

WESTPEAK RESEARCH ASSOCIATION

Cooper Tire & Rubber Company (NYSE: CTB)

Manufacturing – Tire Manufacturing

Pumped Tires

March 11, 2019

Cooper Tire & Rubber Company is a leading competitor and manufacturer worldwide. The company provides services in designing, manufacturing, marketing, and sales for their products. Cooper focuses primarily on the replacement tire market and offers a wide selection of brands, including Mastercraft, Dean, Starfire, Roadmaster, Avon Tyres, Mickey Thompson, and Dick Cepek.

Thesis

Cooper Tire & Rubber Company (CTB) has been excelling in its International Tire Operations segment with growing revenue and demand, despite the contraction in revenue for the Americas Tire Operations segment. The company is currently implementing consumer-driven strategies by expanding its e-commerce platform and distribution channels to improve top-line growth for the Americas Tire Operations segment. We believe that total revenue for CTB will increase in the current period, with the expansion of the International Tire Operations segment and strategies executed for the Americas Tire segment.

Valuation

Using the discounted cash flow and comparable company analysis, weighted 50% each, we have concluded a total return of 30.6% after factoring an annualized dividend of \$0.42. Compared to its current share price of \$28.98, our target price is \$37.44. Therefore, we advise a **buy** rating on CTB.

Analyst: Sunny Shee, BCom. '22
contact@westpeakresearch.com

Equity Research	U.S.
Price Target	USD\$ 37.44
Rating	Buy
Share Price (March 11 Close)	USD\$ 28.98
Total Return	30.6%

Key Statistics

52 Week H/L	\$35.36/\$22.58
Market Capitalization	\$1.62B
Average Daily Trading Volume	721K
Net Debt	\$311M
Enterprise Value	\$1.77B
Net Debt/EBITDA	0.67x
Diluted Shares Outstanding	\$50.07M
Free Float	99.44%
Dividend Yield	1.31%

WestPeak's Forecast

	2019E	2020E	2021E
Revenue	\$2.76B	\$2.77B	\$2.80B
EBITDA	\$473M	\$476M	\$485M
Net Income	\$203M	\$200M	\$198M
EPS	\$4.04	\$3.98	\$3.93
P/E	8.0x	8.1x	8.2x
EV/EBITDA	2.6x	2.2x	2.0x

1-Year Price Performance



Business Overview/Fundamentals

The Company

Cooper Tire & Rubber Company (“CTB” or Cooper) is a leading tire manufacturer worldwide. Founded in 1914 and headquartered in Findlay, Ohio, Cooper is currently the 5th largest tire manufacturer in North America and the 13th largest globally. With a focus primarily on the replacement tire market, the company designs and produces tires for passenger cars, light trucks, medium trucks, motorcycles, and race cars. A great selection of brands is offered by CTB, including Mastercraft, Dean, Starfire, Roadmaster, Avon Tyres, Mickey Thompson, and Dick Cepek.

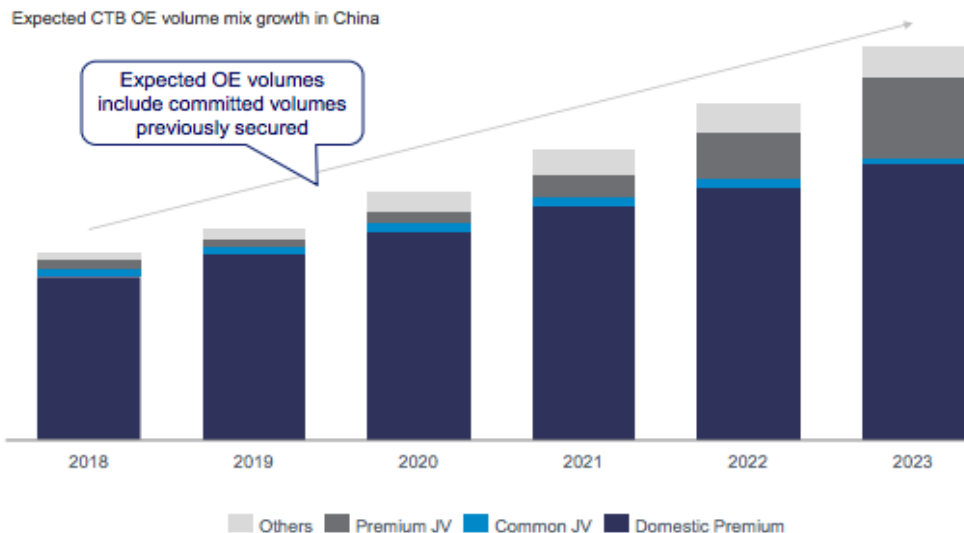
CTB operates under four segments geographically: North America, Latin America, Europe, and Asia. The company merged the North America and Latin America segments into the “Americas Tire Operations” segments in its filings, as both areas obtain similar characteristics economically and in the production and distribution process. The Europe and Asia segments are also combined as the “International Tire Operations” in Cooper’s filings, which includes manufacturing operations in the United Kingdom, the Republic of Serbia and China.

