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THE SATHER RESEARCH ELETTER

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The Corona-conomy

This month's issue uncovers a fantastic opportunity for sustained, long term growth through pricing and demand.

July was a record month for the economy, and not in a good way. The United States officially reported a -32.9% drop for GDP, marking the lowest ever on record. The market, per usual, barely flinched with the new data, leaving economists and professional investors scratching their head. Questions abound—how can the stock market price every bad piece of information in, and how can it again approach all-time highs in the midst of a global pandemic? As the same theme reoccurs month after month, it seems we're in a new reality: the corona-conomy.

From the latest Retail Sales report from the Census Bureau, 6 NAICS segments are all down at least -25% YOY. While all of that carnage is taking place, there are growing revenues in other places, like garden equipment, grocery stores, and non-store retailers. Until there is a vaccine for the new virus, it seems that these trends will continue over the short term. But what if these trends are part of a larger secular cycle? With such a wide range of results in every company unfolding through earnings season, it's increasingly clear that the corona-conomy isn't fair, and is very discriminatory. And while the virus itself may one day go away, its impact will likely remain for much longer after it's gone.

Within the corona-conomy, I see at least 3 great catalysts for the stocks involved that represent secular tailwinds which are likely to stay: cloud, construction, and commodities* (excluding oil and a few others). And I see at least 3 really bad areas where the scars are likely to be permanent: retail, restaurants, and re-fuelers.

Retail, restaurants, and re-fuelers are all down YOY. It's possible that retail experiences a snap-back recovery at some point, but restaurants and re-fuelers are probably out of luck-- those are just meals and gas tanks that can't be doubled up on in the future.

With the cloud, it's obvious that the push to digital and online has been greatly accelerated, even forced, on businesses and individuals alike, all across the board. With commodities, there's early indications that the increased fiat currency spending by governments across the globe in response to the crisis is driving up the price of scarce (non-replenishable) commodities over the very long term.

Finally, there's what seems to be an unexplainable boom in the making in the residential real estate market, as low interest rates are fueling a huge demand for single family homes at the same time that the average Millennial hits prime household forming age. Of course, the construction part of the corona-conomy isn't a surprise to subscribers of this eLetter.

Back in Issue #69, I discussed the inequality of outcomes that COVID was bringing to employees across the country, and how the negative effects were disproportionately affecting consumers not likely to be high real estate spenders anyways. While at the same time, personal balance sheets and incomes have strengthened immensely in the years since the 2008-2009 financial crisis, magnifying the opportunity for determined home buyers who won't let a pesky virus disrupt their long term goals.

The stock market seems to be finally catching on. Holdings in the Real Money Portfolio shot up across the board in July, with stocks supporting a new residential construction boom like $UFPI, providing lumber, and $WHR, providing new appliances, increasing 17.6% and 25.9% in the month alone, respectively. Of course, the homebuilders themselves are finally gaining momentum again, with Model Portfolio position $PHM finally rebounding off its -35% lows and also jumping 26% in July, pushing the position up to a cost-adjusted 15.8% gain for the portfolio.

I still think there's plenty of upside in these residential construction plays, but this month I'm looking at another beneficiary—the aggregates mining industry. Unlike lumber, which is a commodity that can be quickly planted and transported to meet demand, aggregates are a commodity that are mined from quarries, and once those quarries are exhausted, a new source for the commodity must be found.

Aggregates are the raw materials that create two of the most foundational elements in construction both today and historically: concrete and asphalt. Creating concrete and asphalts requires a mixture of materials that are known as aggregates, and these primarily come either as sand and gravel, or crushed stone. Sand and gravel aren't as easy to collect as it may sound-- the sand found on beaches, for example, is too smooth.

A problem for a commodity producer, in general, is the fact that competition can be fierce and difficult to thwart, particularly when a commodity is pretty much the same in form and quality, and the greatest differentiating factor is price. One only has to look at the soybeans planted in Brazil, or the wheat planted in China, to see how a combination of a depreciating currency, coupled with very cheap labor and open trading lanes, makes competing against these producers in more developing economies much more difficult for a U.S.-based producer—which has to deal with U.S. costs of labor and equipment.

