MANOLE CAPITAL MANAGEMENT

Introduction:

We hope you had a wonderful Thanksgiving with family and friends - it's our favorite holiday of the year. What's not to like about turkey, football and *important* couch time? As we approach year-end, we wish each of you a great holiday season and happy New Year. 2025 is going to be a great year for Manole Capital!

In our final newsletter of the year, we will highlight our version of FINTECH (with a few quick examples), showcase our unique trading process, touch on important and timely FINTECH subjects (holiday spending, legal issues, etc.), discuss some macro topics (interest rates, inflation, jobs, the Fed, etc.), and share our expectations and thoughts for 2025. As always, we conclude with our somewhat silly, Cliff Clavin section of "useless information".

Our Version of FINTECH:

Through our fundamentally focused, bottoms-up research process, we have built a high-quality portfolio of both private and publicly traded FINTECH companies. We believe our version of FINTECH is quite different from the broader market's perspective. While some equate FINTECH with bitcoin or other digital currencies, we disagree. We have written extensively on this topic, and you can read some of our cryptocurrency commentary at www.manolecapital/research.

While we benefit from bitcoin's dramatic climb towards the psychological $100,000 level, we do not own digital currencies for our clients. We aren't currency traders and will leave such allocation decisions to others. Instead on owning traditional currencies like the US dollar, euro or the British pound, we prefer free cash-flowing and growth-oriented FINTECH companies.

At Manole Capital, we define FINTECH as ***"anything utilizing technology to improve an established process."*** This definition leads us to focus on the payment sector and exchanges, which represent our two largest areas of exposure. However, our holdings span various sectors classified under the GICS (Global Industry Classification Standards), including Technology, Financial and even Industrials.

Benchmarks:

Over the past 50+ years, the composition of the S&P 500 has changed dramatically. In the 1970s, Industrials and Materials were among the largest sectors, accounting for over 25% of the index. Today, those sectors comprise only about 10%. Conversely, Technology and Financial stocks have grown from less 15% of the index to significant players, with Information Technology comprising 32% and Financials 13%. Combined, FINTECH or Financials and Technology represent nearly half of the entire S&P 500.

Every summer, benchmarks update their holdings and constituents. Passive managers usually try to immediately adjust their portfolios, to match these new index weightings, so they don't have too much dispersion. On the first trading day (following these index changes), stocks impacted can get a nice, one-day pop.

We have been long-term shareholders of Virtu Financial (ticker VIRT), and it got added to the S&P 600 (small cap) this summer. Virtu, classified by GICS as a Financial, aligns with our version of FINTECH. The traditional process for trading equity securities was in "the pits", in an open-outcry environment. That trading process was wonderfully portrayed in our favorite movie - *Trading Places*, with Eddie Murphy and Dan Ackroyd.

Now, a large percentage of equity trading is completed electronically, either off exchange (in dark pools of liquidity), or on electronic platforms like Virtu. Back to our definition of FINTECH, we believe that Virtu is "using technology" to change how equities get traded. Like a modern-day version of old school market makers. Following its inclusion in the index, Virtu's shares rose 10%, contributing to its 85% gain this year.

Another example is RB Global (ticker: RBA), which we've owned for over 20 years. While GICS classifies it as an Industrial company, it doesn't create or manufacture any products. RB Global operates as a live event and online auctioneer of industrial, farm, and office equipment. RB Global is "using technology to improve an established process", by transitioning from traditional auctions to a hybrid and online marketplace. For instance, its largest auction, held annually in Orlando, Florida, attracts global buyers and sellers. By leveraging technology, RB Global enables a broader audience (over half of its sales are from online participants) and higher transaction efficiency. Following its inclusion in the S&P 400 (mid cap) index, RB Global's shares rose 9%, contributing to its 80% gain this year.

