Linamar (LNR.TSE)

"[…] The auto industry is about as brutally competitive an industry now as I have ever seen it. Everybody knows how to make good cars. Everybody. And they rely on the same suppliers. And the cars last a long time with very little service. And everybody leases them at cheap rents, and has all kind of incentives. It has all of the earmarks of a very commoditized, difficult, super competitive market. So I don't think the auto industry is going to be a terribly easy place. And it may actually shrink one of these days. In other words, the culture of everybody having three or four cars could actually shrink. And so, I think that the auto industry is not a cinch. […]"

- Charlie Munger

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"Invert, always invert"

- Also Charlie Munger

Investment opportunity

- Linamar is a family-owned powertrain/driveline autoparts company.
- Due to the bearish outlook on the sector, it is trading at depressed multiples.

- However, Linamar has been expanding its elevation equip. business (Skyjack) at over 30% CAGR in the last 15 years.
- It has recently entered the agricultural parts sector and will repeat the Skyjack playbook.
- These are high-teens EBIT margin businesses that are still obscured by the auto division.

- F. Hasenfrantz (founder) owns over 23% of the company and Linda Hasenfratz (CEO) 6%.
- Linda considers the diversification of Linamar one of her main contributions as head of the company.

Further growth in the industrial sector should change market's perception of the company, from autoparts to diversified industrial, valuing the company multiple times its current price.

Autoparts

- Linamar originated as a company suppling powertrain parts for the auto industry and has been benefited from the consolidation of the sector over the years.
- The current market outlook on the legacy auto business is very negative as EVs need fewer parts, shrinking Linamar's original business. However, two key ideas are ignored:
  - EVs will need time to gain significant market share: beyond Tesla, OEMs haven't had much success with EVs.
  - Due to the transition to EVs OEMs, are divesting the insourced powertrain divisions (the last big outsourced division from OEMs), offsetting the reduction of ICE car volumes.
    - OEMs want to become more leaner, less capital intensive businesses. They will continue pushing in that direction by outsourcing manufacturing processes.
    - On the right, a list of GM factories that could be outsourced to Linamar.
    - The engine is the last part to be outsourced by the OEMs, still 70% of the market is insourced by the OEMs.
    - OEMs will push to close factories and outsource parts. Most of engines are identical, therefore, OEM R&D programs are duplicate. Powertrain supplier's will reach scale benefits.

As a consequence, Linamar's auto division TAM will actually *grow* in the next 10 years.

Bay City Powertrain	Engine components
Bedford Powertrain	Transmission casings
Defiance Foundry	Aluminum/iron engine blocks
Flint Engine South	3.6 High Feature engine, 1.4 (Cruze, Volt generator)
Lansing Regional Stamping	
Parma Metal Center	
Pontiac Metal Center	
Silao Engine	
Silao Transmission	
St. Catharines Powertrain	
Toledo Transmission	6L80 RWD 6-speed 6T30/6T40/6T45
Tonawanda Engine	Ecotec 2.5L Gen III Ecotec 2.4L Gen II
Warren Transmission	6T70, 6T75
Wixom Performance Build Center	6.2L V8 LS3 7.0L V8 LS7 6.2L V8 LS9

Skyjack I

- Beyond autoparts, Linamar has historically supplied a long tail of parts to various businesses.
- This knowledge led to the investment in the access equipment company “Skyjack”.

2001 – First Skyjack stake: CAD22M for 48.5%

- "Skyjack scissor-lifts are recognized as among the best and most reliable in the world. This acquisition will provide needed financial stability for Skyjack and serve as a platform for future growth.”
- “We feel the investment has excellent potential financially, great growth potential and a good synergy with our European business,” said Linamar president Linda Hasenfratz.
- “A combination of Linamar's expertise in high volume manufacturing is an excellent complement to Skyjack's market growth and product development expertise,” said Haessler.

