

# Watchlist Investing Newsletter

*Patently finding and following great public companies to own at the right price.*

**Issue #5 | July 2021**

**“One person said to me, 'I have a list of 300 potentially attractive stocks, and I constantly watch them, waiting for just one of them to become cheap enough to buy.' Well, that's a reasonable thing to do. But how many people have that kind of discipline? Not one in 100.”**

**– Charlie Munger**

## **In this issue:**

- Russell 3000 Project Update / Conclusion.....2
- What’s coming next month .....7

## **Editorial Notes:**

- **Reader experience:** This month’s issue is again laid out in one column. It’s easier and saves a lot of formatting frustration—energy that could be put into research. Please let me know your thoughts on the layout or any other feedback you think would improve the reader experience.
- **Watchlist:** An updated Watchlist (but not the Suspect List) is included at the end of this issue for convenience, in addition to the link to the full Google Sheet.
- **“Guest” writeup:** The Timberland Bancorp entry on p. 6 was completed by Christophe Nour, an intern helping me in the background. He took his findings to the next level and wrote up a quick piece for this issue. Aside from small editorial revisions the work is his. Thank you, Christophe!

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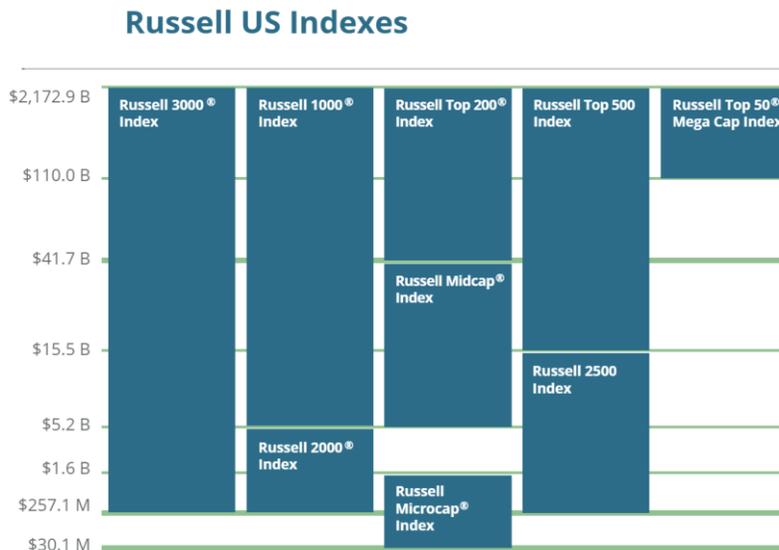
## Deep Dive

### The Russell 3000 Project

This issue features the main event of the Russell 3000 project that's been touched upon over the last few issues. A significant amount of effort went into building the spreadsheet (below) and sorting through the potential opportunities.

To recap, the Russell indices are rebalanced every year to maintain appropriate sizing of companies into the correct size/style buckets. This annual reshuffling can create opportunities to buy companies whose stock prices are artificially driven down because of forced selling by index tracking ETFs and the like. This year the cutoff to remain in the Russell 3000 or Russell 2000 is a market cap of \$257 million (there are a few larger-capitalization companies that got cut because they couldn't maintain other requirements, like public float, domicile, etc.). The initial list was provided on June 4 and the final rebalancing date was June 25.

Here's a nice graphic of the various indices and their cutoff points for 2021. You can see the floor created by starting from the top down, which creates the \$257 million cutoff.



The [June issue](#) featured a Deep Dive on **Bank7 (BSVN; Disclosure: none)** and a Quick Look at **Plumas Bancorp (PLBC; Disclosure: none)**. As it turns out both banks were on the cut list.

This issue will contain my thoughts on potential areas of value and provide a full sortable spreadsheet you might find of value in your own investing program. Click [here](#) or on the screenshot below.

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## Overview of the Russell 3000 Deletions List:

The first thing I did was download the PDF of the preliminary deletions list from the Russell website. You can find that list and lists for other deletions and the additions [here](#). As seen below, the list is heavily weighted toward Health Care and Financials, which together comprise two-thirds of the entire cut list.

