

Watchlist Investing Newsletter

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

Issue #3 | May 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

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Watchlist

A quick note on this month's issue: I decided to do a few Quick Looks instead of one Deep Dive and perhaps one Quick Look. It's just how the research went this month. While both MKC and IFF appear overvalued and thus not immediate actionable ideas, presenting them is in keeping with Munger's quote above. After all, the goal of this newsletter is to find the best companies *regardless of valuation* and get to know them before an event happens that might make them an attractive stock for purchase. The companies presented as part of the Russell 3000 project may be more actionable—and soon given the impending reconstitution of the index.

Quick Looks

McCormick & Co.

(NYSE: MKC; Disclosure: N/A)

Price (4/14/21):	\$88
Shares out (diluted):	269m
Market cap:	\$23.7bn
Revenues (FYE '20):	\$5.6bn
Net income:	\$747m
Equity:	\$3.9bn
Tangible equity:	Neg.
Net debt:	\$4.3bn
Insider ownership:	13.9%

McCormick is one of those companies you sort of *know* is a good business but, at least for me, haven't spent too much time digging in. I thought I'd remedy that this month with a Quick Look at the company.

Closer examination found a mature but dominant business with steady gross and operating margins and a history of growth through acquisitions. The company appears to enjoy a sustainable competitive advantage but generally lacks the outsize growth potential to justify its lofty valuation. MKC would be a great business to purchase at the right price.

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Overview/Industry:

McCormick is the dominant spice manufacturer in the United States. Its 20% market share is 4x the nearest competitor. The industry is mature and grows along with population growth and changes in preferences/habits.

MKC's business is broken out into consumer and flavor solutions. The latter was formerly called industrial and encompasses everything from restaurants to food producers. These two segments broadly define the spices/seasonings market. Unlike its competitors, MKC operates in both segments, which gives it a leg up not only during shifts in demand (e.g., during the pandemic from dining out to in-home meal preparation) but in identifying shifts in consumer tastes.

MKC's growth strategy relies on acquisitions. The company has a stated goal of growing sales via acquisition of strategic brands. Over the past ten years MKC spent \$6.1bn on acquisitions. The largest acquisition was \$4.2bn in 2017 to acquire RB Foods (French's mustard, Franks's Red Hot, Cattlemen's) from Reckitt Benckiser. MKC has made acquisitions in Australia, Italy, China, and India, among other regions. The company has largely stayed away from Germany (where it competes with the Fuchs Gruppe), and in Scandinavian countries where ProviNord Group reins strong).

Business/Financial Overview:

Balance Sheet (FYE '20)	\$ millions
Cash	424
Receivables	529
Inventories	1,033
PP&E, net	1,028
Investments	130
Goodwill + intangibles	8,226
Other	720
Total assets	12,090
Accounts payable	1,032
Accruals	864
CMLTD + ST debt	1,151
LTD	3,754
Deferred taxes	727
Other	622
Equity	3,940
Total liab + equity	12,090

P&L (FYE '20)	\$ millions
Revenues	5,601
COGS	3,301
Gross profit	2,300
GPM	41%
Operating income	1,000
OPM	18%
Net income	747
EPS	\$2.78

MKC requires very little tangible capital to operate. Explicit tangible accounts such as accounts receivable, inventories, prepaids, and PP&E, offset by spontaneous liabilities like accounts payable and accruals, total just \$793 million. As a result of negative core working capital MKC really only needs to invest in physical plant to operate its business. The significant brand assets MKC enjoys amount to over \$8.2 billion. We can get an idea for the hidden value of these intangible assets in the roughly six years of operating expenses it represents, which seems reasonable given MKC's entrenched position with retailers.

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As the table below illustrates, the consumer segment generates two-thirds of revenues but three-quarters of operating profit. This reflects the fact that non-consumers are large (including Pepsi and Walmart at about 11% of sales each) as well as some unbranded outlets such as dollar stores.

MKC 2020 (\$mil)	Consumer	Flavor Solutions	Total
Revenues	\$3,597	\$2,005	\$5,601
	64%	36%	100%
Operating income	\$781	\$238	\$1,019
	77%	23%	100%

Revenues are broken down geographically as follows:

MKC 2020 (\$mil)	Revenues	
Americas	\$3,975	71%
EMEA	\$1,047	19%
Asia Pacific	\$580	10%
Total	\$5,601	100%

Capital Allocation:

Major sources and uses of capital can be seen in the table below. MKC's strategy of growth through acquisitions is readily apparent. Dividends are the next major use of capital. Funding those initiatives is net income, additional borrowings, and a steady reduction in core working capital over the prior decade. MKC now enjoys negative core working capital, meaning any organic growth need only require additional plant and equipment (if/when capacity constrained).