But the aggregates industry receives a very inherent, naturally nationalistic, advantage not shared by other mass produced currencies. Not only is the commodity so heavy, and thus extremely expensive to transport, but it can also be a ticking time bomb when it's transported. For example, newly-mixed concrete has 90 minutes before it needs to be poured. That means that for the time being, aggregate miners in the U.S. are pretty well insulated from foreign competition, particularly those that are oceans away. This, combined with the high capital intensity and technical know-how needed to succeed in the business, means that barriers to entry into the industry are high, and makes business strategy that much more important to stay at the helm of this lucrative industry.

Where I get most excited in the prospects of the aggregates mining business is in its trends over the very long term. While aggregates drive construction, and construction tends to be cyclical, over the long term the price of aggregates has continued to rise through various economic cycles. Take the time period from 1973-2020. The price index for Crushed Stone and Sand & Gravel increased 4.6% CAGR. Even taking construction busts and comparing them to peaks, as an example starting during a boom like Jan 1999 and ending at the worst of the economic cycle in Jan 2009, this price index still averaged a 5.12% growth per year. When you compare this to other commodities, which tend to fluctuate with supply and demand and experience their own boom and bust cycles, aggregates really stand out as a beast on its own.

But it's not just pricing that's a great long term tailwind for aggregates. Demand also tends to grow fairly consistently over the long term, perhaps a surprising revelation for an industry so dependent on construction. In fact, although total public and private construction spending as reported by FRED did slow during the years 2008-2011, the long term trend for increases in total construction spending seems to average out to around a 4% growth per year. From the peak of spending in March 2006 of $1.2T to its recent peak of $1.44T in February, the CAGR was still 1.31%, even considering it was one of the greatest housing booms and busts of all time. Both presidential candidates for the upcoming election have promised infrastructure plans which would boost construction spending without a doubt, and the long term statistics seem to confirm that construction spending is a secular tailwind and growing industry.

Combine these two factors, long term pricing growth of around 4.6% per year and demand/spending growth of around 4% per year, and the industry could grow at 8.6% a year all on its own without the help of a corona-conomy, riddled with tantalizing low interest rates, a growing migration away from offices in the city and towards the suburbs, and an influx of government spending and Fed stimulus that has to land somewhere.

The U.S. aggregate mining industry itself has the beginnings of an emerging duopoly of sorts. The two companies with the largest market capitalization are $VMC and $MLM, with the next 3 not crossing over $5B. One company does appear to be in a high growth phase and could become a contender, $SUM. The question for an investor looking at the U.S. aggregate mining industry then becomes, is there a stock that looks cheaper on a fundamental basis, or has what seems to be an inherently better business model and strategy? The answer, in my mind, is yes. That stock is Martin Marietta- $MLM.

As is prudent when considering a new industry, it pays to analyze the market leaders and compare and contrast them. While both $VMC and $MLM appear to be priced similarly, with P/E's of 25 and 21, they are in-fact priced very differently on a free cash flow basis.

Keeping discount rates and growth rates consistent, at 6% and 10% respectively, each company would have to earn FCF per share of $4.63 ($VMC) and $8.16 ($MLM) in order to maintain its current valuations in a standard discounted cash flow estimation. For $MLM, that's no problem, the company earned $10.29 in FCF per share over the last Trailing Twelve Month period, using a simple CFFO minus Capex formula. However, for $VMC, the company has never earned free cash flows that high, and in fact would need to grow FCF by 13.2% from its current Trailing Twelve Month figures to make this estimate.

Over the last 10 years, $VMC has earned a median 6.2% CAGR on revenue and a median 33.9% CAGR on EPS, while $MLM has earned 10.8% and 17.7%, respectively. From a FCF perspective, I surmise an 11% CAGR for $VMC and 9.9% CAGR for $MLM over the same 10 year time period. What I find most telling is the company's free cash flow uses, which seem to indicate a much better situation, and better decision making, for $MLM than $VMC.

Over the last 5 years, $MLM has spent $1,573 million in 2018 and $168 million in 2016 for acquisitions, which is the primary method of growth for companies at this stage of the industry life cycle for aggregates. Their most significant acquisition was the 2018 one, where they acquired Bluegrass Materials, which provided them with assets in the Middle America and South-east regions. Management reported that these new assets will provide them with 125+ years of reserves, which I estimate would bring them at least $22 billion in revenue over its life, conservatively assuming no price increases for aggregates over the long term at all.

According to my calculations, this acquisition represented a 5.7% ROIC in its very first year, again assuming no price increases. So, already at the onset, the company struck gold with a pretty modest return on its reinvested free cash flow, with serious ROIC appreciation potential as time passes, if the price of aggregates continues to rise.