### Russell 3000 Index Deletions Sorted by Industry

Row Labels	Count of Industry	%
Health Care	106	36%
Financials	95	32%
Industrials	21	7%
Technology	16	5%
Real Estate	12	4%
Energy	12	4%
Consumer Discretionary	10	3%
Telecommunications	9	3%
Consumer Staples	5	2%
Basic Materials	5	2%
Utilities	4	1%
<b>Grand Total</b>	<b>295</b>	<b>100%</b>

### Financials:

The search for financials prompted this entire exercise. The stats for financials break down as follows:

Russell 3000 Project - Financials Cut List Breakdown	
Number of companies:	95
Minimum market cap:	\$78,537,636
Maximum market cap:	\$286,314,402
Median market cap:	\$183,205,400
Average market cap:	\$186,965,443

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### Ames National Corporation (ATLO)

Price (6/24/21):	\$24.71
Market cap:	\$225m
Total assets (12/31/20):	\$2.0bn
5-Yr Avg. ROA:	1.09%
Price/Book (6/24/21):	1.11x
Investor relations link:	<a href="#">IR ATLO</a>

ATLO is a bank-holding company located in Ames, Iowa. Unlike most bank holding companies, ATLO is a multi-bank holding company with a handful of independently managed and branded banks. I like the decentralized approach to management of the individual banks, which pushes decision-making out to those closest to the customer. Charge-offs over the past five years have been 10bps or less. I'm also charmed by the clear use of Excel tables in the annual report. Could be an interesting bank to get to know / follow.

### Auburn National Bancorp (AUBN)

Price (6/24/21):	\$34.95
Market cap:	\$125m
Total assets (12/31/20):	\$993m
5-Yr Avg. ROA:	1.00%
Price/Book (6/24/21):	1.22x
Investor relations link:	<a href="#">IR AUBN</a>

AUBN is based in Auburn, Alabama. The bank has generated a consistent ROA over the past ten years and over the past five years has had negative charge-offs (i.e. net recoveries). The bank has a typical community bank loan book with a concentration in commercial real estate. I like the fact that the bank isn't overly reliant on deposit account fees. It also just instituted a share repurchase program in 2020. I was pleased to see the company had an annual report with a letter to shareholders, but strangely there is no 2020 document. I like enough of what I see in AUBN to add it to the Watchlist.

### Farmers & Merchants Bancorp (FMAO)

Price (6/24/21):	\$21.83
Market cap:	\$245m
Total assets (3/31/21):	\$2.0bn
5-Yr Avg. ROA:	1.23%
Price/Book (6/24/21):	0.99x
Investor relations link:	<a href="#">IR FMAO</a>

Headquartered in Archbold, Ohio, FMAO appears to be a fairly consistent-earning bank trading at book value. The bank has a reliance on customer fees for non-interest income, which presents a longer-term risk. Net charge offs over the past five years are 6bps or below. About 45% of its portfolio is in commercial real estate. As the name of the bank suggests, it has agricultural exposure. Ag exposure, including "pure" ag and real estate has averaged about 20% of the loan book over the past five years.

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## **First Savings Financial (FSFG)**

Price (6/21/21):	\$73.45
Market cap:	\$174m
Total assets (3/31/21):	\$1.75bn
5-Yr Avg. ROA:	1.38%
Price/Book (6/21/21):	1.01x
Investor relations link:	<a href="#">IR FSFG</a>

What caught my eye on FSFG was the valuation at par of book and a 5-year average ROA of almost 1.4% with an upward trend. I'm also skeptical and wondering what I'm missing here. The bank has a September 30 year end, which is odd, and skews the "normal" reporting, but that shouldn't be a major issue. Perhaps there are issues or skepticism around acquisitions that the bank has made in its recent past. There's some goodwill on the books and deposit intangibles (a weird quirk of accounting) as well as mortgage servicing rights, a business it entered in 2019. I tend to shy away from these types of loan "manufacturers" and prefer a simpler business model. But they can be attractive investment candidates for those willing to invest the time to understand them more fully.

## **Greene County Bancorp (GCBC)**

Price (6/21/21):	\$27.72
Market cap:	\$236m
Total assets (3/31/21):	\$2.1bn
5-Yr Avg. ROA:	1.28%
Price/Book (6/21/21):	1.68x
Investor relations link:	<a href="#">IR GCBC</a>

GCBC at first glance appears to be a good bank at a fair-to-rich price. I was pleased to find a letter to shareholders on the IR site, although it appears to be of the garden variety and more a PR piece than true strategic thought. GCBC earns healthy fees from deposit charges and interchange fees, which represents a risk if (when) those get competed down. I like the low 50's efficiency ratio of the bank and the low charge off ratio (under 10bps) over the last five years, although that's with some solid tailwinds economically speaking. Overall, the bank looks to have a fairly typical and diversified loan book. GCBC also earns commissions by referring its customers to a third-party investment brokerage service provider.

