Signal From Noise February 8, 2024

Is There an Investment Premium on "Vice"?

At publication time, we find ourselves just a few days before the end of Carnival season. For many Christians, Carnival precedes the more austere period of self-denial, prayer, and contemplation known as Lent. In some cultures, Carnival means public festivals filled with revelry and indulgence – New Orleans' Mardi Gras revelry and Rio de Janeiro's Carnival are two of the more famous examples of this.

This led us to consider many of the companies engaged in such celebrations – those whose products and services are integral to what might be considered sins or vices. As investments, how do they perform, relative to their more wholesome counterparts?

We have chosen two simple measures of performance: operating margins and stock performance (exclusive of dividends, if any). We will also focus only on companies large enough to be publicly traded – a requirement that takes some types of vice-oriented businesses largely off the table, as they tend to be small and privately held.

It's worth noting that what constitutes a "vice" or a "sin" varies widely based on factors such as geography, religion, and political leanings. Thus, some of the various "vice" companies discussed below might not seem to be so sinful to you, and some of the "virtuous" companies might not seem to be beyond reproach. We make no moral judgments about these companies or their customers.

Intoxicants

Alcoholic- and non-alcoholic beverages are considered Consumer Staples, a sector that Head of Research Tom Lee and Head of Technical Strategy Mark Newton both currently suggest underweighting. As such, both are considered non-cyclical. Although it's easy to see non-alcoholic beverages as a consumer staple, we point out that consumption of alcohol is prevalent enough that the U.S. regarded liquor stores as essential businesses during the global COVID-19 pandemic, allowing them to stay open. (This decision was motivated by a fear that those with an unhealthy dependence on alcohol might be driven to seek dangerous alternatives if deprived of access to alcoholic beverages.)

For important disclosures, see Page 10

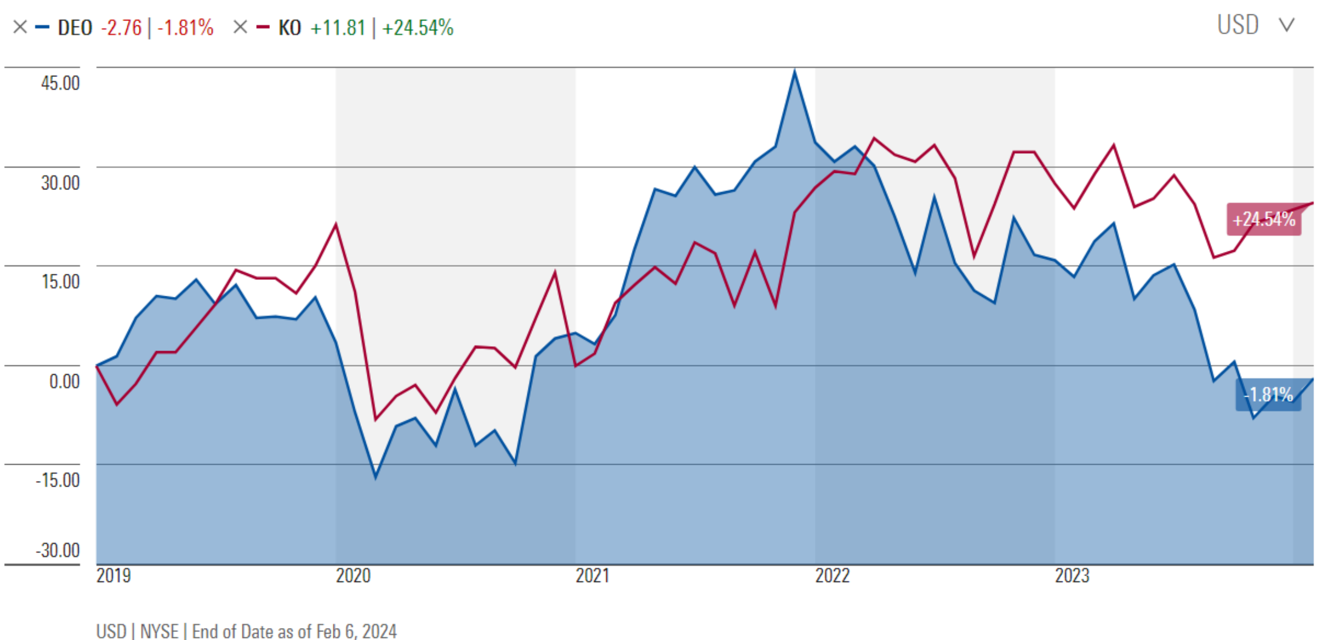
Two of the largest alcoholic-beverage companies in the world are Anheuser-Busch InBev (by revenue) and China's Kweichow Moutai Co Ltd (by market cap). However, given that Anheuser-Busch is primarily focused on beer and Kweichow Moutai only makes variations of a single product – a sorghum-based liquor called Moutai, we have chosen a company with a more diverse product offering.

