

Investor Alert: What profitable advanced industrial materials company is buying back its shares?

What's the most accretive thing you can do with excess cash flow? That's a problem a lot of companies would like to have for sure. Ideally you'd like to grow the business either organically or through acquisitions, or in a mature industry you start to distribute it to shareholders. Over the years we have seen what not to do with extra cash as gold miners have historically been notorious for spending it as fast as they can on acquisitions that may or may not (most of the time not) make sense. Growing for the sake of growing is sometimes not the best use of available cash and can potentially be suboptimal for shareholders.

Neo Performance Materials Inc. (TSX: NEO) has been faced with the issue of plenty of extra cash on the balance sheet for a while as this highly profitable company continues to churn out tremendous quarterly results. The latest quarter, released May 13th (click here to review), saw revenue of \$130.9 million which was 44.3% higher than Q1/20 and 18.6% higher than Q4/20, while adjusted EBITDA was \$22.4 million, an increase of \$12.8 million compared to \$9.6 million in Q1/20 and \$12.3 million in Q4/20 or a sequential quarterly increase of 82%.

So one would predict that the stock price would be reacting positively to these ever improving results. However, that is not the case. After Q4/20 results were reported on March 22nd Neo's stock price closed at \$19.77, then after Q1/21 results were reported (May 13th) the stock closed at \$18.29 and on Friday, May 31st Neo closed at \$16.80. Obviously, there can be

more to a stock's performance than its own results. The expression "a rising tide lifts all boats" has great application to the stock market as a solid bull run can take a lot of extra passengers along for the ride. So was Neo's share price simply following as the market drifted lower? Nope. The TSX Composite rose from 18,815.1 on Mar 22nd, to 19,135.8 on May 13th and finished May at 19,731.0, an overall increase of 4.9% compared to a decline of 15% for Neo shares over the same period. What about the S&P 500? Over the same time frame, it rose from 3,940.6 to 4,112.5 and closed the month of May at 4,204.1, up 6.7%.

Granted this is all pretty basic analysis, and Neo's stock price could be moving up or down for any variety of reasons. If I knew what all those reasons were I'd be living somewhere a lot more lavish right now and possibly have my own hedge fund. Nevertheless, I'm not the only one puzzled by how the market is reacting to sequentially improving results of a company that is in one of the go to sectors of the green revolution, at the same time the overall market is continuing to hit new highs. Neo believes that its shares have been trading in a price range which does not adequately reflect the value of such shares in relation to the business of Neo and its future business prospects. As a result, depending upon future price movements and other factors, Neo believes that its outstanding shares may represent an attractive investment to Neo. Correspondingly, the Company announced its intention to make a Normal Course Issuer Bid for up to 2,111,758 (approximately 10% of the public float) of its issued and outstanding common shares.

If a company is trading at a premium multiple to its peers, then it can be accretive to buy them out using its own shares as currency. Sometimes the most accretive acquisition a company can make is its own shares. Given the size of the share buyback and the fact that of the 37.9 million shares outstanding, 12.5 million are held by one shareholder (Oaktree

Capital Management, L.P.) one would suspect this could provide some support for the share price. We know that Neo thinks all the hard work they've put into the company should be worth a little more. Let's see if the market agrees with them.