

# Mossberg's Investor Digest

## From the Editor...

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In the 70+ years since its founding, **Oil-Dri Corporation of America (NYSE:ODC)**, has been developing, manufacturing and marketing products made from sorbent minerals (primarily calcium bentonite clay).

Cat litter is the largest market for the Company's sorbent minerals. Recently Oil-Dri developed an innovative formula for cat litter that is 25% to 50% lighter, with reduced dust, and improves tracking (sticking to the cat's paws). The innovation has a chance to significantly disrupt the market and more than double the size of ODC's cat litter business.

The company's vertical integration reduces the threat of new entrants and should allow for pricing power and cost control. Oil-Dri has significant mineral and manufacturing assets in seven US states, the UK and Canada. Oil-Dri has more than 275 million tons of proven and probable mineral reserves primarily consisting of calcium bentonite, attapulgite and diatomaceous shale. To put that number in perspective, that is enough clay to meet the cat litter needs of every cat in the US for the next 20 years.

We use a discounted multiple of EV/EBITDA multiple of 9x to reflect a discount from limited liquidity, as well as an A/B share structure. Working backwards from Enterprise value, our back-of-the-envelope model derives a valuation of \$56.80 per share in three years, 67% above the current valuation.

Dave Mossberg  
[Dave@mossbergid.com](mailto:Dave@mossbergid.com)

## June 2019

## Issue #132

Every month we hear ideas suggested from our large network of professional investors. Here are a few of the ideas we heard this month.

**Methode Electronics, Inc. (NYSE: MEI)** is a leading developer of custom-engineered and application-specific products and solutions utilizing the latest technologies. From magnetic signature sensing of mechanical and electrical properties to the revolutionary solid-state touch sensitive switches used in today's appliances and automobiles, Methode's extensive toolbox of technical solutions help our customers differentiate their products. They leverage the talents of over 5,000 employees to serve a diversified group of customers in four market areas: User Interfaces, Sensor and Switches, Power and Data.

**Sensient Technologies Corporation (NYSE: SXT)** - is a leading global developer, manufacturer and marketer of colors, flavors and fragrances. Sensient uses advanced proprietary technologies to produce a broad range of innovative products. They provide customized food and beverage systems, pharmaceutical colors and coatings, cosmetic and personal care formulations, inkjet and specialty inks and colors, and other fine chemicals to most of the world's best-known consumer and industrial companies.

**SP Plus Corporation (Nasdaq: SP)**- is a diverse provider of professional parking, ground transportation, facility maintenance, security, and event logistics services to real estate owners and managers in a wide array of markets. SP's commitment to Innovation<sup>®</sup> has made them an industry leader in delivering advanced capabilities to support their clients' expanding performance and financial needs. Not only can SP provide exceptional market-based expertise in each of their service lines, they utilize the latest in advanced technologies and marketing strategies, and have taken new innovative approaches supporting revenue management to maximize the performance of their clients' businesses.

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Best Idea Profile:

Oil-Dri Corporation of America (NYSE:ODC)

## DESCRIPTION:

In the 70+ years since its founding, **Oil-Dri Corporation of America (NYSE:ODC)**, has been developing, manufacturing and marketing products made from sorbent minerals (primarily calcium bentonite clay). Product applications include:

**Cat litter** - This is the largest market for the Company's sorbent minerals. Recently, Oil-Dri developed an innovative formula for cat litter that is 25% to 50% lighter, with reduced dust, and improves tracking (sticking to the cat's paws). The innovation has a chance to significantly disrupt the market and more than double the size of ODC's cat litter business.

**Animal Health** - Clay used in poultry, dairy, and swine production. Clay is added in animal feed to help animals defend against biotoxins, promote intestinal health, and reduce wet droppings in poultry.

**Agricultural and Horticultural Products** - Clay granules absorb active ingredients like weed killer/fertilizer and are then spread and released directly on the ground, providing a more precise application than chemical sprays.