2002 – CAD9M for the rest of Skyjack

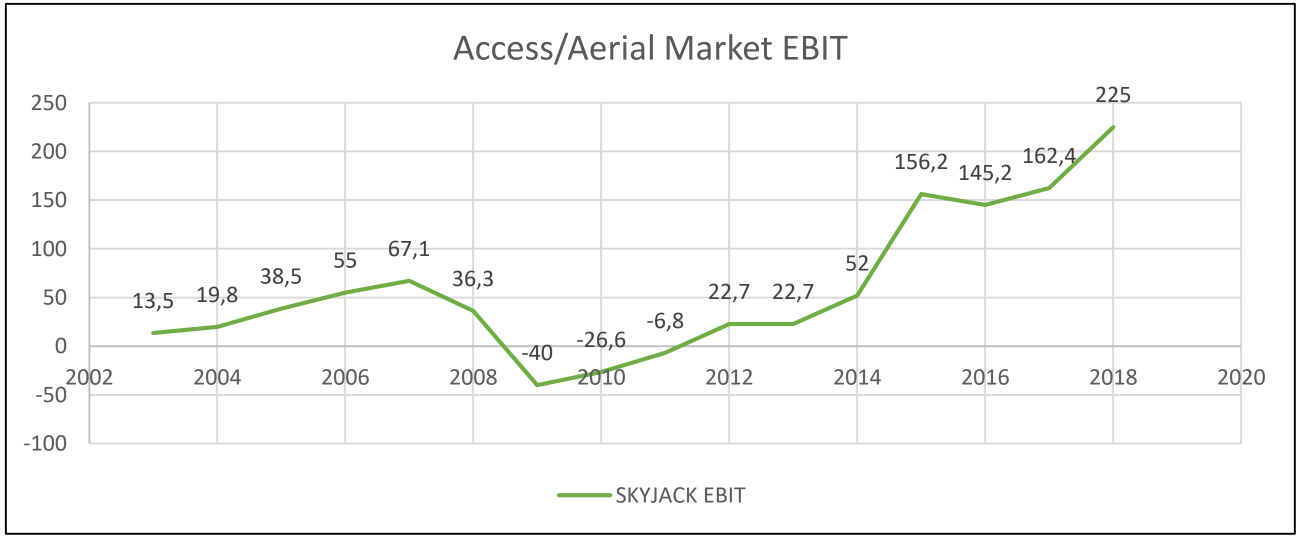
2007 – Carelift acquisition

- "We are thrilled to add Carelift to our portfolio and build on the success we have had in the industrial market," said Linda Hasenfratz, Linamar CEO. "We have seen tremendous growth in demand for our Skyjack products and feel there is great sales potential in leveraging our existing expertise to add a new model to our already successful line of aerial work platforms.“
- In addition, in August of 2007 Skyjack purchased Carelift Technologies which furthers our diversification strategy in the industrial market with a product very complementary to our existing offering, a high mount style telehandler. The telehandler is similar to a rough terrain forklift but has a telescopic arm, like a boom lift. Key markets include non residential and residential construction, with crane applications an emerging market. Key customers include rental houses as is the case with our AWP products. The market is large: US$ 3.2 billion globally today growing to over US$ 3.5 billion with the next 5 years, with most of the growth coming from North America. It is one of the most vibrant growth areas in the industrial market at the moment. We are very excited about this acquisition, which fits perfectly with Skyjack’s strategy of growing their product offering to existing customers and therefore utilizing an existing extremely effective distribution system already in place. We are also proud to be taking on the ZoomBoom brand name, well recognized as a high quality product in the industry.

Skyjack II

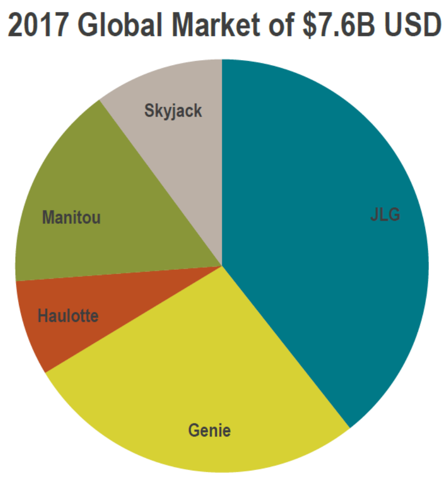
- Skyjack provides access equipment for the construction business.
- The main customer are rental companies ($URI).
- The business is cyclical but much less capital intense than auto (capex 1% of sales) and higher margin (>15% EBIT).

