



JARVIS® NEWSLETTER: AMIDST RISING RATES, DON'T FORGET GROWTH!

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OVERVIEW

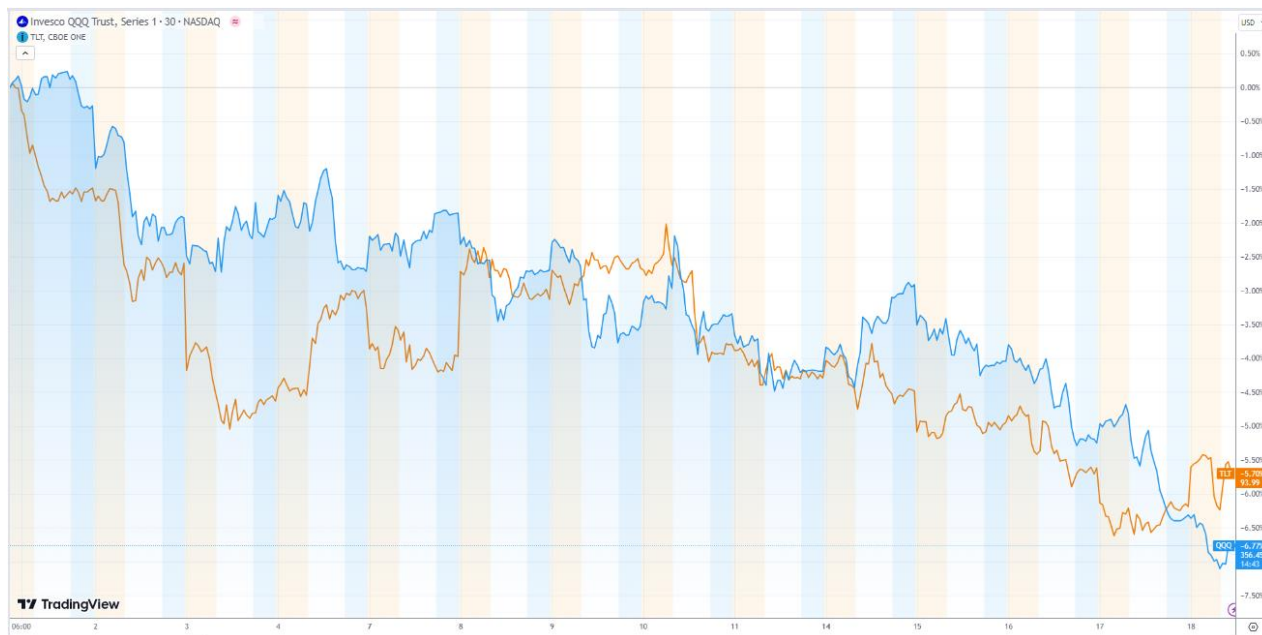
Much has been made this month about the fact that August is traditionally a weak month for the markets (something tells me you'd hear none of that if markets were higher!) After a strong first seven months of 2023, we have seen a pullback in both the stock and bond markets. With such a run in the first half of the year, it is normal and potentially healthy to see a correction in markets if nothing but to chase out the speculative investors.

For the most part, this month's sell-off has been driven by macroeconomic factors. Macroeconomics seem to have a lot of impact on the short-term direction of markets. Over the last few years, we have observed a strong correlation between rising interest rates and lower stock prices, especially in the growth sectors of the market. The month of August 2023 has been no exception, with a rising rate environment driving bond prices lower (as measured through the **iShares 20+ Year Treasury Bond ETF (TLT)**) and also pushing investors away from growth stocks, using the **NASDAQ Composite** as a proxy (see chart below).

Remember that for the long-term, short-term gyrations in the market are nothing but a sideshow for investors like us, who want to fill our portfolios with the best quality businesses. After all, one of the pioneers of the market, Benjamin Graham, is remembered for saying: "In the short run, the market is a voting machine but in the long run it is a weighing machine." When we see temporarily lower prices due to factors not directly impacting a given business, often these are the best times for investors to gain exposure to a world class business!

