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THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Tailwinds Lift Outdoor Advertising, Sales Tax Software Industries

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SECTOR — GENERAL INVESTING

TWST: Could you tell us about your role at Kayne Anderson Rudnick?

Mr. Wright: Sure. I am a Portfolio Manager of the Kayne Anderson Rudnick Long-Short strategy, as well as a Senior Research Analyst covering fintech and non-insurance financials in the small- and mid-cap space.

TWST: And do you want to provide an overview of the firm?

Mr. Wright: Kayne Anderson Rudnick is a Los Angeles-based investment manager founded in the mid-1980s by Ric Kayne and John Anderson. Today, we manage over $50 billion in assets, with strategies ranging from small cap up to large cap, in core, growth and value including strategies in international and emerging markets as well.

There is one unifying investment philosophy across all of those strategies and that's a focus on high-quality businesses. We think of high-quality businesses as being companies with a durable competitive advantage. That competitive advantage allows a company to earn attractive rates of profitability and returns on capital over a long period of time. We focus on high quality for a few reasons. Number one, it allows us to concentrate our investments and it gives us the ability to hold our investments over a long period of time.

TWST: And did you want to talk about the Long-Short strategy?

Mr. Wright: I'd be happy to. Consistent with Kayne's overall investment philosophy, which is to focus on high-quality businesses, our approach to Long-Short has that same quality filter. In the Long-Short strategy, we seek to own high-quality businesses in our long portfolio and then short the stocks of companies that we think to be of low-quality. We also believe in concentrating our investments with the long and short side, similar to what we do in our traditional long-only strategies.

We also believe in being patient with our ideas, so this is not a high-turnover strategy. We think that this approach to long/short with that quality lens is really unique compared to how others are approaching long/short strategies.

TWST: And are there different sectors represented in this strategy?

Mr. Wright: We are sector agnostic on both the long and short side of the strategy. Overall, as a firm, we tend not to have a lot of exposure to areas such as energy or utilities. Generally speaking, we have not found those to be fertile grounds for a lot of high-quality businesses. Similarly, on the short side, not a lot in the utility bucket as well. But at times we have found some opportunities in energy within the short book. Other than that, no kind of specific, meaningful over- or underweights with other sectors.

I think shorting is a topic that has garnered a little bit more attention this year than it typically has. Some stocks — like a **GameStop** (NYSE:GME) — have impacted certain funds.

By design, we avoid high short interest stocks. We don't use leverage and we don't use derivatives. We've really avoided any of those kinds of landmines and instead, it's really been a focus on bottom-up stock selection on both the long and the short side. Then, waiting to see if our thesis plays out. So that's one thing that I did want to try and drive home and make sure your readers are aware of — why we think our approach may be different than the way some other managers are doing their long/short strategy.

TWST: Is it important, too, that the fund is diversified? Would that be a fair thing to say?

Mr. Wright: It is diversified. But that is not the end all be all. In other words, we're not trying to peg ourselves to the sector weights within our benchmark, which is the Russell 3000 Index. Really, the sector weights are driven by bottom-up stock selection and not by any kind of top-down mandate as far as broad diversification.

TWST: And do you want to mention one or two of the holdings in the Long-Short fund?

Mr. Wright: Sure. I'd like to discuss a couple of companies: a sales tax compliance software company and an outdoor advertising company, both long positions, which are interesting companies, but whose experience through the pandemic last year was very different.

I'll start with the company that provides sales tax compliance software mostly to small and mid-size businesses. Its software is used to automate the calculation, collection in sales tax, use tax, excise tax, and anything with respect to taxes on any kind of sale by a business. The process of identifying different local taxes for sales transactions is specific to both the location where the item is sold, as well as the item itself. And so this requires frequent updates to ensure companies are compliant with the local tax laws. Hopefully you can appreciate it would be quite cumbersome if you're selling across all 50 states — how difficult that endeavor might be.

Just to give you an example of how complex this can be, in New York, if you buy a bagel, and you don't do anything with that bagel, it's not subject to tax. However, if you were to cut that bagel, put cream cheese or butter, or toast it — suddenly that bagel is subject to local taxes. Another example would be in Louisiana. If you buy a pre-packaged sandwich, it is not subject to sales tax. But if a retailer were to prepare that sandwich for you on premise, suddenly that sandwich becomes taxable.

There's just a myriad of these types of examples all across the United States. Depending on the service or the item, it could be subject to local taxes. And those tax laws change constantly. And so that's where this company steps in to really solve that headache for small and mid-size businesses.

Highlights

Chris Wright discusses the Kayne Anderson Rudnick Long-Short strategy, which focuses on high-quality businesses held long term. Mr. Wright believes as the economy reopens, ad dollars will come back to outdoor advertising, and adds that outdoor advertising has proven to be a low-cost and attractive means of reaching consumers that hasn't been subject to some of the disruption we've seen in other media channels. He also points to tailwinds in the sales tax compliance software space, including the U.S. Supreme Court's Wayfair decision, which says that businesses without a physical presence in a state can still be subject to state taxes. Overall, he advises caution on the part of investors, given how quickly the market rebounded after pandemic-related selling and the amount of enthusiasm that is built into price levels today for many companies.