MKC Capital Allocation 2011-20		
Sources		
Net income	5,344	55%
ST debt	892	9%
LT debt	2,947	31%
Core working capital	467	5%
Total sources	9,650	100%
Uses		
Growth capex	(248)	3%
Acquisitions	(6,067)	68%
Share repurchases	(354)	4%
Dividends	(2,252)	25%
Total uses	(8,920)	100%
Change in cash	373	
Unaccounted	357	

Moat:

MKC appears to enjoy a moat in its customer captivity and economies of scale in production. MKC has customer captivity in the mind of the consumer via habit as well as via the retailer by its established presence. The company's scale affords it the ability to maintain good margins while providing larger retailers a lower price.

Spices/flavorings appear to be one of those low unit cost / high impact to the final product items that is resistant to competitors undercutting via lower prices. It also has the benefit of a relatively shorter product life unlike something like a can of WD-40 which could literally last a generation on the shelf.

Valuation:

This is where one sort of stops looking at MKC and moves on, at least initially. The business has a current market cap of \$23.7bn. Add in net debt of \$4.3bn and you get an enterprise value of \$28bn. With EBIT of about \$1bn that equates to a going-in return of about 3.6% pre-tax. Management pays out about half of earnings via dividends and buybacks, which leaves a 1.8%

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current return (half of the 3.6%), and 1.8% with which to grow the business. The last decade saw growth funded via additional debt and shrinking working capital, so future growth will largely have to rely on internally-generated cash.

In short, McCormick appears a wonderful business that's currently overpriced. Something to watch but nothing to be tempted to purchase anytime soon.

Other considerations:

- **Management compensation:** A quick scan of the most recent proxy statement reveals MKC pays its management team and directors very well. That includes heavy use of stock options and the like.
- **Share classes:** MKC has two classes of shares. The non-voting shares (94% of total shares) trade under the symbol MKC, while the voting shares trade under MKC.V. Currently there appears to be no difference in pricing between the two classes.

McCormick summary financial statements:

McCormick (MKC) Income Statement (\$mil; (FYE Nov. 30)	2020	2019	2018	2017	2016	2015	2014	2013	2012	2011
Sales	5,601	5,347	5,303	4,834	4,412	4,296	4,243	4,123	4,014	3,698
Cost of goods sold	3,301	3,202	3,210	2,824	2,580	2,559	2,513	2,458	2,396	2,175
Gross profit	2,300	2,145	2,093	2,010	1,832	1,737	1,730	1,666	1,618	1,523
GPM	41%	40%	39%	42%	42%	40%	41%	40%	40%	41%
Operating expenses	1,301	1,188	1,202	1,308	1,191	1,189	1,127	1,115	1,040	982
Operating profit	1,000	958	891	702	641	548	603	551	578	540
OPM	18%	18%	17%	15%	15%	13%	14%	13%	14%	15%
Interest expense	136	165	175	96	56	53	50	53	55	51
Income taxes (benefit)	175	157	(157)	151	153	131	146	134	140	143
Net income	747	703	933	477	472	402	438	389	408	374
Diluted EPS	\$2.78	\$2.32	\$3.50	\$1.86	\$1.85	\$1.56	\$1.67	\$1.46	\$1.52	\$1.40

McCormick (MKC) Capital Allocation	2020	2019	2018	2017	2016	2015	2014	2013	2012	2011
Net income	747	703	933	477	472	402	438	389	408	374
Growth capex	(60)	(15)	(18)	(57)	(45)	(23)	(30)	6	(8)	2
Acquisitions	(803)	0	(20)	(4,329)	(121)	(211)	0	(142)	0	(441)
Dividends	(330)	(302)	(273)	(238)	(218)	(205)	(192)	(180)	(165)	(149)
Share repurchases, net	(4)	(17)	4	440	(209)	(113)	(213)	(133)	(79)	(31)
Change in ST debt (+issuance -repay)	287	41	306	(135)	252	(127)	58	72	(77)	217
Change in LT debt (+issuance -repay)	268	(448)	(772)	3,709	(196)	245	(2)	(5)	(4)	151
Acquisition notes	\$803m: Cholula Hot Sauce (FYE '21: \$710m: FONA Int'l)		Contingent consideration and purchase of minority interests.	\$4.2bn: RB Foods (French's, Frank's Red Hot, Cattleman's); \$124m Enrico (Italian mfr)	\$116m: Botanical Food Co., Australian maker of packaged herbs	\$62m: Brand Aromatics \$49m: D&A (Italy) \$99m: One World Foods (BBQ sauces)		\$145m: Wuhan Asia-Pacific Condiments		\$40m: Kitchen Basics \$287m: Kamis (Poland) \$113m (85% of Kohinoor, India)

