

# Mossberg's Investor Digest

## From the Editor...

Thank you for your subscription to Mossberg's Investor Digest.

Headquartered in Findlay, OH, 103-year-old **Cooper Tire & Rubber Company (NYSE: CTB)** is the 5th largest tire company in the U.S. & 12th largest globally in terms of revenue. The Company is primarily focused on the replacement of auto and truck tires in the Americas and Europe. In Asia, the Company has a higher concentration of OEM customers.

While there is concern over "Peak Autos" and a resulting decline in U.S. auto sales, there are still plenty of factors driving near-term and long-term growth for tires. In addition, a secular growth in premium tires along with greater operating efficiencies should allow for earnings to grow at a much faster pace than the top line.

The company is currently trading at just 8x the consensus 2017 EPS estimate, two turns less than that of comparable Goodyear Tire (NYSE:GT), which trades at 10x the 2017 consensus. Given these companies' track record of consistently producing mid-teens return on capital and dividend track records, we believe it is reasonable to assume that they could see multiple expansion to at least 11x to 12x earnings. Even that multiple seems very low. Our back of the envelope model produces EPS of \$4.13 in 2019 and we believe reflects conservative assumptions. Applying an expanded multiple to this number yields a valuation that is 34% to 46% greater than the current valuation.

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## August 2017

Issue #110

Every month we hear ideas suggested from our large network of professional investors. Here are a few of the ideas we heard this month, but have not reviewed in detail...

**Cooper-Standard Holdings Inc. (NYSE: CPS)**- Cooper Standard is a leading global supplier of systems and components for the automotive industry. Products include rubber and plastic sealing, fuel and brake lines, fluid transfer hoses and anti-vibration systems. Cooper Standard employs approximately 30,000 people globally and operates in 20 countries around the world. Technology leadership, combined with broad product expertise and capabilities, enables them to find solutions to customer challenges.

**Albany International Corp. (NYSE: AIN)**- Albany International has two core businesses: The Machine Clothing segment is the world's leading producer of custom-designed fabrics and belts essential to production in the paper, nonwovens, and other process industries. Albany Engineered Composites (AEC) is a rapidly growing supplier of highly engineered composite parts for the aerospace industry. In 2016, sales were US\$779.8 million. Founded in 1895, Albany International is headquartered in Rochester, New Hampshire, USA; operates 22 plants in 10 countries; and employs approximately 4,400 people worldwide.

**EnPro Industries, Inc. (NYSE: NPO)** - EnPro Industries is a diversified manufacturer of proprietary engineered products used in critical applications. They are a leader in sealing technologies, metal polymer and filament wound bearings, components and service for reciprocating compressors, diesel and dual-fuel engines and other solutions that meet the needs of industries worldwide. Their commitment to innovation, quality and value has propelled their brands to wide recognition and leading positions in their markets. EnPro operates manufacturing facilities in North and South America, Europe and Asia; they employ more than 5,000 people worldwide, and their products are sold to more than 50,000 customers in over 100 countries across the globe.

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Best Idea Profile:

Cooper Tire & Rubber Company (NYSE: CTB)

## DESCRIPTION:

Headquartered in Findlay, OH, 103-year-old **Cooper Tire & Rubber Company (NYSE: CTB)** is the 5<sup>th</sup> largest tire company in the U.S. & 12th largest globally in terms of revenue. The Company is primarily focused on the replacement of auto and truck tires in the Americas and Europe. In Asia, the Company has a higher concentration of OEM customers.

The Company reports revenue in two segments and operates four business segments, which include North America and Latin American in the America's group (80% of revenue) and European and Asian Segment in the International Group. (20% of revenue)

Over the past five years, the company has successfully transformed its mix of business to 70% proprietary brands/ 30% private label brands from a roughly 50/50 mix previously. While the "Cooper" brand is the Company's flagship brand, the company also manufactures tires under the Mastercraft, Avon, Roadmaster, Starfire, Mickey Thompson, Dick Cepek, Dean and Mentor.