Companies discussed: GameStop Corp. (NYSE:GME); Avalara (NYSE:AVLR); Lamar Advertising Co. (NASDAQ:LAMR); Clear Channel Outdoor Holdings (NYSE:CCO) and Outfront Media (NYSE:OUT).

Two things have happened recently that have provided a tailwind for this business. First, you have the U.S. Supreme Court's Wayfair decision, which in essence said that businesses without a physical presence can still be subject to local taxes, so long as the dollar value or the number of items sold hits a certain threshold within that state. So each state can go and determine what that threshold or economic nexus is.

Overnight, the Supreme Court allowed states to go collect taxes for online sales. You can imagine this has become a huge headache for online sellers. And then given what happened last year with the pandemic, local services were shut down and consumers started to buy more goods online — this just compounded the issue for many online sellers. And so that clearly has been a boon for the business both because of the Wayfair decision, as well as what happened due to COVID.

I would contrast that to the other company that I mentioned, which is the outdoor advertising company. Unlike competitors, this company tends to focus on smaller metropolitan areas. Think Baton Rouge, Louisiana, instead of New York City. In those local markets, this company tends to be the dominant billboard player. If you want to have an advertisement up on a local billboard or poster in these smaller markets, you have to go to this company.

And just as a quick aside, something that's unique about the outdoor billboard space is that there's a myriad of state, local and federal zoning regulations that govern where billboards can be placed. Because of these overlapping regulations, it's extremely difficult to try to erect a brand-new billboard. There are some pretty significant barriers to entry to new supply. Really, all the capital investment in the industry goes toward just renovating existing billboards and converting them into digital billboards. But no new billboards really are being erected today.

If you think about what happened last year, during the pandemic, clearly there was a pullback in advertising spending, as everyone tried to reassess what was going to happen as the economy shut down. Advertising spending is the lifeblood of the outdoor billboard market. And so that was clearly a headwind to the business, but this company did a very good job of cutting expenses.

After the onset of the pandemic, they slashed capex by roughly 70%. Again, if you're not converting billboards to digital, there's very little as far as maintenance capex costs for existing billboards. You can toggle capex pretty quickly. So as a result, even though revenue was down last year — double digits — the company actually was able to generate more free cash flow in 2020 than they did in 2019, even though, again, the top line was pressured due to the pullback in advertising spending from COVID.

As the economy starts to reopen, clearly better times are ahead for the industry as ad dollars come back into the market. More importantly, with respect to billboards, they're not subject to some of the negative impacts hurting other types of media — cord cutting, ad skipping, etc. If you think about billboards, you can't close your eyes

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when you're driving or walking, so you're kind of forced to see these ads. That's why ad dollars continue to go towards this channel versus others — say local TV stations or print media.

And so we think that longer-term trend, plus the economy reopening, plus potentially the success of programmatic advertising in the outdoor advertising space — they all present some potential nice tailwinds for this industry and also for this company.

TWST: And with both of these companies, it seems like in a non-COVID-type economy where the economy is growing, that these are both essential items for businesses. Is that something you observe?

Mr. Wright: Yes. I would say much more so for the sales tax compliance software company. Remember that old saying: In this world two things are certain: death and taxes.

If you're selling anything, there's likely to be some type of sales tax associated with that economic activity. And so this company will help simplify that process for you, rather than trying to manage it yourself, which many small and mid-size businesses try to do. Given the Wayfair decision, and because many businesses are selling things online, that's just become too cumbersome. I would agree with you that this is an essential service at this point. Trying to get the sales tax right and being sales tax compliant with various laws.

With respect to advertising, yes, I think all companies need to advertise over the long term to get your brand out there. I will say in the short term, and we saw this last year, when there's uncertainty in the market, that marginal advertising dollar can be scaled back. And so that can be a short-term hiccup for businesses that rely on advertising dollars. We saw that with this company.

But taking a longer-term view, yes, businesses need to get out and market to consumers. And outdoor advertising has proven to be a low cost and attractive channel to do that. Also, it hasn't been subject to some of the disruption in other media channels like print media and linear cable and local TV.

TWST: And I see that in your background, you've also worked on turnarounds and restructuring. What do you think the outlook is for the next year or two about restructuring of companies and turnarounds, and even merger and acquisition activity? Do you think it's going to be a period of time when we're going to see those kinds of things taking place?

Mr. Wright: That's a great question. I have a couple of comments there.

On the M&A front, I would say it seems to be a very robust market. I saw recently that, I think February within the Americas, by deal volume, was the best month on record for M&A volume ever, which is a pretty surprising statistic. And then I think through the first two months of this year, from a global perspective, so global M&A deal volumes — I think it's one of the top two or three periods ever recorded. So clearly, a lot of deal activity going on. And looking at recent announcements from companies, that seems to be continuing.

