

Winning with Quality in the Consumer Discretionary Sector

At CIC, we seek high-quality companies for long-term investment. We feel one of the clearest indicators for high-quality companies is a consistently paid and increasing dividend. Within the Consumer Discretionary sector, we begin with this ‘dividend as a marker for quality’ premise and further winnow the investment universe to a pool of high-quality, competitively advantaged business models steered by what we consider to be enlightened management teams, particularly with respect to shareholder-friendly capital allocation.

As we seek long-term competitive investment returns within the Consumer Discretionary space, our current positioning across CIC strategies can be best summed up as “Winning with Quality.” Broadly, this has resulted in investments in companies that have leading market share, strong balance sheets, and a growing flywheel of Free Cash Flow. We believe many of these companies are steered by intelligent management who reinvest in the business to further competitive advantages while returning excess capital to shareholders, principally through a gradually growing dividend stream.

Consider a handful of illustrative examples currently owned across CIC’s equity strategies: Hasbro (HAS), Starbucks (SBUX), Service Corp International (SCI), Carters (CRI), Target (TGT), Hanes Brands (HBI), and Home Depot (HD). All have superior business models, advantaged market share, and, we think, exceptionally talented management.

Hasbro (HAS) is a leading company in the \$100 Billion plus global toy industry, with roughly 10% market share driven by great brands like Nerf, Play Doh, Monopoly, and partner brands like Star Wars, Disney Princess, and Marvel, among others. Operating margins lead the industry at high teens, well above its closest competitor Mattel, which carries margins below 10%. Hasbro’s Return on Invested Capital (ROIC) has further averaged mid-teens for the past decade. Over the past ten years, Hasbro has been a continual market share gainer, particularly when judged more broadly across Hasbro’s more comprehensive addressable markets, including digital, video, and ‘Etainment,’ as well as the broader toy market. Hasbro’s recent acquisition of EOne Entertainment, a collection of TV, movie, radio, and other media assets, was poorly received by the market and came with increased leverage, providing an entry point for many CIC strategies as the market temporarily mispriced Hasbro’s stock at what we believed to be a severe discount. We think Hasbro’s continued dominance as an entertainment/toy company, blending injection-molded plastic toys with digital gaming, movies, and TV, will continue for many years. We expect this enlightened management team to pay down debt aggressively, deliver on synergy targets for the EOne acquisition, and continue its share gains in the global toy industry.

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Starbucks (SBUX) dominates the single serve coffee business with 63% share in the U.S., over double that of its next closest competition Dunkin Donuts at 29% market share. SBUX also continues to drive unit store growth and market share in China. Both markets present attractive, incremental, four-wall return on investment metrics and margins. SBUX management has recently balanced return of excess capital between share repurchase and a growing dividend, which the market has applauded. In a handful of years, SBUX will have tens of thousands of stores in the U.S. and China, both of which will drive Starbucks' ROIC higher. We think SBUX continues to be one of the most mispriced long-term global growth opportunities within the Consumer Discretionary space, with a thoughtful capital allocation balanced among shareholder-friendly endeavors like share repurchase, dividend growth, and global unit store growth.

Service Corp International (SCI) is the leading player in the North American death care industry, with nearly a 20% market share. SCI exhibits superior margins, with cemetery margins at 30%+ and funeral margins in the high 20s. SCI management has been very thoughtful with respect to well-priced acquisitions as well as opportunistic share repurchase. We expect SCI to continue to use its dominant market share flywheel to create attractive total shareholder returns for the foreseeable future. This future continues to be marked by attractive roll up and Mom and Pop acquisitions as well as further capitalization on what we view as SCI's most underappreciated asset, its dominant market share ownership of cemetery land across North America. We continue to believe the market is underestimating SCI's competitive advantage in its cemetery business, providing continued attractive entry points for several CIC strategies.