## **OP Bancorp (OPBK)**

Price (6/24/21):	\$9.74
Market cap:	\$147m
Total assets (3/31/21):	\$1.5bn
5-Yr Avg. ROA:	1.20%
Price/Book (6/24/21):	1.01x
Investor relations link:	<a href="#">IR OPBK</a>

OPBK is located in Los Angeles, CA. The bank has a focus on lending to Korean-American communities. It does this via full-service branches in California as well as in Korean-American communities in Atlanta, Aurora Colorado, Lynnwood and Seattle Washington, and in Carrollton Texas. It appears to have a good charge-off record across a diversified "typical" loan portfolio including real estate, business, loans, etc.

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### Parke Bancorp (PKBK)

Price (6/17/21):	\$20.36
Market cap:	\$242m
Total assets (12/31/20):	\$2.1bn
5-Yr Avg. ROA:	1.62%
Price/Book (6/17/21):	1.19x
Investor relations link:	<a href="#">IR PKBK</a>

PKBK appears to be attractively priced at 1.2x book despite a five-year average ROA north of 1.6%. The bank is headquartered in New Jersey and does business there and in Philadelphia. A quick look at the \$1.5bn loan portfolio reveals a mix across asset classes with concentrations in commercial and residential real estate. At 13% of the loan book, construction loans are higher than I'm typically comfortable. The C&I portfolio at 8% is up sharply from 3% of the loan book last year. It's likely that this sharp growth is due to PPP loans related to Covid, however, a quick look at the notes to the financials didn't reveal anything. It also appears the bank stopped writing an annual report/letter to shareholders in 2014, which I put down in the negative category.

### Timberland Bancorp (TSBK)

Price (6/24/21):	\$27.90
Market cap:	\$233m
Total assets (12/31/20):	\$1.6bn
5-Yr Avg. ROA:	1.66%
Price/Book (6/24/21):	1.19x
Investor relations link:	<a href="#">IR TSBK</a>

Note: This write-up is a bit longer than the others. Christophe Nour did some deeper digging on the company and found it to be a bank worthy of study and a possible add to the watchlist. Thanks, Christophe!

Timberland is an attractive community bank, operating with 24 branches in the state of Washington, with growing earnings and a very healthy balance sheet. It has been focusing on providing residential and commercial real estate loans, especially since the late 1980s, when the company began to establish a niche of originating residential construction and land development loans. This category had grown steadily over time and has become the major portion of its balance sheet.

TSBK maintains a typical bank structure with 65% of total assets in loans. The loan book mainly consists of Commercial real estate loans (41%) and Constructions Loans (20%). Of the CRE portfolio, 17% consists of office buildings while an additional 20% includes loans made to medical offices, nursing homes and churches.

In the past few years, the asset quality of Timberland has been improving with nonperforming assets as a percentage of total assets of 0.3% in 2020 (compared to 0.88 in 2016). In addition, the efficiency ratio has also improved in recent years, from 63% in 2016 to 48% in 2020. This cost control coupled with asset quality improvements have led to increasing profitability. As a result, over the past 10 years, Timberland has consistently improved its ROE and ROA (now 14% and 1.75% respectively) and the EPS have doubled in 5 years.

The management has been the same for decades (same CEO for 42 years), and there is a 12% insider ownership. I suppose this incentive has contributed to a growing dividend over time (dividend yield of almost 3% for a low payout ratio of 25%). This February, Timberland announced a stock repurchase program up to 5% of the outstanding shares and hiked its dividend by 5%.

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## *Industrials:*

### **Graham Corp (GHM)**

<b>Price (6/24/21):</b>	\$13.42
<b>Market cap:</b>	\$143m
<b>Investor relations link:</b>	<a href="#">IR GHM</a>

GHM caught my eye from the company description, which includes producing critical parts for defense and energy. The company has \$65mm of cash/investments on the balance sheet and no funded debt. The letter to shareholders revealed the company's strategy of moving more heavily into defense, including a recent acquisition in that space this month. This could be an interesting candidate for future study.