The company employs more than 10,000 people in 9 manufacturing facilities, 20 distribution centers, 3 retail stores and 22 technical centers and offices

## Cooper Tire & Rubber Company (NYSE: CTB)

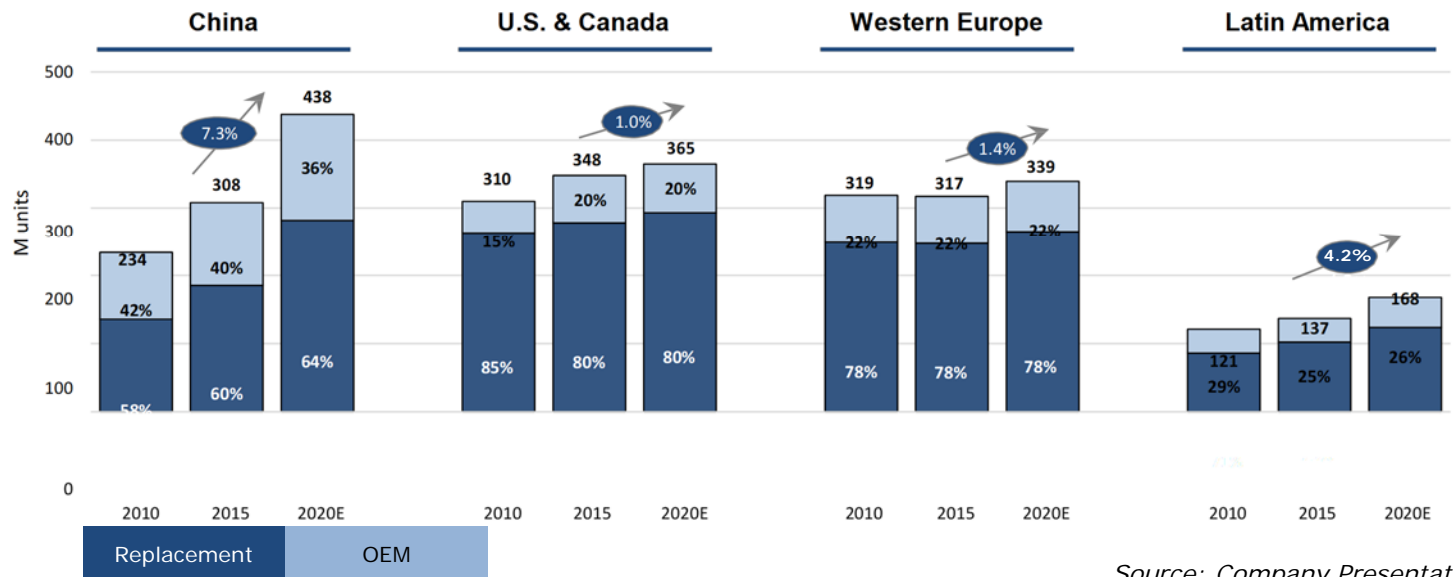
Investment Data (as of 8/26/17)

<b>Recent Price</b>	<b>\$33.80</b>
52-Week Range	\$33.05 - \$44.50
Fiscal Year End	Dec
Dividend	\$0.42
Yield	1.25%
Shares Outstanding	52.2 M
Average Trading Volume (3 mos)	650,000
Market Capitalization	\$1.8 B
Cash	\$302 M
Long-term Debt	\$336 M
Enterprise Value (EV)	\$1.8 B
TTM Revenue	\$2.9 B
EV/ Revenue	0.6x
FY18 EPS (consensus est.)	\$4.08
P/E	8.3x
TTM EBITDA	\$513 M
EV/EBITDA	3.5x
Book Value Per Share	\$20.78

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## KEY INVESTMENT CONSIDERATIONS:

### Robust Market Growth Trends to Continue



Source: Company Presentation

**Long-term tire demand based on miles driven NOT “Peak Autos”** – Goldman Sachs is calling for U.S. light vehicles sales to fall to 15 million cars by 2020, down from 17.5 million in 2016. While there is much concern over a decrease in demand for the number of autos sold, there is still plenty of factors driving near-term and long-term growth for tires.