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McCormick (MKC) Balance Sheet (\$mil; FYE Nov. 30)	2020	2019	2018	2017	2016	2015	2014	2013	2012	2011
Cash	424	155	97	187	118	113	77	63	79	54
Accounts receivable	529	503	518	555	466	455	494	496	466	427
Inventories	1,033	801	786	793	756	711	714	677	615	614
Prepays & other	99	91	79	82	82	79	132	135	126	128
Total current assets	2,084	1,550	1,480	1,617	1,422	1,357	1,416	1,370	1,285	1,223
PP&E	1,028	953	985	809	669	618	603	577	547	523
Goodwill	4,986	4,505	4,528	4,490	1,771	1,759	1,722	1,799	1,695	1,694
Intangibles	3,239	2,847	2,873	3,071	425	372	331	333	324	350
Long-term investments	130	124	121	127	116	113	113	103	86	71
Other LT assets	622	383	269	272	232	253	229	268	228	226
Total assets	12,090	10,362	10,256	10,386	4,636	4,473	4,414	4,450	4,165	4,088
ST borrowings	887	601	560	258	390	140	270	212	140	217
CMLTD	264	98	84	326	3	204	1	3	252	5
Accounts payable	1,032	847	710	640	451	412	372	387	376	367
Other accruals	864	609	648	724	579	484	479	462	419	404
Total current liabilities	3,047	2,154	2,002	1,947	1,423	1,239	1,122	1,063	1,188	993
Long-term debt	3,754	3,626	4,053	4,444	1,054	1,051	1,014	1,019	779	1,030
Deferred taxes	727	698	707	1,095	80	100	108	139	57	72
Other LT liabilities	622	428	313	329	441	395	361	281	442	375
Total liabilities	8,150	6,905	7,074	7,815	2,998	2,786	2,605	2,502	2,465	2,469
Shareholders' equity	3,940	3,457	3,182	2,571	1,638	1,687	1,809	1,948	1,700	1,619
Total liab. + SH equity	12,090	10,362	10,256	10,386	4,636	4,473	4,414	4,450	4,165	4,088
Diluted shares out (avg in mil)	269	268	266	257	256	258	262	267	269	269

International Flavorings & Fragrances

(NYSE: IFF; Disclosure: N/A)

Price (4/23/21):	\$144
Shares out (diluted):	See note
Market cap:	See note
Revenues (FYE '20):	\$5.1bn
Net income:	\$367m
Equity:	\$6.2bn
Tangible equity:	Neg.
Pre-tax return on capital	32%
Net debt:	\$3.8bn
Insider ownership:	<1%

*Note: In February 2021, IFF completed a merger with Nutrition & Biosciences. In connection with that merger, it issued shares equal to 55% of the shares outstanding at the end of FY '20. Readers should keep this in mind when referencing the 2020 results as the business has changed. IFF's current market cap is \$36 billion.

International Flavorings & Fragrances is the lesser-known “cousin” of McCormick. IFF is the secret sauce – sometimes literally – that helps products taste better.

After some initial research into IFF, I found a nice underlying business with a moat operating in a mature industry. IFF has recently grown via acquisitions funded by debt and equity issuance, which presents capital allocation risks. The very good company appears a very poor stock given its rich valuation.

Overview/Industry:

IFF competes in the flavorings and fragrances industry. Its products help food taste better and lend familiar scents to many everyday products such as laundry detergents and cleaners, in addition to personal care products. IFF and its peers work with their customers to develop compounds that achieve the end goals of their

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clients. Importantly, the compounds are owned by the companies producing them. Unsurprisingly, R&D is a big part of this business.

IFF commands a 25% market share. Key competitors include Guvaudan, also at 25%, Firmenich at 16%, and Symrise at 12%.

Business/Financial Overview:

Prior to a major acquisition in 2021, IFF operated in two segments: Taste and Scent. In early 2021 the company acquired via merger a unit of DuPont de Demours called Nutrition & Biosciences. As a result of this acquisition, it revised its categories to four: 1) Nourish, 2) Scent, 3) Health & Biosciences, and 4) Pharma Solutions. Geographically, IFF generates 20% of revenues (2020) in the US and the remainder worldwide.

P&L (FYE '20)	\$ millions
Revenues	5,084
COGS	2,998
Gross profit	2,086
GPM	41%
Operating income	566
OPM	11%
Net income	367
EPS	\$3.21

IFF has consistently generated a gross margin in the 40% range, although it had been as high as 45% around 2015. Its operating margin has come down from a high of 19% in 2015.

Part of that can be explained by the acquisitions IFF has undertaken, including the \$7bn Frutarom acquisition in 2018. Acquisition expenses and restructurings have impacted margins to some extent. Earnings in 2020 included \$100m or 2% of revenues in non-recurring expenses related to the pending Nutrition and Biosciences acquisition.

In addition, the acquisitions have increased capital turnover. In 2015, IFF generated \$2.37 in revenues for every dollar of tangible capital employed. In 2020 it generated \$2.86 or 20% greater turnover. Though this was not enough to counter the impact of lower EBIT margins and pre-tax return on capital fell from a high of 46% that year (2015) to 32% today.

