

“The single most important decision in evaluating a business is pricing power. If you’ve got the power to raise prices without losing business to a competitor, you’ve got a very good business. And if you have to have a prayer session before raising the price by a tenth of cent, then you’ve got a terrible business.”—Warren Buffett

11th of October 2023

Dear Clients and Friends,

We own a diverse portfolio of high-quality companies that we think can thrive in a variety of economic and market conditions. The companies are well-capitalized, the business models are resilient, and the management teams are first-rate. We continue to believe that the valuations of many of our stocks are attractive and see the potential for meaningful appreciation across our portfolio.

Q3 was a difficult quarter for the markets, with the S&P 500 and the Russel 2000 declining 3.3% and 5.1% respectively. Investor optimism that inflation is cooling dimmed as the Federal Reserve signaled that interest rates may stay higher for longer. Consumers and businesses are staring at higher costs: a 30-year fixed rate mortgage is hovering around 8%, brent crude oil is near a high for the year at ~\$90/barrel, and a broad sell-off across the bond markets has driven yields higher, with the 30-year treasury hitting a 16-year high of 4.9% on October 3rd. Sectors of the market that are sensitive to higher interest rates, such as utilities, REITS, and consumer staples, were particularly challenged in Q3.

We carefully consider how changing macroeconomic variables could affect our holdings, and we believe that our portfolios are well positioned for an inflationary environment. One reason that we are confident is that we own many companies that sell essential products and services that customers need or love, for which there is often no meaningful substitutes. Businesses with these characteristics have historically been able to raise prices to offset higher inputs costs in an inflationary environment.

We can see demonstrated pricing power across our holdings. For example, In the U.S. the price of a Netflix subscription has increased from \$11.16 in 2018, to \$16 in 2023. In 2022, Amazon raised the price of an annual Prime membership from \$119/year to \$139/year. Last year, Starbucks raised menu prices approximately 5%. These companies have earned their pricing power due to years of investment, innovation, and great customer service. Crucially, each business has been able to maintain or grow its customer base despite raising prices, demonstrating customer loyalty. We own other businesses with pricing power and believe that owning these companies helps insulate our portfolio from higher inflation.

PORTFOLIO UPDATE

Underlying our optimism about the future return potential of our portfolio is what we believe are temporarily depressed prices in a variety of high-quality businesses with a proven history of profitability and proven management. We see meaningful upside potential in each company below:

Disney (Stock Price: \$84)

Disney has had a tough 2023 as questions around profitability in their new Disney+ streaming division, combined with a series of public relations snafus, dulled investor enthusiasm for the stock. We believe that Disney remains one of the most durable consumer franchises in the world and are constructive on two strategic initiatives at Disney.

First, Disney recently announced a ten-year, \$60B capital investment into its Theme Parks business. Disney's Theme Parks (including hotels and cruise ships) is the crown jewel of the company, generating \$8B in profit in 2022, ~60% of total company operating profit. We like that Disney is increasing investment into its best business, ensuring that families around the world will prize a Disney vacation for years to come.

Second, in 2024, Disney should demonstrate improved profitability in its streaming business. Under CEO Bob Iger, Disney has rationalized content and marketing spend to prioritize streaming profit over subscriber growth. In 2024, the market should begin to see the profit potential of Disney's streaming assets. Disney trades at ~17x estimated 2024 earnings, a discount to the overall S&P 500 multiple of 20x. In Disney, we own one of the world's great brands, at a discount to the market, on the cusp of an improvement in profitability.

CVS (Stock Price: \$71.40)

This year, CVS implemented an enterprise-wide restructuring plan intended to simplify the organization, improve efficiency, and reduce costs. Implementation of the plan has resulted in one-time expenses, including a \$496m pre-tax restructuring charge that weighed on profitability. By 2024, CVS will begin to lap the one-time expenses and should emerge as a more profitable company with market leadership in large, durable segments of the health care industry, including pharmacy benefits management and health insurance. We continue to like CVS's diversified business model and forward-thinking management team. CVS trades at ~8x estimated 2024 P/E, an attractive valuation for a highly profitable and defensible healthcare franchise. We believe CVS could trade closer to 10x estimated 2024 earnings of \$8.60/share and be valued at \$86/share, ~20% upside.

