



MGP Ingredients Inc. Research (8/13/19)

Description: MGP Ingredients produces and supplies distilled spirits, and specialty wheat proteins and starch food ingredients. It operates in two segments, Distillery Products and Ingredient Solutions. The Distillery Products segment provides food grade alcohol for beverage applications that include bourbon and rye whiskeys, as well as grain neutral spirits, including vodka and gin; and food grade industrial alcohol, which is used as an ingredient in foods, personal care products, cleaning solutions, pharmaceuticals, and various other products. This segment also provides fuel grade alcohol for blending with gasoline; distillery co-products, such as distillers feed and corn oil; and warehouse services, including barrel put away, storage, and retrieval services. The Ingredient Solutions segment provides specialty wheat starches for food applications under the Fibersym Resistant Starch, FiberRite RW Resistant Starch, Pregel Instant Starch, and Midsol Cook-up Starch trademarks; specialty wheat proteins for food applications; commodity wheat starch for food and non-food applications; and commodity wheat proteins. The company sells its products directly or through distributors to manufacturers and processors of finished packaged goods or to bakeries primarily in the United States, Japan, Thailand, and Canada. MGP Ingredients, Inc. was founded in 1941 and is headquartered in Atchison, Kansas.

Ticker: MGPI

Price: \$50.70

Market Cap: \$863M

Performance: -10.7% YTD

Analysis

MGPI is not a company many people are familiar with. The company has been struggling this year due to weaker than expected sales and profits and have also lowered their guidance for the full year in their Q2 report after reiterating it in their Q1 report.



The stock is currently sitting at levels not seen since Q3 of 2017 as MGPI is facing some headwinds in their business.

“While we are pleased with the improved results for most parts of our business, sales of aged whiskey have lagged our expectations. We remain confident in both the long-term demand for, and the value of this inventory, and expect to see a significant increase in sales of aged whiskey over the remainder of the year. However, we believe there is some possibility we might have difficulty completing transactions for all of our projected sales of aged whiskey by the close of the year,” said Gus Griffin, president and CEO of MGP Ingredients. “As a result, we are revising our guidance for the full year to include that possibility.” – CEO Gus Griffin.

The company reported Q2 GAAP EPS of \$0.46 missing by \$0.06 on revenue of \$90.5M (+2.5% Y/Y) missing by \$1.04M.

- Consolidated sales increased 2.5% to \$90.5 million
- Consolidated gross profit increased 0.4% to \$19.5 million, as a decline in Distillery Products gross profit was offset by gains in Ingredient Solutions.
- Consolidated operating income decreased 2.3% to \$10.9 million
- EPS increased to \$0.46 per share from \$0.44 per share, reflecting a lower tax rate and other tax related items for the quarter.

This was a pretty underwhelming Q2 report as MGPI now expects FY19 to come in at:

- 2019 sales growth is projected in the mid-single-digit percentage range versus 2018.
- 2019 gross margins are expected to increase modestly as compared to 2018.
- ***The Company's estimate of growth in operating income in 2019 is 10% to 20%.***
- 2019 effective tax rate is forecasted to ***be approximately 19%***, and shares outstanding are expected to be approximately 17 million at year end.
- Earnings per share are forecasted to be in the ***\$2.55 to \$2.75 range*** inclusive of our new, lower projected effective tax rate.

At the **end of Q1**, management was expecting:

- 2019 sales growth is projected in the mid-single-digit percentage range versus 2018
- 2019 gross margins are expected to increase modestly as compared to 2018.
- ***The Company's estimate of growth in operating income in 2019 is 15% to 20% off of the higher than expected 2018 results.***
- 2019 effective tax rate is forecasted to ***be approximately 21%***, and shares outstanding are expected to be approximately 17 million at year end.
- Earnings per share are forecasted to be in the ***\$2.55 to \$2.65 range***.

Interestingly enough, MGPI is guiding for midpoint of EPS now at \$2.65 vs. the prior \$2.60 but this is because they expect a lower tax rate from 21% to 19% and not an increase in the efficiency of the business as seen by the guidance of operating income. MGPI now anticipates operating income growth at a midpoint of 15% vs. 17.5% at the end of Q1.

Are these numbers attainable?

Halfway through the year, operating income stands at \$19.4M. Halfway through 2018, this figure was \$21.5M. Operating income ended 2018 at \$50.1M which means in order to meet 2019 guidance MGPI has to bring in:

10% operating income growth = \$55.1M

15% operating income growth = \$57.6M

20% operating income growth = \$60.1M

2018's 2H operating income was \$28.6M. If MGP replicated this in 2019, they'd only bring in \$48M.