IFF - Balance Sheet (\$mil)	2020	
Cash	657	5%
Receivables	929	7%
Inventories	1,132	8%
Other current assets	342	3%
Total current assets	3,060	23%
PP&E	1,458	11%
Goodwill	5,593	41%
Intangibles	2,727	20%
Other assets	717	5%
Total assets	13,556	100%
ST debt + CMLTD	634	5%
Accounts payable	556	4%
Dividends payable	82	1%
Other current liabilities	632	5%
Total current liabilities	1,904	14%
Long-term debt	3,779	28%
Other liabilities	1,550	11%
Total equity	6,323	47%
Total liabilities + equity	13,556	100%
Diluted shares out (000s)	113,630	

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Capital Allocation:

Even a cursory glance at IFF's financial statements reveals the company's capital allocation strategy.

IFF has taken on big acquisitions, including the aforementioned \$7bn Frutarom deal in 2018, primarily funded through debt. Shares issued in that acquisition essentially "paid for" the \$1.8bn dividends paid out over the last ten years. Net debt has increased from a net cash position of \$800m in 2011 to \$3.8bn of net debt in 2020. Future acquisition activity will have to slow if the balance sheet is to be maintained and without undue dilution.

Looking at the decline in EBIT margin and return on capital over the past three years, Frutarom is not as good a business as IFF's legacy business, but probably still highly satisfactory. The flavorings and fragrances markets are mature, which means organic growth probably won't be much more than global GDP growth.

IFF Capital Allocation 2011-20		
Sources		
Net income	3,576	39%
LT debt	3,834	42%
Share issuance	1,805	20%
Total sources	9,216	100%
Uses		
Growth capex	(581)	6%
Acquisitions	(5,931)	66%
Core working capital	(527)	6%
Repayment ST debt	(45)	0%
Dividends	(1,858)	21%
Total uses	(8,943)	100%
Change in cash	526	
Unaccounted	(252)	

Moat:

Judging by the history of highly satisfactory pre-tax return on capital rates in the 40%-range, IFF likely has a strong moat. Its moat stems primarily from switching costs which maintains strong demand from customers. With IFF's products a small percentage of the total cost of the end product but an outsize proportion of the customer experience, IFF competitors would have a hard time competing on cost alone. The new pharma business also benefits from high switching costs as FDA approval is necessary for any changes in a product.

Research and development also play a factor. IFF spends \$357m or 7% of sales on R&D. The smaller Symrise spends 6% which amounts to just 212m Euro (\$256m). That's a difference of 40%. To the extent that R&D isn't contract-specific (meaning not just the cost of doing business with each customer), IFF has an edge on smaller competitors.

Valuation:

Considering IFF is a mature business (albeit one with very attractive financial characteristics in the underlying business), growth isn't likely to play a big part in valuation. (Not that the business won't get *bigger*, only that it can only grow by putting more capital to work buying competitors.)

If we assume IFF can generate pre-tax returns around 35%, and with a long-run tax rate of 30%, a 25% after-tax return might command 2.5x underlying capital. Tangible capital at FYE '20 was \$1.8bn, which would imply \$4.5bn. Looking at the current market cap of \$36bn + \$3.8bn net debt get us to about \$40bn enterprise value. But this considers the 2021 acquisition. Using the FYE '20 share count, the market value of equity was about \$16bn, which puts the enterprise value of existing operations at \$20bn. In that light, IFF is still multiples overvalued, at least by this initial analysis.

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Even if we consider the \$2.5bn of pro-forma EBITDA as EBIT (giving generous credit for expected “synergies”), the \$46bn enterprise value (\$36bn current market cap of equity + \$10bn combined debt) still commands 16x or an initial return of 6.3%.

Other considerations/risks:

- Acquisition integration issues
- Low insider ownership
- Potential environmental issues with past or present chemical usage

International Flavorings & Fragrances summary financial statements:

IFF - Income Statement (\$mil)	2020	2019	2018	2017	2016	2015	2014	2013	2012	2011
Revenues	5,084	5,140	3,978	3,399	3,116	3,023	3,089	2,953	2,821	2,788
Cost of goods sold	2,998	3,027	2,295	1,926	1,721	1,672	1,726	1,669	1,646	1,683
Gross profit	2,086	2,113	1,683	1,472	1,396	1,352	1,362	1,284	1,176	1,105
Gross margin	41%	41%	42%	43%	45%	45%	44%	43%	42%	40%
Research & development	357	346	312	295	259	246	254	260	234	220
SG&A	949	876	707	570	573	495	508	506	454	444
Amortization of intangibles	193	193	76	35	24	15	7	0	0	0
Operating profit	566	665	584	553	553	588	592	516	487	418
Operating margin	11%	13%	15%	16%	18%	19%	19%	17%	17%	15%
Interest expense	132	138	133	65	53	46	46	47	42	45
Taxes	74	97	108	241	119	120	135	132	189	107
Net income	367	460	340	296	405	419	415	354	254	267
Net margin	7%	9%	9%	9%	13%	14%	13%	12%	9%	10%
Diluted EPS	\$ 3.21	\$ 4.00	\$ 3.79	\$ 3.72	\$ 5.05	\$ 5.16	5.06	4.29	3.09	3.23