While it is nice to get benchmark inclusion and a one-day increase in our shares, we wanted to mention this for a different reason. We exclusively focus on the emerging FINTECH industry, but our definition remains different than the overall market's perception of FINTECH. Both of these holdings are likely not considered FINTECH by other investors and are not owned in the market's largest FINTECH ETF. These examples highlight our unique perspective on FINTECH, which diverges from conventional market views. Both Virtu and RB Global demonstrate how technology can transform traditional processes, embodying our FINTECH definition and unique investment approach.

Our Process:

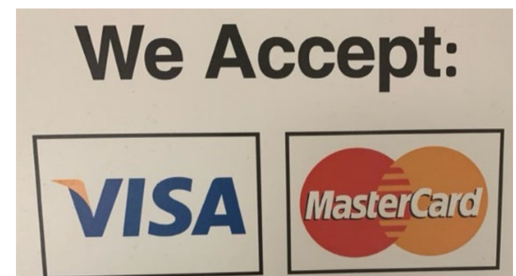
One of greatest investors of all-time, Charlie Munger, left us with invaluable wisdom. Upon his passing, we wrote a brief note reflecting on his legacy, available on our website. Charlie famously said, "***The first rule of compounding: Never interrupt it unnecessarily.***" The power of compounding is undeniable. For example, earning 20% annually for 25 years results in a 100x return. The compounding effect is heavily back-end loaded: after 10 years, the return is 6x, and after 20 years, it is 38x. Achieving this requires patience and discipline.

This principle shapes our disciplined, long-term investment approach to investing. Our long book comprises many names we've held for years, and in some cases, decades. Like Charlie, we aim to hold companies indefinitely, but we believe prudent risk management is necessary to control and manage position weightings. As we continuously monitor fundamentals and adapt to constantly changing market conditions, we may choose to thoughtfully trim or add to a position.

Although our portfolio turnover is low, we adjust positions as opportunities arise. For us, adding to a position during temporary weakness is akin to "watering a plant." Conversely, trimming an overextended position is like giving it a "haircut". We have found that being a long-term investor allows us to capture the benefits of compounding returns. However, market dynamics necessitate regular analysis of fundamentals, and we cannot simply be "buy and hold" forever.

Payments:

Earlier this year, we discussed the settlement between Visa, Mastercard, and US merchants, marking the end of a decade-long legal battle. This agreement, which promised significant reductions in interchange fees, offered relief to merchants and clarity to card issuers. This ongoing interchange battle remains a critical topic for the payments industry, with profound implications for merchants, banks, and consumers alike.



On June 28th, Judge Margo Brodie rejected the interchange fee agreement and upended expectations of a resolution. Judge Brodie deemed the $30 billion in interchange savings and a 7-basis point reduction was insufficient for retailers and not punitive enough for US banks.

Financial institutions issuing credit cards will bear the brunt of this decision, as interchange fees constitute approximately 25% of their credit card program revenue. As banks adjust to revenue pressures, it could lead to higher annual fees, reduced consumer rewards, and decreased credit availability.

Interchange fees, which exceeded $100 billion in 2023, represent the cost merchants pay to accept card payments. While Visa and Mastercard do not directly earn these fees, they play a vital role in managing the complex payments infrastructure connecting thousands of banks and millions of consumers and merchants. Large retailers like Walmart often negotiate lower rates, whereas smaller businesses face flat fees of 2.5% to 3.0%. Despite frustrations, these fees support the secure and seamless payment infrastructure.

This topic involves intricate elements, including merchant discount rates (MDRs), interchange fees, Honor All Cards (HAC) rules, and surcharging. Understanding the payment ecosystem's impact on payment providers requires analyzing the dollar volume and number of transactions, the US mix of business, Visa/Mastercard credit card distribution, the percentage of pricing that is flat fees versus bundled pricing, and potential interchange reductions. That's all…

The rejected settlement favored large merchants at the expense of smaller businesses, a key point of contention. Although it had flaws, all negotiated deals involve compromise. Some parties may feel shortchanged by this settlement, but pleasing everyone is nearly impossible. A negotiated resolution remains preferable to prolonged litigation, which tends to benefit attorneys more than the disputing parties. While some may feel we are back at square one, that may not be the case. We doubt either party will let this case proceed to a jury trial, knowing that any decision would likely face years of appeals. At a recent conference, Visa emphasized that a direct resolution with merchants is "the best way forward."

