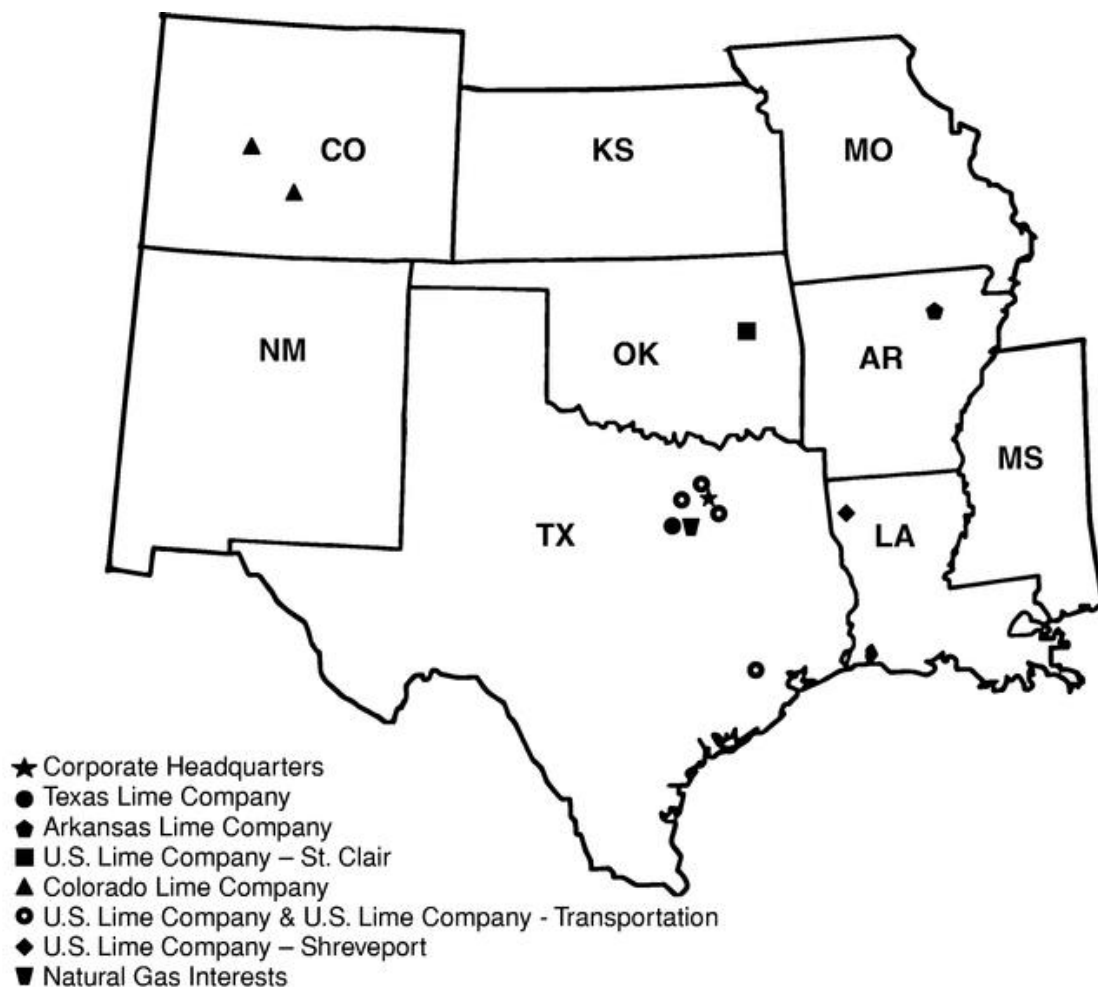


As a microcap investor I am always on the lookout for a company that supports double digit margins, has a moat like business and is trading at a wonderful price. With the vast majority of publically traded microcap stocks out there, finding a quality company with the former metrics is not as easy as it sounds.

Recently, I stumbled upon microcap stock United States Lime and Mineral (USLM). After performing a bottom-up, fundamentally oriented research on USLM, I have come to believe that USLM is a wonderful company trading for a wonderful price. USLM supports a “**MOAT**” like business model, has long-term demand and tailwinds for its core product offering, and has limited downside due to; high cash, zero debt, high insider ownership (low float), current buyback program and high FCF generation. In fact, we believe that USLM could be a buy and hold forever type of business, based upon the analysis performed.

Summary

USLM was incorporated in 1950 and currently conducts operations out of two segments; Lime and Limestone Operations and Natural Gas Interests. Since Natural Gas Interests only represented 3.52% of consolidated revenues in the most recent annual filing, the bulk of the research presented here will be on the Lime and Limestone Operations. Currently, the company has plants and facilities located in Arkansas, Colorado, Louisiana, Oklahoma and Texas.



Source: [2014 Annual Report](#)

Under the core offering, the bulk of the company’s products are; High Calcium Quicklime, Hydrated Lime, Lime Kiln Dust, Lime Slurry and High Calcium. Each of these former products have their own specific uses, however, broadly speaking, the products are used for; soil stabilization for highway building and construction, fuel gas desulfurization, steel manufacturing, paper manufacturing, municipal sanitation (water treatment), asphalt paving, industrial waste stabilization/remediation, the production of construction materials (roofing shingles), and for dying and modifying certain types of soils. In general, the company supplies primarily to the construction, steel and oil industry.