IFF - Balance Sheet (\$mil)	2020	2019	2018	2017	2016	2015	2014	2013	2012	2011
Cash	657	624	649	368	324	182	479	406	324	88
Receivables	929	876	938	664	551	538	494	524	499	472
Inventories	1,132	1,123	1,079	649	592	572	569	534	541	544
Other current assets	342	319	277	215	142	145	169	189	208	212
Total current assets	3,060	2,943	2,942	1,897	1,609	1,437	1,710	1,653	1,573	1,317
PP&E	1,458	1,387	1,241	881	776	733	720	687	655	608
Goodwill	5,593	5,498	5,378	1,156	1,000	941	675	666	666	666
Intangibles	2,727	2,852	3,039	416	366	306	77	31	37	43
Other assets	717	608	289	250	266	285	312	295	320	332
Total assets	13,556	13,287	12,889	4,599	4,017	3,702	3,495	3,332	3,250	2,966
ST debt + CMLTD	634	385	49	7	259	132	8	0	150	117
Accounts payable	556	510	471	338	275	286	230	227	199	209
Dividends payable	82	80	78	54	51	45	38	32	0	25
Other current liabilities	632	577	531	369	314	262	243	302	273	214
Total current liabilities	1,904	1,552	1,128	769	898	725	519	560	623	565
Long-term debt	3,779	3,997	4,504	1,632	1,067	935	934	933	881	778
Other liabilities	1,550	1,508	1,213	509	421	446	523	376	493	515
Total equity	6,323	6,230	6,043	1,689	1,631	1,595	1,519	1,463	1,253	1,107
Total liabilities + equity	13,556	13,287	12,889	4,599	4,017	3,702	3,495	3,332	3,250	2,966
Diluted shares out (000s)	113,630	113,307	88,121	79,370	79,981	80,891	81,494	81,930	81,833	81,467

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IFF - Capital Allocation (\$mil)	2020	2019	2018	2017	2016	2015	2014	2013	2012	2011
Net income	367	460	340	296	405	419	415	354	254	267
Growth capex	(61)	(106)	(81)	(46)	(48)	(26)	(61)	(51)	(49)	(52)
Acquisitions (cash)	0	(49)	(4,857)	(192)	(237)	(493)	(103)	0	0	0
Dividends	(323)	(314)	(230)	(206)	(185)	(159)	(133)	(87)	(131)	(90)
Change in ST debt	(0)	(1)	(1)	(4)	(131)	137	8	(283)	139	93
Change in LT debt	(147)	(155)	2,880	748	431	0	4	198	0	(124)
Share repurchases, net (pos # = issuance)	0	0	2,253	(58)	(127)	(122)	(88)	(51)	0	0
Change in core working capital	16	60	(470)	(125)	11	52	(40)	57	31	(118)
Net change in cash	33	(25)	280	44	142	(297)	73	81	236	(43)
*Core working capital = A/R + Inv. + OtherCA - A/P - OtherCL										
Acquisition notes:		Misc. additional equity method investments	\$7bn: Frutarom (\$4.3bn cash + \$2bn equity + \$0.7bn debt)	\$55m: PowderPure \$152m: Fragrance Resources	\$242m: David Michael Co.	\$312m: Lucas Meyer Cosmetics \$199m: Henry H. Ottens Mfg	\$102m: Aromor Flavors and Frangrances			

IFF - Return On Capital Analysis (\$mil)	2020	2019	2018	2017	2016	2015	2014	2013	2012	2011
Tangible capital employed (FYE)	1,842	1,719	1,608	1,443	1,317	1,278	1,268	1,326	1,257	1,231
Revenues	5,084	5,140	3,978	3,399	3,116	3,023	3,089	2,953	2,821	2,788
Revenues / avg. tangible capital	\$2.86	\$3.09	\$2.61	\$2.46	\$2.40	\$2.37	\$2.38	\$2.29	\$2.27	\$2.27
EBIT margin	11%	13%	15%	16%	18%	19%	19%	17%	17%	15%
Pre-tax return on capital	32%	40%	38%	40%	43%	46%	46%	40%	39%	34%
*Tangible capital employed = equity + debt - goodwill/intangibles - cash										

Gencor Industries

(NASDAQ: GENC; Disclosure: N/A)

Price (4/30/21):	\$11.90
Shares out (diluted):	11,708,000
Market cap:	\$139m
Revenues (FYE '20):	\$77.4m
EBIT:	\$5.5m
Tangible equity:	\$161m
Net debt:	Net cash
Insider ownership:	29%*

*Note: Insiders own 15.9% of regular shares and 100% of Class B shares, which give them the right to elect 75% of directors and effectively control the company.

Gencor operates in the heavy machinery business. It manufactures asphalt plants and

related equipment for road construction. Not surprisingly, the industry is characterized by cyclicality as highway funding bills are passed or defeated and as projects wax/wane. While cyclical, the business/industry does benefit from the fact that asphalt isn't going away anytime soon.