**Purification** - Clay used to bleach, purify and filter edible and non-edible oils (jet fuel).

**Major League Baseball fields** - Pro' Choice is used on 28 of the 30MLB infields to control water and dust.

**Industrial and Automotive** - Clay, and other materials that absorb oil, acid, paint, ink, water and other liquids.

### Oil-Dri Corporation of America (NYSE:ODC)

Investment Data (as of 6/30/19)

<b>Recent Price</b>	<b>\$34.04</b>
52-Week Range	\$24.25 - \$46.73
Fiscal Year End	July
Dividend	\$1.00
Yield	3.4%
Shares Outstanding*	7.6 M
Average Trading Volume (3 mos)	7,000
Market Capitalization	\$259 M
Cash	\$17 M
LT Debt	\$6 M
Enterprise Value (EV)	\$248 M
TTM Revenue	\$273 M
EV/ Revenue	0.8x
TTM EBITDA	\$22 M
EV/EBITDA	11.2x
Book Value Per Share	\$18.10

\*includes class A & B shares

The Company is vertically integrated with significant mineral and manufacturing assets in seven US states, the UK and Canada. Oil-Dri has more than 275 million tons of proven and probable mineral reserves primarily consisting of calcium bentonite, attapulgite and diatomaceous shale. To put that number in perspective, that is enough clay to meet the cat litter needs of every cat in the US for the next 20 years.

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## KEY INVESTMENT CONSIDERATIONS:

### Disrupting the Lightweight Cat Litter Market

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The market for cat litter in the U.S. is mature, generating nearly \$3 billion in annual sales and growing at a 3% annual pace. Oil-Dri, the fourth largest player measured in dollars and the second largest player measured in units, behind Nestle, Arm & Hammer, and Clorox, has developed a lightweight and scoopable cat litter that has the potential to disrupt the market and take significant share from the other players. Based on this new product innovation, management expects to double this size of its business in cat litter during the next 5 years. Oil-Dri is the only major marketer of cat litter who actively competes in both the branded (under the TMs Cat's Pride and Jonny Cat) and private label segments of the market.

**Calcium bentonite versus sodium bentonite** – Bentonite clay is the primary ingredient used in almost all cat litter. The advantage of bentonite is that it is cheap, reduces odor, and will absorb several times its dry weight in liquid. Two types of Bentonite clay, sodium and calcium, are used to make cat litter.

- **Sodium bentonite forms stronger clumps** - When introduced to moisture, sodium bentonite (swelling clay) forms stronger clumps than calcium (non-swelling clay) and can easily be scooped out of a litter box without removing the rest of the litter. As such, sodium bentonite clay has grown in popularity and now represents about 80% of the market for cat litters.
- **Calcium bentonite weighs less** - One cubic foot of calcium bentonite weighs 37 lbs. versus 75 lbs. for sodium bentonite.

**Oil-Dri introduces lightweight cat litter** – In 2011, Oil-Dri introduced and patented a lightweight cat litter made from a mix of both calcium and sodium bentonite clay. The formulation is nearly dust-free, controls odors well, offers comparable clumping performance, and weighs 25% to 50% less than sodium bentonite-based cat litter.

**Why is lightweight important?** Consumers buy cat litter by weight, but use it by volume. So if you develop a lighter weight cat litter, with the same performance, you have a compelling value proposition. For traditional and on-line retailers, less weight means reduced shipping costs. For consumers, who are predominantly women 25-54, all else being equal, a lighter package is preferred to a heavier one. In addition, lower weight equals lower shipping cost, lower carbon footprint and lower environmental impact.

### Significant Barriers to entry

- **Vertical Integration** – Oil-Dri is vertically integrated from mining the clay to packaging the end-product. In addition to its substantial reserves of bentonite clay, the company has six manufacturing and packaging locations in the U.S., one in Canada and one in the U.K.
- **Patent Protected** - Oil-Dri sued Nestle (the largest player in the cat litter market) for copying its recipe for cat litter. This year Oil-Dri was awarded \$3 million in damages after it was determined that Nestle infringed on the its patent for clumping litter.
- **New production sources are limited** – The permitting process of building a new mine or processing plant are arduous. So much so, that there has not been a new plant built in 20+ years.

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## KEY INVESTMENT CONSIDERATIONS:

### Infrastructure Investments

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During the past several years Oil-Dri has been positioning itself for significant growth.

**New Revolver** – In January 2019, the company increased its credit line with BMO from \$25 million to \$45 million. The company has not drawn on its line.

**New ERP System** – The company is completing a multi-year, \$10 million implementation of a new enterprise resource planning system. While the system was disruptive to growth and profitably during the last two years, implementation activities are substantially complete and are now expected to generate improvements in operations, as well as the greater ability to scale the business.