The demand for USLM’s products are derived upon, general economic conditions, the pace of the home and construction market in the US, need/demand for steel, the amount of O&G drilling and governmental/private funding for highway construction.

Market Cap	307.43 M	Enterprise Value	255.44 M
Shares Outstanding	5.60 M	Cash	54.52 M
TTM Revenues	134.94 M	Debt	0.00
TTM EBITDA	37.13 M	Insider Ownership	63.66%

TTM EV/EBITDA	6.88	TTM EV/Revenue	1.89
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Headwinds Have Created a Great Buying Opportunity

In the past year, the price of USLM has fallen to recent lows.



In Q1, Q2 and Q3, revenues fell -18%, -16% and -5.4% YOY, respectively. The reason for double digit topline reduction is due to decreased demand from O&G and steel customers, from the result of a decrease in drilling activities and steel production. One should note that the declination in revenues was partially offset by strong demand concerning the company's construction customers. In the first nine months of 2015, the construction demand was down from weather related issues.

We believe that these recent headwinds in terms of revenue reduction, have created a great buying opportunity. To give the buying opportunity more context per se, we will compare today's downturn with the downturn in the Great Recession.

USLM is very good at generating FCF, even during recessionary periods.

	TTM	2014	2013	2012	2011	2010	2009	2008	2007	2006	2005
FCF	21	20	25	23	29	25	25	10	6	-10	6

In millions

From 2008-2010 (one of the worse recorded recessionary times for the westernized world), USLM still generated \$79mm in FCF. Thus, despite the fact that USLM is heavily tied to cyclical industries, the need for its products outweigh the cyclical nature.

	TTM	2014	2013	2012	2011	2010	2009	2008	2007	2006	2005
--	------------	-------------	-------------	-------------	-------------	-------------	-------------	-------------	-------------	-------------	-------------

Revenues	135	150	134	139	143	133	117	142	125	119	81
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In millions

From 2008-2009, revenues dropped -17.61%, primarily from a decrease in lime sales volume, most notably in the construction and steel market. From 2014-TTM, revenues have declined thus far by -10%. Based on the historical rate of recovery in the topline and the strong forward demand for USLM's products, we believe revenues will recover and incrementally grow in the medium term. Also, based upon the company's ability for double digit margin stabilization, we believe that margins will continue to stay strong amidst the current downturn.

	TT M	2014	2013	2012	2011	2010	2009	2008	2007	2006	2005
Operating Margin	15.86	18.23	16.19	17.50	22.80	20.86	17.86	16.38	14.67	17.71	17.07
EBT Margin	14.46	17.30	14.83	15.95	21.14	18.90	15.46	13.64	11.45	15.28	12.05
Net Income Margin	10.62	12.93	11.06	11.86	15.56	13.61	11.65	10.14	8.34	10.70	9.80

USLM has a much stronger balance sheet today than it did in 2009 as well.

	Cash	Debt	Shares Outstanding
2009	16,466	36,666	6,378
First Nine Months	54,519	0.00	5,600

In millions

Based upon the much strong balance sheet, a tighter share structure, the ability for USLM to generate FCF during downtimes and a stronger recession in the past, we believe that USLM has more than enough ability to emerge from the current downturn stronger than before.

USLM Offers a Compelling Business Model for Long-Term Oriented Investors

USLM has a moat like business model which to us is compelling especially in the microcap space. What makes USLM a moat like business is the fact there are significant barriers to entry into the industry. Barriers to entry into USLM's industry are; scarcity of economically viable limestone deposits, zoning and permitting hurdles, and high capital costs.

Investing in a limestone quarry or production plant is a very timely process due to regulations, capital costs and challenges on the civilian side of the industry. According to geology.com, the permitting process can take 8-10 years alone. This is just the beginning as well. The facilities, need to be close to limestone markets, they need to have paved roads, and railroad networks should also be present in order for the business to be cost efficient in terms of production and distribution. There are also a significant amount of clean air and anti-polluting regulations/hurdles that make it hard for new entrants to emerge into this industry.

Did you know that deposits of limestone are in every state in the US and also in every country in the world? From the former statement, it would appear that this could be damaging to the industry with concerns to the supply side (overproduction). However, the majority of lime locations cannot be mined either due to the depth of the lime (too deep down), not commercially viable due to distance from markets, and not concentrated enough or pure enough for a large investment. The risk of overproduction in the lime industry is low, which allows USLM to support high margins.

Due to the high barriers to entry in this industry, there has been a significant amount of consolidation in the past decade. What is interesting is that 2/3s of North American production is led by three companies (all privatized). In order for USLM to stay competitive they have invested heavily into more modernized facilities/upgrades. USLM also utilizes open pit mining in their Texas and Arkansas locations which is a less expensive method of mining (compared to underground mining) which in turn enhances the company's bottom line. However, the disadvantage of open pit mining is that operations are subjected to inclement weather and overburden removal, which can make revenues lumpy.