Judge Brodie's docket suggests a trial won't occur before mid-2025. Another settlement is likely, and we believe Judge Brodie will eventually approve it. We support market-driven solutions, encouraging negotiation over government or judicial intervention. This case underscores the complexities of the payment ecosystem. While we hope for a resolution balancing all interests, we remain focused on helping you navigate these dynamics to better serve your goals. Let's hope for calmer minds to prevail—and for a resolution that allows us all to shop in peace.

Holiday Shopping:

The weather has turned (for the better here in Florida), the election is behind us, and consumers are out in force. If shopping were an Olympic sport, Americans would claim gold every time. Retailers expressed optimism about Black Friday through Cyber Monday, reporting strong sales without heavy reliance on promotion.

In the lead-up to the holiday season, Americans spent nearly +9% more on Thanksgiving compared to the previous year. Adobe Analytics reported that Americans spent $11.3 million online every minute between 10am and 2pm on Black Friday. On Cyber Monday, online sales hit a record $13.2 billion according to Adobe's forecast.

Square's ecosystem processed 144 million transactions, up +17%. Its online growth was +21% and growth in-stores were an impressive +17%.

Fiserv (owner of First Data) and one of the largest merchant acquirer and payment processor in the world, published a special report reviewing consumer spending growth during the 2024 holiday shopping season. From November 27th through December 2nd, it captured nearly 800 million transactions across millions of US business locations. Credit cards were 64% of card spend at retail, while debit was 36%. However, debit spending growth was +8.9%, while credit spending grew +4.1%.

Over this six-day period, Fiserv found that:

- Same-store total retail sales grew +5.7%, with transactions up +6.7%
- Small business sales surged +11.9%, with transactions increasing +9.3%
- Brick-and-mortar purchases represented 58% of all retail sales
- Physical stores grew sales by +4.6% and transactions by +3.0%
- Addl' details can be found, if you wish to download the full report: 2024 Insights

Stripe is one of the world's largest payment gateways (and a large holding for our hedge fund from Day 1), and it provided spending details of its business from Black Friday through Cyber Monday. We were pleased to see it hit many all-time records.

- 465+ million transactions totaling $31 billion; 137,000 transactions per minute at peak
- 209 million unique cards and wallets used; $121 average spend per card/wallet, up 4.3% YoY
- 428,000 total crypto transactions in in 36 markets
- Stripe's API maintained an uptime of more than 99.9999%
- 20.9 million fraudulent transactions prevented by Stripe Radar totaling $917 million in value
- More than 35,000 businesses had their best day ever on Stripe

Consumer spending remains robust, but credit card debt is climbing to unprecedented levels. Americans are increasingly relying on credit cards to fund both discretionary and essential purchases. According to the Federal Reserve Bank of New York, credit card debt has reached an all-time high of approximately $1.2 trillion—up nearly 6% year-over-year. This equates to roughly $6,500 per American, underscoring the financial strain on households.

Many consumers are swiping their way through higher prices, as purchasing power diminishes. This mounting debt is exacerbated by historically high interest rates, with APRs (average annual percentage rates) exceeding 20%—the highest since the Federal Reserve began tracking. These elevated costs make managing credit card debt increasingly burdensome for consumers and contribute to overall US household debt, now nearing $18 trillion.

Despite these challenges, the resilience of US consumers reflects the dynamism of the retail and payments ecosystems. We remain eager to see how these trends develop and are committed to providing you with actionable insights into economic shifts and spending patterns.

A Brief Look Back:

In the wake of an unprecedented global pandemic, substantial economic stimulus, and soaring inflation, the Fed's decision to raise interest rates was imperative. While some voiced concerns, we consistently emphasized in our newsletters and conversations that the Fed was taking a prudent approach given the uncertainties facing the economy.