Looking at $MLM's Contractual Commitments table for the next 3 years, it appears that the company will have to pay out about $792 million total from free cash flows. Assuming that cash flows don't increase for the next 3 years, which is highly unlikely, the remaining cash flows subtracting dividends and buybacks would amount to a 14.1% retention rate.

This very conservative estimate combined with the conservative 1st year ROIC estimate of 5.7% on an acquisition sums to a 0.8% contribution to growth moving forward. Combining all 3 elements for growth: 4.6% for pricing, 4% for demand, and about 0.8% from reinvestment—leaves a 9.4% growth rate.

Plugging this into the model with the TTM figures for FCF, the stock sits at about a 17% margin of safety. The company's latest earning call reported only a -0.7% revenue slowdown from COVID-19 for this essential business, making last year's cash flows a good measuring stick. The perceived reliability of the growth estimates, combined with today's low interest rate environment, also make the 6% WACC palatable.

The one glaring metric for $MLM is the P/C, at 618.6. Because debt and contractual obligations are so low over the next 5 years, I don't see the lower cash balance as an issue and am willing to adjust (x4) of the VTI to 1.0, signaling an adequate ratio for the P/C. Like with last's months VTI adjustment for $WHR, deeper analysis paints a more accurate picture than the surface level metric.

While interest rates are obviously very low today and this tends to propel home buying and building, the risks of rising interest rates are always a factor to consider as well. But, remember that the true mandate of the Fed is to control inflation at around 2% a year. Energy (especially crude oil) makes up a large portion of measured inflation, which has seen a sharp decline in demand from COVID. Additionally, the employment crises in restaurants, travel, leisure, and storefront retail create downward deflationary pressures on the economy and could delay attempts to control inflation (by raising rates).

With a P/E of 21, P/S of 2.74, and P/B of 2.43, Martin Marietta has reasonable price-based valuations both historically and absolutely. Using the $719.58 in cash from this month's deposit and $WHR sell, **Buy $MLM** [ADJ. VALUE TRAP INDICATOR = 214] for a total 4.0x size.

MODEL PORTFOLIO REVIEW

I'm selling $WHR this month after it went on a tear, up 25.9% in just the month of July. That equates to a 1,490.9% CAGR. For a company whose primary strategy for growth has been share buybacks over the last several years, the rising share price makes it harder for those to be effective. This is what good investments are for, to be sold when fairly or overvalued. **Sell $WHR**.

For investors who haven't reached 15-20 positions yet, this stock is also still a great buy: $WMK.

Special Note: The 40 Year Portfolio is a real money portfolio that tracks the stock picks made in this eLetter. Each month, $150 is deposited into my personal Roth IRA account. Then I buy the monthly stock pick 24 hours after the issue goes out.

The graph below tracks the 40 Year Portfolio with comparisons to 11% annual returns, as well as if the money were instead invested in $SPY. The reason behind 11% annual returns is because $150 a month will become more than $1 million in 40 years with 11% compounded annually.

I started the newsletter on my 25th birthday to try and reach $1 million by the time 40 years pass and I'm 65. This is the best way to align my interests with subscribers. By investing my future like this, I ensure full responsibility for the model portfolio and its results.

FAQ: Starting From Scratch

I'm frequently asked the question of which positions to buy when first subscribing to the eLetter. Say I'm doing just $150 a month. In that case, I'd just buy each new monthly recommendation as it comes out. Each new stock pick is always done at a great price. This might not be the case anymore with older stock picks.

Say I had more than that to invest, like $20k (this happened to me in 2017). I split that into 10 months ($2k), and just invested $2k each month into a new pick. After 10 months, my capital was fully deployed with a good amount of diversification.

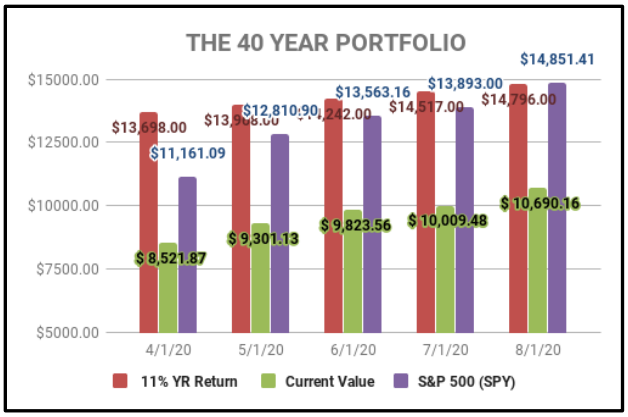
Important: The model portfolio no longer implements a trailing stop. Issue #44 has the research on this decision.