Diageo ($DEO)

Based in London, Diageo owns (either entirely or in part) many well-known beer, wine, liqueur, and liquor brands. Among them areGuinness, Dom Perignon, Baileys, Aviation Gin, Smirnoff, and Johnnie Walker. In the past five years, the company has posted operating margins between 27.07% and 31.41%. The stock has seen some volatility over the last five years, beginning around $152, falling to around $125 during the pandemic, and climbing to $220 before declining choppily back to its current levels. It is currently down around 1.8% from where it was five years ago.

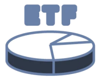
Coca-Cola ($KO)

Although Coca-Cola's namesake beverage is not particularly health-promoting, the company does also sell healthier products. Coca-Cola owns several brands of bottled teas, juices, and water. Over the past five years, its operating margins have been relatively stable, ranging from 27.56% to 29.46% and averaging 28.82%. Its stock price is roughly 25% higher than it was at the beginning of this period.



Source: Morningstar

Interested in investing with ETFs?



FSI Sector Allocation

Rebalanced Monthly

S&P 500 by actively managing one's sector exposure without taking on additional portfolio risk.

Investors can follow the overweight forecast by buying the underlying ETF of the sector.

SEE IF OUR ACTIVE SECTOR ALLOCATION IS RIGHT FOR YOU WHEN YOU ACCESS YOUR FREE TRIAL HERE!

Junk Food

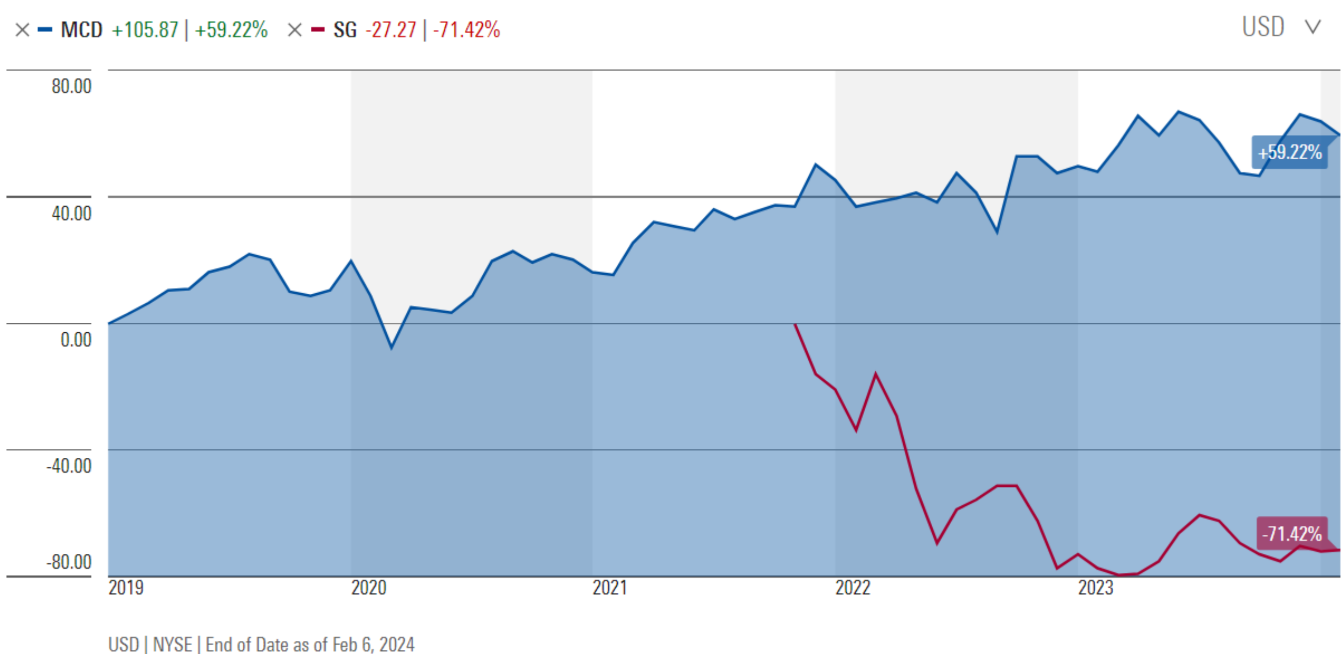
Gluttony is one of the original Seven Deadly Sins. We have opted to compare restaurant options, keeping in mind that restaurants, regardless of the fare they serve, are part of the Consumer Discretionary sector. Lee currently suggests underweighting this sector, while Newton has a neutral rating on it.