Before we look into a peer analysis, one should note that USLM is not your typical mine company or commodity producer. Typically in the mining industry, companies will have to spend a significant amount of time and resources looking for new reserves. In USLM's case, they can continue to operate without running out of reserves for a significant amount of time....

- **Texas Lime**- able to sustain operations for ~75 years.
- **Arkansas Lime**-able to sustain operations for ~100 years.
- **St. Clair**- able to sustain operations for ~25 years.
- **Colorado Lime**- able to sustain operations for ~20 years.

Valuation

Because USLM's most direct competitors are private companies we cannot do a straight comp comparison. However, when looking at USLM's peers; Eagle Materials (EXP), Monarch Cement (MCEM), US Concrete (USCR), and Martin Marietta Minerals (MLM), you can clearly see that USLM is undervalued on a relative basis.

	EV/EBITDA	EV/Revenue
EXP	11.20	3.13
MCEM	2.95	0.77
USCR	9.62	1.16
MLM	13.81	3.24
Average	9.39	2.08
USLM	6.88	1.89

The reason why MCEM is significantly undervalued compared to all of its peers is due to the fact that it recently deregistered from filing with the SEC. Removing MCEM from the relative average puts the EV/EBITDA and EV/Revenue up to 11.54x and 2.51x, respectively. Investors should also make note that a strict relative valuation may be skewed due to the sheer size of the comps compared to USLM.

We believe that USLM will not have a problem making it through this current downturn and will actually return to a more normalized EBITDA run-rate in the next 12-18 months. The former is based on the historical EBITDA in the past five years and macro demand for lime...

	TTM	2014	2013	2012	2011	2010
EBITDA	37	42	36	39	46	41

In millions

We believe that EBITDA will return to ~\$41mm (the 2010-2014 average) in a relatively short fashion. We also believe that EBITDA has a potential to move higher than our estimated \$41mm due to a rise in demand in terms of; higher government spending on highways, a recovering housing sector and eventual normalized capex spending in the oil and steel market.

Exhibit 2.

Public Spending on Transportation and Water Infrastructure Under Alternative Adjustments for Inflation, 1956 to 2014

Billions of 2014 Dollars



Source: Congressional Budget Office based on data from the Office of Management and Budget, the Census Bureau, and the Bureau of Economic Analysis.

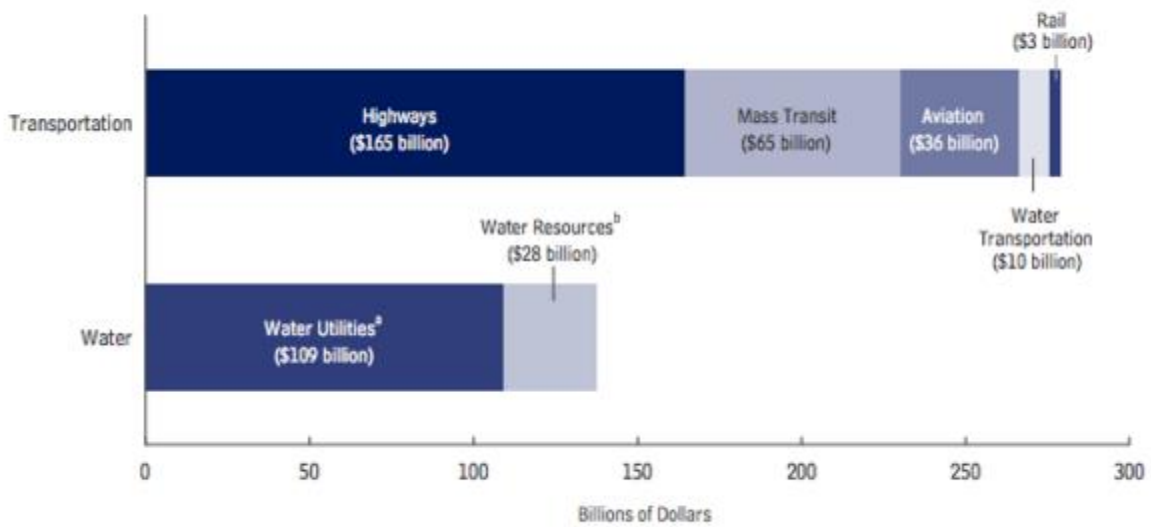
Source: CBO.gov

Per the picture above, inflation adjusted spending on infrastructure has decreased 9% (in 2003-2014) due to an increase in the cost of materials associated with this spending (concrete and asphalt). However, it would be irrational to believe that spending would deteriorate going forward. Based on historical need for infrastructure, and the upkeep required, demand should continue to stay strong, despite the relatively low down tick in the most recent years.

What is interesting and enlightening for shareholders of USLM is that highways are the biggest category of spending on a public level...

Exhibit 1.