Warren Buffett likes to say "Only buy something that you'd be perfectly happy to hold if the market shut down for 10 years", and this was a lesson learned the hard way at the beginning of the life of this portfolio.

The new goal for the Real Money Portfolio will be to achieve an annual turnover rate of about 10- 20%. That equates to 1 or 2 sells per year. In the first 3.5 years of this eLetter, the annual turnover rate was 49%, less than the average of 78% but higher than Buffett's 10%. Instead of selling strictly on a price drop, every position will be re-analyzed with each released annual report. The financial condition of the business will be evaluated, and if there is a serious deterioration of that business, or the stock has greatly appreciated, then I will report a sell recommendation. Other than that, stocks will be held to ride as long as they can— ideally "forever".

All stock positions' recommended prices and dividends are averaged based on **position size** and **recommended date** to portray accurate return results.

Final Word: As a reminder, a recommended action is to call a broker and establish automatic DRIP (dividend reinvestment plan) on all positions. This ensures that dividends will be converted to shares, helping to compound wealth.



Disclosure: Portfolio subject to trading fees. $SPY used for S&P 500 difference.

REAL MONEY PORTFOLIO VALUE:	$10,690
ON PACE TO $1 MILLION IN 40Y (11%):	$14,796
ELETTER VS. S&P 500 DIFF. IN 40 YEARS:	-$1.0m

THE SATHER RESEARCH ELETTER MODEL PORTFOLIO

Company	Ticker	Rec. Date	Avg Cost	Curr. Price	Dividends	Return*	Size
UniFirst Corp	UNF	12/1/2014	$ 108.31	$ 186.48	$ 1.70	73.7%	1.0x
Cisco Systems	CSCO	2/1/2016	$ 23.48	$ 47.10	$ 5.64	124.6%	1.0x
Westlake Chemical Corp	WLK	10/3/2016	$ 98.33	$ 54.50	$ 3.46	-41.1%	4.5x
EnerSys	ENS	8/1/2017	$ 72.27	$ 67.26	$ 1.75	-4.5%	1.0x
Gentex Corp	GNTX	9/1/2017	$ 20.68	$ 26.99	$ 1.34	37.0%	3.0x
Universal Forest Products*^^	UFPI	11/1/2017	$ 37.63	$ 58.22	$ 1.18	57.9%	2.0x
Stepan Company	SCL	2/1/2018	$ 78.42	$ 109.20	$ 2.50	42.4%	1.0x
American Eagle Outfitters	AEO	2/1/2019	$ 19.65	$ 10.00	$ 0.55	-46.3%	12.5x
Tiffany & Co	TIF	6/1/2019	$ 90.62	$ 125.36	$ 2.90	41.5%	4.0x
Parsley Energy	PE	12/31/2019	$ 18.91	$ 10.98	$ 0.10	-41.4%	1.0x
PulteGroup, Inc	PHM	2/2/2020	$ 37.85	$ 43.60	$ 0.24	15.8%	5.5x
Cognizant Technology Solutions Corp	CTSH	4/1/2020	$ 46.47	$ 68.32	$ 0.22	47.5%	2.0x
Weis Markets, Inc.	WMK	5/1/2020	$ 50.03	$ 49.82	$ 0.31	0.2%	3.0x
Sanderson Farms, Inc.	SAFM	10/31/2016	$ 112.20	$ 111.50	$ 5.00	3.8%	8.0x
Whirlpool Corporation	WHR	6/30/2020	$ 129.53	$ 163.12	$ -	25.9%	(Sell) 3.0x
Martin Marietta Materials	MLM	8/1/2020	$ 207.18	NEW	$ -	NEW	(Buy) 4.0x
Dividend Fortress							**Size**
The Walt Disney Co.	DIS	2/29/2016	$ 109.27	$ 116.94	$ 6.59	13.0%	8.0x
Hormel Foods Corp*^	HRL	2/1/2015	$ 25.61	$ 50.86	$ 4.19	115.0%	1.0x
Franklin Resources	BEN	7/1/2016	$ 37.77	$ 21.05	$ 6.75	-26.4%	9.0x
*Return includes dividends							
**See trailing stop notes above							*^Stock split 2:1
***Prices as of close on July 31, 2020							*^^Stock split 3:1
Highest Closed Positions [All Time]		**Rec. Date**	**Sell Date**			**Return***	
Lam Research	LRCX	4/1/2015	9/30/2019			133.4%	
Clarcor Inc	CLC	10/30/2015	12/30/2016			67.2%	
Aaron's, Inc	AAN	1/2/2018	9/30/2019			61.7%	

As discussed in Issue 52, the goal of 15-20 stocks in a portfolio needs to include position sizing. Several stocks from the same or similar industry can be combined to represent one 5% stock position.