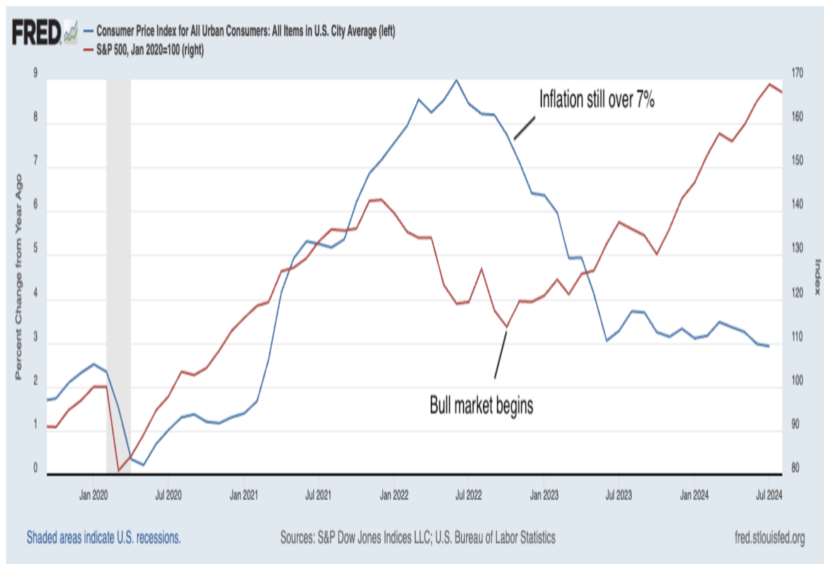
As rates climbed, capital formation slowed, IPO activity vanished, and unprofitable private firms faced difficulties. Throughout this turbulence, we adhered to our disciplined investment philosophy (click here). A core tenet of ours is that holdings must generate free cash flow (FCF), which becomes critical during economic downturns. FCF acts as a financial buffer, allowing companies to play offense rather than defensively retreat. While we stay fully invested, our approach enables strategic capital allocation during uncertain times.

Over the last two years, inflation dominated headlines, driving Fed actions and influencing markets. While inflation fears were valid, they ultimately became the "wall of worry" that stocks climbed.

Looking Forward:

Fed decisions, inflation, and interest rates are data-dependent but also tend to be backward-looking. One of our former colleagues at Goldman Sachs Asset Management emphasized the importance of looking ahead and anticipating future events. While accurately predicting tomorrow's news is impossible, we strive to incorporate various scenarios into our models and investment framework.

At the start of 2023, most investors were worried about runaway inflation and rising interest rates choking off growth. Economists widely predicted a recession, citing the inverted yield curve as evidence. However, that impending recession never arrived. Instead, stocks began rallying even when inflation remained high.



In the St. Louis Federal Reserve chart on the left, we can see inflation (blue line, left axis) versus the S&P 500 (red line, right axis). While it isn't a perfect correlation, as inflation peaked a few months earlier, the stock and bull market kicked into high gear when CPI was still a worrisome +7% on a year-over-year basis.

While the media was focused on a recession, rising interest rates, and inflation, stocks were forward-looking and estimating earnings and growth. The market's forward-looking nature allowed it to estimate future earnings and growth despite short-term concerns.

Politics:

Since the 1920s, there have been 24 US presidential elections. In 20 of them, the S&P 500 registered positive total returns in the election year. In the four instances when the stock market fell, the US economy was impacted by the Great Depression, the early days of World War II, the 2000 tech bubble, and the 2008 Global Financial Crisis. In the rare cases of post-election downturns, they have been tied to broader economic factors, not a specific election or candidate.