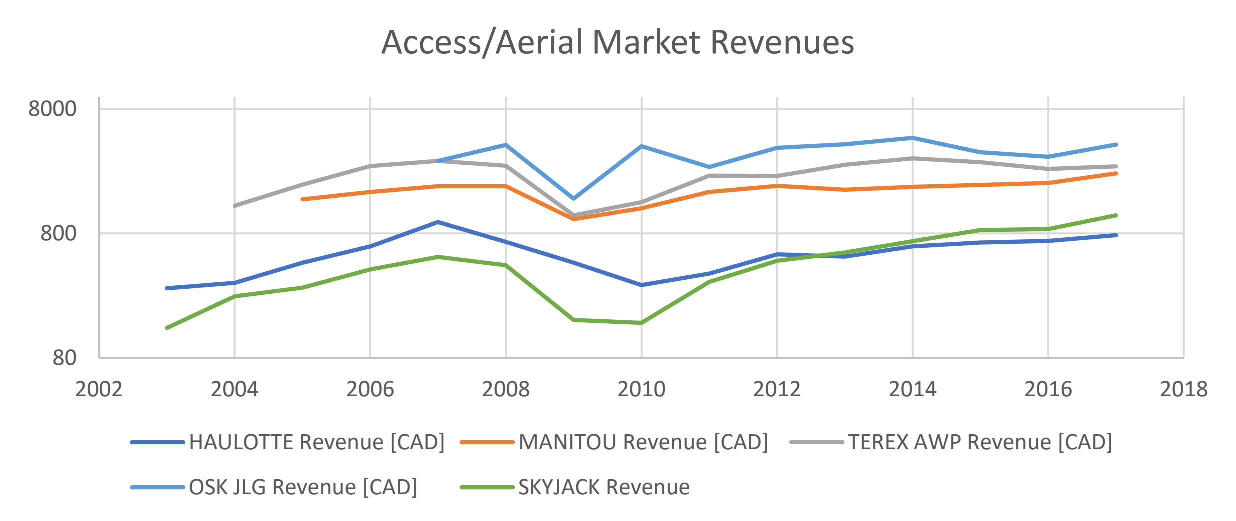
- Linamar paid CAD30M in 2002 and Skyjack is now generating around CAD225M of EBIT.
- The international auto footprint served as platform to internationalize Skyjack.
- Just at peer group valuation Skyjack should be worth $2.4B – A CAGR of 31% of the initial investment + generated cash.

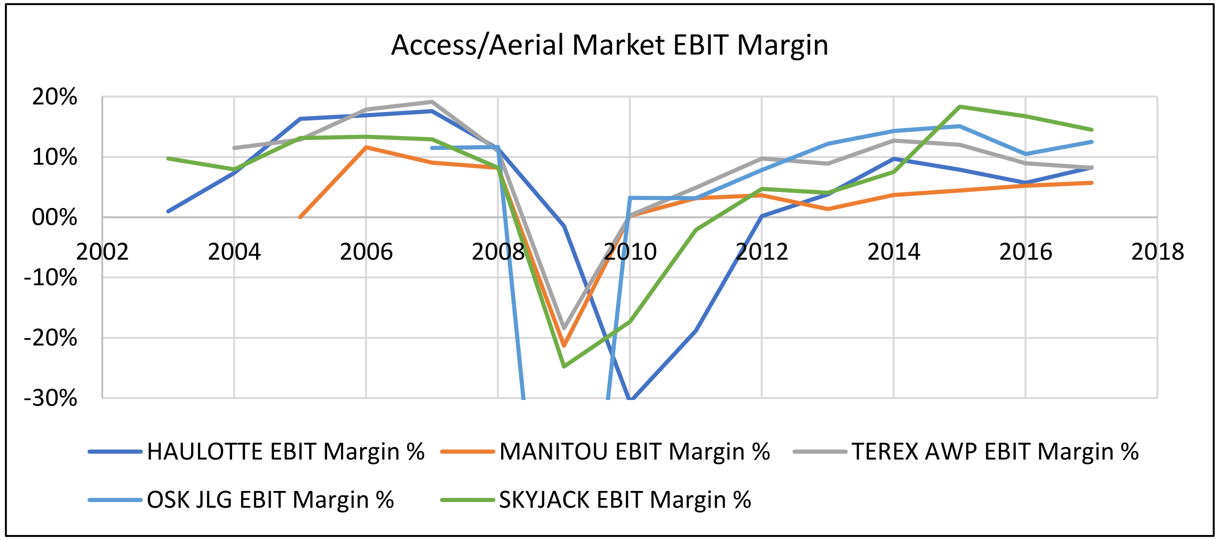


Skyjack III

- Linamar accomplished that in a sector that had low-to-flat growth over these years.
- Skyjack has industry leading margins in this oligopolistic sector.
- Oskosh paid USD3.2B for JLG in 2007, which had Skyjack's current EBIT.







Macdon

- In the end of 2017 acquired agricultural company Macdon for CAD1.1B.
- Macdon is a manufacturer agricultural machinery parts like windrowers, draper headers, corn headers and others.
- Repeating the Skyjack playbook, Linamar had years of experience manufacturing agricultural parts and bought a Canadian company ready to be internationalized.

> *"What that means is if we get the same kind of market share in South America, Europe and Eastern Europe as we have in North America, **we have the potential to quadruple the business**. And Linamar has the depth to be able to make that happen. We already have a global footprint. We have existing operations in Europe. And we can work with the MacDon team to develop the right products and the right distribution strategies to make that happen. So we see this as a huge long-term opportunity for us to grow a substantial agricultural business for Linamar."*

- **Macdon is a fundamentally better business than Skyjack**: less cyclical, growing and has an over 30-year-old consumer brand. EBIT margins should reach 20%.