### **Hurco Companies Inc (HURC)**

<b>Price (6/24/21):</b>	\$34.24
<b>Market cap:</b>	\$226m
<b>Investor relations link:</b>	<a href="#">IR HURC</a>

HURC is a debt-free manufacturer of computerized machine tools based in the US but doing business worldwide. The company manufactures computerized CNC equipment, lathes, and the like. The company has no funded debt and has about \$58mm cash on the balance sheet. HURC appears to be a fairly boring but steady earner and it trades at book value.

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## *Real Estate:*

There are a bunch of REITs in here, an asset class I can't claim much expertise. My review of the list found a good concentration of office-related REITs, which makes sense as that asset class has struggled. I looked briefly into **Maui Land & Pineapple (MLP)** which reminded me of the example of Magna International as described by Bruce Greenwald in his excellent book, *Value Investing: From Graham to Buffett and Beyond*. I'd highly recommend that book, especially now that the second edition is available.

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## *Healthcare:*

Included in this group are a ton of biotech and pharmaceutical companies which make my eyes glaze over. If you're into that sort of thing the Russell indexes contain a ton of them.

Nestled in this list was **Five Star Senior Living Inc. (FVE)**, which operates over 250 senior living facilities in the US and owns about 20 of them.

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## **WHAT'S COMING NEXT MONTH:**

Prior issues and the Russell project focused a lot on banks. Time to shift focus to another industry. The plan for next month is to do a study of the waste management industry.

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## Watchlist

**As of June 29, 2021**

WATCHLIST			Count: 9		
Company Name	Industry	Ticker	Current Price	Market Cap	See Issue #
AAON, Inc.	Building Products	AAON	\$61.42	\$3,220,567,431	1
Berkshire Hathaway	Conglomerate	BRK.B	\$276.61	\$632,395,333,584	1
Hingham Institution for Savings	Banking	HIFS	\$288.57	\$618,232,383	1
Monarch Cement	Building Products	MCEM	\$110.00	\$287,001,400	2
International Flavors and Fragrances	Foods/Seasonings	IFF	\$148.79	\$37,036,790,249	3
McCormick	Foods/Seasonings	MKC	\$88.15	\$23,530,399,992	3
Bank7	Banking	BSVN	\$17.30	\$156,552,121	4
Plumas Bancorp	Banking	PLBC	\$31.96	#N/A	4
Auburn Bancorp	Banking	AUBN	\$35.64	\$127,103,820	5

*Note: Plumas market cap was approximately \$166mm. Not sure why it wouldn't pull the data.*

**To see the latest Watchlist and Suspect List on Google Sheets, head to [www.watchlistinvesting.com](http://www.watchlistinvesting.com) or click [here](#).**

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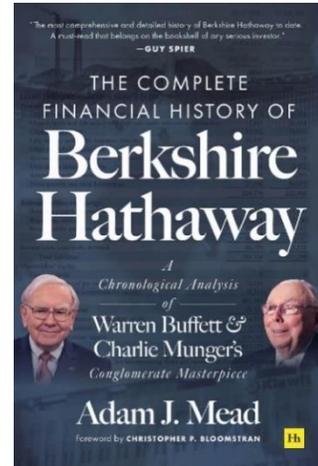
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## About

After nearly two decades as an individual investor, a decade in commercial credit at various banks, and a few years managing money for friends/family in the background, I decided to go full-time managing money for clients in 2020. Watchlist Investing is an extension—albeit separate and distinct—of what I do day-to-day as a practicing capital allocator. Inverting the margin of safety principle, I hope to add value to readers above and beyond the nominal cost of the newsletter.

My investing style is influenced by my background growing up in a family of business owners. I followed suit selling firewood through high school and founding a welding business in college. Looking at stocks as businesses is natural to me. My investing approach rests on fundamental value investing tenets, but it's adapted to suit my style. I'm 100% certain I'm not the best investor or analyst, but I hope to improve over time.

Between 2016 and 2021, I wrote a book on Berkshire Hathaway. *The Complete Financial History of Berkshire Hathaway* was and is my passion project. I hope it brings new shareholders up to speed on the company and provide a fresh look to longtime shareholders, in addition to serving as a resource/reference book. It can be purchased [here](#). I also created [www.theoraclesclassroom.com](http://www.theoraclesclassroom.com) as an extension of the book, which includes an archive of a lot of BRK material.



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