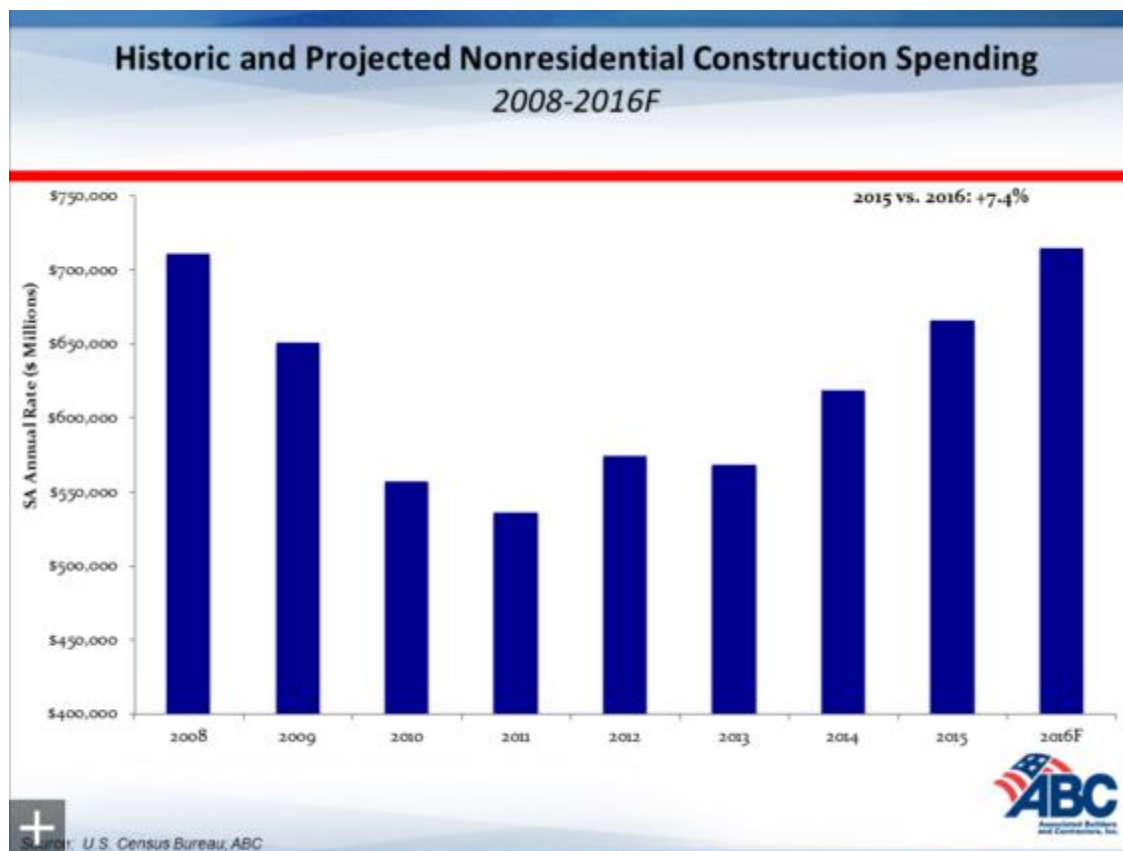
Public Spending on Transportation and Water Infrastructure, 2014



Source: Congressional Budget Office based on data from the Office of Management and Budget and the Census Bureau.

Source: CBO.gov

Non-residential construction spending has also been increasing as of lately and is projected to continue increasing in the near-term.



Source: [Construction Dive](#)

The challenge will be in terms of waiting for capex budgets in the oil and steel industry to return to more normalized levels. The oil and steel industry can be very cyclical in nature but investors should realize that it is not the end of the world. There will be continual demand for O&G going forward as well as steel. In our opinion, we believe that investors should not fret over a downturn in the O&G and steel market. This is due to the fact that USLM has a much diversified set of customers (over 800 customers with not more than one customer representing over 10% of consolidated revenues). In our opinion this is the perfect time to pick up a quality company at a quality price.

Our target base price is based upon EBITDA reverting upwards to \$41mm (the past five year average) due to; strong demand in the construction industry (highways and residential/non-residential production), with more so “normalized” capex budgets in the O&G and steel industry (both of these industries **need** USLM’s products). The base case also relies upon the EV/EBITDA multiple bouncing up 9.01%, from the TTM EV/EBITDA. In our opinion a 7.5x multiple is conservative given the attractive business model and relative “peer” undervaluation.

For the bull case EBITDA will rise back to 2011 levels with a higher multiple attached of 8.0x. With USLM’s historical ability to grow revenues at an incremental rate while supporting double digit margins and high FCF, we believe the bull case has a possibility of occurring in 24-36 months. However it could occur much faster if the O&G and steel industry improves in the more

so, near-term. Based upon the fast recovery from the Great Recession, we believe 24 months should give USLM ample time to revert back in an upward trajectory.

	Base	Bull
EBITDA	41.00	45
Multiple	7.5	8.00
EV	307.5	360
+Cash	54.52	54.52
-Debt	0.00	0.00
Total Equity	362.02	414.52
Shares Outstanding	5.60	5.60
Estimated Equity Per Share	64.65	74.02

In millions

Further Downside Potential?