**New management talent**.... In the past year, the Company has hired a new CFO and COO, both with significant experience at much larger companies. CFO Susan Marie Kreh joined the company in December 2018 and from 2010 to 2017 was CFO & VP of Information Technology of the Power Solutions business of Johnson Controls. COO, Molly Vandenheuvel, joined the company in April 2019. Previously, Ms. Vandenheuvel held senior executive supply chain positions at Abbott Labs and Kraft Foods.

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## Valuation

	2017	2018	2019	2020	2021	2022
Revenue	262.3	266.0	274.0	290.4	307.8	326.3
Revenue Growth			3.0%	6.0%	6.0%	6.0%
Gross Profit	73.7	72.0	64.4	71.2	78.5	86.5
Gross Margin	28.1%	27.1%	23.5%	24.5%	25.5%	26.5%
SG&A	58.5	57.3	56.17	57.9	59.6	61.4
As % of Revenue	22.3%	21.6%	20.5%	19.9%	19.4%	18.8%
Operating Income	15.2	14.7	8.2	13.3	18.9	25.1
D&A	12.8	12.8	12.9	13.1	13.4	13.7
EBITDA	28.0	27.4	21.1	26.4	32.3	38.8
EBITDA Margin	10.7%	10.3%	7.7%	9.1%	10.5%	11.9%
Capex	14.8	15.1	15.2	15.5	15.8	16.2
Cash Flow			5.9	10.9	16.5	22.6
Cash			16	20.9	37.4	60.0
Debt			6	0	0	0
EV/ EBITEDA multiple						9
Enterprise Value						348.9
Market Cap						409.0
Shares Outstanding						7.2
<b>Value Per Share</b>						<b>\$56.45</b>

## Valuation

The table above shows our back of the envelop calculation for the next three years. We make the following assumptions in our calculation:

- **Revenue:** We assume revenue growth will finish FY2019 at 3%, which is consistent with the growth rate achieved during the first nine months of the fiscal year. Thereafter we assume 6% growth per year for the next several years. We expect the growing popularity of ODC's lightweight cat litter will allow for market share gains and assume overall revenue growth that is roughly 2x that of the market.
- **Gross Margin:** We assume gross margins for FY19 will come in at 23.5% of revenue, which is consistent with year-to-date performance. Thereafter, we expect one percentage point gain in margin for each of the next three years. We expect that margin improvement will come from a mix of increased prices and improved ERP efficiencies, which negatively impacted levels in 2019. We believe our assumptions for improvement may be conservative given the company's historical gross margin performance.
- **SG&A Expenses:** We expect SG&A expenses to grow at half the rate of sales growth.
- **EBITDA Margin:** Our model produces 420 basis points of improvement in EBITDA margin during the next 3 years, 75% from gross margin improvement and 25% from operating leverage.

