

## Materials and Processing

Daniel Junghans,  
junghan2@msu.edu

### Recommendation: Hold MOS and Sell DOOR

We look to add to our position in MOS if the price drops below \$17 and sell a portion of our position in DOOR at the current stock price. We like The Mosaic Company's dominance in the mineral and phosphate mining industry in the United States due to the high barriers to entry. However, demand for MOS crop nutrients remains highly cyclical, which could cause a problem if demand for crops ever drops. We like Masonite International's strong position in the construction and remodeling sector, but future changes in mortgage rates, mortgage interest deduction, and related tax changes pose a huge threat to the profitability of the company.

### Key Investment Highlights

#### **The Mosaic Company expands revenue and gross margin but reports a net loss.**

During the third quarter of 2020, The Mosaic Company grew revenues from the past quarter and reported \$2.381 billion dollars in sales. The gross margin increased by 27% from the previous year to \$355 million dollars. The total sales volume was also 3% higher than the same period last year. This growth of revenue was negatively impacted by several notable items, costing \$93 million dollars after tax. \$68 million dollars in noncash charges arose from an annual review of estimated future phosphate asset retirement and an environmental remediation reserve.

#### **Phosphates, potash, and performance products sales all fell during the third quarter of 2020.**

During the third quarter for The Mosaic Company, several key products saw a decrease in sales volume. Phosphate sales were down 6% year over year due to inventory limitations. During the quarter, severe weather and turnarounds limited production and limited the company's ability to rebuild inventory. Because of low inventory, a portion of phosphate sales that were committed at the end of the third quarter will be delivered in the fourth quarter. Potash sales were down 2% year over year due to seasonal sales occurring earlier in the year. Lastly, performance product sales were down slightly from last year.

#### **Masonite International Corporation increases revenues from Q2 but reports net loss and asset impairment.**

For the third quarter, Masonite International Corporation reported net sales of \$587.7 million dollars. The gross profit was \$160.3 million dollars and 27.3% higher than the previous year. Before the end of the third quarter,

### Potential Companies

Warrior Met Coal, Inc. (HCC). This company uses its assets extremely efficiently (ROA: 22%) and is moderately liquid (Current Ratio: 3.44) compared to the materials and processing sector. Warrior Met Coal could be a rewarding company to invest in because it is the leading producer of metallurgical coal for the steel industry and continues to dominate the global market.

Schweitzer-Mauduit International (SWM). This materials company is extremely asset efficient (ROA: 5.8%) and has an average liquidity (Current Ratio: 2.71) for the sector. Schweitzer-Mauduit has branched out from selling paper and has increased revenue through selling advanced materials & structures. This new line of products has the potential to make this company a great investment.

Silvercorp Metals, Inc. (SVM). Currently, this company is extremely liquid (Current Ratio: 5.68) and uses its assets very efficiently (ROA: 6.8%) compared to the rest of the sector. Silvercorp Metals owns several silver, lead, and zinc mines all over china and has established itself as China's premier silver producer. This market dominance makes Silvercorp Metals a very promising company to look into.

Fortuna Silver Mines Inc. (FSM) unlike previous companies listed, this one has a moderately above average asset efficiency (ROA: 2.8%) and has below average liquidity (Current Ratio: 1.70) compared to other companies in this sector. Fortuna Silver Mines is an attractive investment due to its rapid expansion of precious metals mines in Mexico, Peru, and Argentina.

## Sector Recommendation

Masonite International determined that the continued suppressed demand in the architectural door market due to COVID-19 is an indicator that goodwill impairment has occurred. A quantitative impairment test was conducted and resulted in a \$51.5 million dollar charge to the Architectural goodwill balance. This impairment was a large factor in Masonite International's \$21.7 million dollar net loss.

### **Sector Overview**

The Mosaic Company is the world's leading producer of concentrated phosphate and potash crop nutrients. They currently operate five phosphate mines in the Americas as well as several potash mines in Canada and the United States. The Mosaic Company mines and refines phosphate and potash to be sold to international crop nutrient manufacturers, distributors, and retailers. Masonite International is a designer, manufacturer, and distributor of interior and exterior doors for the construction and remodeling sectors of the residential and non-residential building construction markets. Masonite International markets their products to contractors, builders, homeowners, retailers, dealers, and lumberyards. Their segments have performed as seen below.

