Armanino Foods of Distinction (AMNF)

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Disclaimers

- I am not a registered investment advisor and I do not offer any investment advise
- No parts of this talk are suggestions to invest, not invest, buy or sell any kind of securities or other financial instruments

Armanino Foods of Distinction – business

- Production and marketing of frozen and refrigerated food products
  - Pesto sauces, stuffed pastas, pasta sheets, specialty Italian pastas, focaccia, and cooked meat products
- Sales: to food brokers to retail, foodservice, and industrial accounts; to retail and foodservice distributors; club-type stores
  - Top brokers: 4.4M, 2.8M, 2M sales (15%, 11% and 7%)
  - Company claims that broker is not important, supermarket contract is important
  - Two customers 62%, 15% receivables – unknown identities
  - 50% sales one distributor
- Founded in 1978 and is based in Hayward, California.

Armanino Foods of Distinction – business (cont’d)

- Production:
  - Company production
  - Outsourced 3rd party production
- Unlisted stock (pink sheets)
  - No SEC forms, no 10-K, 10-Q, etc
  - Was listed (2005), unlisted to save expenses, etc.
  - Not a fraud (AFAIK), real facilities, real products
  - Pays dividend from 2000 with some special dividends
  - Stock buyback

Armanino Foods of Distinction - Misc thoughts

- What can go wrong?
  - Microcap – governance issues, etc.
  - Agri commodity prices squeezing margins
  - Clients move to other brands
  - Competitors capture shelf space, supplier chain
  - Shorter shelf life compared to dried or canned products – better quality?

Armanino Foods of Distinction - Misc thoughts

- Opportunities:
  - Pretty good results so far, maybe some expansion in the future

Strategic considerations

- Moat (*switching costs, habit, low cost*):
  - What are the moats? Brand? Quality?
  - What does it take to sustain the moats? Increase brand value
  - Bargaining power of suppliers/customers? Unknown
- Is it a low risk business? Somewhat.
- Is there high uncertainty? Medium
- How capital intensive is the business? No
- Future growth – Unknown
- Are the revenues and cash flows of the business sustainable or overstated / understated due to boom or bust conditions? Possibly overstated due to rising agri prices currently

Management

- I don't usually do management analysis. Included for template completeness
- Former CEO died on 2009 – changes?
- CEO 450K shares, COB 3M shares, D. Armanino 1M shares
- CEO salary+bonus 275K, D. Armanino 200K – normal??
- No dilution
- Can I trust management?
- Management shareholding (> 10%)
- Management incentives?
- Are the salaries too high?
- Is there heavy insider buying?
- Is there heavy insider selling?
- Do I like the management? (Operators, capital allocators, integrity)
- Profitable reinvestment
- What has management done with the cash?
- Where is Free Cash Flow invested? Share buybacks, dividends, reinvested, ROE & ROCE, incremental BV

Piotroski Score

Only applicable to Graham Cos – N/A to AMNF

1. Net Income: Bottom line. Score 1 if last year net income is positive.
2. Operating Cash Flow: Better earnings gauge. Score 1 if last year cash flow is positive.
3. Return On Assets: Measures Profitability. Score 1 if last year ROA exceeds prior-year ROA.
4. Quality of Earnings: Warns of Accounting Tricks. Score 1 if last year operating cash flow exceeds net income.
5. Long-Term Debt vs. Assets: Is Debt decreasing? Score 1 if the ratio of long-term debt to assets is down from the year-ago value. (If LTD is zero but assets are increasing, score 1 anyway.)
6. Current Ratio: Measures increasing working capital. Score 1 if CR has increased from the prior year.
7. Shares Outstanding: A Measure of potential dilution. Score 1 if the number of shares outstanding is no greater than the year-ago figure.
8. Gross Margin: A measure of improving competitive position. Score 1 if full-year GM exceeds the prior-year GM.
9. Asset Turnover: Measures productivity. Score 1 if the percentage increase in sales exceeds the percentage increase in total assets.

- Total: / 9

Is it a good business?

- 3+ year history of profits (unknown before 2009 – need to dig to find out)
- ROE:
  - 2009: 28 2010:38 2011:46(stock buyback) 2012 q1:49
- Margins
  - 2009: 7 2010:10 2011: 10 2012q1:10
- 3 year sales growth 8%, earnings growth 18%
- No dilution
- Strong balance sheet
  - Debt << cash/short term investments
- ROIC = Earnings / (Equity + Debt – Cash) = Earnings / (Assets – non-debt liabilities - Cash)
  - ~ ROE

Is it a good business? Cash flow

- Good cash flow:
  - 2011 2.4M earnings, 1.9M operating cash flow, 1.6M FCF (FCF = OCF – capital expenditures)
  - Free Cash Flow/Share barely higher than dividends paid

Is business cheap? – Buffettology calculations

- Buffettology calculations do not make much sense since company does not reinvest money into expansion/production
- ROE 20%
- Earnings in 10 years = ROE*Equity*$(1+\text{ROE})^9$ = \$6M
- Equity in 10 years = Equity*$(1+\text{ROE})^9$ = \$28M
- Market cap = 6M x P/E (15) = \$90M
- Rate of return = 11% after tax (calculations omitted)

- 9 year earnings growth: N/A. Assuming XX% earnings growth: YY% share price growth.

Is business cheap? DCF

- Discounted cash flow
  - Current earnings of 2.4M (FCF ~1.6M)
  - 10% growth for 5 years, leveling after that
    - 15% discount -> $23M current valuation
  - 5% growth for 10 years, leveling after that
    - 15% discount -> $21.5M current valuation
  - 10% growth for 10 years, leveling after that
    - 15% discount -> $29M current valuation
- Owner's yield = earnings / (market cap + debt - cash) = earnings/EV
  - 2.6M / (26M+1.7M-2.4M) = 10%

- What makes up the margin of safety? Valuation, brand??
- Is there a sufficient margin of safety? Maybe.

Is business cheap? - Graham investment considerations

- N/A for AMNF – included for completeness
- 5 P/Book – not a net net
- Altman Z score (http://en.wikipedia.org/wiki/Altman_Z-score)