THE NELSON EXCLUSIVE

Confidential

December 2016

BRIAN NELSON, CFA

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Table of Contents

December 2016……...…….…….3

Nelson Responds to Questions……....…….……4

November 12: Looking for Longs to Rally…….……..……7

About Your Editor…….10

Income Generation: Watsco (WSO)…….……...……....11

Capital Appreciation: Tootsie Roll (TR) ……..…….……..16

Bonus – Short Consideration: Royal Bank of Scotland (RBS)…....….....…..23

Inaugural Letter to Members, July 2016…….…….25

Letter to Members, August 2016……27

Letter to Members, September 2016...……29

Letter to Members, October 2016…...……31

Letter to Members, November 2016……...……33

December 2016

"A strong hit rate and a solid average realized annualized return are developing with Nelson Exclusive ideas. We're also looking for currency headwinds that have negatively impacted some of our previous ideas to alleviate in coming months, helping overall performance in time." – Brian Nelson, CFA

Highlight Date	Company Name (symbol)	Highlight Price	Current or Close Price	Dividends Received	Realized Gain	Realized Annualized Gain	Time Horizon	Notes
Income Ideas								
Jul, 16	Universal Corp (UVV)	57.74	55.85	1.06	-	-	0-30 yrs	Announced 46th consecutive yearly dividend increase November 8! Rallying back.
Aug, 16	B&G Foods (BGS)	51.54	42.50	0.42	-	-	0-2 yrs	Raised its dividend November 4 by ~11%, to $1.86 per common! Watching debt load and acquisition program (Green Giant).
Sep, 16	Maxim Integrated (MXIM)	41.12	37.87	0.33	-	-	0-10 yrs	Solid net cash position, strong free cash flow -- ~3.5% yield! Weighed down by general tech malaise.
Oct, 16	Douglas Dynamics (PLOW)	31.94	31.85	-	-	-	0-20 yrs	Insider buying! Stock rallying back after Q3 results! Yield of ~3%. Very pleased with share-price recovery.
Nov, 16	Ennis Inc. (EBF)	14.60	16.30	NA	11.6%	605.5%	Closed -- 11/12/2016	Captured more than 2 years' worth of income via capital appreciation in one week! Excellent.
For Capital Appreciation								
Jul, 16	Bloomin Brands (BLMN)	17.87	19.28	0.07	8.3%	22.6%	Closed -- 11/12/2016	Simply taking what the market gives us. May re-open idea again! Still believe in long term. Stock very cheap.
Aug, 16	Healthcare Srvs Group (HCSG)	38.91	38.53	0.369	-	-	0-20 yrs	Consecutive quarterly dividend increases -- oh my! Strong end market. About even on call.
Sep, 16	Grupo Aeroportuario (ASR)	157.87	140.51	-	-	-	0-20 yrs	Strength in US dollar hurting, but holding up okay. Still love the long-term picture though! Travel to Cancún not going away.
Oct, 16	Swedish Match (SWMA.ST)	314.80SEK	285.4SEK	-	-	-	0-20 yrs	Tobacco (snus) demand is about as resilient as it gets through the economic cycle! Currency hurting shares.
Nov, 16	Symrise AG (SYIEY)	16.25	14.96	-	-	-	0-20 yrs	EBITDA margins don't get much steadier than Symrise's (18-22% from 2006-2015). Down in sympathy with IFF.
Short Considerations								
Jul, 16	Lands' End (LE)	16.76	16.10	NA	3.9%	NEW 10.7%	Closed -- 12/2/2016	Worried Eddie Lampert may get desparate; has been buying. Decided to close out short position. Very volatile equity. Not being greedy.
Aug, 16	Vivint Solar (VSLR)	2.94	2.85	NA	3.1%	NEW 10.8%	Closed -- 12/2/2016	Stock just not acting right despite ongoing negative solar backdrop (Trump, FSLR outlook, panel oversupply). Locked this in.
Sep, 16	Lloyds Banking (LYG)	3.31	2.78	NA	16.0%	96.1%	Closed -- 11/4/2016	Picking our spots, and taking profits when reasonable. Still don't like Lyolds' leverage and worried about Brexit; also hearing RBS failed BOE stress test.
Oct, 16	GoPro (GPRO)	16.68	11.12	NA	33.3%	400.0%	Closed -- 11/4/2016	Wow -- big winner here. Recalled Karma drone; concerns about execution. Stock keeps falling, but we're not looking back.
Nov, 16	Seritage Group Properties (SRG)	44.31	48.10	-	-	-	0-2 yrs	REIT trading on euphoric expectations and equity increasing against rising 10-year rate, too. Buffett's watching.
	Average Realized Annualized Gain %					**190.9%**	Variable	Overall: Strong hit rate and solid average realized annualized return developing. Currency headwinds should alleviate.

Nelson Responds to Questions

November 7

I wanted to thank many of you for your continued feedback as we seek to optimize the Nelson Exclusive to best fit the needs of its members. Today, I received a few questions about how to interpret the time horizon dynamic of the ideas within the Nelson Exclusive.

First, there are a couple reasons why we include the time horizon feature at all. One, since the ideas are not a portfolio, we want to provide a yardstick to use to measure the performance of the calls, and two, we want to provide a time period that captures the essence of the idea, itself.

For example, in the case of an income idea with a 30-year time horizon, we think such an idea has all of the makings of generating strong income over that 30-year time horizon, not that we'll be waiting for 30 years for the call to work out. Said differently, we think an idea like Universal Corp (UVV) is suited to generate strong dividend income from today over the next 30 years, similar to how the company has raised its dividend in each of the past 45 years.

Another example may be in the case of a capital-appreciation idea with a 20-year time horizon. In this particular case, we think it may be a great source of capital appreciation performance over that 20-year time horizon. Said differently, we think an idea like Bloomin' Brands (BLMN) has material upside potential over the next 20 years, but should it be taken out at a substantial premium over its current bargain-basement price, we could very well close the idea in the next 3-5 years, hypothetically speaking.

Two particular instances like this just happened in the November Exclusive. For example, in the case of short consideration GoPro, the idea was closed in a matter of a few weeks for a 30%+ gain on the short side, even though we outlined its time horizon at a 10-year interval. Lloyds Group (LYG) was the other example. Such instances may happen with our long ideas, too.

In summary, the way to think about the time horizon is that it is inclusive, from today through the targeted period (or when the idea is closed), not that we'll be waiting for decades before the idea works out. I apologize sincerely for any confusion in the matter. Please let me know if you have any additional questions or concerns.

November 12

We continue to emphasize the risks inherent to market dynamics. I think it speaks to our genuineness and frankness in helping the investor and putting their needs ahead of ours. Market conditions have little to do with when we roll out products like the Nelson Exclusive. We're here for the long haul, not interested in capturing fads or flash-in-the-pan product opportunities. The Nelson Exclusive was rolled out to meet needs of members, and interest in it has been phenomenal!

As for Exclusive performance, all things considered, I'm satisfied with it -- remember, we're not just throwing out ticker symbols, but we've written over 140 pages across 5 editions. A large portion of the value is within the information itself. But even still, income ideas are raising their dividends, and as in the November 12 note, “Looking for Longs to Rally,” we're taking what the market gives us. Said differently, if the market is giving us Bloomin' Brands at a 20%+ annualized gain, we'll take it even if the thesis may not happen for years to come. It

doesn't mean that we aren't right on the call because it has advanced in the near term; it just means that we're prudent (and consistent in the case of risk mitigation).

Also, and as we incorporate feedback, many readers seem to want gains/performance now, and I think rightsizing returns on an annualized basis is the best way to measure our work (at least for now). For example, if readers are looking at the near term, then we have to tie performance of each idea to a similar yardstick (remember ideas in the Exclusive are not a portfolio). Surely, a 10% gain in one week is better than a 10% gain in two years. Timing matters immensely, and efficient returns on capital is something we want to be able to speak about when it comes to the Exclusive. We've nailed strong portfolio performance in the newsletters, and we'd like to deliver on other areas of investing, too.

It's always tough to talk about short considerations to long-only investors, but they are an equal dynamic in the Exclusive product. I understand readers want to focus on what they want to focus on, but we approach each idea on the same measurement stick; for now, realized annualized gain. As we think more about how to measure performance, particularly with respect to income ideas, that may change, too. I like that we've been able to lock in winners across all three areas of the Exclusive, and I hope this helps to build confidence among those that are still new to our research and analysis.

I think political and currency risks have impacted the performance of some of our previous ideas, but in a few months or years, we could see something totally different, a complete reversal if Trump no longer is President in 4 years. But if 4 years is too long, for example, then we highlight why we're taking profits on some of our near-term ideas. I think we're delivering in a number of ways. Grupo Aeroportuario's (ASR) long-term growth prospects look very good, and some are looking at it now as a consideration (another value-add of having access to the Exclusive -- tons of information to make an informed decision at a time in the future).

