

# Wickham Investment Counsel Inc.

Quarterly Review

July, 2019

## Deal or No Deal

As a portfolio manager, you are constantly looking for investment opportunities, and re-assessing current holdings. You must get out to kick the tires and speak to management. May 30, 2019 offered such an opportunity as Linamar Corporation held its annual general meeting and investor day in Guelph, Ontario. For the motivated analyst, this is like a morning at Canada's Wonderland followed by a good game of golf.

Linamar was founded fifty-five years ago by Frank Hasenfratz in his house as a machining company. It now has a market capitalization of \$3 billion, 60 plants globally, over 3,000 robots and 30,000 employees in North America, Europe and Asian locations. In the transportation sector, core capabilities are metal casting, light weight casting, engine, powertrain, transmission, body and automotive drive train manufacturing for sale to OEM second tier 1 suppliers. It is an advanced, technology driven manufacturing company. Linamar is also transitioning into electric vehicles. Pure battery electric vehicle penetration could reach 13% of the global market by 2030 and hydrogen fuel cell electric vehicles are the ultimate future. Its motto is 'Think Big, Act Small'.

Linamar also has two other brands in Skyjack, which makes automated lift platforms and MacDon, which makes high performance farm harvesting equipment. They speak of interconnected, value creation, manufacturing models.

Linamar is a diversified manufacturer as both Skyjack and MacDon account for about 40% of overall earnings. All three brands have strongly growing, global ambitions. The plant tours demonstrated a broad innovation strategy, such as; McLaren Engineering robotics, Artificial Intelligence, vision systems, data collection, production and analysis and additive manufacturing.

Yet the stock price has been flat at \$46 since 2014, in spite of earnings growth as the attached chart shows, and well below the book value of \$58.15. The stock is trading cheaply at 5 times earnings and 4.4 x 2020 earnings before interest, taxes and depreciation. There should be \$500-\$700 million of free cash flow in 2019. This is a value portfolio manager's dream. Linamar is repurchasing its own stock (up to 7% of the shares outstanding this year). Chairman Frank and daughter, Linda Hasenfratz CEO own 30% of the company and are equally frustrated.

What is holding back the stock? This is an integrated business with parts supplied from global plants. It is built for a free trade environment. Markets like to worry and Trump tariffs and slowing China growth are triggering a concern about the slowing global car sales. Indeed, the current valuation of Linamar may have a recession already baked in. All auto stocks are weak and Canadian auto stocks trade a discount to US auto stocks. As well, in Linamar's case, Skyjack and MacDon brands account for 40% of earnings but are valued like auto stocks, and about 50% below their manufacturing peers.

As well, some would argue that Linamar is lagging its Canadian competitor, Magna, which is five times larger, and investing heavily in electric vehicles for the future.

### Linamar stock price vs Annual EPS excluding extraordinary items



With sentiment souring about global auto production this year and heightened risk around US-China trade negotiations, the view on the auto space remains cautious. Linamar's response is to deliver on earnings growth and free cash flow and to pay down debt, while maintaining its near term technology spend. Once Linamar proves it can deliver, there eventually will be a response in the share price and a positive re-rating.

	Dec 31, 2012	Dec 31, 2013	Dec 31, 2014	Dec 31, 2015	Dec 31, 2016	Dec 31, 2017	Dec 31, 2018	Jun 28, 2019	% Change Dec-Jun
<b>Stock Market Indices</b>									
S&P/TSX Comp.	12,434	13,622	14,632	13,010	15,288	16,209	14,323	16,382	14.38%
Dow Jones Ind.	13,104	16,577	17,823	17,425	19,763	24,719	23,328	26,600	14.03%
S&P 500	1,426	1,848	2,059	2,044	2,239	2,674	2,507	2,942	17.34%
Nasdaq Comp.	3,020	4,177	4,736	5,007	5,383	6,903	6,635	8,006	20.67%
<b>Commodities</b>									
Gold - US\$	1,676	1,202	1,184	1,060	1,252	1,309	1,281	1,414	10.36%
Crude Oil WTI - US\$	91.82	98.42	53.27	37.04	53.72	60.42	45.41	58.47	28.76%
Natural Gas - US\$	3.44	4.25	2.91	2.35	3.74	2.95	2.94	2.31	-21.43%
<b>Currencies</b>									
€ in Cdn \$	1.31	1.47	1.41	1.50	1.42	1.50	1.56	1.49	-4.58%
£ in Cdn \$	1.62	1.76	1.82	2.04	1.66	1.69	1.74	1.66	-4.52%
US\$ in Cdn \$	0.99	1.06	1.16	1.38	1.34	1.26	1.37	1.31	-4.47%
<b>Interest Rates</b>									
Cdn Prime rate	3.00	3.00	3.00	2.70	2.70	3.20	3.95	3.95	0.00%
US Prime rate	3.25	3.25	3.25	3.50	3.50	4.50	5.50	5.50	0.00%
Cdn 10 Yr bond	1.80	2.78	1.79	1.41	1.72	2.04	1.95	1.47	-24.62%
US 10 Yr bond	1.63	3.03	2.17	2.27	2.44	2.40	2.69	2.00	-25.65%

Source: The Globe & Mail