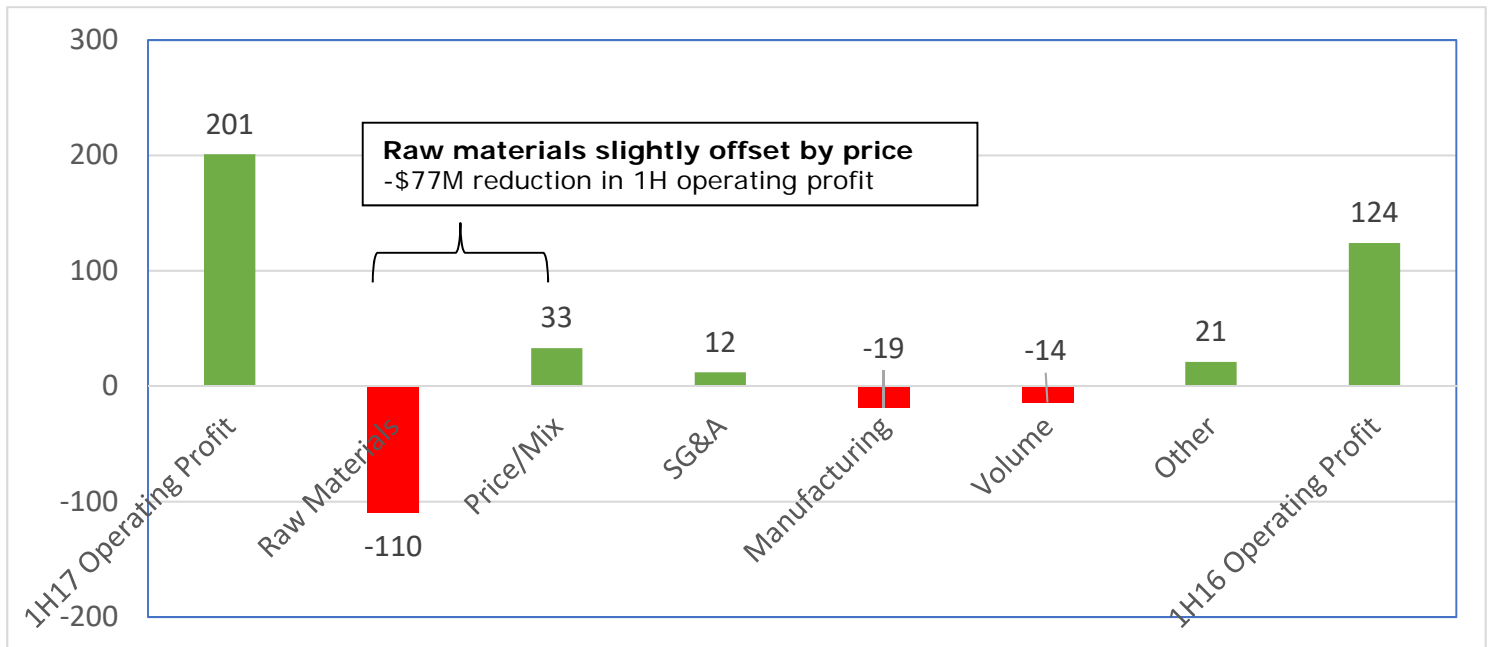
- **Replacement accounts for 80% of sales in mature markets and 65%+ in developing markets** - While there may only be around 100 million new cars sold every year, there are more than 10x as many that are on the road. According to Business insider, there are more than 1.1 billion cars on the road and nearly 400 million trucks.
- **There is still plenty of auto growth overseas** – Even if auto sales decline, according to HIS, global auto unit sales are expected to grow 2.1% per year from 93.1 million in 1996 to 103.5 million in 2021.
- **In the long-term, adoption of autonomous vehicles and transportation-as-a-service may reduce the number of cars, it will not reduce the number of miles driven** – According to Tony Saba’s report Rethinking Transportation, over the next 15 years, new disruptive technologies of transportation-as-a-service and autonomous vehicles will lower the cost per mile driven to \$0.05 to \$0.10 per mile, versus the anticipated cost of driving an internal combustion vehicle of \$0.30 to \$0.75 per mile. It is anticipated that this economic factor will encourage consumers to abandon their cars in favor of transportation as a service, which means fewer cars on the road. At the same time, the reduced costs of transportation will likely increase the number of miles driven. According to Deloitte, the number of miles driven in the U.S. will increase by approximately 1% annually over the next 15 years. In developing markets, such as India and China, the low cost of transportation-as-a-service should have a far greater effect on the number of miles driven.