Key Takeaways

- [Why We Spend Time on Security Selection](#)
- [Celsius Holdings \(CELH\)](#)
- [Axon Enterprises \(AXON\)](#)
- [Conclusions](#)



Month to Date (August 2023) chart of NASDAQ (blue) against Long-Term Treasuries (TLT - orange) – Source: TradingView

As markets weaken in August, we still remain optimistic for the direction of things in the back half of 2023. Set time [directly on my calendar](#) and I would love to walk you through what we think is a good strategy for taking advantage of a market pullback. We know corrections can be worrying, so we aim to be a resource for you as you look to put together the best possible long-term financial strategy that fits your goals and risk tolerance.

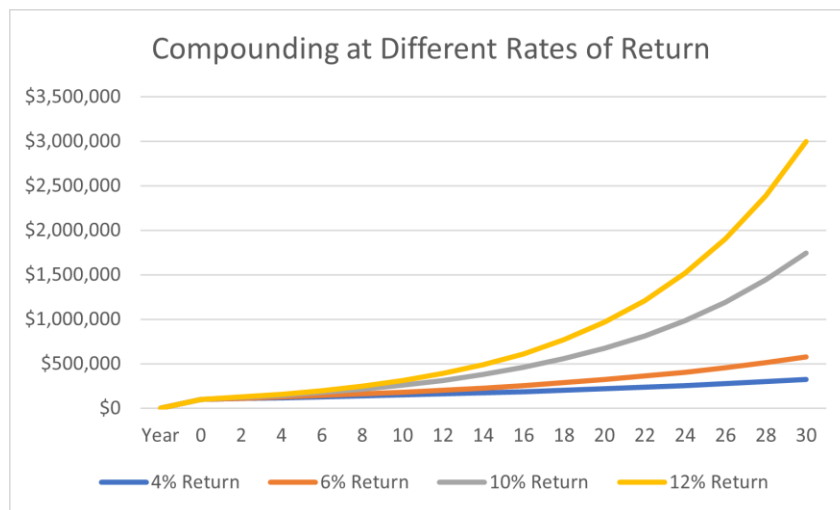
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With that all being said, let's get into it!

WHY WE SPEND TIME SELECTING SECURITIES

As professional advisors that work with investors on a daily basis, we see our job as helping clients build wealth and achieve certain financial milestones. As an example, we aim to help people increase their net worth from \$1 million to \$2 million, from \$2 million to \$5 million, or from \$5 million to \$10 million. For investors looking to accumulate wealth, the most important aspect of the journey is having a strong growth-oriented strategy in place. Purchasing safe instruments, like bonds, is a good way to preserve wealth and there is a place for those sorts of securities in many portfolios. But the way we like to achieve growth for clients is by selecting stocks associated with rapidly growing business, whose revenues are preferably accelerating. In our view, revenue growth of a business is the most direct driver of long-term performance of any given stock.

To illustrate the point about preserving vs. growing wealth, take a look at the chart below illustrating the difference in outcomes over a 30-year period at different rates of return for an initial \$100,000 investment (not considering taxes). A quick glance at the chart should explain why we spend so much time, money, and effort seeking out superior businesses – a small differential in results can make a profound difference over time:



Growth of \$100k over 30 years at different rates of return

As we will likely say until we are blue in the face, we think earnings season is the best time for investors to separate the wheat from the chaff, so to speak. We get the opportunity to hear directly from CEOs and other high-ranking executives about the course of business at a multitude of companies. Really, what we are trying to do as investors when we read earnings call transcripts and earnings reports is to understand a company's growth trajectory and where profitability levels are heading. We largely try to ignore macroeconomic developments themselves, simply because anything macro-related that impacts a given business, we will likely read in the earnings transcript.

This earnings season has felt somewhat unusual to us. We have seen a number of companies report strong sales and profit numbers, only to see their stocks sell off significantly. A few things may be at play here: perhaps investor expectations were too high or possibly the macro environment overwhelmed any positive developments at the company level. No matter the reason, lower prices are creating some interesting opportunities for growth-oriented investors. There may be some overall economic challenges, but we think there are some stellar businesses that are performing quite well, despite the macro environment that seems to be capturing many investors' attention today.