Note: In this table below, the total stock positions figure out of 20 refers to the number of 5% position size positions in the portfolio, which can differ from the total number of stocks.

Account Holdings July 2020 (end of)			Total Stock Positions: 18/20			Market Value	Position Size
Ticker	**SECTOR: CONSUMER CYCLICAL**	**Shares**	**5**	**Stock Positions: 5/20**	Total G/L	**$4,099.38**	**38.35%**
AEO	American Eagle Outfitters Inc	101.503			-$884.54	$1,015.03	9.49%
PHM	Pultegroup Inc	23.078			$130.71	$1,006.20	9.41%
GNTX	Gentex Corp	30.315			$189.64	$818.20	7.65%
TIF	Tiffany & Co New	6.147			$204.22	$770.59	7.21%
WHR	Whirlpool Corp	3			$97.26	$489.36	4.58%
Ticker	**SECTOR: CONSUMER DEFENSIVE**	**Shares**	**3**	**Stock Positions: 3/20**		**$1,943.44**	**18.18%**
SAFM	Sanderson Farms Inc	10.373			-$60.83	$1,156.54	10.82%
WMK	Weis Markets Inc	9.049			-$1.97	$450.82	4.22%
HRL	Hormel Foods Corp	6.608			$154.33	$336.08	3.14%
Ticker	**SECTOR: COMMUNICATION SERVICES**	**Shares**	**1**	**Stock Positions: 1/20**		**$1,196.65**	**11.19%**
DIS	Walt Disney Co	10.233			$62.15	$1,196.65	11.19%
Ticker	**SECTOR: BASIC MATERIALS**	**Shares**	**3**	**Stock Positions: 3/20**		**$1,095.79**	**10.25%**
WLK	Westlake Chemical Corp	8.333			-$286.27	$454.15	4.25%
UFPI	Ufp Industries Inc	7.161			$138.79	$416.91	3.90%
SCL	Stepan Co	2.058			$61.56	$224.73	2.10%
Ticker	**SECTOR: FINANCIAL**	**Shares**	**1**	**Stock Positions: 1/20**		**$901.47**	**8.43%**
BEN	Franklin Resources Inc	42.825			-$691.70	$901.47	8.43%
Ticker	**SECTOR: TECHNOLOGY**	**Shares**	**2**	**Stock Positions: 2/20**		**$805.26**	**7.53%**
CTSH	Cognizant Technology Solutions	7.029			$172.92	$480.22	4.49%
CSCO	Cisco Systems Inc	6.901			$147.69	$325.04	3.04%
Ticker	**SECTOR: INDUSTRIALS**	**Shares**	**2**	**Stock Positions: 2/20**		**$327.48**	**3.06%**
UNF	Unifirst Corp-Mass	1.012			$70.48	$188.72	1.77%
ENS	Enersys	2.063			-$14.54	$138.76	1.30%
Ticker	**SECTOR: ENERGY**	**Shares**	**1**	**Stock Positions: 1/20**		**$89.06**	**0.83%**
PE	Parsley Energy Inc	8.111			-$68.86	$89.06	0.83%
					CASH:	$231.63	2.17%

The table above was taken directly from my online brokerage account for the Real Money Portfolio. This was done at the end of last month's issue and doesn't include this month's stock pick. Each sector's total position size should all together add up to equal 100%.

The position size percentages will change as their stock prices change. It's best to combine these figures with the Size at cost from the Model Portfolio chart on page 5 when making decisions.

Note: You'll notice that not every stock's market value is right around $150 even if the total G/L (gain/loss) of the position is close to $0. This is because of the nature of how stocks are actually added to a portfolio. In any given month, I will try to buy as much of a stock as possible. Whatever is left over is rolled into the next month, which is why the starting market values can sometimes vary widely. It all depends on how much money was in the account at the time and at a what price a stock happened to be trading at.