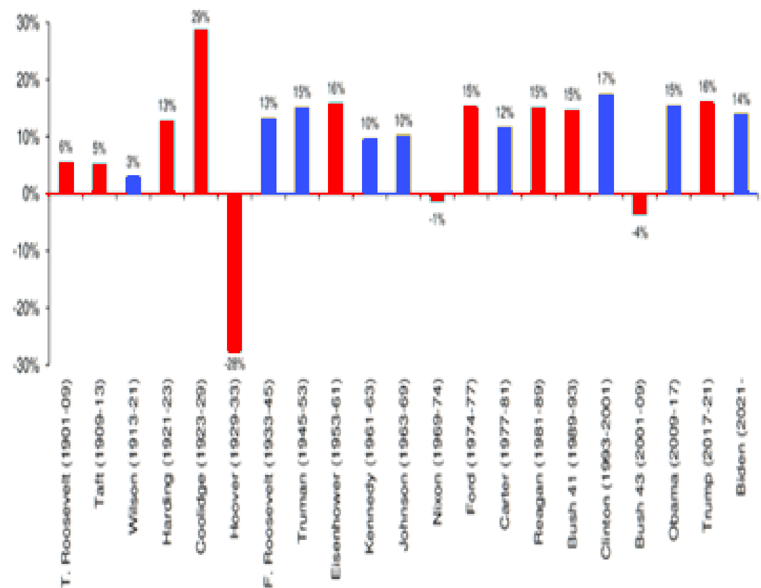
2024 has seen the highest year-to-date equity gain, in an election year, since 1936. US presidential election years tend to be drama-filled and emotionally charged. For some investors, this has been a stressful year, filled with uncertainty. Instead of straying from our investment philosophy, we have remained disciplined, patient, and focused on the long-term. Despite media narratives claiming this is "the most important election in our lifetime," history reminds us that election results do not drive market outcomes. Long-term results depend on the economy and corporate earnings.

Now that the election is behind us, many investors are wondering how it will impact the market. From an investment standpoint, it is critical to set aside specific political views and focus on business fundamentals and economic data. Regardless of who sits in the oval office, we remain focused on identifying opportunities where economic and corporate fundamentals drive long-term growth.

Evidence consistently shows (and this chart provides further proof) that the stock market responds more to earnings trends and economic growth than to political leadership changes. Over the last century, only President's Hoover, Nixon and Bush 43 had negative annualized S&P 500 performance.

While politicians come and go, Americans continue to spend (services generated 72% of US GDP last year), and companies continue to innovate.

The real drivers of economic growth remain corporate earnings, small business growth, infrastructure investment, and personal consumption.



The 2nd Trump Administration:

The economic impacts of the 2nd Trump presidency will likely center on tariffs, immigration, and an extension of prior tax reforms. Not all tariffs are the same and some might be used for negotiation purposes. While tariffs will be a focus of his administration, we aren't clear on how significantly they will impact growth or inflation. We expect this administration to push significant legislation and policies in the first 100 days, with a strong focus on small businesses. Better financial conditions, lower regulatory burdens, and reduced interest rates could position small businesses for growth in 2025.

We expect the Trump administration to "come out of the gate, with guns a blazin' ", with potentially hundreds of pre-prepared executive orders. Some might get challenged in court, but the volume may be overwhelming. He knows that he only has 1, four-year term to get things done, and we imagine he is better prepared to execute on his policies than he was back in 2016.

Macroeconomic data continues to show strong US growth, with moderating inflation. For example, 3rd quarter GDP grew at a healthy +2.8%, continuing a 2-year streak of robust growth. Unemployment remains low at just over 4%, although there are signs of gradual labor market unwinding. Meanwhile, the Fed's preferred inflation gauge, the PCE (personal consumption expenditures) index, rose +2.8% on a core basis in October. The persistence of core PCE inflation closer to 3% instead of the Fed's desired 2% is pesky. As we mentioned in our last few newsletters, the last mile of the Fed's inflation fight was going to be the most challenging.

The Fed voted in November to lower rates by 25-basis points, following its bold, 50-basis point cut in September, bringing Fed Funds down to 4.50-4.75%. All recent Fed commentary leads to us to believe that it likely will lower the target towards 2.0% (over the next couple of years), as inflation declines. As our loyal readers know, we never guestimate on future Fed moves, but prefer to examine the CME's FedWatch Tool. That now shows the likelihood of a 25-basis point rate cut at over 85% on December 18th, up from 61% in mid-November.

