the most recent update of its camera. The company had serious issues with the pricing of its Hero 4 Session capture device that resulted in inventory writedowns and substantially lower than expected revenue. We're not sure it has a good handle on rolling out new product iterations, something that will be vital to its long-term success as a one-trick pony of sorts in a niche market. Samsung has released a 360 degree capture device that is compatible with its smartphones, and could encroach on one of GoPro's final areas of advantage, the ease with which its content is shared and offloaded from the capture device.

One of the most troubling statistics related to the GoPro investment case has nothing to do with its financial performance, or cash burn since its IPO. Instead it is directly related to the lack of shareholder voice heard on voting matters. We have serious concerns with GoPro's corporate governance due to founder, CEO, and Chairman Nick Woodman controlling nearly 77% of GoPro's voting power. He owns nearly all of the firm's Class B shares, which do not trade on the open market and feature 10 votes per share; minority shareholders are taking on a significant amount of oversight risk. The future of the company is very nearly entirely in Woodman's hands, unless he chooses to step down, a development that is very unlikely given the growing stock-based compensation levels seen as of late.

Our short thesis for GoPro can essentially be boiled down to this: we think there is a finite number of consumers that have a desire to purchase a GoPro camera and that number is not significant enough to provide the firm with sustainably profitable growth. We do not see it has having a material enough competitive advantage to keep competitors at bay, which will only eat into the share of the action camera pie that GoPro is able to take advantage of. Brand recognition is a positive force for the company, but we do not view this advantage as significant, especially after considering the disappointment that took place in the 2015 holiday season following the release of the Hero 4 Black and Silver capture devices. Perhaps most concerning of all is the corporate governance issues minority shareholders must face, as significant oversight risk is prevalent.

Image Source: GoPro

	Shares Beneficially Owned				
	Class A		Class B		
Name of Beneficial Owner	Shares	%	Shares	%	% of Total Voting Power[1]
Directors and Executive Officers:					
Nicholas Woodman[2]	—	*	35,865,555	98.35	76.88
Michael Marks[3]	245,881	*	—	*	*
Edward Gilhuly[4]	1,711,352	1.68	—	*	*
Kenneth Goldman[5]	878	*	55,416	*	*
Peter Gotcher[6]	378	*	73,212	*	*
Alexander Lurie	10,332	*	—	*	*
Anthony Bates[7]	67,833	*	1,091,113	2.92	2.31
Jack Lazar[8]	2,254	*	256,819	*	*
Nina Richardson[9]	55,910	*	169,174	*	*
Sharon Zezima[10]	4,504	*	32,781	*	*
Brian McGee[11]	276	*	—	*	*
All executive officers and directors as a group (11 persons)[12]	2,099,598	2.06	37,544,070	98.66	78.25
Other 5% Stockholders:					
Nicholas Woodman and Jill R. Woodman, as Co-Trustees of the Woodman Family Trust under Trust Agreement dated March 11, 2011[13]	—	*	32,666,309	89.99	70.27
Silicon Valley Community Foundation[14]	5,721,739	5.62	—	*	1.23

Kris Rosemann and Chris Araos contributed to this article.

July 1, 2016

Inaugural Letter to Members

Dear Valued Member,

Welcome! You are one of a very limited number of members that will ever bear witness to the pages that follow.

The launch week of the Nelson Exclusive coincided with news that Britain has voted to leave the European Union. The decision, while sending the European banks tumbling violently, does little to muddy the context setting the background of the inaugural edition of this publication.

Broader stock market valuations are at frothy levels, and interest rates continue to hover near all-time lows. The investment-decision landscape is more complicated today than ever before for all types of investors, from those seeking long-term capital appreciation to those that are targeting certain income goals. Cyclicals today are trading at peak multiples on peak earnings, and even consumer staples equities have reached valuation levels that may be more appropriate for aggressive growth equities, not mature operators. *Said differently, the market has laid down the gauntlet.*

The next few years in the markets may be among the most difficult witnessed since the Great Recession. Even a broader market pullback 20% from current all-time highs wouldn't be abnormal given that the collective market valuation of S&P 500 companies has effectively tripled from the March 2009 panic bottom. The launch of the Nelson Exclusive in such conditions can be considered perilous as broader market performance inevitably will act as ballast to the returns of ideas surfaced. In this spirit, I want to remind you that not all ideas in this publication will be successful, and some that are eventually may encounter tough sledding over extended periods of time. As a swimmer cannot achieve his best time swimming against the current, a stock selector cannot achieve his best performance in a down market. Regardless, the value placed on a steady hand during challenging times is priceless.