This means the company will have to really step it up a notch to meet even the low point of guidance which is another \$35.7M in 2H19. \$35.7M vs. the \$28.6M in 2018's second half is

24.8% growth just to meet the 10% operating income growth for 2019. At the 15% midpoint target, they'd have to grow 2H operating income 33.5% Y/Y. In order to meet the high-end estimate, the company would have to grow operating income 42.3% Y/Y.

The company will be launching its new Remus Volstead Reserve Straight Bourbon Whiskey in November, a one-time, extremely limited, 14-year old bottled-in-bond offering at a retail price of \$199.99 per 750-ml bottle. This could help sales a bit but will less than two months from one product be enough to save the day?

Here is a look at some of their other brands:



Why else does CUBE believe it's going to be tough to pull off the guidance? In the press release, the CEO also said, "While 2018 will continue to be a tough comparison due to the loss of a major customer at the end of the year, we remain very confident in the long-term growth capabilities of this segment as we leverage the sustained consumer interest in plant-based proteins, high fiber, high protein, non-GMO and clean label products."

I dove into who this customer might be and with a high probability it is probably Diageo (DEO). In 2017, Diageo began production at their \$115 million Bulleit Distilling Company distillery in Shelbyville, KY. Just last month, the company announced they broke ground on a new \$130 million distillery in Lebanon, KY, about 66 miles south of Louisville. In other words, it looks like DEO is vertically integrating their business even more now which is terrible for a company like MGPI who operates in that part of the supply chain.

Competition isn't helping MGPI either. As of 2018, Kentucky had 68 distilleries – up 250% in the last decade. That's 32 counties with at least one distillery – they only had 8 in 2009. Most of these distilleries have come from familiar major names like Beam Suntory's Jim Beam and Maker's Mark, Brown-Forman, Heaven Hill, Four Roses, Sazerac and Barton and Wild Turkey. But new production facilities from Diageo as previously mentioned,

Bardstown Bourbon Company, Lux Row, Michter's, O.Z. Tyler and Louisville Distilling Company have all added significant capacity. Once again, not good for MGPI.

MGPI's share price has skyrocketed over the years because of its unique position on the public market to play the "bourbon boom" but that picture is starting to look like its fading.

We discussed the income statement above and the balance sheet and statement of cash flows aren't looking much better. MGPI currently has about \$2.2M in cash on them with a majority of their current assets held in inventory to the amount of \$114M. The company does have a \$139M line of credit they can tap into if needed (at the start of the year). Debt as of the most recent quarter stood at \$48.7M, up from \$31.6M at the start of 2019.

The company brought in roughly \$2.2M in unlevered free cash flow (\$2M in levered free cash flow) in Q2. The last twelve months cash flow stands at -\$2.3M and for FY2018 it was about -\$8M. I'd still they are good to make their debt payments and their dividend, while small, should remain intact as their current ratio stands at 5.3x and quick ratio stands at a healthy 1.5x.

Looking at the fundamentals, if MGPI does hit the midpoint of their EPS guidance for the year of \$2.65, the stock trades at about 19x earnings. Given the industry MGPI is in and the fact that earnings growth and revenue have stalled out a bit, we'd say this is a pretty fair valuation. In comparison to DEO and Constellation Brands (STZ), they trade at 26x and 23x earnings, respectively, with far better margins, growth, higher dividend yields, more diversified portfolios and markets, and way better cash flow.

The best-case scenario in my view for MGPI is that they get bought out by one of the many growing players in this space. I think it would make sense for the companies like STZ and DEO as well as the smaller private players as a way of better competing against the giants and broadening their scope. Otherwise, there isn't anything too exciting happening in CUBE's view for MGPI. It's best days of growth seem to be behind them, competition is growing fierce, the dividend yield of 0.79% is not attractive, cash flow is weak, and consumer behavior for this industry has shown to be fickle and can change in a blink of an eye which also presents some risks. If one wanted to play the bourbon route the two giants in STZ and DEO would make a lot more sense given how much less risk there is, the fact that they have their own distilleries, other brands in different niches, and the ability to market and maneuver around changing consumer demands/trends.

Technical Analysis



MGPI has pretty much broken through every single support level. The stock is significantly below all of its moving averages and was unable to hold the crucial \$54-55 area which was a 2-year support. According to the fibonacci levels, the next real area of support is \$40.87 and I believe over time it can go back down to those levels. Volume after this drop has been very weak and that shows me that there is still little demand for MGPI stock, even after the pullback. RSI, MFI, and Williams%R haven't been that reliable for the stock either.