I don't think the Trump election has eliminated the risks the market currently faces (valuations), but instead, it may have created new ones (a significantly rising 10-year Treasury and headwinds to non-US economic growth), even if his election may be a net positive to business, in aggregate. I'll keep updating readers as we go!

November 13

We continue to receive a number of perspectives from members, and while many prefer our ideas with long-term horizons, many others like near-term horizons, too (and feel our long-term horizons don't matter as much to them because they are baby boomers that don't have 20, 30 years, etc). We continue to receive contradicting feedback across a variety of aspects of the Exclusive, but we think we can accommodate all requests; many readers seem to want gains/performance now. As we incorporate member feedback, there will continue to be a great mix of various time horizons in the Nelson Exclusive; specifically, only four positions (now six) have been closed out of the first 15 ideas. There are still many good ideas that we haven't closed out yet (the vast majority of them).

That said, you are correct. The Nelson Exclusive is much more valuable than just the timing of when we surface or close a position. The depth of information in it allows readers to take their time and ponder whether such an idea is right for them. This is only something that I encourage among our readership. As you know, we're not just throwing out ticker symbols, but we've written over 140 pages across 5 editions. The time investment by us is substantial, which is why I emphasize that a large portion of the value of the Nelson Exclusive is within the information itself. For example, many are just now considering previous idea Grupo Aeroportuario (ASR) now that the stock has come in a bit after Mexican-peso currency impacts related to the Presidential election. Even

though the idea was surfaced a couple months ago, the information to consider the idea is still immensely valuable.

One of the considerations that we want to continue to emphasize is the risks inherent to current market dynamics. Not only are valuations stretched, but the rising 10-year Treasury yield may negatively impact the prices of dividend-paying stocks, something we've been concerned about for some time (look at how the REITs have plummeted in the past few months as the 10-year surpassed 2%). We're paying attention to a large number of factors when it comes to considerations behind each idea in the Exclusive, even macro and asset flight considerations (dividend paying stocks --> fixed income). I think speaking our mind and acting accordingly is not only prudent but also points to our genuineness and frankness in helping the investor and putting their needs ahead of ours.

Here's how our assessment of broader market dynamics came into play with dividend-paying Ennis (EBF), the latest November income idea. In light of the rising 10-year Treasury yield and the rapid bounce in shares as a result of market optimism related to the Trump victory, if the market is handing us Ennis or any stock for that matter at a large annualized gain, certainly we must consider locking it in as a prudent measure. No stock is ever a perpetual buy and no stock is ever a perpetual sell. Fundamental changes may be reason to remove a stock, but the price is an important reason, too (for example, Apple at $1,000,000 per share may be a terrible investment, but Apple at $1 per share may be an excellent idea, all things equal -- price will always be an important consideration, from our perspective).

In many ways, in today's frothy market conditions, we're taking what the market gives us, and a 10%+ spike in Ennis in one week was fantastic. We're not being greedy, but if we can capture two years' worth of dividends in one week -- how great that must be even for an income investor! Of course, there are four more income ideas released previously in the Exclusive, and even more to come. Two of them have already raised their dividends, one for the 46th consecutive year and one by a 10%+ clip in just the past few weeks. All of them have substantial dividend yields.

We're not a short-term trading service, and while I understand that the Ennis idea turned into a trade, we are looking for all of our ideas to work out for members (even if this may be unachievable) -- the time horizon (and the stock price) may be perhaps the biggest determinant as to whether an idea is a good one or a bad one. Also, please remember a forecast of future free cash flows long into the future still impacts the stock price today. Future free cash flow expectations 5, 10, 15 years from now and beyond impact buying and selling decisions today, which impact the stock price today. Free cash flow analysis will continue to be vital regardless of what time horizon one prefers. We're not a short-term trading service, and we continue to surface many long-term ideas (the vast majority), even as we take the chance to capitalize on opportunistic market movements.

Please let me know if I can elaborate on anything further.

Looking for Longs to Rally

This note was originally released to members by email, November 12, 2016.

"The income ideas are delivering where it counts, we'll be looking for the long ideas highlighted for capital appreciation to rally once ancillary dynamics settle, while the short considerations have been doing quite well."

Positions closed for gains thus far: Ennis (income), Bloomin' Brands (capital appreciation), GoPro (short), Lloyds Banking Group (short). See note as follows. [Positions in Lands' End and Vivint Solar were closed subsequent to this note, December 2.]

By Brian Nelson, CFA

What a week last week was! The "Trump rally" was a nice shot in the arm to the markets! As most market participants continue to celebrate, the broader market themes remain the same: valuations are still stretched and the risks of rising Treasury yields on dividend-paying stocks and Eurozone uncertainty on global economic growth are still running rampant. Nevertheless, optimism of a new, business-friendly President reigns supreme, "Assessing Reactions to Trump's Victory."

Let's chat a bit. The self-imposed shackle that limits Exclusive ideas to ones that fall outside Valuentum's vast 1,000+ stock coverage universe may be the publication's most valuable add-on attribute (source of value), but you should know that the limitation itself, a driver of incremental ideas above and beyond, can often act as a handicap as we seek ideas beyond the "low hanging fruit" (i.e. beyond those in the newsletter portfolios and at www.valuentum.com).

Even without such a self-directed handicap, however, the Nelson Exclusive has a bar that is set mighty high in light of the strong performance of the newsletter portfolios prior to its launch. To offset the hazards that come with venturing outside our coverage universe, we strive to deliver on analytical depth in our work such that readers can make the most informed decision with respect to each new idea released in the Exclusive. Some ideas may be of interest, while others may not. Though the markets have been relatively flat the past 12-18 months, only more recently catching a bid, I think the Nelson Exclusive is delivering on what it has set out to do.

Let's start with the ideas we've surfaced thus far for income generation, meaning ideas that we think have a strong combination of dividend yield and dividend growth prospects, and then we'll move to those surfaced for capital appreciation, and then to short considerations. The July income idea Universal (UVV) yields ~4%, and on November 8, the tobacco leaf supplier announced its 46th consecutive annual dividend increase, to $2.16 per common on an annualized basis. We view this strong dividend payer that has just raised its dividend in a positive light as an income idea, the context in which the company was highlighted.

On November 4, the August income idea B&G Foods (BGS) raised its dividend a whopping ~11%, to $1.86 per common on an annualized basis, now implying an outsize ~4.6% yield. B&G Foods' stock has been under selling pressure the past couple months, and while I don't like it either, it is another example of a high-yielder raising its dividend, or what we set out to identify when the stock was highlighted as an income idea. Certainly a weaker core business in its third-quarter report and arguably its association with manufacturing in Mexico in light of a Trump victory are two reasons for the sell-off (its debt load and its financing strategy may be two others), but that it makes 30% of its Green Giant products in Irapuato, Mexico, should help margins considerably as labor costs in Mexican pesos weaken. Margins could surprise to the upside in coming periods.

The income ideas for September and October, Maxim (MXIM) and Douglas Dynamics (PLOW), currently yield ~3.4% and ~3%, respectively, and are roughly flat, though news of insider buying at Douglas Dynamics more recently was very welcome. The November income idea Ennis (EBF) is up nearly 12%, and we're alerting you today (November 12) that we're taking what was once an intermediate-term idea off the table in what is now a "trade" for a very nice annualized gain (605%). We talked about how we think about time horizons in a previous letter to you and how we're taking what the market gives us and not being greedy. Ennis is a prime example of how strong performance in just a matter of days or weeks can truncate our original time horizon. We let the market tell us when it's time to take profits.

As it relates to income ideas thus far, Universal and B&G Foods are doing what they do best, raising their respective payouts, Maxim and Douglas Dynamics are roughly flat, and we caught a nice updraft on Ennis which has made taking profits in such a short time the right thing to do. Remember - the Exclusive ideas are not a portfolio of ideas like the Best Ideas Newsletter and Dividend Growth Newsletter, so when we have time to cash in on winners quickly, we will. We think measuring our ideas on realized annualized gain is the best way to do so, and for Ennis the measure is substantial. We'll continue to be as transparent as possible so you can assess our performance in any way that you'd like.

Let's now move to ideas that were surfaced for capital appreciation. We're starting to get a feel for the time horizon that ideas may begin to turn north in light of many market participants trading on the information in the months that follow, and it looks like that consideration might be measured in many months, instead of weeks. For example, our very first idea highlighted for capital appreciation, the one in the July edition, Bloomin' Brands (BLMN), has now finally advanced to the tune of 8% since it was profiled. To really hit the contingent time horizon and profit-taking dynamics home, we're going to close out this position (November 12), too, for an annualized gain of ~22%.

Several ancillary dynamics may be impacting the other capital-appreciation ideas highlighted in the Nelson Exclusive. It may be business as usual for August idea Healthcare Services Group (HCSG), from what we can tell, with the company raising its quarterly dividend for the 53+ consecutive quarter (yes, quarter) October 11, but Trump's influence on Obamacare may impact its end market, though we don't expect material reverberations on its business dealings in any case. Significant currency weakness in the Mexican peso has impacted airport operator Grupo Aeroportuario's (ASR) equity even if weakness in the Mexican peso is a boon for incremental air travel into vacation destinations. We think shares have overreacted on a fundamental basis, and we expect some stabilization in the Mexican peso as Trump pulls back some of his harsh rhetoric.