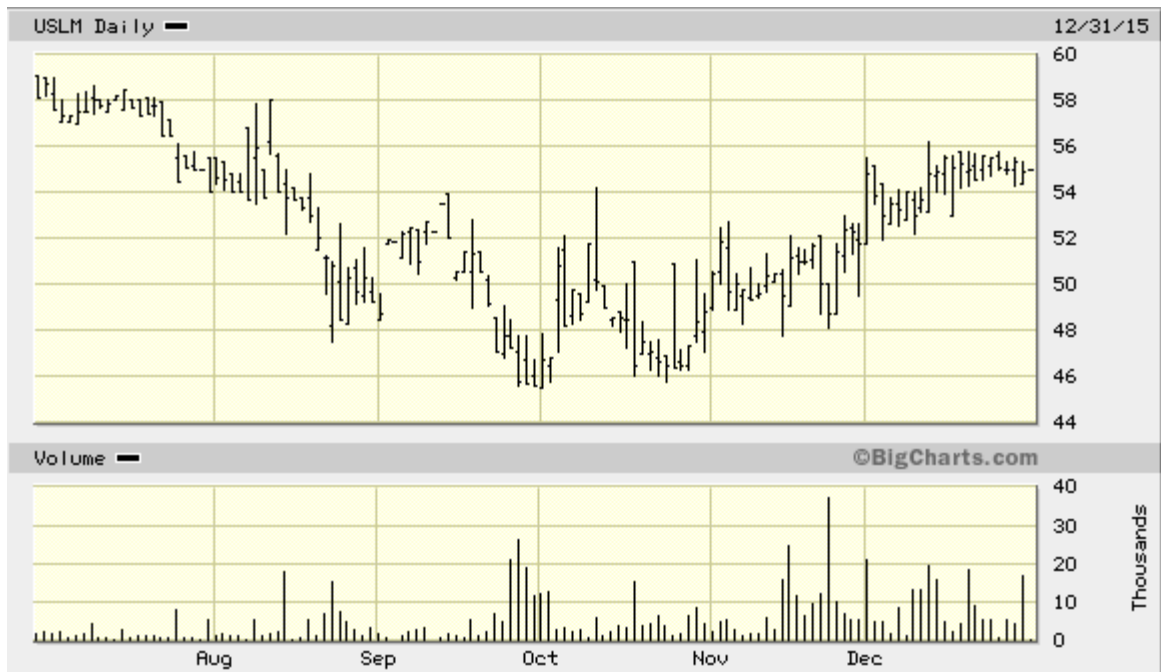
We believe that a substantial slide in the price of USLM's stock would be unlikely (<\$40/share) for several reasons. First, insiders own a substantial amount of the company (63.66% of the shares outstanding). This has put the float at a low 2.03mm shares outstanding. Unless there is an abnormal amount of insider sales going forward, in theory the low float coupled with high insider ownership will cap the downside.

Investors should note that if an insider starts to liquidate his or her position (tax reasons or other expenditures) they could have potential to take the price of the stock to decent lows due to the illiquidity associated with the stock price. However this could be good news for an investor wanting to buy a decent block of the stock for an even greater discount.

Another reason why we believe downside is limited is due to the recently announced [share repurchase program](#). The program allows the company to buy back \$10mm worth of shares in the next twelve months (**at the current price of \$55/share that is 3.24% of the shares outstanding**). Investors may be thinking that the program is understated due to the high cash position on the balance sheet. This may be true, however, it may be all the company can buy due to the illiquidity associated with the trading volume.

Also, the company may be saving up money to make a decent acquisition in the future, so keeping the buyback at a low \$10mm is prudent on management's decision. Finally, the company is looking to modernize the St. Clair facility in which they would replace the kiln. This could cost the company of upwards to \$35mm (yet another reason for the lowball buyback program). Overall, the buyback program will in theory limit the downside.

The final reason why we believe the downside is limited is due to a stabilization or lower loss of revenues in Q3 and recent price reversion.



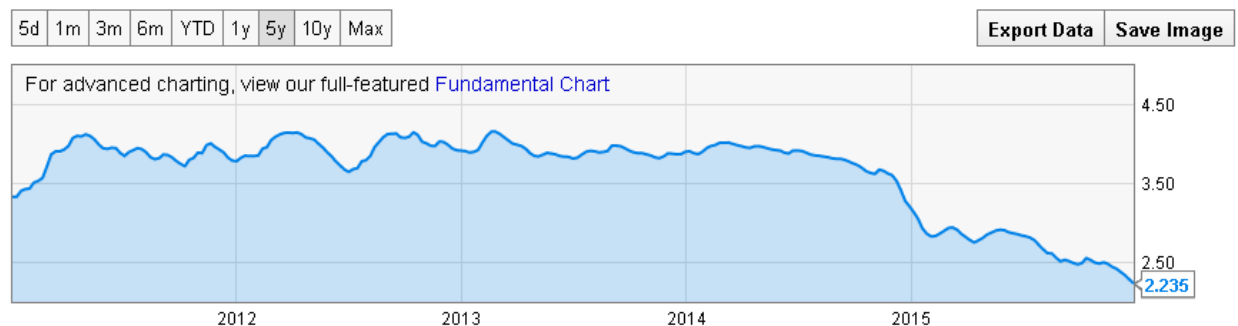
In Q3, revenues only fell -5.4%, which to us means that demand is starting to make its comeback. However, investors should be aware that demand may be up due pent-up demand from Q2 that did not get fulfilled from weather related issues. However, based upon the recent price action in the share price, the market may believe that USLM is making a comeback in terms of higher demand or revenue appreciation.