I came across GENC while sorting the list of Russell 3000 companies (see below) for non-bank companies. That sort found 15 companies in four sectors that appeared to be good prospects for future study. One of those was GENC. I was attracted to the small market cap, high insider ownership, and huge net cash position.

Upon further digging my excitement waned as I realized the company had the potential to be a value trap. High insider ownership is a good

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thing, but not if it comes at the cost of drifting into sub-par capital allocation. GENC has \$125m (78% of its equity and 90% of its market cap) in cash/marketables. While part of that is a good thing considering GENC operates in a cyclical industry, the amount appears excessive.

GENC doesn't pay a dividend and hasn't been a repurchaser of its own shares. That seems to be a mistake. Shares traded between 67% and 100% of book value between 2011 and 2015.

Management could have (should have) repurchased undervalued shares while still maintaining liquidity to ride out cyclicalities and provide dry powder for acquisitions.

In October 2020 GENC purchased a paving equipment business from Volvo for \$14.4m. Very little is known about the business other than it was apparently purchased at book value (inventories of \$11m + fixed assets of \$3.4m).

GENC is run by the Elliott family. Chairman, E.J. Elliott is 91, and his sons Marc and John hold the president and CEO titles, respectively. Through my research I found out CFO, Eric Mellen, is E.J.'s son-in-law, although I couldn't independently verify that.

In my research I came across [this in-depth article](#) written by a forensic accountant which chronicles various attempts by outsiders to gain seats on the board and extract value from the business. It also points toward some misdeeds by company management and insiders beginning about 25 years ago. While it appears the misdeeds are largely behind the company, the fact that this past does exist might be a reason for pause.

Something might happen to create a catalyst event. The passing of the 91-year-old current chairman could be such an event, but that isn't imminent or certain, especially given the Class-B control shares. Perhaps the next generation of Elliots can be persuaded to buy back shares if/when they trade below book value. Or they might desire more cash for themselves and pay a dividend (or they could start paying themselves rich salaries, which is always a risk).

To sum up, GENC appears to be a decent cyclical business controlled by insiders who have resisted outside attempts to change its ways. GENC is one of those companies to maintain on the Suspect List to keep an eye on but is a pass right now given too many unknowns and possible issues.

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Gencor Industries summary financial statements:

Gencor - Balance Sheet											
FYE Sept. 30 (\$ thousands)	2020	2019	2018	2017	2016	2015	2014	2013	2012	2011	2010
Cash	35,584	10,302	8,012	22,933	18,219	11,152	7,193	9,557	3,361	1,715	3,004
Marketable securities	89,498	105,322	104,058	87,886	85,938	84,357	87,112	83,113	81,375	72,486	73,327
Accounts receivable	1,992	1,603	993	1,184	1,110	874	1,448	1,200	1,206	1,573	1,979
Costs and estimated earnings in excess of billions	6,405	13,838	11,900	6,768	4,921	2,396	344	0	3,448	4,450	580
Inventories	27,090	25,366	21,890	16,687	11,634	12,770	13,673	14,126	11,918	12,878	17,341
Prepays	1,189	499	1,348	1,660	1,598	817	849	795	782	1,632	2,205
Total current assets	161,758	156,930	148,201	137,118	123,420	112,366	110,619	108,791	102,090	94,734	98,436
Property and equipment, net	8,341	8,389	7,889	5,722	5,239	6,388	7,141	8,079	8,127	8,349	7,773
Other assets	995	53	53	53	53	1,390	68	78	95	1,292	1,018
Total assets	171,094	165,372	156,143	142,893	128,712	120,144	117,828	116,948	110,312	104,375	107,227
Accounts payable	1,728	1,907	1,838	1,320	1,443	1,529	947	1,283	1,881	1,978	1,373
Customer deposits	3,853	1,918	4,563	8,628	4,484	4,418	324	1,943	480	756	1,478
Accrued expenses	2,605	2,660	2,085	2,426	2,264	1,452	1,689	2,810	3,517	2,842	3,323
Current operating lease liab.	328										
Total current liabilities	8,514	6,485	8,486	12,374	8,191	7,399	2,960	6,036	5,878	5,576	6,174
Deferred and other income taxes	746	3,372	2,640	1,601	316	0	693	484	974	0	2,525
Non-current operating lease liab.	614										
Shareholders' equity	161,220	155,515	145,017	128,918	120,205	112,745	114,175	110,428	103,460	98,799	98,528
Liabilities + SH equity	171,094	165,372	156,143	142,893	128,712	120,144	117,828	116,948	110,312	104,375	107,227
Shares outstanding (000s)		14,708	14,723	14,680	14,524	14,283	14,385	14,280	14,277	14,277	14,277

Notes:
1. 3:2 stock split July 2016.
2. FYE '20 from company release. Full 10K/annual not available.