We use a discounted multiple of EV/EBITDA multiple of 9x to reflect a discount from limited liquidity, as well as an A/B share structure. Working backwards from Enterprise value, our model derives a valuation of \$56.80 per share in three years, 67% above 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 April 2016 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. Date	Relative Perf. vs. Russell 2000	
PAR Technology Group (NYSE: PAR)	30-Apr-16	\$6.39	\$28.20	341.2%	36.8%	304.5%	
Full House Resorts Inc. (Nasdaq: FLL)	30-May-16	\$1.60	\$1.85	15.6%	34.4%	-18.8%	
Control4 Corporation (Nasdaq: CTRL)	30-Jun-16	\$7.99	\$23.76	197.4%	34.3%	163.1%	
KapStone Paper and Packaging Corporation (NYSE: KS)	31-Jul-16	\$14.28	\$35.00	145.1%	26.8%	118.3%	
Ampco-Pittsburgh Corp. (NYSE: AP)	31-Aug-16	\$11.12	\$4.01	-63.9%	24.7%	-88.7%	
Select Comfort Corporation (Nasdaq: SCSS)	30-Sep-16	\$22.51	\$32.50	44.4%	23.6%	20.8%	
Northwest Pipe Co. (NWPX)	31-Oct-16	\$13.16	\$25.76	95.7%	29.8%	65.9%	
Mitel Networks Corporation (Nasdaq: MITL)	30-Nov-16	\$7.25	\$11.15	53.8%	17.0%	36.8%	
Black Box Corporation (Nasdaq: BBOX)	31-Dec-16	\$15.25	\$1.10	-92.8%	14.0%	-106.7%	
RadNet, Inc. (Nasdaq: RDNT)	31-Jan-17	\$5.80	\$13.74	136.9%	13.6%	123.3%	
Guidance Software, Inc. (Nasdaq: GUID)	28-Feb-17	\$6.60	\$7.10	7.6%	11.5%	-4.0%	
Calgon Carbon Corporation (NYSE: CCC)	31-Mar-17	\$14.25	\$21.50	50.9%	11.6%	39.3%	
LRAD Corporation (Nasdaq: LRAD)	30-Apr-17	\$1.51	\$3.32	119.9%	10.4%	109.4%	
Trecora Resources (NYSE: TREC)	31-May-17	\$10.65	\$9.51	-10.7%	12.9%	-23.6%	
EVINE Live Inc. (Nasdaq: EVLV)	30-Jun-17	\$1.00	\$0.41	-59.0%	9.3%	-68.3%	
LSI Industries Inc. (Nasdaq: LYTS)	31-Jul-17	\$8.38	\$3.65	-56.4%	8.5%	-65.0%	
Cooper Tire & Rubber Company (NYSE: CTB)	31-Aug-17	\$33.80	\$31.53	-6.7%	10.1%	-16.8%	
RealNetworks, Inc. (Nasdaq: RNWK)	30-Sep-17	\$4.78	\$1.88	-60.7%	3.7%	-64.4%	
NCI Building Systems, Inc. (NYSE: NCS)	30-Oct-17	\$15.65	\$5.83	-62.7%	3.7%	-66.5%	
TransAct Technologies, Inc. (Nasdaq: TACT)	30-Nov-17	\$13.60	\$11.13	-18.2%	0.2%	-18.3%	
Regis Corporation (NYSE: RGS)	30-Dec-17	\$15.36	\$16.59	8.0%	0.7%	7.3%	
Team, Inc. (NYSE: TISI)	30-Jan-18	\$16.95	\$15.31	-9.7%	-2.3%	-7.4%	
Andina Acquisition Corp II (Nasdaq:ANDA)	28-Feb-18	\$9.85	\$5.02	-49.0%	2.3%	-51.3%	
GSE Systems, Inc. (NYSE:GVP)	31-Mar-18	\$3.25	\$2.30	-29.2%	1.1%	-30.4%	
Telaria, Inc. (NYSE:TLRA)	30-Apr-18	\$4.13	\$7.33	77.5%	0.3%	77.2%	
Avaya Holdings Corp. (NYSE:AVYA)	31-May-18	\$21.57	\$11.92	-44.7%	-5.3%	-39.4%	
Tenneco, Inc. (NYSE:TEN)	30-Jun-18	\$43.96	\$11.10	-74.7%	-5.9%	-68.9%	
Alithya Group Inc. (Nasdaq: ALYA)	31-Jul-18	\$3.40	\$2.64	-22.4%	-7.4%	-14.9%	
Data I/O Corporation (Nasdaq: DAIO)	30-Aug-18	\$5.37	\$4.43	-17.5%	-10.7%	-6.8%	
TPI Composites Inc. (Nasdaq: TPIC)	28-Sep-18	\$28.55	\$24.72	-13.4%	-8.8%	-4.6%	
Shiloh Industries, Inc. (Nasdaq: SHLO)	31-Oct-18	\$8.59	\$4.85	-43.5%	2.3%	-45.9%	
Richardson Electronics (Nasdaq: RELL)	30-Nov-18	\$7.18	\$5.62	-21.7%	0.9%	-22.6%	
Universal Electronics Inc. (Nasdaq: UEIC)	31-Dec-18	\$24.92	\$40.87	64.0%	14.7%	49.3%	
CSS Industries, Inc. (NYSE: CSS)	31-Jan-19	\$8.91	\$4.87	-45.3%	3.1%	-48.5%	
Comtech Telecommunications Corp. (Nasdaq:CMTL)	28-Feb-19	\$26.25	\$28.08	7.0%	-1.8%	8.8%	
Landec Corporation (Nasdaq:LNDL)	31-Mar-19	\$12.28	\$9.36	-23.8%	0.4%	-24.2%	
Dawson Geophysical (Nasdaq: DWSN)	30-Apr-19	\$2.46	\$2.46	0.0%	-2.8%	2.8%	
Fortress Transportation and Infrastructure Investors (Nasdaq:FTAI)	31-May-19	\$15.61	\$15.12	-3.1%	5.5%	-8.7%	
				<b>Average</b>	<b>14.6%</b>	<b>8.6%</b>	<b>6.0%</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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