The Americas Tire Operations segment includes three company-owned retail stores, which are the only locations that sell products to end users. The major customers of this segment are independent dealers, wholesale distributors, and retail tire chains. The competitive price, quality, convenience of distribution channels, and relationship with stakeholders are factors contributing to Cooper’s outstanding performance in competing for the sales of replacement tires. A close relationship has developed through the years with retailers and dealers of the segment, which guarantees Cooper a competitive advantage in the industry.

Revenue Analysis of Business Segments

Original Equipment Growth in China

Cooper’s success in China’s original equipment (OE) market has led to an increase in volume and vehicle platforms in the country. Cooper sells its products to original equipment manufacturers (OEM), which offers products from Cooper directly to end users. Management has projected a compound annual growth rate of 3% in the OE market in China from 2018 to 2023, as shown in the graph below. The revenue for the International Tire Operations segment has been steadily increasing and would continue if assumptions of the CAGR are proved to be true in future years.



Source: Investor Day Webcast

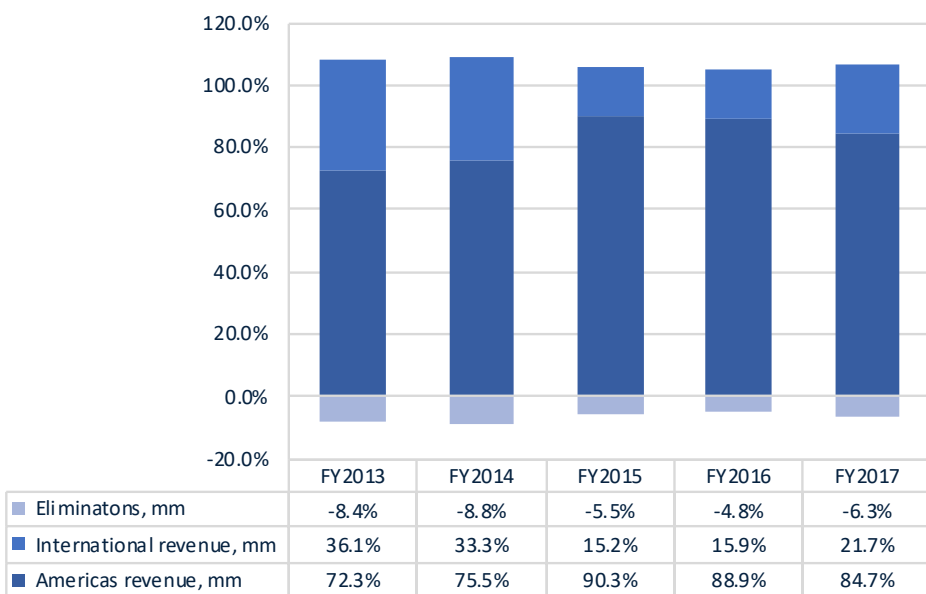
Americas Tire Operations

The major component of CTB’s revenue comes from the Americas Tire Operations segment, yet the top line growth of the segment has been continuously decreasing for the past three fiscal years, beginning from 2016. The decline in unit volume has led to a lower production volume and thus, a higher manufacturing cost per unit produced, which has negatively impacted the company’s operating profit. In conclusion, the unit volume of each segment is a crucial revenue driver to the company’s revenue growth.

International Tire Operations

The International Tire Operations segment’s revenue reached its absolute minimum in 2015 with a decrease in 60.4% compared to 2014. This is the result of selling ownership in Prinx Chengshan Tire Company Ltd. (“PCT”), a joint venture in China that supplies all medium truck tires for Cooper at that time. In November 2014, CTB decided to sell ownership of PCT because of the risks engaging in business abroad and the labour issues in the Chinese manufacturing facility. Workers of PCT halted production for three months in 2013 to protest against Cooper’s merger

REVENUE BREAKDOWN BY SEGMENTS



with Apollo Tyres, an Indian tire company. The unit volume drastically decreased in both 2014 and 2015 due to the halt in production and the absence of PCT after selling its ownership. Although CTB no longer has ownership in the Chinese manufacturing company, an off-take agreement was signed to secure supplies of medium truck tires from PCT. We believe that Cooper's decision of selling off PCT and securing an off-take agreement is a conservative move. The risks involved with owning businesses overseas are unpredictable, as similar incidents in PCT may reoccur in the future. This conservative move prevents future risks from arising.

Sustainability with The Cooper Way

Cooper Tire & Rubber Company realizes their responsibility in the environment as well. The company employs a sustainable strategy by engaging in corporate social responsibility. Annual sustainability reports are published on the company's website for stakeholders to examine improvements and progresses made in the past year. Three qualities that CTB follows to reach their sustainable goal are being caring and connected, efficient, and innovative. Although Cooper Tire & Rubber Company is smaller compared to most of its competitors, being one of the only two tire companies qualified as an Energy Star Partner provides the company an advantage in the industry. According to its 2017 sustainability report, Cooper has reduced energy usage intensity by 15%, compared to 2009. The massive reduction in energy consumption has created greater efficiency in Cooper's plants worldwide, which benefits its cost reduction strategy.