Let's first cover what the Exclusive is and then we'll talk about what it is not. As you know, the Valuentum investment coverage universe is vast, and what we're seeking to deliver in this publication is ideas that fall outside its reach. We're breaking down the traditional barriers of equity coverage to identify underfollowed gems across the investing spectrum, delivering in each monthly edition one idea for income investors, one idea for readers seeking long-term capital appreciation, and a bonus idea for those looking for a "short" consideration (1). Underfollowed doesn't mean obscure, however, and the ideas that we're targeting will be investable ones, avoiding thinly-traded instruments and penny stock "traps." We'll clearly define our expected time horizon for each consideration, and where applicable, we'll update our theses in subsequent editions. We'll keep score, tracking performance over time.

Let's talk about what the Exclusive isn't. The Exclusive does not constitute individual investment advice, and the ideas within it are not personal recommendations. Each of you reading should always work with your personal financial advisor who knows your individual goals and risk tolerances. I do not. Only you and your

personal financial advisor know what's best for your life circumstances. The personal financial advising markets and what we do at Valuentum via financial publishing are two different verticals in the same industry, but they are different nonetheless. I just want to be very clear about this because I can never tell you to buy or sell anything at any time, even if this may be what you want. It's not that I don't have conviction in my work – it's the rules of the business.

Within the twelve editions of the Nelson Exclusive each year, we'll be highlighting in total 36 ideas for consideration with varying investment parameters. That's a lot. Depending on the time horizon set forth with each idea, fantastic performance might mean a success rate of 60%, great performance might be 55%, average performance might be 50%, while anything below that mark may constituent a poor showing. Obviously, I'm aiming for a 100% success rate, but I also have to be realistic. The great Joe DiMaggio may have hit safely for 56 consecutive games in the last baseball season before the United States was thrust into World War II, but he "only" hit .357 that year. That season of '41, the great Ted Williams would be the last player to hit .400, meaning that one of the best hitters in baseball…ever…was still called out ~60% of the time.

The greatest investors face a similar paradigm. Stock selection is a process where there will be homeruns and strikeouts. You know me. The Exclusive is not a "get-rich-quick" product, and you should keep a close eye on your wallet if you encounter anyone promising anything of the sort. In the inaugural edition of the Nelson Exclusive, I'm going to take 36 swings – they are going to be hard and through the zone, and I'm not going to pull my shoulder out or take my eye off the ball. Market conditions are expected to be stormy in coming years as "reversion-to-the-mean" dynamics rain down, and a crafty lefthander with great "stuff" may be on the mound, but we're stepping up to the plate and digging in.

Batter up!

Sincerely,

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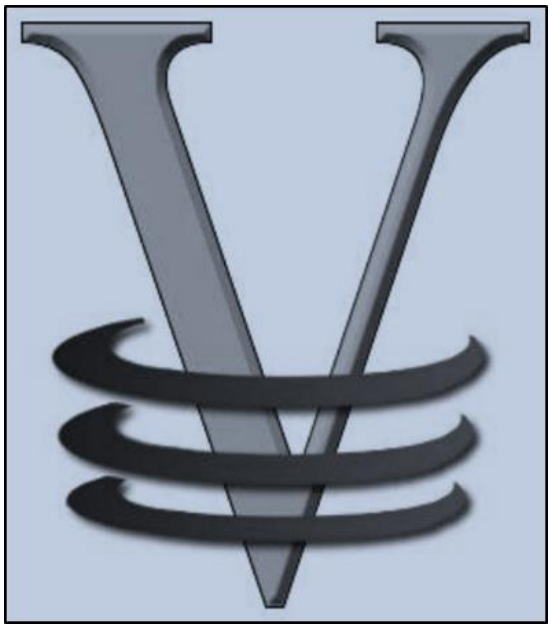

P.S. On a very personal note, I wanted to thank you for your continued support. Without you, neither the Nelson Exclusive publication nor Valuentum would exist. This fact is not lost on me. I thank you deeply.

August 1, 2016

August 2016

Dear Valued Member,

It's a heat wave. I'm not talking about heat advisories issued across most of the United States these past few weeks, but I'm talking about the sizzling stock market and the hot air that continues to inflate its bubbly mass. Times are tough, and investors face challenges like never before. More than half the world is navigating through a negative interest rate environment, and stock market valuations are at nosebleed levels. The least-risky business models in the form of tried-and-true consumer staples entities have become some of the most risky stocks, as valuations stretch, stretch, and stretch some more. Nobody knows for certain what the next few years hold for the stock market, but if a reversion to the mean is in the cards, many are sure to be disappointed.