Carters (CRI) is the leading player in infant and toddler apparel, with dominant revenue share in the infant apparel market. This advantaged position has delivered solid, double-digit operating margins and 12% ROICs for many years. In the overall infant/youth apparel market, CRI has roughly 15% market share, with a leading 27% market share in apparel for 0-2 year olds, nearly four times the next largest competitor. CRI continues to drive incremental revenue growth, notably through its age-up strategy: selling more apparel to age groups 6 to 12 years old. Our entry opportunity in Carters was created by a misstep in Asia with a joint venture partner, which has since been corrected. Going forward, we expect CRI's North American retail store strategy as well as its international investments to pay continued attractive dividends. We see CRI returning to premium valuation multiples merited by its dominant market share position and continued entrenchment and advancement of that competitive advantage, supplemented by smart, shareholder-friendly capital allocation.

Target (TGT) has distinguished itself as a new world order retailer, with significant investments over the past few years in Ecommerce and omnichannel capabilities, empowering the existing Target store base as a delivery enabler to reduce shipping and freight costs for order fulfillment. In a widely diverse retail environment, we think TGT continues to distinguish itself as a retail frontrunner, with above industry comps and continued growth in market share in its five sub-segment categories: Apparel, Food and Beverage, Essentials and Beauty, Hardlines, and Home and Décor. Target's operating margins continue their long-term gradual ascent; we think they can reach high single digits. The long-term demise of the department store industry continues to be TGT's market share opportunity, and this thesis has a long half-life. TGT

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management has proven very thoughtful, particularly with respect to enabling TGT for a new digital retail world dominated by Ecommerce. Few retailers have been as aggressive and forward-thinking as Target's management with respect to Ecommerce, and we think this thesis is only gradually unfolding now. Consequently, we expect several more years of TGT outperformance relative to department store peers and many other retail peers. Our thesis that TGT will continue to distance itself from big box peers with respect to omnichannel retail suggests double-digit Total Shareholder Returns (TSRs) for several years to come.

Hanes Brands (HBI) is the leading North American underwear manufacturer, including socks, tees, hosiery, and intimates, with nearly 40% market share at big box retailers like WalMart. New management is driving revenue growth and has high global growth expectations for its Champion athleisure brand. We think the market is temporarily underestimating HBI's dominance, which over time, should result in valuation multiple expansion to historical norms after several years of relative underperformance. Additionally, HBI may have a global sleeping giant in the Champion brand. At HBI's current depressed price-to-earnings multiple, very little of this potential upside is appreciated by the market. We think HBI offers ample runway for a long-term Total Shareholder Return in the mid-double digits, enhanced by its attractive 3%+ dividend yield.

Home Depot (HD) is the leading player in the \$600 Billion North American home improvement and home renovation market, with a high-teens percentage market share in a large, growing market. Senior leadership has been forward-thinking in their investment in Ecommerce and omnichannel with industry leading comps. Return on investment capital is an industry leading 40%+, a retail unicorn. HD recently completed the acquisition of Home Depot Supply which will accelerate Home Depot's market share in the professional home improvement channel, a rapidly growing, profitable sub-segment within home improvement. Home improvement trends continue to show very strong growth characteristics, and the lack of underlying supply for new homes, despite significant demand, creates long-term tailwinds for our continued investment in Home Depot. Relative to its closest competitor, Lowe's (LOW), Home Depot continues to deliver high, same-store sales comparables, as well as superior margins and a very strong balance sheet. We think our Home Depot investment represents a bet on the best team in retail continuing to perform like the best team in retail. We like the odds for the long term, despite the strength we have enjoyed in Home Depot stock over the past five years.

The common theme among our Consumer Discretionary investments is high or dominant market share, superior business models, and thoughtful management. Our "Winning with Quality" approach to the sector has resulted in a portfolio of what we believe to be high-quality, competitively advantaged business models steered by enlightened capital allocators. Our focus on sector frontrunners: advantaged business models, outstanding management, and strong balance sheets, coupled with opportunistic purchase of these high-quality companies' stocks, we feel has delivered CIC investors competitive returns with lower risk over the past several years.

We expect many of these investments to continue to outclass the competitive set for many years to come,

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and, in several cases, we think the investment case continues to be compelling, as the market misses some clear competitive advantages and prices some companies at too-low multiples.

Going forward, we will continue to search for new frontrunners within the Consumer Discretionary sector, with a watchful eye toward outstanding management, advantaged business models and market share growers, and superior balance sheets. As these new frontrunners emerge across the broader landscape, we will seek to include them opportunistically across our portfolios within the Consumer Discretionary sector.

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