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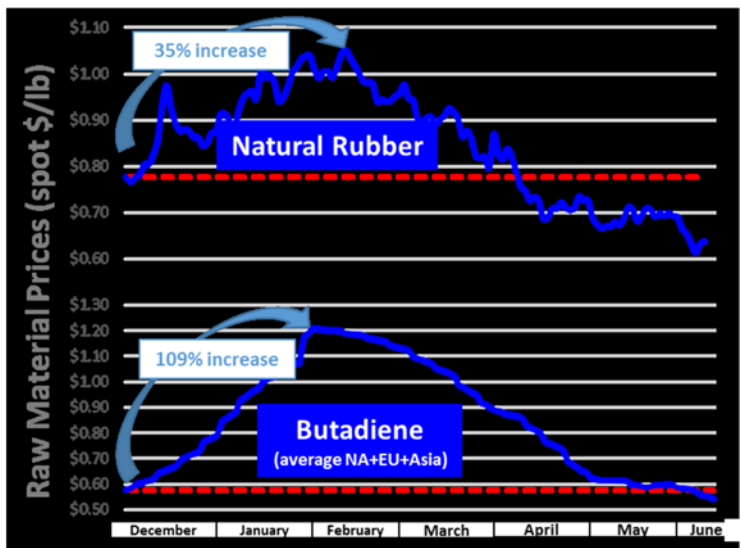
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## KEY INVESTMENT CONSIDERATIONS: (continued)

### Recent weakness in financial performance is not a trend



- Operating Profit decreased 38% during 1H17** - The chart above shows the major drivers of operating profit for the first six months of the year. First and second quarters showed a 46% and 32% drop in operating profit this year largely due to a sudden spike in raw material costs as illustrated in the chart to the right. As fast as input costs increased during the first part of the year, they have returned to levels where they started the year and appear to be stable. Combined with recent price increases, financial performance should improve in the back half of the year.

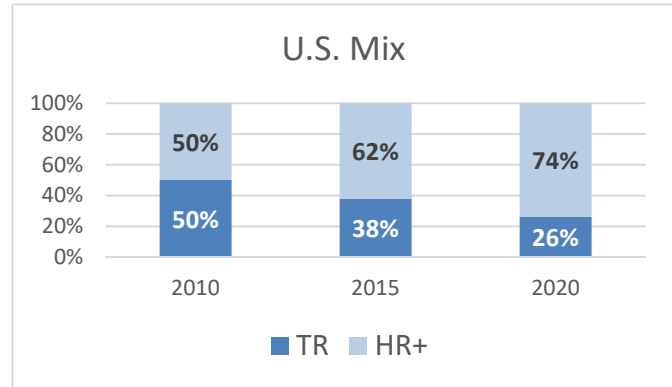
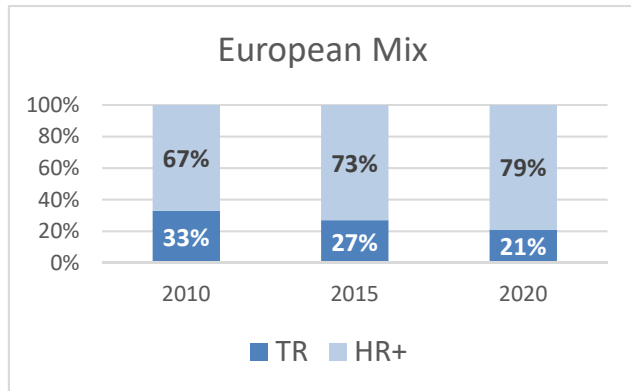


- Volatility in raw material prices can cause temporary decrease in margin performance** – Because raw materials comprise 40% of a tire's COGS, and 65% of inputs are influenced by oil prices, increased volatility in input costs can cause temporarily decreases in financial performance. However, the industry is generally able to pass along cost increases by increasing prices, which only lag costs slightly.

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## KEY INVESTMENT CONSIDERATIONS: (continued)

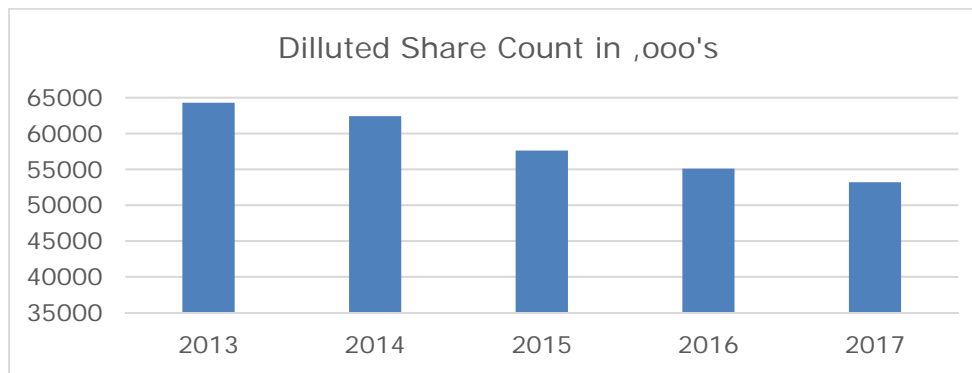
### Continued demand shift to higher value/higher margin products



Source: Company Presentation

**The mix is shifting to premium Tires** – The charts above show how the shift to premium, HR rated or greater tires is expected to continue through the next several years. Premium tires produce a higher margin and price point for Cooper.