McDonald's ($MCD)

The Golden Arches need no introduction, what with 40,000+ locations on every continent except Antarctica. In recent years, the company has expanded its menu to include some healthier options (many incorporating local flavors), but at the core of its offerings are items that nutritionists discourage patients from eating. Operating margins over the last five years have ranged from 51.30% to 57.24, averaging 53.70% over that period. The stock is up around 59% over this time period.

Sweetgreen ($SG)

Salads are frequently mentioned in discussions of healthy menu options, and they are the specialty of this fast-casual chain, founded in 2006. (Sweetgreen also serves healthy bowl options.) The company went public in 2021 and, as of this writing, has more than 1,000 locations in 20 states. Incurring significant costs due to its expansion efforts, Sweetgreen has seen negative operating margins since its IPO in 2021, at an average of -24.06% and dipping as low as -63.12% during the pandemic in 2020. Its shares are down 71.42% since their debut.



Source: Morningstar

Tobacco

In wealthier countries, public health campaigns have been reasonably successful in convincing people to give up smoking, with cigarette taxes, regulations on where people can smoke, and advertising restrictions driving down the prevalence of smoking. Not surprisingly, with smoking far less ubiquitous and less socially acceptable than it was in the last millennium, the use of tobacco has come to be seen as more of a serious vice rather than just a common, if ill-advised, habit.

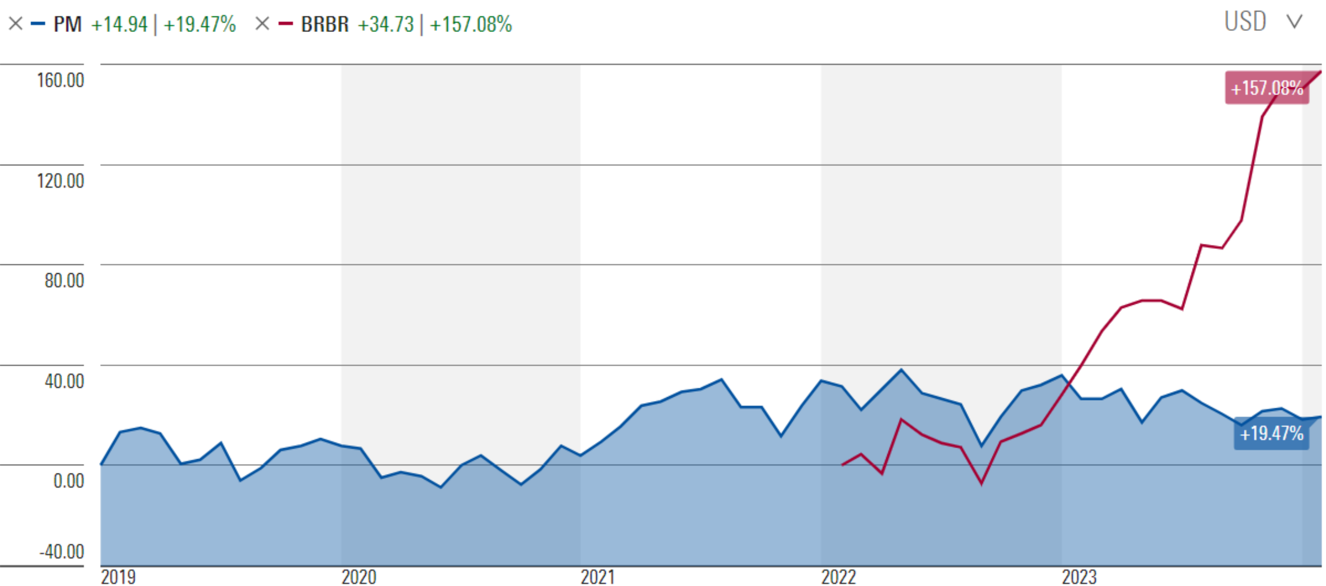
Philip Morris ($PM)

