

An Update on Our Investments in Building Products Companies

This article is authored by MOI Global instructor Phil Ordway, Managing Principal at Anabatic Investment Partners, based in Chicago, Illinois.

Armstrong (AWI) shares fell 3.6% in 2018 but the company is performing in line with our expectations and its prospects have improved in a few important ways since we first invested three years ago.

After spinning off its low-margin, underperforming flooring segment in April 2016, Armstrong completed its restructuring in 2018 by closing the sale of its international operations to Knauf for \$250 million in net cash. I think it was a good decision for the company. The price was attractive, and it removed a complicated, low-margin segment while allowing management to focus on the better markets in the company's portfolio. It also reinforced the balance sheet, which is now as strong as it has been in many cycles. The company's competitive position and market share remain dominant, and its lead has widened in several key categories.

Capital allocation remains crucial and it is at the top of my list of concerns. By the end of next year Armstrong will have allocated between a half billion and \$1 billion of capital over the preceding 24-36 months.^[1] The board recently approved the initiation of a small dividend to go with its previous (and small) accelerated share repurchase program and its ongoing open-market share repurchases. Now more than ever the company's capital allocation decisions will determine our fate as investors.

Builders FirstSource (BLDR) share price tanked as the market turmoil spread in the fourth quarter of 2018. The year presented numerous challenges for the company. Commodity prices whipsawed the homebuilding industry, and the volatility in the price of lumber – a key product for BLDR – was exceptional. After hitting \$639 per 1,000 board-feet on May 17, 2018 – an all-time record that was far higher than previous cyclical highs – lumber collapsed by almost 50% and finished the year *down* 26%. A weaker housing market, tariffs, wildfires, and delivery bottlenecks all hindered the company.

Despite everything that went wrong in 2018 there is a better story to tell looking forward. BLDR continues to entrench its business as the low-cost distributor and supplier of choice in its markets. Regardless of the exact number of housing starts in any given year, the country needs more housing over time and BLDR will be a prime beneficiary.

Even a “bad” year like 2018 wasn't so tough – the company was very profitable, generating copious free cash flow that further deleveraged the balance sheet. The shares could remain volatile, but it is worth remembering the business outlook and the odds implied by the current market price.

^[1] Including the cash received from Knauf.

Disclaimer: Gross Long and Gross Short performance attribution for the month and year-to-date periods is based on internal calculations of gross trading profits and losses (net of trading costs), excluding management fees/incentive allocation, borrowing costs or other fund expenses. Net Return for the month is based on the determination of the fund's third-party administrator of month-end net asset value for the referenced time period, and is net of all such management fees/incentive allocation, borrowing costs and other fund expenses. Net Return presented above for periods longer than one month represents the geometric average of the monthly net returns during the applicable period, including the Net Return for the month referenced herein. An investor's individual Net Return for the referenced time period(s) may differ based upon, among other things, date of investment. In the event of any discrepancy between the Net Return contained herein and the information on an investor's monthly account statement, the information contained in such monthly account statement shall govern. All such calculations are unaudited and subject to further review and change. For purposes of the foregoing, the calculation of Exposure Value includes: (i) for equities, market value, and (ii) for equity options, delta-adjusted notional value.

THE INFORMATION PROVIDED HEREIN IS CONFIDENTIAL AND PROPRIETARY AND IS, AND WILL REMAIN AT ALL TIMES, THE PROPERTY OF ANABATIC INVESTMENT PARTNERS LLC, AS INVESTMENT MANAGER, AND/OR ITS AFFILIATES. THE INFORMATION IS BEING PROVIDED SOLELY TO THE RECIPIENT IN ITS CAPACITY AS AN INVESTOR IN THE FUNDS OR PRODUCTS REFERENCED HEREIN AND FOR INFORMATIONAL PURPOSES ONLY.