Gencor - Income Statement											
FYE Sept. 30 (\$ thousands)	2020	2019	2018	2017	2016	2015	2014	2013	2012	2011	2010
Revenues	77,420	81,329	98,614	80,608	69,991	39,230	40,017	48,943	63,182	59,692	
Cost of goods sold	58,467	58,917	71,818	59,449	52,466	31,724	32,194	37,940	51,152	50,278	
Gross profit	18,953	22,412	26,796	21,159	17,525	7,506	7,823	11,003	12,030	9,414	
<i>GPM</i>	<i>24.5%</i>	<i>27.6%</i>	<i>27.2%</i>	<i>26.2%</i>	<i>25.0%</i>	<i>19.1%</i>	<i>19.5%</i>	<i>22.5%</i>	<i>19.0%</i>	<i>15.8%</i>	
R&D	3,061	3,295	2,915	2,147	1,567	1,422	1,422	1,713	2,339	2,211	
SG&A	10,356	9,647	9,991	8,776	8,142	6,878	6,427	6,712	9,298	8,946	
Operating expenses	13,417	12,942	12,906	10,923	9,709	8,300	7,849	8,425	11,637	11,157	
Operating income	5,536	9,470	13,890	10,236	7,816	(794)	(26)	2,578	393	(1,743)	
<i>OPM</i>	<i>7.2%</i>	<i>11.6%</i>	<i>14.1%</i>	<i>12.7%</i>	<i>11.2%</i>	<i>-2.0%</i>	<i>-0.1%</i>	<i>5.3%</i>	<i>0.6%</i>	<i>-2.9%</i>	
Interest and dividend income	2,321	2,307	1,535	650	754	883	1,787	2,281	2,269	2,256	
Gain (loss) on securities	(1,160)	1,047	(363)	1,297	828	(3,638)	2,212	1,456	4,120	(3,113)	
Other	(16)	0	2	(5)	2	3	440	18	70	66	
Earnings before taxes	6,681	12,824	15,064	12,178	9,400	(3,546)	4,413	6,333	6,852	(2,534)	
Income taxes (benefit)	1,150	2,628	2,370	3,760	2,357	(1,727)	940	(392)	2,380	(2,758)	
Net income	5,531	10,196	12,694	8,418	7,043	(1,819)	3,473	6,725	4,472	224	
Diluted EPS	\$0.38	\$0.69	\$0.86	\$0.57	\$0.48	-\$0.13	\$0.36	\$0.71	\$0.47	\$0.02	

Note: FIFO inventory 2019 and 2018. LIFO before 2018.

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RUSSELL 3000 PROJECT:

With the help of two interns, I've been working through the Russell 3000 list specifically looking for banks that might get removed during the reconstitution event in June (when those not making the cut due to size get removed and others are added).

Next month will feature a couple of banks on this final list that might be good candidates for purchase. In the meantime, here is some more data on them:

Bank Name	Market Cap (4/26/21)	Assets (\$mil)	5 Yr Avg ROA	Price/Book (4/26/21)	Current Price (4/26/21)	52 Wk Low	52 Wk High	Insider Ownership
SB FINANCIAL GROUP, INC. (XNAS:SBFG)	\$ 130,426,900	\$1,260	1.15%	0.90	\$ 17.65	\$ 12.02	\$19.98	9%
PLUMAS BANCORP (XNAS:PLBC)	\$ 143,803,875	\$1,110	1.49%	1.41	\$ 27.72	\$ 17.00	\$31.02	19%
FIRST CAPITAL, INC. (XNAS:FCAP)	\$ 153,633,700	\$1,020	1.10%	1.39	\$ 45.52	\$ 44.77	\$81.71	4%
Bank7 Corp. (XNAS:BSVN)	\$ 156,012,000	\$1,020	2.28%	1.45	\$ 17.24	\$ 7.24	\$19.00	21%
OP BANCORP (XNAS:OPBK)	\$ 156,588,000	\$1,370	1.20%	1.07	\$ 10.42	\$ 5.54	\$12.39	21%
FIRST SAVINGS FINANCIAL GROUP, INC. (XNAS:FSFG)	\$ 162,682,500	\$1,220	1.38%	0.98	\$ 68.50	\$ 36.78	\$74.00	20%
ESQUIRE FINANCIAL HOLDINGS, INC. (XNAS:ESQ)	\$ 180,947,000	\$881	1.26%	1.44	\$ 23.11	\$ 10.83	\$26.79	14%
LEVEL ONE BANCORP, INC. (XNAS:LEVL)	\$ 201,267,400	\$2,450	0.98%	1.05	\$ 26.40	\$ 14.15	\$28.77	23%
NORWOOD FINANCIAL CORP. (XNAS:NWFL)	\$ 210,354,200	\$1,840	0.96%	1.08	\$ 25.56	\$ 21.39	\$30.47	9%
GREENE COUNTY BANCORP, INC. (XNAS:GCBC)	\$ 217,006,900	\$1,860	1.28%	1.56	\$ 25.49	\$ 20.00	\$29.39	7%
NATIONAL BANKSHARES, INC. (XNAS:NKSH)	\$ 226,641,900	\$1,520	1.23%	1.21	\$ 35.86	\$ 23.37	\$39.99	4%
TIMBERLAND BANCORP, INC. (XNAS:TSBK)	\$ 228,367,300	\$1,570	1.66%	1.18	\$ 27.45	\$ 15.35	\$30.75	13%
PCB BANCORP (XNAS:PCB)	\$ 228,930,000	\$1,920	1.26%	0.95	\$ 14.80	\$ 7.82	\$16.43	16%
LCNB CORP. (XNAS:LCNB)	\$ 230,285,300	\$1,750	1.06%	0.96	\$ 17.97	\$ 11.28	\$19.99	7%
AMES NATIONAL CORPORATION (XNAS:ATLO)	\$ 231,170,400	\$1,910	1.09%	1.13	\$ 25.34	\$ 16.53	\$27.90	1%
NORTHEAST BANK (XNAS:NBN)	\$ 243,874,900	\$1,260	1.31%	1.36	\$ 29.76	\$ 13.77	\$30.92	8%
NORTHRIM BANCORP, INC. (XNAS:NRIM)	\$ 263,153,000	\$2,100	1.24%	1.19	\$ 42.41	\$ 18.20	\$48.19	4%
FIDELITY D & D BANCORP, INC. (XNAS:FDBC)	\$ 283,268,300	\$1,710	1.07%	1.70	\$ 56.20	\$ 30.50	\$70.97	23%