A strengthening dollar may also be the reason for near-term weakness in shares of October idea Swedish Match (SWMA.ST), but recent California tax legislation on cigarettes, a state cigarette tax of as much as $2.87 per pack, may actually aid the snus maker, perhaps acting as a catalyst for consumers to seek alternatives to smoking. A weaker-than-expected quarter at rival International Flavors & Fragrances (IFF) has likely weighed on November idea Symrise (SYIEY), but we think the latter is actually taking market share as it continues to grow faster than the overall flavors and fragrances market. That we're taking profits on Bloomin' Brands, the first capital appreciation idea highlighted, and that the remaining four ideas thus far have been touched by regulatory/currency issues rather than any firm-specific dynamics, should be viewed in a positive light.

Now let's move to the short considerations, which in my view have been simply awesome, punctuated by October idea GoPro (GPRO), which we locked in at a 33.3% gain, or 400% annualized. Shares of GoPro have even kept falling. September idea Lloyds Banking (LYG) was locked in at a ~16% gain, or 96% annualized, while August idea

(SHLD), however - July idea Lands' End (LE) and November idea Seritage Group (SRG) -- are trading modestly above our highlight price, largely because of the backing by Eddie Lampert and Warren Buffett, respectively, in our view, as fundamental performance at both of them remains terrible. The short considerations have been the biggest source of outperformance thus far in ideas highlighted in the Nelson Exclusive.

We're not going to get everything right, but to instill confidence in our process, we've now taken meaningful annualized profits on ideas across all three categories, two (now four) with respect to short considerations (just 5 months in!). Certainly, we're not ecstatic about how all ideas have performed, but we're not disappointed either. The income ideas are delivering where it counts, we'll be looking for the long ideas highlighted for capital appreciation to rally once ancillary dynamics settle, while the short considerations have been doing quite well. The ideas surfaced in the Nelson Exclusive cannot be viewed as a portfolio of ideas, and not all may be right for you in light of varying needs and risk tolerances across our membership, so be sure to check with your financial advisor if any of the ideas are right for you.

Your satisfaction is my top priority.

My continued best wishes.

Kind regards,

Brian Nelson, CFA
President, Investment Research & Analysis
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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.

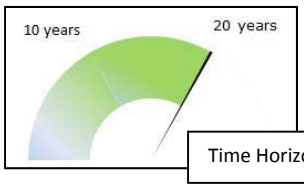
Highlights:

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

Watsco (WSO)

"Watsco has paid dividends for over 40 consecutive years. The Company's philosophy is to share increasing amounts of cash flow through higher dividends while maintaining a conservative financial position. Watsco recently instituted a 24% increase in its annual dividend rate to $4.20 per share. Future increases in dividends will be considered in light of investment opportunities, cash flow, general economic conditions and the Company's overall financial condition. From 2000 to 2015, Watsco's operating cash flow was approximately $1.6 billion compared to net income of approximately $1.5 billion, surpassing the Company's stated goal of generating cash flow in excess of net income." -- Watsco 8-K Oct. 25, 2016

Thesis

Being comfortable is high on most peoples' priority list, and, depending on your interpretation of the difference between physiological and safety needs, maintaining physical comfort is near the base of Maslow's Hierarchy of Needs. Such a priority is the basis of demand for Watsco's (WSO) services; the firm is the largest distributor of air conditioning, heating and refrigeration equipment in North America.

The air conditioning, heating and refrigeration distribution industry in North America is a mature one, characterized by a large number of small distributors--there are well over 2,000 distribution companies--competing intensely for market share. These distributors sell to the replacement and new construction markets for both residential and commercial applications. The residential replacement portion of the market has grown in size and importance in recent years as a result of an aging installed base of central air conditioning and heating units, the introduction of more energy-efficiency models, home remodeling and expansion trends, and the unwillingness of consumers to live without heating or cooling systems in their homes. The last point is emphasized by the fact that approximately half of energy use in the average US home is used in heating and cooling.

In addition to the above listed factors, a favorable regulatory market is driving demand in the residential replacement market. The EPA's planned phase out of R-22 Refrigerant, a formerly commonly used refrigerant that has been discovered to be detrimental to the ozone layer, is helping push air conditioning system replacement demand

Corporate Profile

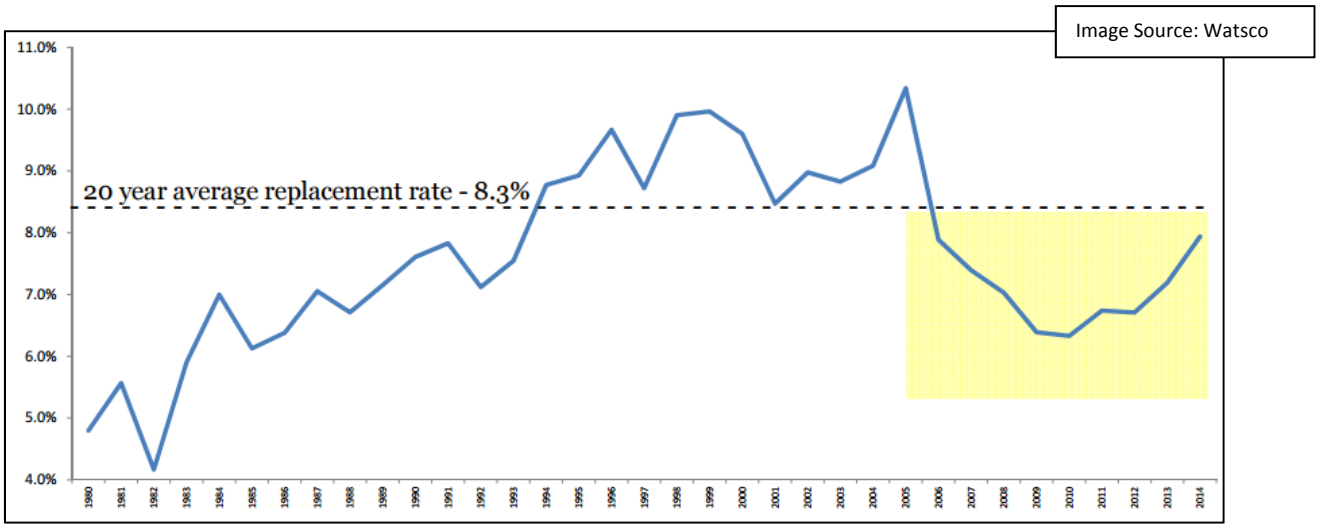
Watsco is the largest distributor of air conditioning, heating and refrigeration equipment and related parts in North America. As of September 30, 2016, the firm operated ~570 locations in 37 US States, Canada, Mexico, and Puerto Rico with additional market exposure to Latin America and the Caribbean via exports. The company was incorporated in Florida in 1956 and is headquartered in Miami.

Image Source: Watsco

Key Statistics	
Last Close	$150.57
52-week range	$106.58 - $152.34
Market Cap	$4.88 B
Avg Daily Vol (30 wks)	171,027
Annual Dividend Yield	2.79%
Trailing Dividend Payout Ratio	57%
Trailing P/E	30.7
Net Debt (LFY)	$211 M
Net Debt/EBITDA (LFY)	0.6x

higher. Ongoing increases in national requirements for seasonal energy efficiency ratios in heating and cooling systems should benefit the replacement market as well.

A solid position in the replacement market provides a degree of stability to Watsco's operations. The firm estimates that 65%-70% of its sales come from replacements, while only 10%-15% of total sales are derived from new construction. Watsco's overall addressable replacement market continues to trend higher since the Great Recession, but the annual replacement rate as of 2015 remains below the 20-year average of 8.3%. The air conditioning segment of the US market is even more attractive in terms of its replacement cycle as Watsco estimates that replacements currently account for approximately 85% of total units. Shipments of central air conditioning units in the US have advanced at a healthy 4% compound annual growth rate since 1980, a pace that is expected to continue based on 89 million central air conditioning and heating systems currently installed in the US that are over 10 years old.



Despite the long-term evidence supporting a stable growth environment, Watsco is not immune to short-term fluctuations in demand. Its performance can be impacted by weather, specifically mild summers and winters in select regions, and there is a degree of seasonality in its operations. Demand in a large portion of its residential markets peaks in the second and third quarters of the calendar year, which has the potential to make quarterly performance comparisons more difficult.

In addition to its exposure to the elements, Watsco is subject to a concentrated supplier base. It made ~84% of total purchases in 2015 from its top ten suppliers with 62% coming from Carrier (UTX), with which it has three joint ventures, and 9% from Rheem. Any material disruption in the firm's relationships with these suppliers has the potential to disrupt, at least temporarily, its financial performance.