Going Forward

Going forward in 2016 we believe there will be a slight margin expansion from lower gas/diesel prices. This margin expansion will come from potential for lower delivery prices and lower operating costs. USLM's delivery costs are almost 100% wholly associated with the price of diesel. Thus, when diesel prices increase, USLM typically will have higher fuel surcharges from the freight companies the company utilizes. The opposite is also true.

US Retail Diesel Price Chart

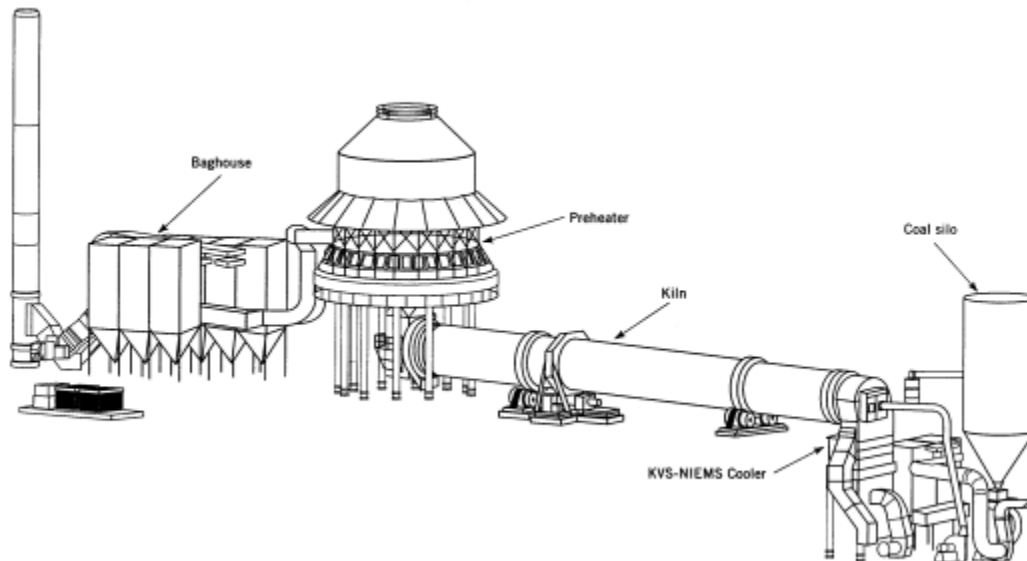
[View Full Chart](#)



Source: [Y-Charts](#)

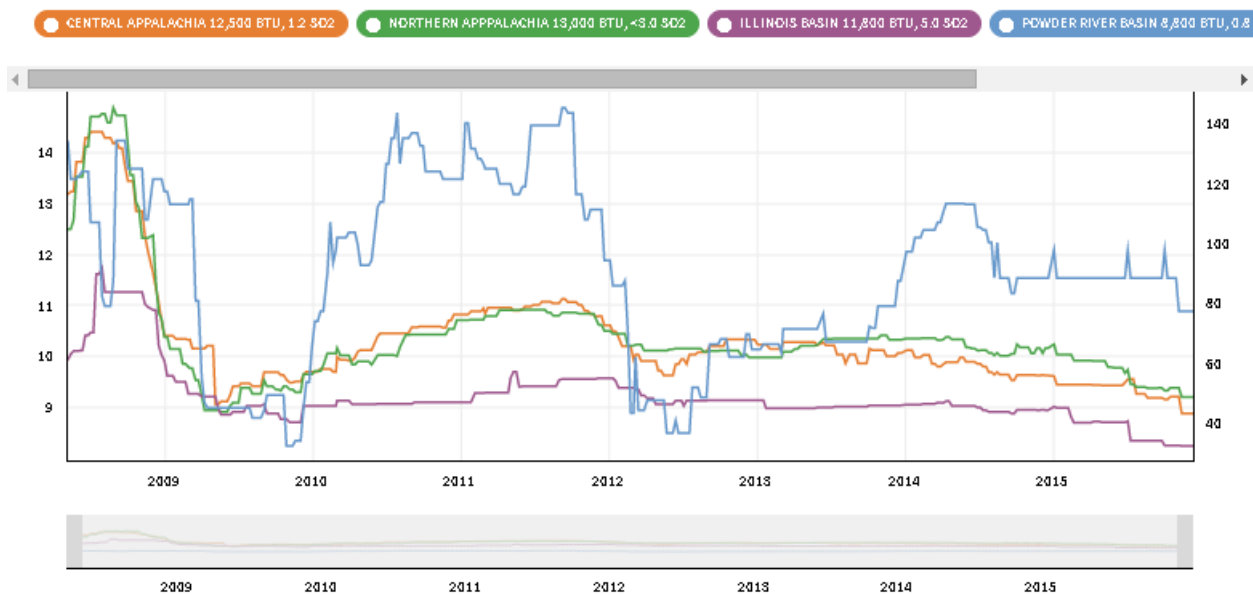
Investors should also note that the decrease in the price of diesel will help offset the decrease in demand from the O&G and steel industries.