This month I've chosen to present a list of non-bank companies from the Russell that could face removal. The list is comprised of fifteen companies that made it through a rough filtering that included a quick peek at their business and financial statements. Here's that list, which pulls from the following sectors: Consumer Defensive, Industrials, Consumer Cyclical, and Basic Materials.

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Name	Sector	Market Cap 3/10/21	Market Cap 4/28/21	Change
🏠 LIFEVANTAGE CORPORATION (XNAS:LFVN)	Consumer Defensive	\$ 133	\$ 124	-6%
🏠 ALPHA PRO TECH, LTD. (XNYS:APT)	Industrials	\$ 145	\$ 129	-11%
🏠 INTEVAC, INC. (XNAS:IVAC)	Industrials	\$ 152	\$ 167	10%
🏠 BGSF, INC. (XNYS:BGSF)	Industrials	\$ 155	\$ 150	-3%
🏠 FARMER BROS. CO. (XNAS:FARM)	Consumer Defensive	\$ 156	\$ 177	13%
🏠 GRAHAM CORPORATION (XNYS:GHM)	Industrials	\$ 165	\$ 139	-16%
🏠 GENCOR INDUSTRIES, INC. (XNAS:GENC)	Industrials	\$ 181	\$ 178	-2%
🏠 WEYCO GROUP, INC. (XNAS:WEYS)	Consumer Cyclical	\$ 185	\$ 193	4%
🏠 TRECORA RESOURCES (XNYS:TREC)	Basic Materials	\$ 191	\$ 193	1%
🏠 Mastech Digital, Inc. (XNYS:MHH)	Industrials	\$ 194	\$ 191	-2%
🏠 OIL-DRI CORPORATION OF AMERICA (XNYS:ODC)	Basic Materials	\$ 203	\$ 256	26%
🏠 ALICO, INC. (XNAS:ALCO)	Consumer Defensive	\$ 231	\$ 225	-3%
🏠 LAKELAND INDUSTRIES, INC. (XNAS:LAKE)	Consumer Cyclical	\$ 241	\$ 234	-3%
🏠 HURCO COMPANIES, INC. (XNAS:HURC)	Industrials	\$ 242	\$ 224	-8%
🏠 PARK AEROSPACE CORP. (XNYS:PKE)	Industrials	\$ 295	\$ 273	-8%

WHAT'S COMING NEXT MONTH:

Queued up for next month are possible quick looks into a couple of the banks from the list above, and possibly a few more from the non-bank list above.

I'm also toying with the idea of doing a Deep Dive on Old Dominion Freight Line, although

I'm hesitant to do a deeper dive on a larger, somewhat more well known company. What do you think, would you rather have a few more Quick Looks vs. one Deep Dive? Is more value added by focusing on smaller companies?

NOTES FROM READERS: None this month. Please feel free to opine on how I can do better, whether that be in analysis, writing, or presentation. If you have in-depth knowledge on the companies presented here I'd also be very interested to know. Lastly, I'm always looking for new ideas.

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

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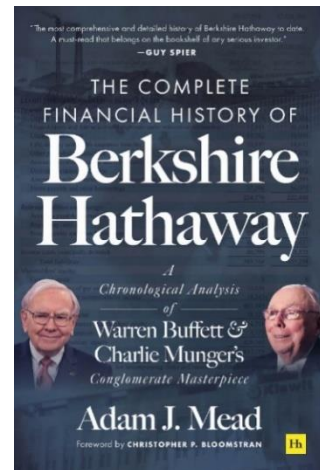
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About

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 as an extension of the book, which includes an archive of a lot of BRK material.



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