While inflation remains above the Fed's target, recent rate cuts suggest a gradual normalization, creating a supportive environment for the stock market. The Fed will remain data dependent (regardless of whether Powell remains as Chairman

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through May of 2026), and it should continue to normalize interest rates - which will be good for stock market. The Fed's interest rate cuts align with an all-time high in the S&P 500, a scenario historically associated with further market gains. The Fed has cut interest rates, when the market is at an all-time high, 20 times. A year later, stocks were higher 20 times. All we are trying to emphasize is that the Fed is likely to be a strong tailwind for the market.

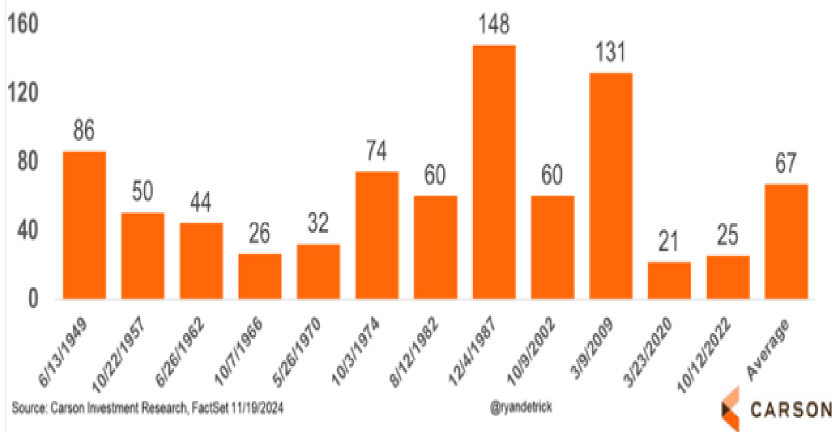
The Stock Market:

While nothing is ever certain (except for death, taxes and my Miami Dolphins losing in cold weather football games), the Fed appears to have managed a smooth economic landing. October saw weak equity returns due to election uncertainty, but markets have rallied meaningfully since then. With election outcomes now resolved, major indices have posted one of the strongest rallies in years.

Despite challenges in 2022, the markets roared back, underscoring the resilience of US innovation and corporate strength. Over the past century, 39% of years have experienced returns over +20% returns and the last two years have delivered consecutive strong performances. Historical data suggests that following a +20% year, US stocks have averaged an +8.9% return, reinforcing the potential for continued gains.

Looking at S&P 500 returns since 1980, there are far more positive years than negative ones (33 of the 44 years). In addition, one-quarter of every year (from 1980 to 2024) has had a positive return of 25% or higher and one-third of years have been over 20%. The last couple of years of excellent performance isn't the anomaly; it's actually more of the norm!

Bull markets do not necessarily have to downshift or revert to the mean on a specific timeline, just because stocks have risen for a couple of years in a row. If corporate earnings and profit margins remain healthy, and cash flow accelerates, there is no reason to assume stocks require a "breather".



Typically, easing monetary policies, a healthy labor market, and a resilient consumer lift markets. Geopolitical issues remain a wildcard, but the market has climbed a "wall of worry" over the past two years, including conflicts in Ukraine and the Middle East, and still posted remarkable gains.

This FactSet and Carson Investment Research chart shows the length of various bull markets. The current bull market, that started in October 2022, might have more runway and "last longer" than some investors think.

A Return of Animal Spirits?

A favorable market and lower interest rates should lead to an increase in M&A activity and a revival of the IPO market. Private markets appear optimistic about a capital market resurgence, and we anticipate IPO activity to gain traction. We already see activity building, and our recent performance has been aided by a couple of transactions. Private equity firms, flush with cash, are under pressure to deploy capital and deliver returns. With interest rates declining, competition for assets may intensify, potentially igniting a strong M&A trend in 2025.

Historically, the payment sector has been a favorite for deal activity due to its secular growth, strong balance sheets, and steady free cash flow. For payment companies that have underperformed the broader market, shareholder interest in potential deals may increase.

