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West Michigan Stocks Again Led the Way in 2016

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Once again stocks of West Michigan-headquartered publicly traded companies outperformed the major national stock market indexes. The West Michigan Index increased 18.6% in 2016, marking the seventh annual increase in the eight years since financial markets bottomed out in early 2009.

Table 1, Stock Market Returns, shows how the West Michigan Index has performed compared with the major indexes over the past three years.

As shown in Table 2, the stock prices of eleven out of the fourteen companies comprising the Index increased, and most of the eleven rose more than the Index. How is that possible? It's because each company's importance to the Index is weighted by its total market capitalization, that is, the market value of all outstanding shares. The more shares a particular company has and/or the greater the number of shares, the more the influence its price change has on the Index. For example, Perrigo Corporation has nearly nine times the number of shares outstanding as does Mercantile Bank, making Perrigo's 43.2% price drop nine times as important as Mercantile's 53.6% rise. All by itself, Perrigo's price drop lowered the Index's gain by 4%.

Table 1: Stock Market Returns[1]

	2016	2015	2014	3-Year Cumulative
West Michigan Index	18.6%	- 6.5%	17.4%	30.2%
NASDAQ Composite Index	7.5	5.7	13.4	28.9
S&P 500 Index	9.5	- 0.7	11.4	21.1
Dow Jones Industrial Average	13.4	- 2.2	7.5	19.2

[1]The West Michigan Index consists of 14 publicly traded companies headquartered in West Michigan. Each company's return is weighted by its market value — the number of shares of common stock outstanding multiplied by the company's stock price. The index matches the weighting methodology used by both the S&P 500 Index and the NASDAQ Composite Index. The Dow Jones Industrial Average is price weighted.

Table 2: West Michigan Company Returns

	2016 Prices		2016 Price Change
	Closing	Opening	
SpartanNash Company	$39.63	$21.64	82.7%
Macatawa Bank Corporation	10.50	6.05	72.1
Mercantile Bank Corporation	37.78	24.54	53.6
Universal Forest Products, Inc.	103.82	68.37	49.5
Independent Bank Corporation	21.95	15.23	42.5
Wolverine Worldwide, Inc.	22.02	16.71	31.4
Stryker Corporation	120.52	92.94	28.9
Gentex Corporation	19.96	16.00	23.0
Steelcase Inc.	17.90	14.90	20.1
Herman Miller, Inc.	34.60	28.70	19.2
Community Shores Bank Corporation	2.30	2.18	5.5
ChoiceOne Financial Services, Inc.	23.75	23.80	- 0.2
Meritage Hospitality Group Inc.	11.30	11.25	- 0.9
Perrigo Corporation PLC	82.31	144.70	- 43.2

The 2016 performance of each of the companies in the Index is described below. Most of the discussion is based on year-to-date performances as reflected in quarterly earnings reports through the third quarter.

SpartanNash Corporation

SpartanNash's stock was the top performer in 2016, rising nearly 83%. That follows a 17% price decrease in 2015. In fact, the company's price at the end of 2015 was its lowest year-end price in four years, suggesting there was unfounded investor pessimism late in 2015. The company's price held fairly steady at around $30 per share for most of the year, but jumped up nearly $10 after the presidential election.

The company owns 159 supermarkets across 47 states, Europe, and several countries. Supermarket banners include Family Fare Supermarkets, Family Fresh Markets, D&W Fresh Market, Econo Foods, and SunMart. The company also is the leading distributor of grocery products to military commissaries in the US, and operates as a grocery distributor.

The Banks – ChoiceOne, Community Shores, Independent Bank, Macatawa Bank, and Mercantile Bank

In general, 2016 was a very good year for banks across the US, and that certainly includes West Michigan banks. Many investors believe rising interest rates are good for bank earnings. The rationale is that banks raise their loan interest rates more quickly than the rates on their deposits which fund those loans. Although many economists disagree with that rationale, as long as investors continue to believe it's true, bank stocks will rise when interest rates rise. The Federal Reserve raised rates in December and suggested it would do so as many as three more times in 2017.

Perhaps more important than rising interest rates is the belief that President-elect Donald Trump will stimulate the economy with tax cuts, infrastructure spending, and with other business-friendly policies. If so, bank loan demand will increase, leading to higher bank profits. Bank stock prices shot up after it became clear that Trump would be the next president. Here's a look at West Michigan bank stock performance:

ChoiceOne Financial Services, Inc.

Sparta-based ChoiceOne's stock barely changed during 2016, falling 0.2%. Its revenue and earnings per share have been stuck in a rut for two years, and compared with its peer banks, its performance metrics are about average. The good news is the company opened a loan office in downtown Grand Rapids during the summer, and indications are that it will contribute significantly to ChoiceOne's future profitability.

ChoiceOne has 3.3 million shares of stock outstanding, the least of any of the fourteen companies in the West Michigan Index and about one-hundredth of the number of Stryker shares. It's influence on the Index is small.