Often times, investors associate growth stocks with the technology sector, and for good reason. Many of the fastest growing and most innovative businesses fall in this category. However, part of responsible investing is diversification across sectors, which has the potential to reduce volatility of an overall portfolio. This is an important goal, as lower portfolio volatility does make it easier to make calm and rational decisions when we face a market correction like the one that is occurring right now.

In today's letter, we are going to focus our attention on earnings results from two of our favorite companies in today's market, both of which generate very high levels of revenue growth and sit outside the tech sector: **Celsius Holdings (CELH)**, an energy beverage producer in the Consumer Defensive sector and **Axon Enterprises (AXON)**, a business in the industrial sector, most well known for its TASER product. These are two businesses that show that even in difficult market conditions, companies with accelerating growth can swim upstream against a struggling overall market environment. Below are our takeaways from reading these companies' filings.

CELSIUS HOLDINGS (CELH)

We have been enthusiastic about Celsius for a couple of years now, due to the exponential growth that this energy drink maker has delivered over the last five years. Since 2013, Celsius had grown sales by double-digits every year, but growth has accelerated markedly since 2019, as you can see below (blown up to show detail):

Celsius Holdings, Inc. (CELH) \$172.94 Last Rpt Date: 08 Aug '23 Key Statistics FactSet Fundamentals

Standardized	As-Reported	Search for an item							
GAAP/IFRS	Non-GAAP	Supplemental	Growth	Common Size					
Annual Growth - % change from previous period									
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		JUN '23 LTM	DEC '22	DEC '21	DEC '20	DEC '19	DEC '18	DEC '17	DEC '16
✓ Sales		95.66	107.97	140.41	73.96	42.85	45.46	58.89	32.19
> Cost of Goods Sold (COGS) incl. ...		76.99	105.29	160.89	60.53	41.83	52.14	59.11	28.03
		JUN '23 LTM	DEC '22	DEC '21	DEC '20	DEC '19	DEC '18	DEC '17	
		95.66	107.97	140.41	73.96	42.85	45.46	58.89	

Celsius Holdings (CELH) sales growth since 2016 – Source: FactSet

As you can see here, we observe accelerating revenue growth, as the popularity of Celsius energy drinks has skyrocketed over the past 3 years. Celsius has one of the best-tasting energy drinks on the market and has become a hit with fitness enthusiasts, due to the product’s relatively healthy list of ingredients, which omits aspartame, high-fructose corn syrup, and artificial flavors/colors. Brand loyalty is extremely strong for Celsius, and business results have been supercharged by [a distribution agreement](#) with **PepsiCo (PEP)**.

On this quarter’s earnings call, CEO and Chairman John Fieldly started things off by noting that the 2nd quarter was the company’s third under the new distribution agreement with Pepsi and that the sales results are quite profound, as we analyze the company’s growth. First quarter 2023 was the first time the company exceeded \$200 million in quarterly sales, while second quarter 2023 was the first quarter when Celsius generated \$300 million in sales. In fact, the \$326 million revenue number delivered in the most recent quarter represents a staggering 112% year-over-year growth.

Overall, the energy drink space is a growing one, but Celsius is taking up a huge portion of that growth, representing 35% of the overall growth in the US energy drink market. A year ago, Celsius made up 4.3% of market share in energy beverages, but just announced its share grew to 8.6% last quarter. The growth trajectory here is stunning.

One of the major drivers has been the partnership with Pepsi. Through this relationship, Celsius has gained shelf space in colleges, hospitals, casinos, and other outlets, which has aided in the company’s growth. Pepsi has also helped with international growth, as international sales increased 76% year over year in the quarter. Interestingly, a very small fraction of Celsius sales come from the international channels, in fact less than 5%. Company management noted that one competitor generates 35-40% of sales overseas. With Pepsi, CEO Fieldly thinks there is a great opportunity for the company to make inroads outside the US. Quite directly, Fieldly stated that the Pepsi partnership has “exceeded all of our expectations internally.”

Celsius has a few other growth initiatives in play, including partnerships with Miami FC (fortuitously signed before the club inked international superstar Lionel Messi to a contract) and popular boxer Jake Paul. The company is also hiring some 170 graduating seniors to sell the company’s products on college campuses.