Tyson (Stock Price: \$47.90)

Tyson encountered a difficult macro environment in 2023 as steep declines in beef and chicken prices, coupled with higher input costs, caused operating income to fall from \$3.6B to \$68m through Q3. Tyson's Management has responded by closing underperforming facilities and rationalizing overhead. In the short-term, commodity price fluctuations have a material impact on Tyson's earnings. Over the long-term, we believe that Tyson's market leadership, portfolio of trusted consumer brands, and decades of experience and operational know-how position the company to adapt to dynamic commodity markets and benefit from the growing global demand for high-quality protein diets. Founded in 1935 and still family-controlled, we believe that the Tyson family will successfully steer the company through the current macro environment. Tyson trades at ~9.5x our normalized earnings estimate of \$5/share, a meaningful discount to Tyson's historical average multiple of 12x. If earnings stabilize and Tyson's multiple reverts back to its historical average, Tyson could be valued at \$60/share, 25% upside.

Bristol-Myers ("Bristol:" Stock Price: \$56.50)

Bristol faced a challenging 2023 as investors anticipated two of Bristol's largest drugs, Eliquis and Opdivo, losing patent protection, enabling generic drug makers to offer competing products. We have confidence that Bristol's history of innovation, and deep product pipeline, will produce new, valuable medicines that will replace the lost revenue from Eliquis and Opdivo. The early signs are encouraging. In 2022, the FDA approved nine new Bristol medications, and the worldwide sales of Bristol's new product portfolio grew 79%. At ~7.5x estimated 2024 P/E, Bristol trades at a discount to its pharma peer group and its historical average earnings multiple of 10x. We believe the severe discount is unwarranted and Bristol's multiple could re-rate closer to 10x as the market gains confidence in the drug pipeline. With over \$7.00/ share in projected earnings in 2024, Bristol could be valued at \$70/share, 23% upside.

Ally Financial ("Ally:" Stock Price: \$25)

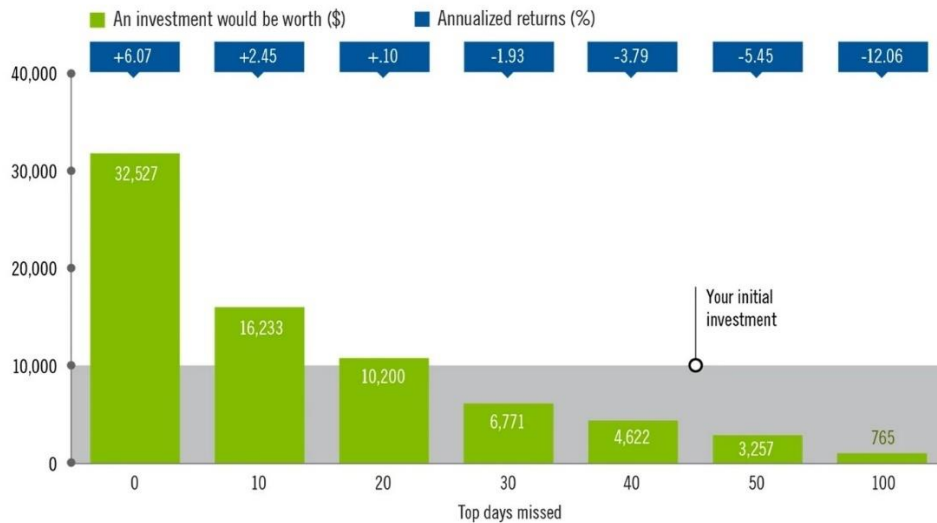
Like many financial stocks, Ally has had a challenging year as higher rates drove mark-to-market losses in its securities portfolio and the market feared that an economic slow-down could crimp Ally's auto lending business. We believe Ally is well-capitalized, its securities portfolio will recover, and the auto lending business will prove less cyclical than the market anticipates. Ally trades at ~5.7x estimated 2024 P/E, a price that we believe is too cheap for a business with Ally's balance sheet strength and market dominance. We believe Ally could earn \$5/share in 2025, trade 10x earnings and be valued at \$50/share, 100% upside.