The parent company of Marlboro, Philip Morris, is one of the largest producers of cigarettes, heated and smokeless tobacco products, and nicotine products. Although its

cigarette sales remain strong in Asia and Europe, the company is trying to phase cigarettes out of its product lineup. Still, the cigarette alternatives it sells or is developing are generally not regarded as particularly healthy by the medical community either. Over the past five years, the company has seen average operating margins of 38.2%. Over that period, $PM stock is up 59.22%.

Bellring Brands ($BRBR)

The effect of smoking on cardiovascular and physical fitness is considerable, so here we are comparing a tobacco company to one whose products are geared toward athletic pursuits. Bellring Brands is a manufacturer of protein-focused products intended to help athletes and fitness enthusiasts build muscle, lose fat, and recover from workouts more efficiently. To this end, Bellring sells a range of supplement powders, bottled beverages and shakes, as well as snack bars. In the past five years, the company has notched average operating margins of 16.27%, and its stock is up 157% since its IPO in 2019.



Source: Morningstar

Research only available to banks & hedge funds, now available to individuals

WEEKDAYS
Tom Lee's First Word

ON MARKET EVENTS
Tom Lee's Intraday Word

The best market research out there — on a near-daily basis.

These are released periodically after crucial market developments.

DAILY

Daily Technical Strategy

Daily commentary on market trends and short term opportunities.

DAILY

⚡ Flash*Insights*

By-the-minute notifications and updates on breaking market news on an as-needed basis from FS Insight's thought leaders.

WEEKLY

US Policy

Weekly update on developments in Washington DC and how they may impact Wall Street.

WEEKLY

Weekly Roadmap

Weekly summary of market events and updates on our key theses.

EARNINGS SEASON

Earnings Daily

A multi-faceted update of earnings developments.

GET A FREE TRIAL AND VIEW ALL OUR MACRO RESEARCH!

Live entertainment

Las Vegas Sands ($LVS)

Most major faiths either discourage or entirely prohibit gambling. This includes not just the Abrahamic religions, but also Hinduism and Buddhism. Despite this, and despite many jurisdictions making it illegal, games of chance have near-global appeal, with enthusiasts often traveling great distances to try to beat the odds at major casinos. Though it recently divested itself of casino holdings on the Las Vegas Strip, Las Vegas Sands remains one of the largest casino companies in the world, with marquee gambling destinations in Macau and Singapore. The global pandemic significantly impacted the company's operating margins and profitability, resulting in a -2.58% average margin over the past five years.