Community Shores Bank Corporation

The year began with some good news. The Bank learned that both the FDIC and Michigan's Department of Insurance and Financial Services terminated the Consent Order which had been effect for five years. That action reflected the bank's stronger financial position after it raised $5 million from a stock offering and used $3.7 million of it to increase bank capital. The Bank's regulatory expenses will decrease now that the Order has been lifted.

Its stock rose 5.5% in 2016 on top the previous year's 45% gain. While that sounds good, you need only look at these 2016 end of year price-earnings ratios of West Michigan banks to recognize a potential problem:

ChoiceOne	14.6
Mercantile Bank	20.4
Independent Bank	21.2
Macatawa Bank	22.9
Community Shores	121.1

Community Shore's stock price is way too high relative to its earnings – about six times too high -- and as such, represents considerable risk to its owners, and suggests owners are extremely optimistic about the bank's future. While the bank has come a long way since its 2010 problems, it still struggles to consistently earn a profit from quarter to quarter.

Community Shores Bank Corp. serves the Muskegon and Norton Shores area.

Independent Bank Corporation

Ionia-based Independent Bank Corporation's stock price held nearly steady at $15 per share during the first half of 2016, then jumped to around $16.75 during the third quarter. The Trump effect drove the price to nearly $22 by the end of the year, making for a 42.5% annual increase. Earnings increased sharply in the second quarter, and near the end of the third quarter, two events added to the Bank's stock price: a 25% increase in the dividend in October (following a 33% increase a year earlier) and the Trump effect. Overall, a great year for Independent Bank.

Macatawa Bank Corporation

Stock of the Holland-headquartered bank rose nearly 74% in 2016. The rise continued throughout the year, but as with most banks, accelerated after the election. Investors found plenty to like about Macatawa's performance. Through the first nine months of 2016, revenue, loan growth, and capital strength all increased while non-interest expenses stayed the same. Investor optimism remains high.

Mercantile Bank Corporation

Grand Rapids-based Mercantile Bank also had a great 2016. Its stock price began the year at $24 per share, began increasing in June, reaching almost $28 in early November, and then added $10 more per share due to the Trump effect and great third quarter earnings. Third quarter consensus income was $30.7 million, but the Bank reported $35 million, a nice surprise. Overall, the stock price rose nearly 54% during the year.

Universal Forest Products, Inc.

UFPI is a well-run company in the right place at the right time. Its sales, earnings, and stock price have boomed over the past two years, rising almost 50% in 2016 following a 28.5% gain in 2015. The company continued its long-term trend of acquiring other firms in the industry during 2016, adding customers and new products. It also is benefiting from continued strengthening in demand in the US construction industry. Stock analysts are optimistic these factors will carry over into 2017. Compared with the company's major competitors, UFPI's stock trades at a lower price/earnings ratio. That's another indication the company's stock price may increase further.

Those of you who have followed UFPI's performance over the years likely remember when its stock price was stuck around $6 per share. That was in the mid-1990s. At the closing 2016 price, that represents a 17-fold increase and a compound annual rate of return of around 14%.

Universal designs, manufactures, and markets wood and wood-alternative products to retail, construction, and industrial customers.

Wolverine Worldwide, Inc.

Rockford-based Wolverine-Worldwide is a world leader in designing, manufacturing, and marketing of branded casual, active lifestyle, work, outdoor sport, athletic, children's, and uniform footwear and apparel. Its stock price increased 31.4% in 2016 representing a nice rebound from 2015's more than 43% decline.

Wolverine's third quarter sales fell 11% as analysts expected, but the announcement combined with the September stock market swoon knocked down Wolverine's stock price by 12%, and the lower price held throughout the remained of the year. Investors in WWW should be aware of the company's high exposure to fluctuations in the strength of the US dollar. When the dollar is high, as it is now, Wolverine's products cost more to customers outside the US, and the company's sales and profits suffer. The strong dollar reduced third quarter earnings by 18 cents, or by about 12%.

Optimism among Wolverine's executives is high for 2017 and 2018. The company is making progress with a major multi-year initiative to diversify its manufacturing base, lower production costs, close brick and mortar stores while expanding e-commerce, divest non-performing brands, and implement a more flexible debt structure. These actions will increase profitability. Executives describe Wolverine's 2016 progress toward achieving these goals as "tremendous."

Stryker Corporation

At the beginning of 2016, the focus was on the decrease in Stryker's price-earnings ratio from 57 at the beginning of 2015 to 30 at the beginning of 2016, even though the company's price remained nearly unchanged. Earnings had increased substantially, but the stock price hadn't. That reflected reduced investor optimism about Stryker's future. In a way, that trend continued in 2016. While the company's stock price rose 28.9%, the P/E ratio fell to 27.3. To put this in perspective, had the 57 P/E ratio from 2015 held, Stryker's price today would be well over $200 per share.