While inflation dominated headlines for the last couple of years, we believe that top and bottom-line growth remains critical for businesses and investors. Looking at recent quarterly results, we have noticed a clear differentiation between certain companies' growth profiles. Cyclical companies tend to ride the roller coaster both up and down, which is why we focus our attention on secular growing FINTECH companies. This way, we don't have to time the market or guess what part of the economic cycle we are in. Instead, we can invest in steady, predictable growth companies, that are able to manage their way through some of these dizzying cycles.

Conclusion:

We anticipate a healthy market environment and a resurgence in M&A activity, though uncertainty and volatility will likely persist under a second Trump Administration. Inflation lingers as a concern, geopolitical risks persist and growing deficits and ballooning national debt weigh on the horizon, but we will stay focused and disciplined, avoiding the temptation to chase rallies or alter our approach. Our philosophy remains unchanged: focus on long-term growth, free cash flow, and prepare for the unexpected, regardless of short-term volatility.

Excessive capital flows can pose risks, even in seemingly stable times, for investors, companies, and the broader economy. History shows that the market thrives despite its "wall of worry", often using these issues and concerns as fuel for growth. We anticipate that the Fed will lower interest rates gradually, conserving its policy tools for future economic challenges. Rather than speculating on rate changes, we remain focused on delivering value and generating alpha for our clients. While challenges remain, the US economy continues to be the envy of the world, underpinned by resilience, innovation, and ingenuity.

As we enter our 10th year, we are grateful for your trust and loyalty. Looking ahead, we remain committed to our version of FINTECH and providing access to exciting opportunities in this dynamic and rapidly evolving space. Please reach out anytime —we value our relationship and are always here to chat.

Warren Fisher, CFA
Founder & CEO
Manole Capital Management
warren@manolecapital.com

Cliff Clavin's "Useless" Information:

In the 1980s, one of our favorite TV shows was ***Cheers.*** The know-it-all postal worker was named Cliff Clavin and played by actor John Ratzenberger. This recurring segment of our newsletter highlights some "useless" information that Cliff would be proud of.

Market Size:

The total value of the entire S&P 500 now exceeds $50 Trillion. For some perspective on that enormous number, it is 50x its value when this bull market started in 1982 and 6x since the 2008 Global Financial Crisis. The market is 100x its value with the end of 1974, when the entire value of the equity market was $500 billion. Interestingly, that is 1/7th the market cap of Apple today.

Paper Checks:

Last quarter, there were 95 million paper checks written in the US. You can admit it…you wrote one or two, right? Paper checks are still around and will likely be written for years to come. Zelle is the bank owned electronic payment platform doing account-to-account or person-to-person payments. Last quarter, it did 256 million transactions or 2.7x the number of traditional paper checks written.

End of an Eras:

Taylor Swift's Eras Tour ended in Vancouver on December 8th, and she did a remarkable 149 concerts/shows. Taylor's tour visited five continents, sold roughly 10 million tickets and generated roughly $2 billion in revenue. Fans traveled an average distance of 338 miles to see her show and spent an average of $1,300 per ticket. Merchandise sales totaled $440 million, her movie brought in $261 million, and the Era Tour book even sold 814,000 copies at $40 a copy.

(Credit: Paolo Villanueva @itspaolopv)

That's Wicked!

(Credit: Universal Pictures)

The Wizard of Oz story has gained new attention, with the release of the movie *Wicked.* It is an adaptation of the Broadway musical and a prequel that reimagines the character of the Wicked Witch of the West.

A recent Heritage auction sold Dorothy's sparkly and sequined red heels. In the 1939 musical, Judy Garland wanted to return from Oz to Kansas, clicked her heels three times and sang, "There's no place like home." I bet she never would have imagined that her slippers would sell for $28 million. Other memorabilia from *The Wizard of Oz*, such as a hat worn by the Wicked Witch of the West that "only" went for $2.4 million.

Robotaxi's:

Over the last decade, General Motors spend $10 billion developing its Cruise robotaxi program. It officially got scrapped on December 10th.

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