### **Sector Analysis**

The allocation of sales by product type for The Mosaic Company is as follows: Phosphate Crop Nutrients 28.4% (\$677), Potash Crop Nutrients 30.5% (\$727.3), Crop Nutrient Blends 15.8% (\$376.5), Performance Products 15.2% (\$361.3), Phosphate Rock 0.61% (\$14.5), and Other 9.4% (\$224.9). The Mosaic Company is a key player in the mineral & phosphate mining sector in the United States and earns 34.8% of the industry revenue. Revenue for the mineral & phosphate mining industry in the United States was \$7.58 billion dollars in 2020. Revenue for this industry fell in 2020 by 4.53%. The revenue for this industry is expected to grow over the next five years due to increased global demand for mineral and phosphate products. An investing opportunity for The Mosaic Company may arise if unemployment levels drop and consumer spending surges. The Masonite International Corporation breakdown of net sales by reportable segment is as follows: North American Residential 71.6% (\$420.5), Europe 12.6% (\$74.3), and Architectural 14.8% (\$86.7). Masonite International is a key player in the wood door & window manufacturing industry earning 11% of the industry revenue. Revenue for this industry in 2019 was \$13.1 billion dollars which is a 2.42% increase from the previous year. Over the next five years, revenue growth is expected to decelerate as residential construction demand slows. Revenue growth failing to decelerate over the next five years may present a lucrative investment opportunity.

### **Positive & Negative Catalysts**

A major catalyst for The Mosaic Company will be next quarter's earnings. Sales were up 3% in the third quarter, and they expect that prices and demand will recover closer to pre-COVID-19 levels next quarter. The next

**Sector  
Recommendation**

catalyst for this business is the completion of their cost targets. They have already completed five of the seven 2021 cost targets and are on track to exceed its full year transformation target of \$50 million dollars. First quarter earnings are the next biggest positive catalyst for Masonite International. Leading indicators from Masonite International indicate sales and gross margin growth continuing into the first quarter of 2021. The Architectural Billings Index (ABI) has also almost returned to pre-COVID-19 levels, signaling that the non-residential construction sector is recovering.

A risk involved in owning The Mosaic Company revolves around government policies and economic conditions affecting the agricultural industry. According to Mosaic, grower economics in global markets remain attractive, but future shifts in crop demand could negatively affect their profitability. Another risk is the cyclical demand for crop nutrients. If crop nutrient prices become more volatile, operations results may deteriorate. Risks associated with Masonite include the systematic risk of government regulation and changes in interest rates. Increased mortgage rates, changes in mortgage interest deduction, and related tax changes can have a great material impact on sales and profitability.

**What to Watch – Next**

Current Analyst estimates expect revenue for The Mosaic Company to just pass \$1.9 billion dollars for the next quarter. Since 2016, first quarter earnings have dropped by an average of 22% from the prior year's third quarter earnings. Considering this trend, along with the cyclical demand Mosaic faces, we believe that The Mosaic Company may not meet expectations. Since the beginning of the last fiscal quarter, the average stock price has risen dramatically for The Mosaic Company. Current street estimates for Masonite International put their revenue at \$578 million dollars for the first quarter of 2021. Due to leading indicators and past earnings growth, we believe that Masonite International will beat earnings estimates. The average stock price has had no dramatic shifts this past quarter.

**Final Take**

Recommendation: Hold onto The Mosaic Company unless the stock price drops to \$17.00 (buy) or rises above \$30.00 (sell). Cyclical demand and a history of low first quarter earnings have led me to believe that the stock price for The Mosaic Company will drop slightly in the short term. I believe we should sell a portion of our position in Masonite International at the current market price of \$96.45 and buy back in if the stock price drops to \$70.00. While I believe that Masonite International will have no problem beating earnings expectations, I have seen no explanation for the dramatic increase in the stock price. Earnings over the past quarter were high by historical standards, but not high enough to justify the recent spike in stock price. Since SIA is overinvested in the materials and processing sector

compared to the Russell 2000, It would be wise to reduce the size of our position in Masonite International.