The first of Watsco's three joint ventures with Carrier, a subsidiary of United Technologies, was formed in 2009, with the other two created in 2011 and 2012, respectively. The agreements were made as a strategic decision to enhance Watsco's positioning in the North American HVAC/R market through improved ease of access to Carrier's products, as well as an augmented scale advantage. Wastco now owns 80% of Carrier Enterprise I, 70% of Carrier Enterprise II, and 60% of Carrier Enterprise III after purchasing an additional 10% ownership interest in Carrier Enterprise II in November 2016. Combined, these three joint ventures accounted for 62% of Watsco's 2015 revenue.

Though Watsco's joint ventures with Carrier have increased its dependence on the supplier, it has also boosted its scale advantage in a highly fragmented market. Advantages that come with increased scale for Watsco include greater resources to attract top-level talent, more locations and SKUs, strategic and efficiency advantages, and the ability to develop and employ cutting edge technology at an industry leading pace. The firm's technology initiatives include the development of mobile apps to help customers operate and interact with distribution locations more efficiently, enabling connectivity with suppliers, enhanced e-commerce management tools, the building of the largest digital HVAC/R product information source, and other efficiency and supply chain initiatives. There is clearly upside potential for the firm in terms of using technology to enhance its operations.

Despite its long wish list of technological and efficiency improvements, Watsco has done well in improving margins in recent years. Gross margins have improved to 24.5% in 2015 from 24% in 2013, while operating margins expanded to 8.2% from 7.2%. The firm plans to continue improving margins by prioritizing the higher-growth, higher-margin replacement markets in which it already operates, as opposed to business related to new construction.

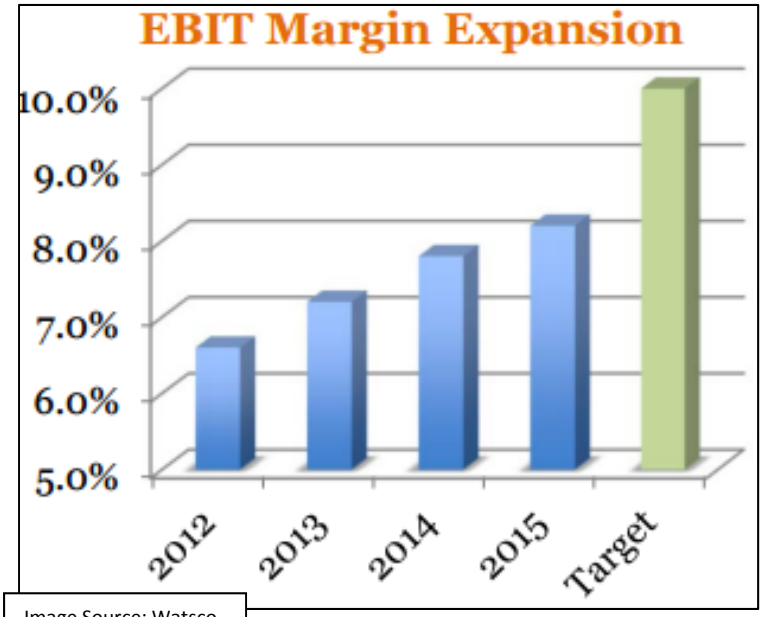


Image Source: Watsco

We like management's focus on margin improvement and what it means for the firm's dividend growth potential. Watsco already has a rich history of paying dividends, having paid a dividend for over 40 consecutive years. There is

a blip on its track record after management decided to pay a $5 per share special dividend in late 2012 and reduce the quarterly payout for the following two years as a result of uncertainty regarding federal tax implications on dividends. We're not worried about it though.

Since the reduction in the regular quarterly dividend in early 2013, Watsco has hiked the payout in a big way multiple times, most recently a 24% increase in October 2016. The recent trajectory gives us confidence in management's ability to continuing improving the payout. The firm's stated philosophy regarding its dividend "to share increasing amounts of cash flow through higher dividends while maintaining a conservative financial position." It also routinely targets cash flow from operations to exceed net income, and in the 15-year period from 2000-2015, it reported operating cash flow of roughly $1.6 billion compared to net income of ~$1.5 billion. Such an achievement is a display of the high-quality nature of Watsco's earnings, a huge positive for a dividend payer.

Image Source: Watsco

(in thousands, except per share data)	2011	2012	2013	2014	**2015**
Revenues	$ 2,977,759	$ 3,431,712	$ 3,743,330	$ 3,944,540	**$ 4,113,239**
Operating income	199,050	224,908	271,209	305,747	**336,748**
EBITDA[1]	210,775	240,819	288,915	323,674	**355,865**
Net Income attributable to Watsco, Inc.	90,450	103,334	127,723	151,387	**172,929**
Diluted earnings per share	2.74	2.70	3.68	4.32	**4.90**
Adjusted diluted earnings per share[2]	2.74	3.03	3.68	4.32	**4.90**
Dividends per share	2.23	7.48	1.15	2.00	**2.80**
Operating cash flow	61,452	173,343	150,269	144,980	**221,383**
Total assets	1,268,148	1,682,055	1,669,531	1,791,067	**1,788,442**
Long-term obligations	—	316,196	230,557	303,885	**245,814**
Shareholders' equity	1,001,710	1,022,040	1,127,392	1,132,039	**1,203,721**

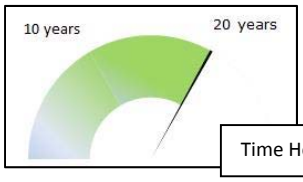
Such high quality earnings have resulted in solid dividend coverage for Watsco. Free cash flow has averaged over $150 million in the past three years (2013-2015), well in excess of annual run-rate cash dividend obligations of just under $100 million, and the firm's meager net debt position, ~under $185 million as of September 2016, keeps its net debt-to-annualized EBITDA ratio at a healthy 0.5x. It is worth noting that the company is acquisitive, though the majority of its acquisitions are rather limited in size. Watsco has made 59 acquisitions since 1989, and management can be expected to continue evaluating the competitive landscape for potential tuck-in acquisitions as it works to expand market share in its highly-fragmented industry.

Watsco's payout has strong ties to ownership. Chairman and CEO Albert Nahmad owns 52% of aggregate voting power in the company, which means the income received via dividend checks are very substantive to management. Such a high level of 'skin in the game' should be comforting to income investors to a degree, as it is likely that the strategies Mr. Nahmad pursues will benefit the payout of a healthy and robust dividend. Ultimately, we would like to see the roles of CEO and Chairman separated for corporate governance purposes, but we have a hard time envisioning a scenario in which Mr. Nahmad would give up a material portion of his quarterly income without a fight.

Though we love the income potential associated with shares of Wastco, they are changing hands at relatively lofty multiples, more specifically ~26x consensus estimates for 2017. A lofty multiple is never welcome news, but the fact that Wastco routinely converts more than 100% of earnings to free cash flow softens the blow to a degree and is a decent reminder that not all P/E ratios are created equal.

Due to the stable growth dynamics present in the HVAC/R replacement market and our opinion of Watsco's potential to grow the yield in a material way, we are assigning this idea a long-term time horizon. Nevertheless, the position will be constantly evaluated, and any opportunity to secure material profits, or any changes to our long-term thesis surrounding the company could result in a changing in our opinion and therefore our position.

Kris Rosemann contributed to this article.



Time Horizon: Long-term

Tootsie Roll (TR)

"The 116-year-old company, run by one of America's oldest CEOs, has become increasingly secretive over the years, severing nearly all of its connections to the outside world. Tootsie Roll shuns journalists, refuses to hold quarterly earnings calls, and issues crookedly-scanned PDFs for its earnings releases. The last securities industry analyst to maintain coverage of the company stopped last year because it was too hard to get information." – Tootsie's Secret Empire, Wall Street Journal, August 22, 2012

Thesis

Who knew Tootsie Roll (TR) was such a mystery?

Located just a few miles from where I grew up in the south suburbs of Chicago, I never knew Tootsie Roll marched to the beat of a different drum. The company continues to be a modern-day Willie Wonka factory, as the *Wall Street Journal* article would go on to say, and it simply brings a smile to my face pondering the age-old question: How many licks does it take to get to the Tootsie Roll center of a Tootsie Pop?

That commercial…

Image Source: Tootsie Roll

Corporate Profile

Tootsie Roll has been making candy for nearly 120 years. Some of its brands including the legendary Tootsie Roll and Tootsie Roll Pop, Blow Pop, Cella's chocolate covered cherries, Dots, Crows, Junior Mints, Charleston Chew, Sugar Daddy (Babies), and beyond. The company is based in Chicago and is controlled by the Ellen Gordon family. Its market capitalization is ~$2.3 billion.