Launched in this midst of this market "chaos," the Nelson Exclusive seeks to deliver three ideas each month to meet the needs of the discerning investor seeking income generation, capital appreciation, and "short" considerations. Last month, the rubber hit the road with the launch of the first edition – and boy did it not disappoint. The inaugural short idea Lands' End (LE) has fallen 15% in just the past month alone. Big deal – you may say, but this poor performance occurred in an appreciating and bubbly broader equity market. Not only was this short idea swimming against the current, but it reacted directionally right out of the gates. We'll keep monitoring shares, but those that took a liking to the idea are doing pretty good already. Eddie Lampert's pocketbook may be the only thing that could save longs in Lands' End.

Last month's income idea Universal Corp (UVV) has appreciated roughly 5% while going ex-dividend since it was profiled in the July edition of the Exclusive, and we're anxiously awaiting the company's release of first-quarter fiscal 2017 results on August 4. The corporate yields ~3.6%, well above the paltry payout of the average S&P 500 company, or ~2%. I like Universal a lot because it's tied to the tobacco end market, which tends to be more stable than most, and we doubt the firm will put its lengthy dividend growth track record at risk for anything. Universal's net leverage continues to fall, and its free cash flow generation comfortably covers cash dividend obligations. Currency impacts from Brexit and falling unit cigarette consumption are two risks worth watching closely, however.

We're taking the long road with Bloomin' Brands (BLMN). I continue to be impressed with its portfolio of restaurants that include Outback Steakhouse, Carrabba's, Bonefish Grill, and Fleming's. The stock is trading at a very attractive relative multiple, and precedent transactions imply a fair market value from a suitor or private equity at a price at least 50% higher than today's levels. Targeted adjusted diluted earnings per share of ~$1.35 in fiscal 2016 means the company is trading at a mere ~13 times. Bloomin' announced that it will expand more aggressively in the Middle East July 5, reported that it has franchised its South Korean business July 12, and while its fiscal second-quarter numbers, released July 29, came in a little light, we're expecting big things from its Dine Rewards loyalty program and ongoing improvements across its restaurant portfolio.

Traffic across the restaurant industry has hit a snag as of late, but we expect the trend to be short-lived. People love to eat out. Bloomin' looks to be a long-term winner, *once* comp trends turn for the better.

As the months pass and the seasons change as they always do, I'll be updating our thoughts on previously highlighted ideas much like I've done in this August 2016 note. I won't be holding anything back – if things are going the way we intended them as in the case of Lands' End, I'll say it. If we're taking the long road and not paying too much attention to near-term quarterly results as in the case of Bloomin', I'll make sure to emphasize that, too. I like what we've done with the Nelson Exclusive in setting the bar as high as it gets. I hope you enjoy the August edition that follows.

Sincerely,

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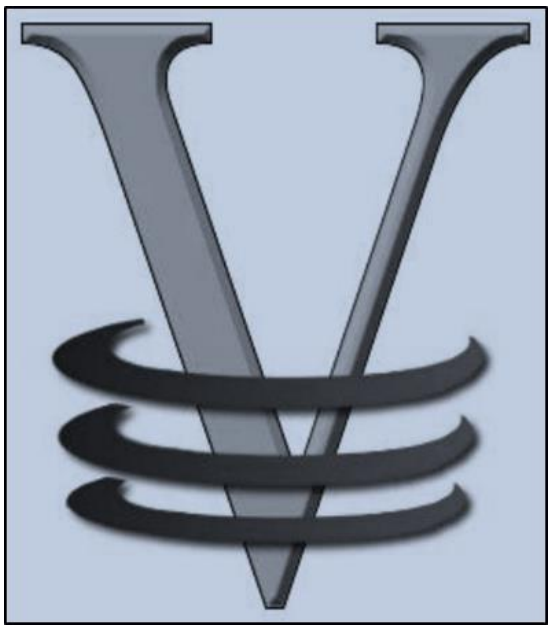

September 2016

Dear Valued Member,
How fast a few months goes by! Incredible. Let's get an update on the six ideas that were collectively released in the previous two editions of the Exclusive from July and August.

July

Income: Universal Corp (UVV)
We remain big fans of tobacco leaf supplier Universal, and we didn't see anything in its fiscal first-quarter 2017 report, released August 4, that would change our minds. Shares are up nicely since we highlighted them in the inaugural July edition, and its 3.6% dividend yield remains a head-turner.