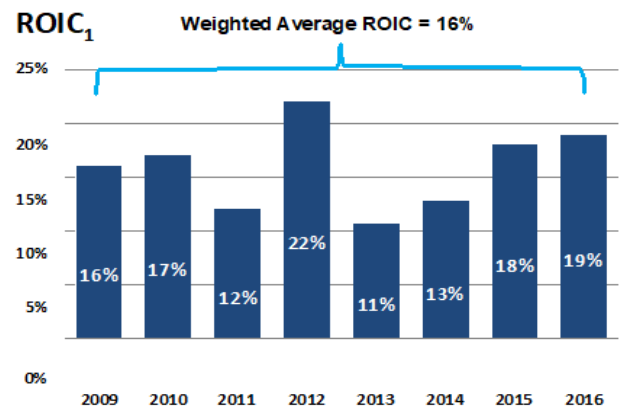
### A solid steward of capital



**A History of Buying Back Shares** – Cooper has completed \$455 million in share repurchases from August 2014 through June, 30 2017 (approximately 21% of outstanding). The board has authorized another \$300 million in repurchases through December 31, 2019.

**15+ years or regular dividends** – The company recently announced its 181<sup>st</sup> consecutive dividend payable on June 30, 2017.

**Consistent double digit Return on Invested Capital** – As the chart shows, on average the company has delivered a 16% return on invested capital since 2009.



Source: Company Presentation

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## Valuation

	2016	2017	2018	2019
Total Revenue	2,925	2,900	2,987	3,087
		-1%	3%	3%
Operating Profit	384	275.5	291.2325	308.705
Operating Profit Margin	13.1%	9.5%	9.8%	10.0%
Interest Expense and Other	17	17	17	17
Income before taxes	367	258	274	291
Tax Rate	32%	32%	32%	32%
Taxes	115.8	82.62592	87.66032	93.25152
<b>Net Income</b>	<b>248</b>	<b>176</b>	<b>186</b>	<b>198</b>
Shares Outstanding	55	52	50	48
<b>EPS</b>	<b>4.51</b>	<b>3.38</b>	<b>3.73</b>	<b>4.13</b>

In our back of the envelop calculation above, we make the following assumptions for growth and improvement in profitability:

- **Revenue Growth** – We conservatively model overall growth for the business to resume following the end of 2017. Modest growth assumes relatively little growth in the Americas, and 15% growth in the international division, which should be supported by growth of its joint venture, GRT, as well as growth in the Asian Market overall.
- **Operating Expenses** – Our model shows 9.5% operating income for the year 2017, which is consistent with management's guidance to reach the upper range of the 8% to 10% target set earlier in the year. We conservatively estimate 25 basis points of improvement for each of the following two years. There are multiple opportunities to expand margin performance including a mix shift to premium tires and improving operating efficiencies. We believe our assumptions for operating margin improvement are conservative given the company's operating performance in recent years, which has averaged 12%+ rate.
- **Shares Outstanding** - The Company has recently extended its share repurchase program, authorizing \$300 million of purchases through the end of 2019. Our model assumes the repurchase of 4 million shares at \$150 million, roughly half the authorized amount

The company is currently trading at just 8x the consensus 2017 EPS estimate, two turns less than that of comparable Goodyear Tire (NYSE:GT), which trades at 10x the 2017 consensus. Given these companies' track record of consistently producing mid-teens return on capital and dividend track records, we believe it is reasonable to assume that they could see multiple expansion to at least 11x to 12x earnings. Even that multiple seems very low. Our model produces \$4.13 in 2019 and we believe reflects conservative assumptions. Applying an expanded multiple to this number yields a valuation that is 34% to 46% greater than the current valuation.

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## Mossberg's Investor Digest Idea Performance

The table below shows the relative change in the value of the ideas published since September 2015 and the Russell 2000. **Performance data quoted represents past performance and does not guarantee future results.** Current performance of ideas may be lower or higher than the performance quoted.