Image Source: TootsieRoll

Image Source: TootsieRoll

In case you were wondering, here are three independent studies that dig into that question that Tootsie Roll so proudly includes on its website. How fun:

> Purdue University
> A group of engineering students from Purdue University reported that its licking machine, modeled after a human tongue, took an average of 364 licks to get to the center of a Tootsie Pop. Twenty of the group's volunteers assumed the licking challenge-unassisted by machinery-and averaged 252 licks each to the center.
>
> University of Michigan
> Not to be outdone by a Big Ten rival, a chemical engineering doctorate student from the University of Michigan recorded that his customized licking machine required 411 licks to reach the Tootsie Roll center of a Tootsie Pop. (411-364. Go Blue!)
>
> Swarthmore Junior High School
> Rejecting the notion that one needed active college status to undertake the Tootsie Pop licking challenge, a group of junior high students at Swathmore School used human lickers, reporting an average of 144 licks to reach the center of a Tootsie Pop.

Tootsie Roll is quick to add on its website: "Based on the wide range of results from these scientific studies, it is clear that the world may never know how many licks it really takes to get to the Tootsie Roll center of a Tootsie Pop." I think Mr. Owl knows.

With all of that fun out of the way, let's now focus on the investment thesis. There are four primary reasons why Tootsie Roll made it into the December 2016 edition of the Nelson Exclusive. First, I like that Tootsie Roll isn't well covered by analysts, which may offer opportunities relative to more widely-followed equities in the confectionary space. Second, its financials are solid, and I love that it has both a net cash position and is substantially free cash flow positive; most of its consumer-staple rivals have large net debt positions. Third, this is the type of company that I could see Warren Buffett buying, or scooped up by another confectionary giant. Fourth, in light of the company's financials, Tootsie Roll could experience phenomenal dividend growth in coming years should it turn up the gears, a capital allocation decision that could be a strong catalyst for shares.

The story of Tootsie Roll begins in 1896 when, according to the company, a poor Austrian-immigrant Leo Hirschfield invented the Tootsie Roll and named it for his daughter, selling the new hand-rolled candy for just one penny at the time. Tootsie Roll has been a staple in Americana, supporting America's troops throughout history--not only in World War I, but also from 1942-1945 when the Tootsie Roll was a part of World War II G.I. rations, offering a nice boost of energy to service men and women when needed. Tootsie Rolls are so heavily ingrained in American culture that it is even said that Frank Sinatra is buried with them! Mr. Owl was born in 1970, and even has his own Twitter handle at @MrOwl, and this age-old company, while secretive, is all over the world of social media with millions of 'page likes' across its brands.

Image Source: Tootsie Roll

The company points to the caliber of its people, efforts to run a trim organization, and investments in the latest and most productive equipment as differentiating factors, but other confectionary giants and even new entrants embrace and execute on these dynamics, too. Complicating matters is that the confectionary space is ultra-competitive and making candy isn't really that difficult. Therefore, it becomes critically important for confectionary entities to capture the customers' mindshare and find a way to get the candy in front of the consumer. Well, ironically, the two biggest competitive advantages that Tootsie Roll has going for it, in my opinion, address both of these considerations: its portfolio of established brands and its formidable distribution network, where channels expand into more than 75 countries.

Tootsie Roll has been successfully marketing its candies to every generation since the latter years of the 19th century, and even Mr. Owl, who is approaching 50 years' old, still resonates with older millennials, as something nostalgic that they watched on television when they were younger. Marketing its brands to new customers will always be a constant challenge, but Tootsie Roll has the experience, know-how and the all-important Halloween selling season as a reminder for consumers every year. Its candies can be found just about anywhere consumer goods are sold, and the company's distribution network would be nearly impossible for a start-up to replicate with much success. Tootsie Roll is a "moaty" company, as Warren Buffett might say.

Let's now talk financials. Though Tootsie Roll has had its ups and downs in recent years, 2015 revenue still tops that achieved five years ago in 2011, and product gross margins have expanded to 36.6% from 30.9% during the same time. That's simply remarkable for a candy company to improve upon margins by this magnitude in recent years, and we expect product mix, pricing, ingredient cost, and productivity improvements to all have played a role in the enhanced profit showing. Net earnings attributable to Tootsie Roll leapt ~50% over this 5-year look-

Image Source: Tootsie Roll

(Thousands of dollars except per share, percentage and ratio figures)

	2015	2014	2013	2012	2011
Sales and Earnings Data (2)					
Net product sales	$ 536,692	$ 539,895	$ 539,627	$ 545,985	$ 528,369
Product gross margin	196,602	198,962	188,667	180,412	163,144
Interest expense	76	99	92	137	121
Provision for income taxes	26,451	28,434	23,634	22,160	16,974
Net earnings attributable to Tootsie Roll Industries, Inc.	66,089	63,298	60,849	52,004	43,938
% of net product sales	12.3 %	11.7 %	11.3 %	9.5 %	8.3 %
% of shareholders' equity	9.5 %	9.2 %	8.9 %	8.0 %	6.6 %
Per Common Share Data (1)(3)					
Net earnings attributable to Tootsie Roll Industries, Inc.	$ 1.08	$ 1.02	$ 0.96	$ 0.81	$ 0.68
Cash dividends declared	0.35	0.32	0.32	0.82	0.32
Stock dividends	3 %	3 %	3 %	3 %	3 %
Additional Financial Data (1)(2)					
Working capital	$ 221,744	$ 200,162	$ 179,990	$ 136,476	$ 153,272
Net cash provided by operating activities	91,073	88,769	109,823	101,418	51,098
Net cash provided by (used in) investing activities	(8,523)	(30,459)	(47,963)	(40,435)	(51,157)
Net cash used in financing activities	(53,912)	(44,664)	(37,425)	(76,234)	(36,597)
Property, plant & equipment additions	15,534	10,704	15,752	8,886	16,351
Net property, plant & equipment	184,586	190,081	196,916	201,290	212,162
Total assets	908,983	910,386	888,409	846,737	857,856
Long-term debt	7,500	7,500	7,500	7,500	7,500
Total Tootsie Roll Industries, Inc. shareholders' equity	698,183	690,809	680,305	649,815	665,935
Average shares outstanding	61,441	62,358	63,195	64,044	64,907

(1) Per common share data and average shares outstanding adjusted for annual 3% stock dividends.
(2) Certain reclassifications have been made to prior year numbers to conform to current year presentation.
(3) The fourth quarter 2012 includes a $0.50 special dividend.

back period, to ~$66.1 million in 2015, good enough for a 12.3% net margin (up four percentage points from 2011). Free cash flow (cash flow from operations less all capital spending) has averaged north of $80 million during the past three years (2013-2015), and long-term debt has stood at a measly and immaterial $7.5 million over this time. Cash and investments stood at more than $253 million at the end of 2015, showcasing a robust net cash position. The financials don't get much better for a confectionary player, in my opinion.

Let's now talk M&A. Sadly, long-time chairman and chief executive of Tootsie Roll Melvin Gordon, who had run the company for more than 50 years, passed away at 95 in January 2015. His wife, Ellen, whose father had been the President of Tootsie Roll for years when she was a child, is now the current chairman and CEO, herself in her 80s, making her one of the oldest (if not the oldest) chief executives of a public company. Ellen Gordon has acted as Chief Operating Officer of the company from 1978 to 2015, so she knows something about making candy and running a fantastic business. In fact, her whole life has been surrounded by these two things! In coming years, however, once Mrs. Gordon is no longer able to apply her faculties to the job, Tootsie Roll may find its hat in the M&A ring, most likely as a target, but even perhaps as an acquirer or seller of assets as new blood inevitably takes the helm.

Image Source: Tootsie Roll

Name		Number of Shares of Common Stock and Class B Common Stock Owned Beneficially and Nature of Beneficial Ownership(1) Direct	Indirect	Percentage of Outstanding Shares of Class
The Estate of Melvin J. Gordon, Ellen R. Gordon as Trustee	Common	1,629,446	—	4.4%
	Class B	1,629,446	—	7.1%
Ellen R. Gordon	Common	9,987,192	119,950(2)	27.2%
	Class B	11,044,612	44,039(2)	48.5%
Ellen R. Gordon, as a fiduciary	Common	—	6,842,331(3)	18.4%
	Class B	—	6,145,889(3)	26.9%
Leigh R. Weiner	Common	1,312,245	93,679(4)	3.8%
	Class B	2,753,204	292,826(4)	13.3%

Tootsie Roll is a financially-healthy entity with a fantastic asset base and portfolio of brands. So, who might be interested in buying the company? I think Berkshire Hathaway (BRK.A, BRK.B) is a likely suitor, but truly any consumer goods or confectionary company would love to have Tootsie Rolls' cash-flow-generating portfolio of brands under its umbrella, in my opinion. What's more, candy deals have been happening at quite the robust pace, too, from Mars buying Wrigley to legacy Kraft acquiring Cadbury to Hershey (HSY) acquiring Brookside Foods and beyond. Things also heated up during the summer of 2016 when Mondelez (MDLZ)--which owns Cadbury, Chips Ahoy, Trident gum and a number of other brands (once itself a part of Kraft)--had expressed interest in buying chocolate-giant Hershey's (HSY) assets.