Owning great businesses at temporarily discounted prices has tended to work out well. We believe that history will repeat and that these companies will emerge as stronger businesses with higher stock prices.

THE VALUE OF STAYING INVESTED

When economic conditions change rapidly, such as we have experienced with the rapid and unprecedented rise in interest rates, many investors respond by selling stocks, moving to cash, and waiting on the sidelines until conditions appear stable. While these impulses are understandable, they are rarely the right course of action for the long-term equity investor. The reason is simple; missing even a few of the best days in the market each year can be devastating to long-term returns. Since no one knows when those days will come, trying to time entry and exit in the market is fraught. The chart below conveys this phenomenon:

Chart A: The Cost of Timing the Market



Source: Franklin Templeton

The chart above depicts how missing even a few trading days can meaningfully reduce long-term returns. To put a finer point on it, there were 5,036 trading days during the 20-year period from January 1, 2000 - December 31, 2019; missing the 10 best trading days would have reduced an investor's return by 50%.

We strive to maintain a firm grasp of the obvious; in this case the data makes obvious that trying to time the market during down periods can drastically reduce long-term returns. Avoiding this behavior can be challenging, especially when fear seems to seep into the market. But over the long-term, staying invested and not timing the market is the prudent approach.

Sincerely,

Ben Weiss, JD
Chief Investment Officer

Tom Eidelman, CFA
President

NEW INVESTMENT

Foot Locker (Ticker: "FL;" stock price: \$21)

We bought a new position in Foot Locker in the quarter. Foot Locker is one of the world's largest shoe retailers with 2,714 stores in 29 countries and \$8B in estimated 2023 revenue. With a broad selection, a devoted customer base, and widely recognized brand, Foot Locker has been a staple of the shoe industry for decades. We were attracted to Foot Locker's stock due to its history of consistent profitability, a proven new CEO, and cheap valuation that offered significant upside potential.

Prior to Covid, Foot Locker was a consistently profitable, cash-generative company that earned between 4-\$5/share and traded between 10-13x earnings. Due to an oversupply of inventory and markdowns across the shoe and apparel industry this year, Foot Locker's earnings have declined meaningfully in 2023. After analyzing the business, we felt that the earnings decline would be temporary, earnings could recover to the historical 4-\$5 range by 2025, and the stock could be valued at 40-\$50/share.

We feel that there could be upside to those numbers given that Foot Locker brought in a new CEO in 2022, Mary Dillon, who we believe is one of the best CEOs in retail. Prior to Foot Locker, Ms. Dillon was the CEO of Ulta Beauty from 2013-2021. Ms. Dillon took Ulta from \$2.7B in sales to \$8B in sales and Ulta was one of the best performing stocks in the S&P 500 during her tenure.

Ms. Dillon is executing much of the Ulta Beauty playbook at Foot Locker, implementing a strong loyalty program, opening more off-mall locations, and broadening the merchandise assortment to include popular brands such as Hoka and On Cloud. Ms. Dillon has a good hand to play; sneaker culture is thriving and Foot Locker's younger customer base, well-known brand, and longstanding supplier relationships make it a trusted destination for sneaker-lovers everywhere.

As stated above, by 2025, we estimate that Foot Locker earnings can rebound to \$5/share and the stock could be worth 40-\$50/share, ~100%+ upside potential. If Ms. Dillon's strategic initiatives fundamentally improve Foot Locker's business model, we believe the earning multiple could re-rate to 15x and the stock could be worth \$75/share.

DISCLOSURES

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