USLM utilizes six preheater rotary kilns; two at the Texas Lime Plant, three at the Arkansas Plant and one at the St. Clair Plant (there is also another rotary kiln at the St. Clair Plant that is not a preheater kiln). The picture below is your typical rotary kiln.



Source: [EPA Lime Manufacturing](#)

Since USLM utilizes rotary kilns for the manufacturing of lime, coal is one of the best energy inputs to use. Investors should note that USLM could use coke or natural gas as well, but both coke and natural gas cannot be used exclusively in the production of limestone and should be mixed with coal. The historically low price of coal coupled with the utilization of rotary kilns can be thought of as a potential way for USLM to enhance their operating margins going forward.



Source: [US Coal Prices By Region](#)

In our opinion, the low price for commodities will help USLM's bottom line, despite a reduction in the topline from O&G producers.

Performing acquisitions in the industry in which USLM operates can be expensive and not realistic given USLM's size, regional locations and overall stability and need for the products (on a macro basis) USLM sells. Since a direct acquisition of another limestone producer may be out of the question (at least at the moment), USLM has recently performed a small bolt-on vertical acquisition. In December of 2014, USLM acquired the land, buildings and transportation units (trucks, trailers, etc.) of a Houston, Texas trucking company.

As I stated before, this was a small bolt-on acquisition (spent \$3.7mm). Before USLM performed the acquisition, the trucking company exclusively delivered USLM's products to its customers and slurry facilities. This acquisition should help to improve margins slightly. We hope that the company continues to perform additional vertical integration acquisitions going forward, thus improving their supply chain. USLM does not plan on delivering any third-party products with this new trucking company.

We also believe that due to the long lifespan of the company's reserves vertically integrating is a long-term benefit. First, USLM can utilize the same warehouse/facilities of the trucking business for years to come. Secondly, due to the long lifespan of their mines, the risk of having to sell the vertically integrated business for a loss is slim to nil.

In 2013, USLM received the air permit needed to replace their non-preheater kiln. A new kiln will be much more fuel efficient, however, it could cost upwards of \$35mm. With the current cash balance of ~\$54mm, an untapped credit facility of \$75mm (with low interest rate of LIBOR 1.00%-2.00%) and recurring/predictable FCF of >\$20mm, we believe the cost of this new kiln, is

not very substantial at all. An investment in a new fuel efficient kiln, will help enhance USLM's bottom line. We are expecting the investment in the new kiln to be in 2016-2017.

Some may look at USLM as a no growth company due to the scarcity of limestone assets. In fact one Seeking Alpha user commented on a recent article written on USLM stating the following...



The_Hammer

Comments (4721) | + Follow | Send Message

it seems nat you do not belong in this one. its boring and low activity. this company is a no growth cash cow. only way to get cash-flow growth is expand or acquire. buybacks done at opportune times is wonderful way to build value. although a measly 10 mil a responsible buyback since the company must keep a cash war chest for potential acquisitions.

24 Nov, 08:00 AM Report Abuse

Like Reply

Source: [Why U.S. Lime & Minerals Should Consider A \\$20 Per Share Special Dividend](#)

We disagree with the former comment and believe that USLM can achieve topline and FCF growth with the businesses it already operates. First, USLM owns the Monarch Pass Quarry, which it bought in 1995. Since the purchase, the company has not carried out any operations on the property. It has been estimated that if normalized production ramps-up on the property, they could supply its Salida and Delta, Colorado plants for ~15 years. Beginning operations at the Monarch Pass Quarry has real potential to boost the topline and cash flow going forward. With the currently strong balance sheet, this could be very possible.

Another way for the company to improve its topline and cash flow is to utilize the 1,500 acres adjacent to its St. Clair mine. The company is currently undergoing production at this property, however, it is only a small portion to the whole underlying property. Ramping up production at this property could help improve the topline going forward.

USLM also has the ability to improve its topline by continuing to increase its utilization rate.

	2014	2013	2012
Utilization Rate	67%	57%	60%

In the past three years the company has incrementally grown its utilization rate at a decent CAGR of 3.74% annually. Based on our assessment of the demand of the company's products going forward (on a macro perspective), investors should expect a continual incremental increase in the utilization rate. Even an incremental increase of the utilization rate to 75%, in the next 2-3 years, would be able to increase the company's topline going forward.

Another interesting aspect in terms of the utilization rate is that, the higher the utilization rate, the lower the unit cost of running the kiln. For an example, if a kiln is not operating at full capacity, it makes operations very inefficient, for it requires the same amount of fuel running at full capacity and under capacity). Going forward, the higher the utilization rate, the lower the overall unit cost. Larger plants can outperform smaller plants in terms of costs. This is a risk in it of itself for USLM due to their smaller size.

If the company does not increase its capex in order to improve its topline going forward (from a new kiln to an increase in the utilization rate) we would like to see the company do one of two different things. First, we would like to see an increase of the dividend. An increase to \$1.00/share. In 2014, to pay the annual \$0.50/share dividend the company spent ~\$2.8mm. An increase to \$1.00/share would cost the company ~\$5.6mm, easily fundable given the FCF generation and pristine balance sheet.