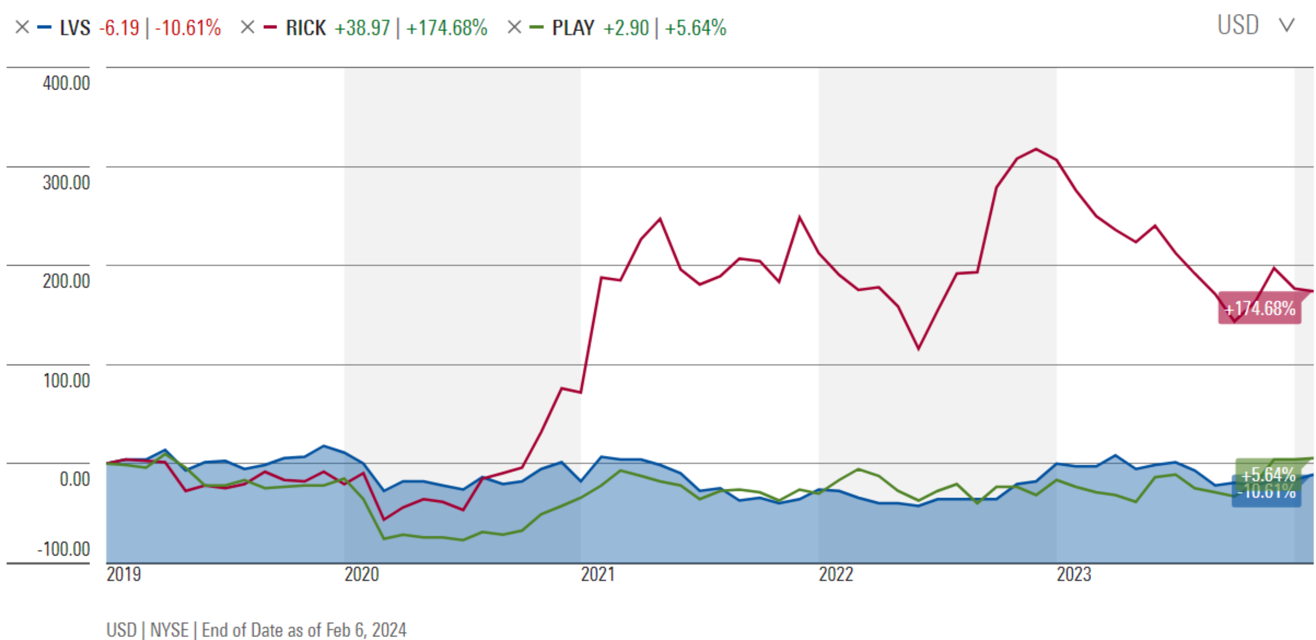
Looking back 10 years shows operating margins fluctuating between 22.54% and 28.41%, outside of pandemic years. The stock is down roughly 9.6% from its levels five years ago.

RCI Hospitality Holdings (RICK)

RCI Holdings is one of the few publicly traded companies involved in sexually explicit entertainment, operating various chains of higher-end clubs featuring what in the old days was euphemistically called "exotic dancing." The Houston-based company runs 44 such clubs across the United States, as well as a family-oriented, military-themed sports bar/dining chain with 13 locations, all in Texas. As with many businesses focused on in-person experiences, RCI saw its margins take a hit during the pandemic, although its five-year average operating margin is still 21.25%. The stock is up about 174% over its 2019 levels.

Dave & Buster's ($PLAY)

Dave & Buster's offers entertainment of a more family-friendly variety. Although its establishments generally serve alcohol, they also feature arcade and video games, simulation (VR) experiences, televised sports, and more. Dave & Busters has generally maintained operating margins of between 12% and 15%, except 2021, when this figure was -55.29%. (Its most recent five-year average is 4.34%.) Over the past five years, its stock is up 5.64%.



Source: Morningstar

After five comparisons, we found "vice" stocks outperforming a roughly analogous wholesome counterpart twice. It seems that being bad can sometimes pay off – but not always. With such a small sample size, no other conclusion can be drawn from this surface examination, except to note that in investment, as in life, the dichotomy between "good" and "bad" is not always clear-cut.

Webinars!

We host monthly webinars throughout the year with exclusive insights from our research team & high-profile special guests.

Become a member today and get full access to ALL webinars & future events!

Our Upcoming and Latest Webinars!

Tom Lee's "Super Granny" Shots Update – February 2024

RealFi: An On-Chain Private-Credit Marketplace

Hyperion Decimus: A Sophisticated and Risk-Managed Way of Investing in Liquid Digital Assets

Mark Newton's Live Technical Analysis – February 2024

Tom Lee's "Super Granny" Shots Update – January 2024

ACCESS OUR WEBINARS WITH A FREE TRIAL!