Perhaps most impressive is the company’s profitability, even as the growth rates continue to accelerate. The company had been targeting gross margins in the mid-40% region, but delivered 48.8%, a huge jump compared to the 38.5% gross margin figure reported at the same time last year.

With accelerating growth and expanding margins coming out of a consumer defensive business, we think the story at Celsius Holdings is one of the most impressive we see anywhere in the current market environment. We have expectations that growth will eventually slow, but we like developments in profitability here, as well as the business moves that management is undertaking.

AXON ENTERPRISES (AXON)

We have been following **Axon Enterprises (AXON)** since before its name change, when the business was known as TASER International. Axon has produced the flagship TASER product since the company's inception, but made the name change in 2017 to reflect that fact a growing and more diversified product offering.

In the current environment, law enforcement faces a number of challenges, both in day-to-day operations and in public perception. According to Axon, the TASER weapon is one of the most effective tools available to help officers with de-escalation. Body cameras help with accountability in ethical policing, which is crucial for public confidence, as well as officer safety.

Axon produces not just the well-known TASER, but sells other hardware to law enforcement organizations, including body cameras. But the biggest growth segment for Axon now comes from the company's software and service divisions. Axon sells a suite of software including evidence.com. Other products consist of records software that helps officers fill out reports more quickly and accurately, systems to help prosecutors process evidence more quickly, among many other products.

There are plenty of interesting developments underway at Axon in 2023. The company has stated that its focus areas for the year are four: revenue, profitability, new market expansion, and new product adoption. According to management, there has been strong progress on all these fronts.

In the second quarter, Axon generated 31% revenue growth, which we think is impressive given the maturity of the company. What we think is even more exciting from this perspective is the fact that Axon's cloud software business grew 62% year over year in the most recent quarter. We like when companies can shift their revenue mix more to recurring revenue streams with high margins like software. Software now comprises 35% of the revenue mix, compared to 29% last year. The TASER hardware business itself grew 14%, spurred on by a new model, the TASER10. Police chiefs seem to be very happy with the new TASER product, which has been a major factor in many successful de-escalations out in the field.

In terms of profitability, gross margins remained stable at roughly 61%. Management was happy with this result, considering the many growth initiatives currently in progress. Going forward, management is looking to automation and scale efficiencies from new product launches to improve overall company margins.

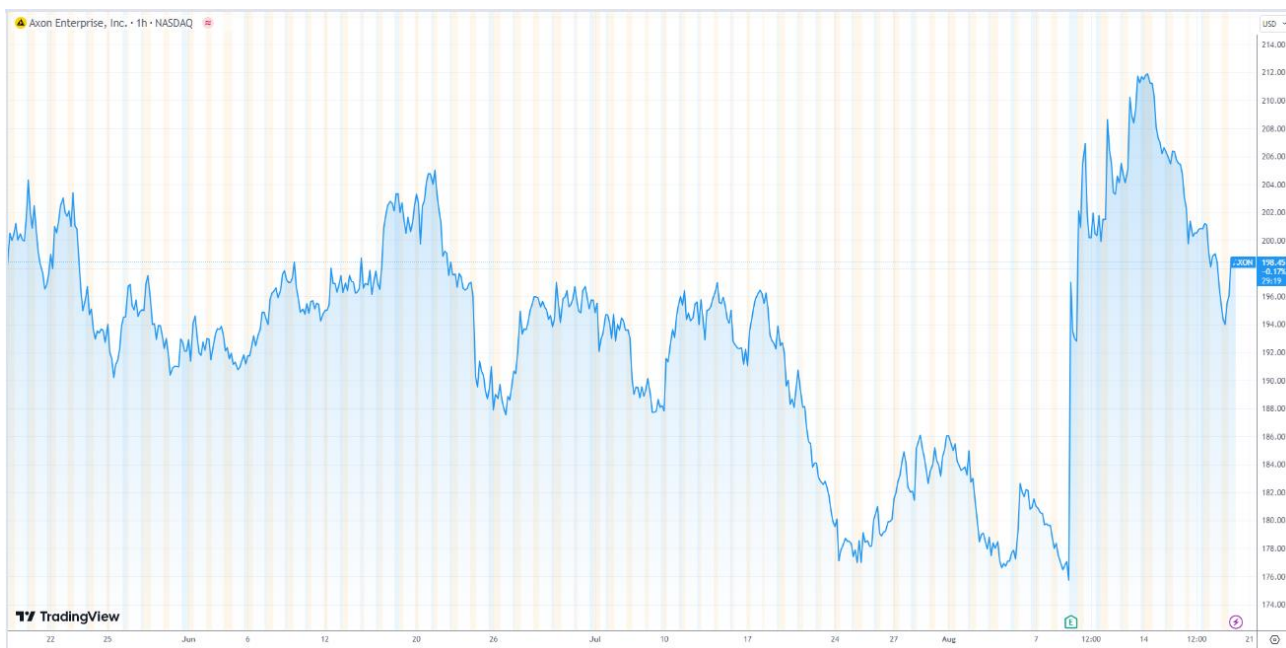
New market expansion has been a major focus for Axon. Just 1/5 of the business comes from international markets, even though the international addressable market is 5x larger than that of the US. One strategy to address this imbalance is acquisition. In July 2023, [Axon acquired](#) Belgium-based Sky-Hero, a company that is known for producing indoor tactical drones. Sky-Hero already was selling solutions to the US Federal Government, along with SWAT teams in the US and in Europe. CEO Patrick Smith thinks that the acquisition could be instrumental in unlocking more relationships across Europe.