> *The acquisition of MacDon provides a truly once-in-a-lifetime opportunity to move our agriculture business into a market leading position while providing meaningful diversification to the end markets we serve. We believe the long-term growth fundamentals for the agriculture industry are very strong given the growing and developing global population, noting the market is in the early stages of cyclical recovery." said Linda Hasenfratz, Linamar's CEO, "MacDon is a strong, well-managed company and an innovative market leader in both customer penetration and technology evolution; it will be the centerpiece of our agriculture business, which includes our existing European corn header business, highly complementary to MacDon products. We get diversification, innovation, growth and a solid deal, we couldn't be happier.*

- Additionaly, Macdon has acquired part/consumibles distributors: Westward Parts Services (2012), Sprayer Parts Warehouse (2018).

Management

- Linda Hasenfratz is the daughter of Linarmar's founder and CEO since 2002 (note the Skyjack acquisition date). She owns 6% of the company and has been recently (dec-18) buying more shares.
- She has been hinting to the fact that the company is more than auto company

> *"[…] We've expanded the business in all kinds of new directions I am really happy about that I think that's been great for us we want to continue to diversify… Still within metallic manufacturing, that's where we are really good at.* ***So we are sticking to out core but finding new markets to do that, just as we did with Macdon on the agricultural equipment side, with Skyjack on access equipment… Of course we have our transportation business, but we think there are other areas we can take those skills to as well.*** *So we want to keep building […]*

- The company has a "100 year vision" and a sector expansion plan adjacent to the core manufacturing skills: Food (Macdon), Water and Age Management.

We believe Linda wants to turn Linamar into a diversified industrial company as the key accomplishment as her role as CEO.

Why does the opportunity exist? I

These will disappear with EVs

The market is currently viewing Linamar as an auto company despite 40% of the EBIT being non-auto, the success of the Linamar platform and the runway for growth with Macdon.

Why does the opportunity exist? II

- Linamar's "legacy" auto sector is obscuring the better businesses.
- Companies that don't have the auto "stigma" are properly valued in similar occasions i.e. Rheinmetall.
- Rheinmentall is a European "defence contractor" that happens to have 60% of its EBIT from supplying auto driveline parts.
- Its defence segment has been flat in recent years and, overall, margins are lower than Linamar's.

		Sales 2017	Sales CAGR 12-17	Op. Margin '17	EBIT '17	EBIT CAGR 12-17
Rheinmetall	Auto [EUR]	2861	3.1%	8.7%	249	12.4%
	Defense [EUR]	3036	7.1%	5.7%	173	3.6%
Linamar	Auto [CAD]	5430	14.7%	10.0%	543	22.6%
	Skyjack [CAD]	1116	18.3%	14.5%	162	48.1%

- Even though Rheinmetall has lower margins, growth and a shorter runway for growth, the market is valuing it *higher*

Rheinmetall E2018	E2018 Auto EBIT share	54%
	Mkt. Cap.	4090
	EV/EBIT	**9.54**
Linamar E2018	E2018 Auto EBIT share	60%
	Mkt. Cap.	3400
	EV/EBIT	**6.16**

Rheinmetall E2018	Auto EBIT [MEUR]	262
	Defense [MEUR]	219
	Debt [MEUR]	500
Linamar E2018	Auto [MCAD]	520
	Skyjack [MCAD]	225
	Macdon [MCAD]	123
	Debt [MCAD]	1950

Valuation

- A conservative valuation approach is proposed for the next 3 years
  - **Auto** earnings are flat – Cycle downturn offset by larger TAM.
  - **Skyjack** flat to low growth – Cycle slowdown offset by portfolio expansion
  - **Macdon** geographical expansion + agricultural cycle recovery nearly doubles the earnings

	EBIT '18	EBIT '21	xEBIT '21	Mkt. Val.	EBIT CAGR 12-17	eEBIT CAGR 18-21
Auto [MCAD]	520	550	6	3300	22.6%	1.9%
Skyjack [MCAD]	225	260	9	2340	48.1%	4.9%
Macdon [MCAD]	123	230	11	2530	-	23.2%
Mkt. Val. '21				8170		
Mkt. Val. '18				3400		
Upside				140%		
Debt '18	1950					
WC '18	1000					
Debt '21	0					

- Linamar's execution doesn't have to be stellar for a significant appreciation of the shares
- Market's perception should change as 2018 will be the first year with all the industrial parts present in the results