Perhaps the 57 value was too high, but the 27.3 P/E seems too low. Through the first nine months of 2016, sales were up 13% while net earnings were up 25%. Reflecting its strong growth, Stryker increased its dividend 12% in December. Most analysts expect double digit revenue and earnings growth to continue. Stryker is known for its product innovations, strategic acquisitions, strong sales force, and diversified revenue base. Further, if changes to Obamacare eliminate the 3.8%-of-sales medical device tax – a proposition for which there is considerable support on Capitol Hill — Stryker will be a major beneficiary.

Gentex Corporation

The stock of Zeeland-based Gentex closed the year at nearly $20, a price representing a 23% increase in 2016. Long-time investors in Gentex remember when the price peaked at $37 a little more than two years ago, but that was before a 100% stock dividend in December 2014, reducing the effective price to $18.50. In fact, the stock is now at an all-time record high price. That's attributable to the auto industry's record vehicle sales and further auto industry adoption of Gentex's main products – automatic-dimming rearview mirrors and other automotive industry electronics.

The company's stock rose throughout 2016. Sales rose about 10% through the year's first three quarters, but the pace of earnings increases accelerated in the third quarter: Net income increased 18% while earnings per share increased 19%. Company guidance for 2017 is for revenue to increase 6-10%.

Herman Miller, Inc. and Steelcase Inc.

Herman Miller's stock had an up and down year, but ended the year rising $5.60 due to the Trump effect. That gain was just about equivalent to the company's entire 19.2% stock increase for the year. The same can be said for Steelcase: an up and down year followed by a sharp increase after the election.

Both companies began the year expecting to perform better than they did in 2015. The optimism didn't last long. Both companies disappointed investors when they failed to meet analysts' earnings expectations in the second half of 2016. They blamed lower than expected North American demand and uncertain geopolitical risks. A strong US dollar also took its toll on foreign sales.

Steelcase is a case in point for a lesson in investing: Never invest in an IPO. Sure, now and then someone makes a fortune, but that's not typical. Most individuals who manage to buy IPO shares wish they hadn't. With Steelcase, the company's price on the day of its 1998 IPO was $36.30. Six months later it had fallen to under $20 per share, and has varied between $10 and $20 in the 18 years since. Here's the lesson: Wait at least six months after an IPO before buying shares of the company. Shares will more accurately reflect the fair price, not the price trumped up by accounting manipulations made in preparation for the IPO and investor over-confidence.

Meritage Hospitality Group Inc.

Meritage Hospitality Group's stock fell slightly in 2016 after outperforming all other West Michigan companies in the Index in 2015, when it rose 115%. The company, headquartered in northeast Grand Rapids, operates 183 quick service and casual restaurants in eight states and has approximately 330 full-time employees and 6,300 total employees. Meritage recently announced a new five-year plan covering years 2017 through 2021 including continued high growth in revenue and sales, renovations of existing restaurants, and continued acquisition of new restaurants. Over the past five years the company's stock price more than quadrupled, and the number of restaurants doubled. The company's net income plateaued in 2016, but perhaps offsetting the lack of good news about earnings, the company increased its dividend from three cents semi-annually to two cents each quarter, a 33.3% increase. It should be noted that seven officers and directors own almost 88% of Meritage's stock. Such concentration of ownership usually is a red flag for potential investors.

Perrigo Company PLC

2016 was a most memorable year for Perrigo. Problems for the country's leading manufacturer and seller of over the counter healthcare products and generic prescription drugs began in April 2015 when Mylan N.V. made an unsolicited tender offer bid to acquire Perrigo for $204 per share. Perrigo's price quickly rose to near the bid price, but the company fought the bid, spending over $100 million fighting the tender offer, successfully convinced enough shareholders to reject the bid, and caused Mylan to withdraw its offer. Perrigo promised shareholders dramatic increases in both earnings and the stock price if they rejected the offer. That was in November 2015, and by then, Perrigo's price had dropped more than $50 per share to $146. On January 11 last year, the company increased its earning guidance for 2016.

A month later, the fourth quarter 2015 earnings report was released, showing record earnings, and a full-year 2016 earnings per share estimate of $9.50 to $9.80. Then things went south. Joseph Papa, who had served as CEO for ten years and was widely credited with Perrigo's incredible growth, abruptly left to become chairman and CEO of Valeant Pharmaceuticals. Further, earnings guidance for 2016 was lowered by 13%, and then lowered another 17% in August. Not only did 2016's third quarter have no earnings, but the company lost $8.86 per share — not the dramatic increase investors had been promised.

Starboard Value LP and its affiliates — Perrigo's single largest stockholder with 4.6% of Perrigo's shares — accused Perrigo of mismanagement and asked company executives what their plans are to turn around the company's fortunes. And the price is now down to $82. Only time will tell. ■