You add on top of that, just the amount of capital that's been raised via SPACs — special purpose acquisition companies — and all of those vehicles have to go out and do a deal over the next couple of years. It really would support the idea that there should be elevated M&A volumes, at least in the near term.

With respect to restructuring, that's an interesting one. If you think back to the depths of COVID last year, there was a question of what the fiscal response is going to be from the government. I talked to various restructuring shops, and they thought that there would be significant activity last year. But that didn't really pan out quite as expected. While there were some out-of-court restructurings last year, I don't think it was at a level that many had expected.

And the reason being just the response from both the Fed and the U.S. government has been significant in the form of slashing rates and trillions of dollars of fiscal stimulus, which I think gave a lifeline to a lot of companies and kept the capital markets window open. So lots of companies were able to go and refinance and raise capital very cheaply, and very quickly.

If you look at high-yield spreads, they've continued to compress and are near all-time lows. So it seems like capital is readily available. I think the contrarian, or the naysayer, might say all we've really done is kick the can down the road. There probably were a number of companies that should have gone through some type of restructuring process last year. Instead, they raised capital — typically in the form of debt — and really just kind of exacerbated the situation.

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That will have to be rectified somewhere down the road. But so long as we have this kind of accommodative rate environment and fiscal support from the government, it seems to be pushing off that probably necessary — in some instances — restructuring event from happening anytime soon.

So, to be determined, but I think there definitely are some companies that could use restructuring of their balance sheets. It's just unclear when that's going to be — for so long as we have all of this money sloshing around the economy.

TWST: And as you look ahead to this year and the following year, are there any concerns or trends that you think are noteworthy that investors may want to be aware of?

Mr. Wright: I try not to make any kind of macro calls, but a couple of things that I would highlight for your readers. If you think back to last year, the Russell 3000 hit an all-time high in February, and then sold off roughly 35% before bottoming in March. By the end of August last year, the market basically fully recovered. And then the vaccines were announced in November and we have been hitting new highs ever since then — since the vaccine announcement.

In summary, it really took the market only five months to recover from that sharp sell-off due to the recession caused by COVID. You compare that to what happened during the financial crisis. That took over five years for the Russell 3000 to recover from its pre-financial crisis level. You have what happened last year — five months of recovery compared to a five-year period during the financial crisis. That's a pretty quick U-turn, I would say.

On top of that, when you look at things like cyclically adjusted p/e multiple — so CAPE, which Bob Shiller puts out — that's near all-time highs. The only other period that looked higher was during the tech bubble. If you look at market cap to GDP, that's at an all-time high. As I mentioned before, high-yield spreads are near all-time lows. So all of that would, I think, lead one to think that the market is quite buoyant right now.

And so, proceed with caution, I guess would be my big key takeaway. That's kind of the market environment that we seem to be operating in right now. Granted economic activity is expected to pick up quite significantly this year, especially given the easy comparisons to last year. But we'll see what happens over the next couple of years. But proceed with caution, I guess will be one of my biggest takeaways for investors, just given how quickly we have rebounded and the amount of enthusiasm I think that is built into price levels today for many companies.

TWST: And for many investors, last year sort of illustrated the importance of holding onto stocks for a longer time, even if maybe there was a momentary or short-term blip in performance. Do you think that is a fair thing to say about what happened during the course of the year?

Mr. Wright: I think that is a fair statement. And I think that statement should be applied to anyone who's thinking about investing in the market. I think last year should really drive home for folks that there are going to always be unforeseen events that happen, which can create turbulence in the market. But hopefully investors or anyone thinking of investing in the market take a much longer-term view and are willing to ride out those periods of volatility and hold on.

There have been studies showing that while you can look at the overall long-term return of the market — which assumes a buy-and-hold strategy — that differs significantly from the typical investor who tends to, unfortunately, sell at lows and buy at highs once the market has recovered.

I just think for a lot of folks, it becomes very difficult to try and hold when the market goes down. But hopefully that period last year, where we saw the market go down and then quickly recover, reinforces that investors should take a longer-term view. Make sure you know the companies that you own, and if you have conviction that they're going to survive and possibly thrive, then you should continue owning shares in those businesses. Try not to get caught up in the short-term noise or volatility of the market.

TWST: And to some extent, there are a lot of distractions out there now — perhaps cryptocurrency or certain types of trading apps or even day trading. Or people might even turn on the TV and watch business news. And investors think they have to immediately react as opposed to holding onto investments that they've had for a while, that are growing.

Mr. Wright: I think to a certain extent. But I would argue there has always been "the hot investment idea." I think that can change in different periods of time, but I think there's always been certain distractions that are out there. For instance, several years ago, gold bugs was a term that was used for people investing in precious metals that caught a lot of attention. If you think pre-financial crisis, real estate became a very hot area, with lots of people jumping into that market. It is kind of human nature to a certain extent — that fear of missing out.

If someone sees someone else making a lot of money, a lot of people want to try and get in on that action, whether or not they have any level of expertise or knowledge that would give them some kind of edge. I think that seems to be a common case throughout history.

TWST: Thank you. (ES)

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