Capital Appreciation: Bloomin' Brands (BLMN)
Shares of Outback Steakhouse owner Bloomin' Brands have been on fire since we highlighted it in the July edition of the Exclusive. The company is just downright cheap, and the prospect of a go-private transaction at a huge mark-up is something that offers its equity substantial support, in our view. It may be the most undervalued restaurant entity out there, by a long shot.

Short Consideration: Lands End (LE)
The path of our short considerations will be volatile, for sure. We maintain our view that the long term is ominous at Lands End even as shares have caught a bid for technical reasons as of late. The next downdraft could be the most severe for the entity. The company's second-quarter fiscal 2016 results, released September 1, were more of the same. Net revenue dropped more than 6%, while operating income tumbled ~85%. The company lost money in the quarter versus net profits in the year-ago period.

August

Income: B&G Foods (BGS)
The owner of the Green Giant brand has done it again! The executive team has come to market in yet another secondary share issuance, and we're huge fans of the financing strategy. The company can use such capital for debt repayment or for the purchase of another solid packaged food brand. We prefer the former but if the executive team has another deal like the Green Giant one in mind, we're all for it. The company should continue to issue equity at current prices or higher, particularly if such actions strengthen its leveraged balance sheet or reinforce the dividend payout.

Capital Appreciation: Healthcare Services Group (HCSG)
This one is in a class by itself – Healthcare Services Group has increased its dividend every quarter for some time now! The last time it upped the payout was in July. The company doesn't have a glamorous business in laundering and dining services, but it does have a good one – and a solid end market at that. We think the company fits the bill nicely as it relates to the kinds of equities that are working in today's frothy market.

Short Consideration: Vivint Solar (VSLR)

Shorts may get whipped around on this one as small "hedgies" can move the needle on this ~$350 million market cap solar energy provider. Vivint's financials may be the worst we've ever seen, however, and its end market may be among the worst in our coverage universe. Vivint's shares have collapsed considerably since the beginning of the year, but it's likely the company is a $0 before this decade is up. That doesn't mean it can't run to $5 or $10 per share first though. Be mindful of such a possible path.

I hope you enjoyed these brief thoughts on our previous ideas, and most of all I hope you enjoy the next three ideas that make up the September edition of the Nelson Exclusive!

Sincerely,

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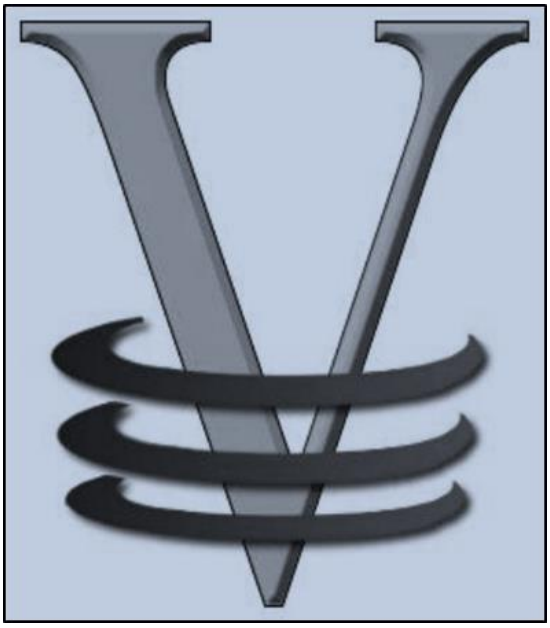

The Nelson Exclusive: Volume 1, Issue 4

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(1) A short sale is the sale of a stock that an investor does not own or a sale which is consummated by the delivery of a stock borrowed by, or for the account of, the investor. Short sales are normally settled by the delivery of a security borrowed by or on behalf of the investor. The investor later closes out the position by returning the borrowed security to the stock lender, typically by purchasing securities on the open market.

Investors who sell stock short typically believe the price of the stock will fall and hope to buy the stock at the lower price and make a profit. Short selling is also used by market makers and others to provide liquidity in response to unanticipated demand, or to hedge the risk of an economic long position in the same security or in a related security. If the price of the stock rises, short sellers who buy it at the higher price will incur a loss.

Brokerage firms typically lend stock to customers who engage in short sales, using the firm's own inventory, the margin account of another of the firm's customers, or another lender. As with buying stock on margin, short sellers are subject to the margin rules and other fees and charges may apply (including interest on the stock loan). If the borrowed stock pays a dividend, the short seller is responsible for paying the dividend to the person or firm making the loan (Source: SEC https://www.sec.gov/answers/shortsale.htm)

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