Secondly, a tender offer would also be able to increase shareholder value going forward. A tender offer would be able to increase shareholder value in one of two ways. First, the company would be able to decrease the shares outstanding, thus improving overall shareholder value. Secondly, a tender offer would be able to cash out minority shareholders (this is a significant benefit given the illiquidity situation).

Overall, USLM has a significant amount of resources and ability to increase shareholder value either through topline growth or returning money to shareholders.

Risks

- Demand for USLM's core product offering is seasonal. In general high demand for the products is typically in Q2 and Q3. Thus in Q1 and Q4, revenues, based on the historical past, are lower in general. Also, since USLM utilizes open-pit mining (great for the bottom line), inclement weather can have a negative impact on the demand for USLM's core product offering (this is especially true for their construction related customers).
- Since demand for USLM's core product offering is dependent upon stable economic growth, a recession may have an adverse effect upon the company's operations. The steel, O&G and construction industry is known to be very cyclical. Based upon how USLM fared during the Great Recession and the forward prospects for the overall demand for the company's products, this risk can be somewhat mitigated.
- Continual regulations from the EPA and other government bureaucrat's may increase USLM's expenses and hinder their bottom line. However, regulations also protect the company from increased competition from new entrants into the industry.
- Competition from Mississippi Lime (one of the big three in the industry) acquired Falco Lime Inc. [in 2003](#). This facility produces high quality products in Mississippi, Louisiana, Alabama and Arkansas. Since USLM has operations in Louisiana and Arkansas, the company has faced pricing pressures from Mississippi Lime (a larger a much more developed player). **This may be one of the reasons why USLM operates at a subpar utilization rate of ~60-65%**. With expected demand for limestone products this risk can be somewhat mitigated. That is unless demand rapidly falls.

- MLM also has recently invested into (in 2014) 1,200 acres in Medina County, Texas. This property is rich in [high quality limestone](#). They plan on producing 10mm tons of product per year. 10mm tons is a significant amount of product that could potentially flood the market. Remember, at USLM's Texas Lime location, they have an estimated 20mm tons of proven recoverable reserves with 80mm tons of probable reserves. Thus 10mm tons of new high quality product on the market may put pressure on margins. MLM is also much larger than USLM which is a risk in it of itself, for they have the ability to operate at a higher utilization rate.
- If the company does not increase its utilization rate and does not return value to shareholders in the form of a higher dividend, continual share repurchase programs or tender offer, USLM could be a sitting duck. We would like to see their cash position get put to work in the near-term instead of wasting away in the bank.

Conclusion

The current downward pressure on USLM's stock price has produced an exceptionally well run company at a very attractive price. We believe that the need and demand for lime in the westernized world, coupled with the irreplaceability of this important commodity will act as a long-term tailwind for USLM. Current regulations and high barriers to entry will protect USLM's business model and their high reserves will let USLM produce for many years to come.

On a fundamental standpoint, high margins, strong FCF generation and a pristine balance sheet help protect future downside. There is a significant amount of cash that can be put to work in the form of; increasing the utilization rate (topline growth) or a higher dividend mixed with continual share repurchases. The ability for the company to be able to self-fund operations without diluting shareholders or raising debt is a very attractive feature for a microcap company as well.

We have a high conviction that USLM will give investors decent upside in the next 12-18 months with a price target of \$64-74/share. However, we also believe that USLM is a great investment for long-term investors (upwards of ten years) due to the compelling business model and macro associated tailwinds. USLM is off the radar of most investors and analysts, yet the attentive microcap investor can take advantage of this well ran company that is overlooked and underappreciated.

Interested in Learning More About the Lime Industry?

If you want to learn more about the Lime Industry the following links should be able to give you a good start in learning further into the industry.

- The link [here](#) provides the investor with publications concerning the Environmental, Asphalt, Soil Stabilization, and Building Construction with regards to the Lime Industry. The publications go from as early as 1985 until most recently. It is a great way to learn more about the Lime Industry as a whole and how important the industry is for economic growth.

- [This link](#), provides investors with suppliers to Lime Companies, in which phone numbers and emails are listed. Investors interested in scuttle-butting or sleuthing should utilize this list to get an edge in their investment decision. I plan on reaching out to a few suppliers on the list myself.
- [Here](#) is a link that shows investors, US and Canadian Lime companies. You can also find an interactive map [here](#) with locations of US and Canadian Lime companies. There are a few high calcium mines where I live (Michigan) which I may try to get tours in the near future.
- In the sourced link earlier in this article, and below the picture of the rotary kiln, is a great research report of the entire Lime Industry. Investors who want to learn about the Lime Industries production process, the supply side and demand side, industry organization, and other economic characteristics should read the report.
- [This link](#) is a great source for viewing important statistics and other information concerning the production and demand for lime in the US and the world.
- [Here is a video](#) of a Lime Calcination Plant utilizing a rotary kiln and rotary dryer. It really puts into perspective the high capital costs associated with becoming a major player into the industry...at least in my opinion.