THE INFORMATION HEREIN IS NOT INTENDED TO BE A COMPLETE PERFORMANCE PRESENTATION OR ANALYSIS AND IS SUBJECT TO CHANGE. NONE OF ANABATIC INVESTMENT PARTNERS LLC, AS INVESTMENT MANAGER, THE FUNDS OR PRODUCTS REFERRED TO HEREIN OR ANY AFFILIATE, MANAGER, MEMBER, OFFICER, EMPLOYEE OR AGENT OR REPRESENTATIVE THEREOF MAKES ANY REPRESENTATION OR WARRANTY WITH RESPECT TO THE INFORMATION PROVIDED HEREIN. AN INVESTMENT IN ANY FUND OR PRODUCT REFERRED TO HEREIN IS SPECULATIVE AND INVOLVES A HIGH DEGREE OF RISK. THERE CAN BE NO ASSURANCE THAT THE INVESTMENT OBJECTIVE OF ANY SUCH FUND OR PRODUCT WILL BE ACHIEVED. MOREOVER, PAST PERFORMANCE SHOULD NOT BE CONSTRUED AS A GUARANTEE OR AN INDICATOR OF THE FUTURE PERFORMANCE OF ANY FUND OR PRODUCT. AN INVESTMENT IN ANY FUND OR PRODUCT REFERRED TO HEREIN CAN LOSE VALUE. INVESTORS SHOULD CONSULT THEIR OWN PROFESSIONAL ADVISORS AS TO LEGAL, TAX AND OTHER MATTERS RELATING TO AN INVESTMENT IN ANY FUND OR PRODUCT.

THIS IS NOT AN OFFER TO SELL OR SOLICITATION OF AN OFFER TO BUY AN INTEREST IN A FUND OR PRODUCT. ANY SUCH OFFER OR SOLICITATION WILL BE MADE ONLY BY MEANS OF DELIVERY OF A FINAL OFFERING MEMORANDUM, PROSPECTUS OR CIRCULAR RELATING TO SUCH FUND AND ONLY TO QUALIFIED INVESTORS IN THOSE JURISDICTIONS WHERE PERMITTED BY LAW.

ALL FUND OR PRODUCT PERFORMANCE, ATTRIBUTION AND EXPOSURE DATA, STATISTICS, METRICS OR RELATED INFORMATION REFERENCED HEREIN IS ESTIMATED AND APPROXIMATED. SUCH INFORMATION IS LIMITED AND UNAUDITED AND, ACCORDINGLY, DOES NOT PURPORT, NOR IS IT INTENDED, TO BE INDICATIVE OR A PREDICTOR OF ANY SUCH MEASURES IN ANY FUTURE PERIOD AND/OR UNDER DIFFERENT MARKET CONDITIONS. AS A RESULT, THE COMPOSITION, SIZE OF, AND RISKS INHERENT IN AN INVESTMENT IN A FUND OR PRODUCT REFERRED TO HEREIN MAY DIFFER SUBSTANTIALLY FROM THE INFORMATION SET FORTH, OR IMPLIED, HEREIN.

PERFORMANCE DATA IS PRESENTED NET OF APPLICABLE MANAGEMENT FEES AND INCENTIVE

FEES/ALLOCATION AND EXPENSES, EXCEPT FOR ATTRIBUTION DATA, TO THE EXTENT REFERENCED HEREIN, OR AS MAY BE OTHERWISE NOTED HEREIN. NET RETURNS, WHERE PRESENTED HEREIN, ASSUME AN INVESTMENT IN THE APPLICABLE FUND OR PRODUCT FOR THE ENTIRE PERIOD REFERENCED. AN INVESTOR'S INDIVIDUAL PERFORMANCE WILL DIFFER BASED UPON, AMONG OTHER THINGS, THE FUND OR PRODUCT IN WHICH SUCH INVESTMENT IS MADE, THE INVESTOR'S "NEW ISSUE" ELIGIBILITY (IF APPLICABLE), AND DATE OF INVESTMENT. IN THE EVENT OF ANY DISCREPANCY BETWEEN THE INFORMATION CONTAINED HEREIN AND THE INFORMATION IN AN INVESTOR'S MONTHLY ACCOUNT STATEMENT IN RESPECT OF THE INVESTOR'S INVESTMENT IN A FUND OR PRODUCT REFERRED TO HEREIN, THE INFORMATION CONTAINED IN THE INVESTOR'S MONTHLY ACCOUNT STATEMENT SHALL GOVERN.

NOTE ON INDEX PERFORMANCE

INDEX PERFORMANCE DATA AND RELATED METRICS, TO THE EXTENT REFERENCED HEREIN, ARE PROVIDED FOR COMPARISON PURPOSES ONLY AND ARE BASED ON (OR DERIVED FROM) DATA PUBLISHED OR PROVIDED BY EXTERNAL SOURCES. THE INDICES, THEIR COMPOSITION AND RELATED DATA GENERALLY ARE OWNED BY AND ARE PROPRIETARY TO THE COMPILER OR PUBLISHER THEREOF. THE SOURCE OF AND AVAILABLE ADDITIONAL INFORMATION REGARDING ANY SUCH INDEX DATA IS AVAILABLE UPON REQUEST.