As usual, *Signal From Noise* should serve as a starting point for further research before making an investment, rather than as a source of stock recommendations. This piece is meant to explore whether companies that might be somewhat controversial might still be worth considering, but as with all our research, it is the investor or reader who must make that decision for themselves.

We also encourage you to explore our full Signal From Noise library, which includes deep dives on topics such as **cybersecurity**, the path to automation, and **infrastructure**. Other past topics include opportunities associated with our **aging power grid** and the rise of **Generation Z**.

Disclosures

This research is for the clients of FS Insight only. FSI Subscription entitles the subscriber to 1 user, research cannot be shared or redistributed. For additional information, please contact your sales representative or FS Insight at fsinsight.com.

Conflicts of Interest

This research contains the views, opinions and recommendations of FS Insight. At the time of publication of this report, FS Insight does not know of, or have reason to know of any material conflicts of interest.

General Disclosures

FS Insight is an independent research company and is not a registered investment advisor and is not acting as a broker dealer under any federal or state securities laws.

FS Insight is a member of IRC Securities' Research Prime Services Platform. IRC Securities is a FINRA registered broker-dealer that is focused on supporting the independent research industry. Certain personnel of FS Insight (i.e. Research Analysts) are registered representatives of IRC Securities, a FINRA member firm registered as a broker-dealer with the Securities and Exchange Commission and certain state securities regulators. As registered representatives and independent contractors of IRC Securities, such personnel may receive commissions paid to or shared with IRC Securities for transactions placed by FS Insight clients directly with IRC Securities or with securities firms that may share commissions with IRC Securities in accordance with applicable SEC and FINRA requirements. IRC Securities does not distribute the research of FS Insight, which is available to select institutional clients that have engaged FS Insight.

As registered representatives of IRC Securities our analysts must follow IRC Securities' Written Supervisory Procedures. Notable compliance policies include (1) prohibition of insider trading or the facilitation thereof, (2) maintaining client confidentiality, (3) archival of electronic communications, and (4) appropriate use of electronic communications, amongst other compliance related policies.

FS Insight does not have the same conflicts that traditional sell-side research organizations have because FS Insight (1) does not conduct any investment banking activities, and (2) does not manage any investment funds.

This communication is issued by FS Insight and/or affiliates of FS Insight. This is not a personal recommendation, nor an offer to buy or sell nor a solicitation to buy or sell any securities, investment products or other financial instruments or services. This material is distributed for general informational and educational purposes only and is not intended to constitute legal, tax, accounting or investment advice. The statements in this document shall not be considered as an objective or independent explanation of the matters. Please note that this document (a) has not been prepared in accordance with legal requirements designed to promote the independence of investment research, and (b) is not subject

to any prohibition on dealing ahead of the dissemination or publication of investment research. Intended for recipient only and not for further distribution without the consent of FS Insight.

This research is for the clients of FS Insight only. Additional information is available upon request. Information has been obtained from sources believed to be reliable, but FS Insight does not warrant its completeness or accuracy except with respect to any disclosures relative to FS Insight and the analyst's involvement (if any) with any of the subject companies of the research. All pricing is as of the market close for the securities discussed, unless otherwise stated. Opinions and estimates constitute our judgment as of the date of this material and are subject to change without notice. Past performance is not indicative of future results. This material is not intended as an offer or solicitation for the purchase or sale of any financial instrument. The opinions and recommendations herein do not take into account individual client circumstances, risk tolerance, objectives, or needs and are not intended as recommendations of particular securities, financial instruments or strategies. The recipient of this report must make its own independent decision regarding any securities or financial instruments mentioned herein. Except in circumstances where FS Insight expressly agrees otherwise in writing, FS Insight is not acting as a municipal advisor and the opinions or views contained herein are not intended to be, and do not constitute, advice, including within the meaning of Section 15B of the Securities Exchange Act of 1934. All research reports are disseminated and available to all clients simultaneously through electronic publication to our internal client website, fsinsight.com. Not all research content is redistributed to our clients or made available to third-party aggregators or the media. Please contact your sales representative if you would like to receive any of our research publications.

Copyright © 2024 FS Insight LLC. All rights reserved. No part of this material may be reprinted, sold or redistributed without the prior written consent of FS Insight LLC.