Though a Mondelez-Hershey deal looks to be off the table for now, it does speak loudly about one thing. If Mondelez is on the hunt for a company like Hershey, Tootsie Roll might also be a consideration (if not by it than by others), even if the latter is a much smaller entity and perhaps not itself a big needle-mover. For comparison, Mondelez and Hershey generated $29.6 billion and $7.4 billion in revenue during 2015, respectively, while the much-smaller Tootsie Roll hauled in $536 million in sales during the same year. But Tootsie Rolls' smaller size may actually be a good thing--it means it's an easier company for an acquirer to swallow. Mondelez, for example, wouldn't have to raise much debt or equity at all to get a deal done, and while it may stretch Hershey's balance sheet a bit to gobble up Tootsie Roll, strategic reasons behind such a deal may make a lot of sense.

The point here is not that we're speculating or fantasizing about castles in the air, but rather explaining that, if Tootsie Roll should ever decide to sell itself to a larger strategic entity in the future (5, 10 years down the road or tomorrow), the company's equity could easily fetch a considerable premium to today's price – and a justifiable one, too. In light of its aging executive suite and deal talk sweeping the confectionary industry, it's more reasonable, in my view, that Tootsie Roll be valued as a take-out candidate. In a transaction with a larger suitor, for example, Tootsie Rolls' entire SG&A (~$110 million) could, in my opinion, effectively be "absorbed" by the combined entity's books -- and assuming ~$145 million in annual run-rate synergies (let's say 10% of Tootsie Rolls' cost of goods sold are also eliminated in a combination), we estimate the value of the synergies alone accruing to a larger strategic suitor--whether it be Mondelez or Hershey or other--would equate to a substantial part of Tootsie Rolls' existing market capitalization (assuming a very conservative ~10% discount rate -- $145 million divided by 10%, or ~$1.45 billion, or about 60%+ of its market cap). This may sound far-fetched, almost hard to believe, but the synergies alone may justify the deal for a larger, strategic acquirer. Optimizing SG&A spending would be the secret to making the numbers work, of course.

Okay--but what if Tootsie Roll doesn't sell out? Well, I think the company has all the makings of a fantastic dividend growth story, having already paid dividends for more than 70 consecutive years. The company's free cash flow generation alone covers its annual cash dividend payments more than 4 times by itself, and its net cash and investments on the books adds another 12+ times buffer to the annual cash dividend payment (~$250+ million divided by $20 million). Incredible. Even though we've highlighted Tootsie Roll as an idea for capital appreciation in light of its substantial value to a strategic acquirer, Tootsie Roll's dividend growth prospects are simply phenomenal. The company could effectively triple its dividend overnight and still have strong annual dividend coverage metrics with free cash flow alone (its dividend payout ratio stood at just 32% at the end of 2015). In the event of a more-aggressive dividend policy or if Tootsie Roll decided to lever up cash returns to shareholders, however, the stock could rally considerably. The company is truly a financial gem in the confectionary space.

Let's now cover the risks. There's not a lot that is going to derail Tootsie Roll, in my opinion, and it has a 100+ year history to support this view. I believe people will be eating Tootsie Rolls for the next 100 years, too, no matter the political and social opposition to sugar and sweets today. In any case, the first risk to potential investors is Tootsie Rolls' standalone valuation. The company's market capitalization less net cash stands at more than 30 times net earnings, but this isn't too different that of its peer group, including Buffett's baby Kraft-Heinz (KHC), which is trading at even a loftier multiple despite holding a massive net debt position – and that's really the big difference on a standalone basis. Where most consumer staples are trading at lofty multiples and holding massive amounts of leverage, Tootsie Roll is much more financially-conservative when it comes to its debt position. We like that a lot, and we think this helps distance Tootsie Roll from the pack.

Brand innovation is also a key risk. We mentioned Mr. Owl and its famous "How Many Licks?" theme as a reason that brings about a sense of nostalgia, even for older millennials, but presentation and package size innovation will become even more important for all of its product lines going forward in the intensely-competitive confectionary environment, not only around the all-important Halloween selling season but also in theater and retailing markets. Line extension and new product roll-outs will be part of Tootsie Rolls' future, and the company continues to be successful in this department, too. More recently, it re-launched its Tootsie Fruit Chews and added Tootsie Fruit Chew Pops to its product suite to capitalize on demand for fruit-flavored Tootsie Rolls.

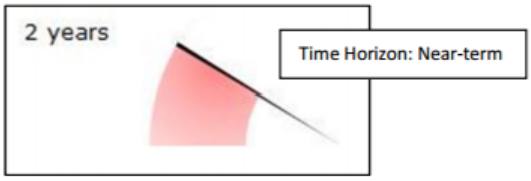
Managing commodity cost fluctuations and optimizing its supply chain will be critical to preserving the trajectory of Tootsie Rolls' margin profile. Ingredient costs have and will always be volatile, however, and Tootsie Roll has demonstrated a fantastic track record of hedging sugar, corn syrup and soybean oil needs in years past (cocoa and chocolate are other primary costs). Wal-Mart is a big customer at ~24% of sales, but we can't envision a possibility where Tootsie Roll products won't be found at its stores. Tootsie Roll also has an e-commerce presence, where candy can be bought directly from its website. Pricing pressure from competitor products is a concern, but Tootsie Rolls' brand awareness is fantastic, and while volumes may face pressure at times, we again point to margin performance as reasons to be optimistic about aggressive pricing.

As for more extraordinary considerations, the majority of the company's candy is made in a single production facility (Chicago), so there could be temporary issues in the event something impedes production at the facility. Labor stoppages are a possibility as certain of its employees are unionized, but we have no reason to believe the relationship with its workers is any cause for alarm. The funded status of its pension was ~65% as of January 2014, the latest reading we have, but strong market performance since then likely implies a much more funded proposition. We're not viewing its underfunded pension as any cause for concern.

Tootsie Roll is a controlled company, meaning that the Gordon estate effectively will decide the future fate of the company. Ellen, who is currently in her mid-80s, will ultimately have to make some tough decisions in the coming years about Tootsie Rolls' legacy. Will it be better run as part of a larger entity, should its brands be split off and sold to benefit the estate, or should dividend growth be enhanced to pave the way for decades of income for future Gordon generations. No matter what, we think the future is bright at Tootsie Roll! We hope Ellen and Mr. Buffett have a conversation, sooner than later. Berkshire will pay up for its fantastic assets, in my view.

Image Source: Tootsie Roll

Name and Principal Position	Year	Salary	Bonus(1)	Stock or Option Awards	Non-Equity Incentive Plan Compensation	Change in Pension Value and Nonqualified Deferred Compensation Earnings	All Other Compensation(2)	Total($)
Melvin J. Gordon,	2014	$ 999,000	$ 1,000,000	—	—	—	$ 1,375,406	$ 3,374,406
Former Chairman and	2013	999,000	1,383,000	—	—	—	1,377,164	3,759,164
Chief Executive Officer(3)	2012	999,000	1,383,000	—	—	—	1,411,450	3,793,450
Ellen R. Gordon,	2014	999,000	1,685,000	—	—	—	1,663,936	4,347,936
Chairman, Chief Executive	2013	999,000	1,604,500	—	—	—	1,527,731	4,131,231
Officer and President	2012	999,000	1,383,000	—	—	—	1,413,450	3,795,450
Former Chief Operating Officer(4)								
G. Howard Ember, Jr.,	2014	868,000	313,000	—	—	—	351,834	1,532,834
Vice President/	2013	847,000	293,500	—	—	—	297,561	1,438,061
Finance	2012	829,500	288,200	—	—	—	305,015	1,422,715
John W. Newlin, Jr.,	2014	999,000	408,000	—	—	—	656,429	2,063,429
Vice President/	2013	999,000	388,500	—	—	—	610,854	1,998,354
Manufacturing	2012	999,000	469,200	—	—	—	564,349	2,032,549
Thomas E. Corr,	2014	999,000	432,500	—	—	—	574,861	2,006,361
Vice President/	2013	999,000	412,000	—	—	—	531,393	1,942,393
Marketing and Sales	2012	999,000	460,000	—	—	—	478,107	1,937,107



Royal Bank of Scotland (RBS)

"The Royal Bank of Scotland Group (RBS) did not meet its common equity Tier 1 (CET1) capital or Tier 1 leverage hurdle rates before additional Tier 1 (AT1) conversion in this scenario. After AT1 conversion, it did not meet its CET1 systemic reference point or Tier 1 leverage ratio hurdle rate." – Stress testing the UK banking system: 2016 results