Company	Pub. Date	Original Price	Recent Price	Change	Russell 2000 Change Since Pub.	Relative Perf. vs. Russell 2000	
Calloway Golf Company (NYSE: ELY)	30-Sep-15	\$8.39	\$13.49	60.8%	25.1%	35.6%	
New Gold (NYSE: NGD)	31-Oct-15	\$2.47	\$3.66	48.0%	18.6%	29.4%	
Townsquare Media (NYSE: TSQ)	30-Nov-15	\$11.43	\$10.10	-11.6%	15.0%	-26.6%	
Build-A-Bear Workshop (NYSE: BBW)	31-Dec-15	\$11.72	\$9.00	-23.2%	21.3%	-44.5%	
Dycom Industries, Inc (NYSE: DY)	31-Jan-16	\$62.18	\$80.78	29.9%	33.0%	-3.1%	
Rackspace Hosting, Inc. (NYSE: RAX)	29-Feb-16	\$21.54	\$32.00	48.6%	33.2%	15.3%	
Kopin Corporation (Nasdaq:KOPN)	31-Mar-16	\$1.66	\$3.79	128.3%	23.6%	104.7%	
PAR Technology Group (NYSE: PAR)	30-Apr-16	\$6.39	\$10.98	71.8%	21.8%	50.0%	
Full House Resorts Inc. (Nasdaq: FLL)	30-May-16	\$1.60	\$2.50	56.3%	19.7%	36.5%	
Control4 Corporation (Nasdaq: CTRL)	30-Jun-16	\$7.99	\$23.13	189.5%	19.6%	169.9%	
KapStone Paper and Packaging Corporation (NYSE: KS)	31-Jul-16	\$14.28	\$21.33	49.4%	12.9%	36.5%	
Ampco-Pittsburgh Corp. (NYSE: AP)	31-Aug-16	\$11.12	\$13.45	21.0%	11.1%	9.9%	
Select Comfort Corporation (Nasdaq: SCSS)	30-Sep-16	\$22.51	\$30.22	34.3%	10.1%	24.2%	
Northwest Pipe Co. (NWPX)	31-Oct-16	\$13.16	\$16.05	22.0%	15.6%	6.3%	
Mitel Networks Corporation (Nasdaq: MITL)	30-Nov-16	\$7.25	\$8.21	13.2%	4.2%	9.1%	
Black Box Corporation (Nasdaq: BBOX)	31-Dec-16	\$15.25	\$3.45	-77.4%	1.5%	-78.9%	
RadNet, Inc. (Nasdaq: RDNT)	31-Jan-17	\$5.80	\$9.90	70.7%	1.1%	69.5%	
Guidance Software, Inc. (Nasdaq: GUID)	28-Feb-17	\$6.60	\$7.08	7.2%	-0.7%	7.9%	
Calgon Carbon Corporation (NYSE: CCC)	31-Mar-17	\$14.25	\$12.70	-10.9%	-0.6%	-10.3%	
LRAD Corporation (Nasdaq: LRAD)	30-Apr-17	\$1.51	\$1.67	10.6%	-1.6%	12.2%	
Trecora Resources (NYSE: TREC)	31-May-17	\$10.65	\$12.40	16.4%	0.5%	15.9%	
EVINE Live Inc. (Nasdaq: EVLV)	30-Jun-17	\$1.00	\$0.95	-5.0%	-2.7%	-2.3%	
LSI Industries Inc. (Nasdaq: LYTS)	31-Jul-17	\$8.38	\$5.59	-33.3%	-3.3%	-29.9%	
				<b>Average</b>	<b>31.1%</b>	<b>12.1%</b>	<b>19.0%</b>

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The value proposition of the digest is essentially an "Idea Generator". During the course of my 18-year career in capital markets, I've had the chance to meet and work closely with some very smart professional investors who have consistent track records of outperforming the market indexes. Some of these investors, which include mutual fund managers, hedge fund managers, and other professional investors, are kind enough to share their best ideas with me. I conduct my own analysis of their ideas and publish summaries of those ideas I think represent timely investment opportunities. Over time, I trust the majority of these ideas will pan out and help subscribers generate index-beating returns.

The goal of the Best Idea Profiles in this newsletter is to briefly describe the most relevant investment merits and risks of a company. It is not intended to be an exhaustive report including every detail. With limited space available, I am forced to include only those data points that I feel are most important for subscribers to know before they begin their own due diligence. Thank you for your interest in Mossberg's Investor Digest.

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