Finally, new product adoption is a major catalyst for Axon. Along with the new TASER 10, Axon launched a new body cam product in Axon Body 4 in June. Body camera sales provide an entry point for upselling customers into the cloud software ecosystem, with reliable recurring revenue through evidence.com, records management,

computer-aided dispatch, along with Axon Air, a drone solution. CEO Smith also remarked that he sees two key growth areas for Axon in the coming years: robotic security and Generative AI. The Sky-Hero acquisition is just one part of the robotic security aspect of growth. Generative AI is a very interesting opportunity here for Axon. Smith explained that the company is working on a product that will transmit data collected by body cameras to a system that will generate draft police reports for law enforcement officers, freeing their time up for more important tasks. We think the growth potential for Axon in many areas is quite robust.

Axon raised full year guidance for 2023 results to a growth rate of 27-29%, after noting the success of the company's two major product launches in 2023. The company promoted a number of key executives in an effort to free CEO Smith to spend more time with customers and technology. We think this could allow Axon to perform even better in the near term.

With all the good news reported in the most recent earnings filing, Axon bucked current market trends and its own stock price correction with a very strong stock price move:



3-month stock price chart of Axon Enterprises (AXON) -- Source: TradingView

TAKEAWAYS

We are certainly in the midst of a market correction, spurred not only by profit taking after a strong first half of the year but also, and more importantly, rising interest rates. We think the economy overall is relatively strong, which is part of the reason interest rates continue to rise. Whatever the reason, we think there are plenty of opportunities out there in the market for individual businesses to continue performing well.

Two such businesses that we covered this quarter were **Celsius Holdings (CELH)** and **Axon Enterprises (AXON)**. We like the growth trajectories of both businesses, along with their clear focus on profitability. We also like the fact that they offer growth opportunities outside of tech, allowing growth-oriented investors to diversify some of their holdings away from the technology sector.

If you are an investor looking to build wealth and reach the next financial milestone, a growth strategy is essential and we think individual stock selection is a potentially effective avenue for you to achieve those goals. For us at

Left Brain, no matter what happens in the overall market at the index level, we will continue to search for superior businesses like the ones we covered in today's letter.

Should you want help with your growth strategy, contact me directly at (630) 547-3316 or briand@leftbrainwm.com, or schedule time directly on [my calendar](#) if you want to engage a professional money manager like Left Brain to figure out to do with cash in the bank. We can either talk growth stocks like the ones mentioned here or fixed income opportunities available to investors in the current rising interest rate environment.

Thanks again for your continued support of the Jarvis Newsletter.

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