Image Source: Bank of England

The Royal Bank of Scotland Group plc

Table 1E Projected consolidated solvency ratios in the stress scenario

	Actual (end-2015)	Minimum stressed ratio (*before* the impact of 'strategic' management actions or AT1 conversion)	Minimum stressed ratio after 'strategic' management actions and before conversion of AT1: Non-dividend 'strategic' management actions only[i]	Minimum stressed ratio after 'strategic' management actions and before conversion of AT1: All 'strategic' management actions including CRD IV distribution restrictions	Minimum stressed ratio (*after* the impact of 'strategic' management actions and conversion of AT1)	Hurdle rate	Systemic reference point	Actual (2016 Q3)	Submit revised capital plan?
Common equity Tier 1 ratio[a][b]	15.5%	5.5%	5.8%	5.9%	6.7%	6.6%	7.1%	15.0%	Revised capital plan received and accepted
Tier 1 capital ratio[c]	19.1%	8.1%[f]	8.5%[f]	8.5%[f]	8.5%[f]			19.1%	
Total capital ratio[d]	24.7%	12.5%[f]	12.8%[f]	12.9%[f]	12.9%[f]			24.1%	
Memo: risk-weighted assets (£ billion)	243	255[f]	255[f]	255[f]	255[f]			235	
Memo: CET1 (£ billion)	38	14[f]	15[f]	15[f]	17[f]			35	
Tier 1 leverage ratio[a][e]	5.6%	2.7%	2.9%	2.9%	2.9%	3.0%	3.2%	5.6%	
Memo: leverage exposure (£ billion)	702[g]	591[h]	591[h]	591[h]	591[h]			703	

Thesis

After closing previous Nelson Exclusive short consideration Lloyds Banking Group (LYG) for a rather sizable realized annualized gain, we are now highlighting UK-bank rival Royal Bank of Scotland (RBS) as a short idea tied to similar macroeconomic dynamics.

US RMBS litigation and investigations

- May require additional provisions in future periods that in aggregate could be materially in excess of the provisions existing as of Q1 2016
- These provisions do not include potential penalties and compensatory damages imposed by US DoJ, which may be substantial

Image Source: RBS

Royal Bank of Scotland continues to be under scrutiny, and fines related to a US Department of Justice mortgage probe could be north of $10 billion. More recently it was revealed that the bank failed the Bank of England stress tests and now has to sell valuable assets to shore up its capital base.

We're not expecting a collapse in the bank's shares as with what happened during some of the big banks during the Financial Crisis years ago, but we think a weakened capital position heading into economic growth concerns in the UK as a result of Brexit and general malaise across Europe make for an ominous position.

As the pound (currency) suffers and concerns over both residential and commercial real estate prices in the UK mount, the makings of a financial crisis in the UK seem to be in place. If confidence in the UK banking system wanes considerably, as one of the weakest links, RBS' equity price may come under substantial pressure.

In any case, however, opportunities to drive earnings growth and return cash to shareholders will be limited for some time at RBS, in our view. We don't think we've heard the last of the ramifications of Brexit on the UK banking sector, a topic that has moved to the background of late.

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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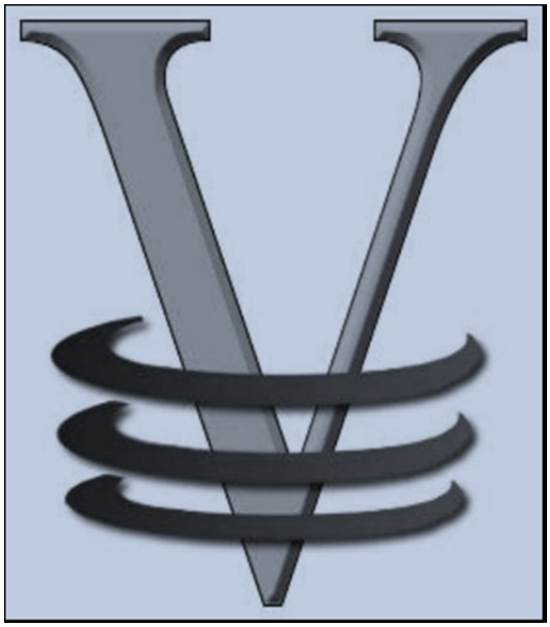

P.S. On a very personal note, I wanted to thank you for your continued support. Without you, neither the Nelson Exclusive publication nor Valuentum would exist. This fact is not lost on me. I thank you deeply.

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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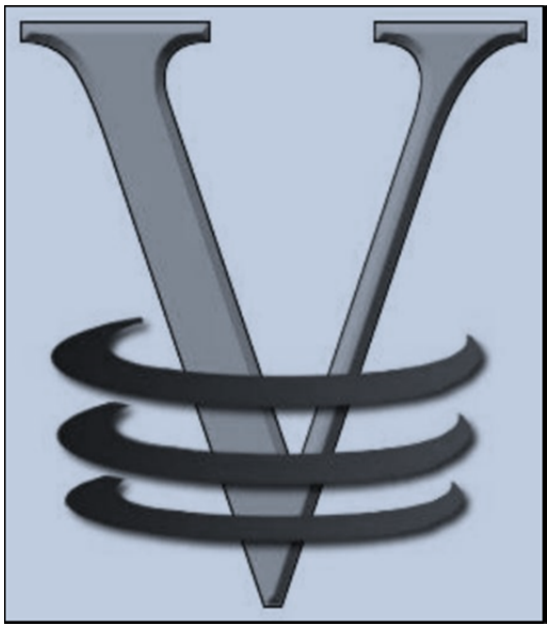

October 2016

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,

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November 2016

Dear Valued Member,

The last trading session prior to the release of this November edition of the Nelson Exclusive marked the ninth consecutive daily decline in the S&P 500 index, its longest losing streak in nearly 36 years. New ideas surfaced in this publication continue to face one of the most difficult market environments witnessed in decades, and just like an Olympic swimmer cannot achieve his best recorded time while swimming against the current, many new ideas in this publication won't immediately achieve their potential until broader market "currents" become more cooperative. Since mid-September, the S&P 500 has dropped nearly 5%, and the index now resides at levels first reached in December 2014.

Rising yields on the 10-year Treasury since May have started to complicate the long-term "yield question" for income-oriented investors as many market participants plan for another hike in the federal funds rate in coming weeks. Growing uncertainty regarding the outcome of the Presidential election (just a few short days away), looming aftershocks of Brexit (and the impact on the pound and property markets), emerging-market health (particularly Brazil and South Africa), and political badgering of drug stocks (the DOJ just announced charges against many generic pharma entities) have given even risk-seeking speculators reason for pause. The market has laid down the gauntlet for those venturing into new ideas on the long side, and under such less-than-ideal conditions, the Exclusive itself remains a bold new initiative navigating troubled waters. We continue to steer the ship with prudence and care.

The Nelson Exclusive will never be a "get-rich-quick" publication, and in light of the current challenging market environment, the time horizon we outline for each new idea continues to be of both significant importance and significant duration. In most cases, the time horizon on the ideas surfaced for income and capital appreciation consists of a number of years, sometimes much longer (decades). On the page in which each new idea is introduced, there is an image of a throttle that reveals the time horizon we ascribe to that particular idea, and we encourage readers to keep such context in perspective upon quarterly company updates. Investors judging new ideas in the Nelson Exclusive with a shorter-term outlook, one that may differ than the time horizon set forth for each idea, may not be as satisfied given how we're positioning this publication toward longer-term thinking.

That said, we're also taking what the market gives us when it gives it to us. We'll be closing the calls on two short considerations highlighted in previous editions of the Nelson Exclusive, Lloyds Group (LYG), highlighted in September, and GoPro (GPRO), highlighted in October. Though uncertainty continues to rein supreme about the magnitude of the fallout on the UK economy as a result of Brexit, the market is handing us a winner in Lloyds Group, and we're going to take the opportunity to lock in gains on this short consideration, which has fallen in price to $2.78 per share from $3.31 per share when it was originally highlighted. We're also taking off the table short consideration GoPro, whose equity price has fallen even more aggressively in the past few weeks, from its highlight price of $16.68 to $11.12, a gain on the short side of more than 30%. It's good to get a few big winners underneath our belts, particularly in a market that remains very unforgiving.

But how should we measure performance of ideas in the Exclusive? Since ideas in the Exclusive are not

constructed in a portfolio like those housed in the newsletters and should not be viewed collectively as a portfolio, grouping and assigning arbitrary equal weights to the stocks in a portfolio to tally performance would make very little sense, in my opinion. There is also the idea of unrealized gains/losses on income-oriented positions, ideas that have been highlighted on their merits for a combination of income and/or dividend growth rather than on their prospects for capital appreciation. How might one assess these ideas? For example, August income idea B&G Foods' (BGS) stock price has come under pressure, but the company just raised its quarterly dividend 11% on November 4, to $0.465 per share. *This was great news for income investors. How do we capture this in a performance metric?*

Then, of course, how should we think about the performance of stocks with longer-term time horizons such Bloomin' Brands (BLMN) and Healthcare Services Group (HCSG), two ideas for capital appreciation, highlighted July and August, respectively? Should unrealized gains/losses accumulated over a few short months on these ideas be included in a performance measurement? I think doing so would make little sense. Then there's the idea of giving credit to ideas that work out on a more-timely basis, as in the case of the October short consideration GoPro, which has fallen considerably in just a few short weeks. With this now-closed idea, investor capital had not been tied up for long at all, so a strong argument can be made to use realized annualized gains to reflect the enhanced capital efficiency.

Here's what I think makes the most sense in light of all these considerations. First, we'll emphasize complete transparency, so you can judge our performance in any way that you want. Second, we'll offer our opinion of how we assess our own performance. In my view, the performance of ideas surfaced in the Nelson Exclusive should be assessed at the time when we either close the "call," as in the case of Lloyds Group and GoPro, or when the time horizon of the idea expires, with performance calculated on a realized annualized return basis averaged throughout the portfolio. This thinking may evolve over time, especially when it comes to how to evaluate income ideas (since they are not added for capital appreciation), but I think it is a great place to start.

Further, I think it helps to encourage long-term thinking, where appropriate, and particularly in today's difficult market. For example, when I think about the long-term income that can be generated from Universal Corp (UVV), or Bloomin' Brands' valuation upside in light of precedent transactions, or Healthcare Services Group link to very favorable demographic trends, or Grupo Aeroportuario's (ASR) expansion potential in Mexico, a long-term investment perspective just makes sense. What doesn't make sense, however, is evaluating long-term theses over a short couple of months, or evaluating short-term ideas over many years. *The time horizon matters.* The table at the top of the following page will help us get started on performance tracking.

Let's now cover some recent developments at previous ideas.

Food products' company B&G Foods experienced some troubles with its base business performance during the third quarter, report released November 4, but where weakness resided management seemed to have a good explanation (almond prices, currency exchange rates, pricing issues, timing related, and so on). Though we're still not crazy about its debt load, B&G Foods' financial strategy remains intact: leverage the equity market's appetite for yield with new issuance to use proceeds to scoop up key brands like Green Giant while paying down debt. It's not their stated strategy, of course, but it's how we interpret it, and we hope the market remains open to new share issuance. The company's Mama Mary's pizza crust business, Bear Creek single-serve cups, and Green Giant performed well, and while B&G Foods trimmed its 2016 sales outlook slightly, the company raised its adjusted EBITDA guidance for the year.

	Company Name (symbol)	Highlight Price	Current Price	Dividends Received	Realized Gain	Realized Annualized Gain	Time Horizon
	Income						
Jul	Universal Corp (UVV)	57.74	53.35	1.06	-	-	30 yrs
Aug	B&G Foods (BGS)	51.54	41.60	0.42	-	-	2 yrs
Sep	Maxim Integrated (MXIM)	41.12	38.95	-	-	-	10 yrs
Oct	Douglas Dynamics (PLOW)	31.94	26.50	-	-	-	20 yrs
Nov	Ennis Inc. (EBF)	14.60	14.60	-	-	-	5 yrs
	Capital Appreciation						
Jul	Bloomin Brands (BLMN)	17.87	16.91	0.07	-	-	20 yrs
Aug	Healthcare Srvs Group (HCSG)	38.91	34.80	0.184	-	-	20 yrs
Sep	Grupo Aeroportuario (ASR)	157.87	151.40	-	-	-	20 yrs
Oct	Swedish Match (SWMA.ST)	314.80SEK	302.2SEK	-	-	-	20 yrs
Nov	Symrise AG (SYIEY)	16.25	16.25	-	-	-	20 yrs
	Short Consideration						
Jul	Lands' End (LE)	16.76	15.85	-	-	-	2 yrs
Aug	Vivint Solar (VSLR)	2.94	2.85	-	-	-	2 yrs
Sep	Lloyds Banking (LYG)	3.31	2.78	-	16.0%	96.1%	Closed
Oct	GoPro (GPRO)	16.68	11.12	-	33.3%	400.0%	Closed
Nov	Seritage Group Properties (SRG)	44.31	44.31	-	-	-	5 yrs
	Average Realized Annualized Gain %					**248.0%**	

Maxim Integrated (MXIM) reported results for the first quarter of fiscal 2017 October 20, and while it experienced a modest disappointment with the Note 7 smartphone cancellation, revenue was flat and free cash flow robust, the latter covering dividends paid ~1.2 times in the quarter. At the end of September, the company held~$2.27 billion of cash and cash equivalents on the books and total debt of ~$1.24 billion, good for a solid net cash position. We're huge fans of net cash positions on the balance sheet, especially attached to capital-light entities like Maxim Integrated that throw off gobs and gobs of free cash flow. Management spoke to a diverse customer base as reasons not to be concerned about the Note 7 debacle.

October income idea Douglas Dynamics (PLOW) experienced some selling pressure following its third-quarter results, released October 31, but we didn't see any reason to panic. CEO James Janik even scooped up 10,000 shares November 3 (insider buying) after the sell off and had this to say about the quarter and outlook a few days earlier:

> "When combined, our second and third quarter results slightly exceeded our initial expectations and so we are comfortable reiterating the increased and narrowed guidance we issued last quarter. We are pleased with the initial results from the Dejana acquisition and expect a strong overall performance again in 2016. While the structure and focus of the Company has changed this year, and the influence of weather has diminished, we know our fourth quarter results will still be impacted by the magnitude, timing and location of snowfall. As we look towards the winter season, we are well prepared to execute our strategy and well positioned to deliver long-term future success."

Expectations for a mild winter may have been the cause of the share-price pressure (the weather has been beautiful in the Midwest thus far, for one), but we're focused more on long-term trends than on yearly weather patterns. For example, Douglas Dynamics has hauled in free cash flow of ~$40 million on average during the past 3

years versus annual run-rate cash dividend obligations of ~$20 million. Free cash flow through the first nine months of the year has been positive, but we are expecting a big fourth quarter. The company holds a net debt position on the books, so we'd like to see free cash flow stay robust at a multiple of cash dividends paid for the foreseeable future. We'll let you know if anything changes in that department.

One of our "hidden gem" restaurant ideas Bloomin' Brands is having a rough go at it as it struggles through a difficult same-store-sales environment for restaurants, in general. Falling food prices at the grocery store coupled with changing demographic trends (millennials spending more on wearable gadgets than eating out, for example) have been headwinds. We think shares continue to be significantly undervalued, trading at just ~12.5 times the high end of the current year's guidance range, but the market won't give Bloomin' Brands any credit until it rights the trajectory of same store sales, which are expected to fall 1%-1.5% for the full year 2016. That might take some time.

Healthcare Services Group kept its consecutive quarterly dividend growth streak alive, raising its quarterly payout for the 53rd consecutive quarter October 11, to $0.185 per common. Revenue at the company has advanced 9% through the first nine months of the year, while net income has increased nearly 17%. We like the trajectory of both measures, and the leverage in the business that the pace of bottom-line expansion implies. A similar story at Swedish Match (SWMA.ST) was on display. Revenue in its third quarter report, released October 28, expanded by 9% on a local-currency basis, while adjusted operating profit jumped 11% -- and how can we forget that Swedish Match will distribute a special dividend of 9.50 SEK per share after reducing its ownership stake in STG (Scandinavian Tobacco Group) from 31.1% to 18.1%.

Our short theses on Lands' End and Vivint Solar still hold water, though Eddie Lampert continues to load up on the former while the latter seems to generally avoid a lot of the repercussions from news flow related to larger players. For example, on November 3, when prices of most solar equities, including First Solar (FSLR) and SunPower (SPWR) fell by "double-digits" in light of potential global oversupply of panels, Vivint's Solar's shares were largely unchanged. We continue to believe the end game for Vivint Solar is bankruptcy, while steady-state performance at Lands' End implies more rough sledding to come, absent interference by Mr. Lampert, of course.

As we wrap up, just a couple reminders. First, the ideas in the Nelson Exclusive are for your consideration only and are not personal recommendations. I'm not aware of your goals or risk tolerances, so I can't possibly know whether any particular idea is right for you. Only you and your financial advisor know what's suitable for you. Second, we plan to release three new ideas each month in this publication regardless of market conditions or our opinion of the future direction of the markets. This means that we may at times bring long ideas to light when the market is frothy, as arguably it is today with the S&P 500 trading at ~16.4 times forward earnings, above its trailing 5- and 10-year averages, or short ideas when the market as a whole is underpriced, which we do not believe it is today. Unlike the newsletter portfolios where we wait for a fat pitch to drive outperformance, in the Nelson Exclusive, we're swinging three times each month no matter what. As a way to communicate near-term risks to the stocks highlighted in light of such broader market conditions, however, we continue to emphasize the time horizon for ideas highlighted in the Exclusive.

I believe that's it for now, but please feel free to reach out if you have any questions. Thank you deeply for your interest and membership. I hope you enjoy this November edition of the Nelson Exclusive!

The Nelson Exclusive: Volume 1, Issue 6

The Nelson Exclusive is published monthly. Contact us at info@valuentum.com for more information.

(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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