Caring and Connected

The company believes that employees' health and safety are the foundation of being a leading competitor in the industry. Therefore, a Safety Excellence System and "Drive to Zero" campaign have been established to promote CTB's goal of creating a zero-injury workplace. A key performance indicator is the Total Recordable Incident Rate (TRIR), which has improved over 80% since 2007 among all manufacturing facilities. As less accidents occur, fewer workers' compensation is paid out, accompanied by a lower turnover of employees. Consequently, Cooper will have a sufficient amount of highly skilled employees that will generate greater efficiency and productivity. We are confident that the campaigns will build an exceptional reputation for the company and further reduce costs from training new employees.

Efficient

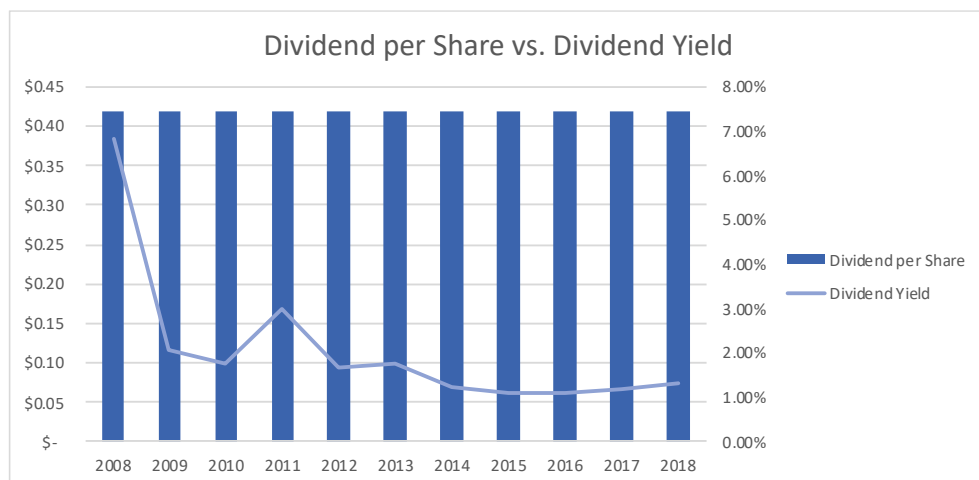
Many manufacturing locations have made changes to reduce energy consumption and improve efficiency through various streams such as using LED lighting technologies, installing equipment that can transform waste heat to electricity, and aiming to eliminate solvent-based paint in the future. From 2015 to 2017, CTB has successfully saved 75 million kilowatt hours of electricity.

Innovative

Following a large amount of consumption of raw materials, CTB has collaborated with partners in a five-year research project to study guayule as an alternative material in tires. Many environmentally friendly substances are tested to replace non-renewable fillers in tires such as sugar, starches, eggshells, lignin, etc. By seeking alternative materials, CTB lowers its reliance on current raw materials and secures earnings from future fluctuations in raw material costs.

Dividend Policy

Cooper Tire & Rubber Company has been paying dividends since 1973. The dividend per share of each quarter has been constant since 1999 at \$0.105, which resulted in the annualized \$0.42 dividend per share. Management has no further discussions in changing Cooper's stable dividend policy.



Source: Bloomberg

Company Strategy

Cooper Tire & Rubber Company focuses on three strategic imperatives which are driving top-line profitable growth, developing a competitive cost structure, and building organizational capabilities.

Drive Top-Line Profitable Growth

Cooper is executing this strategy by focusing on consumers' preferences, improving on digital platforms, and channels related to consumers. Rather than having product and technological capabilities to drive consumer behaviours, Cooper decides to place consumers' needs ahead to drive product development. According to CTB's research, 73% of their buyers research tires online prior to their purchase, which shows a huge area of future growth in e-commerce for the company. Besides enhancing the e-commerce platform, Cooper has been expanding on retail channels that can increase exposure and convenience for consumers, such as independent retailers, mass merchants, and auto dealers.

Cooper also developed a two-phased original equipment strategy to drive top-line profitable growth. The original equipment volume in China grew 94% from 2015 to 2017, which is a result of partnering with major OEMs. The strategy involves continuing growing its OE business in China and selecting global OEMs to focus on the automotive aftermarket.

Develop a Competitive Cost Structure

Cooper Tire & Rubber Company has manufacturing facilities overseas and claims that some of them are placed in countries that provide lower costs than others. These include a manufacturing facility in Serbia, a joint venture in Mexico, and the Cooper Kunshan Tire manufacturing operation in China. According to the statistics on CAP IQ, Cooper has the second highest COGS, as a percentage of revenue, compared to the companies used in our comparable company analysis. Cooper has a great space to improve on its gross profit margins. We believe that the manufacturing facilities overseas that provide lower costs could contribute to the company's competitive cost structure and also help expand Cooper's global market.

	LTM COGS	LTM Total Revenue	% of COGS of Total Revenue
Titan International, Inc.	1420.25	1615.0	87.9%
Cooper Tire & Rubber Compny	2386.2	2794.6	85.4%
The Goodyear Tire & Rubber Company	12091.0	15670.0	77.2%
Compagnie Generale des Etablissements Michelin	16456.56	24422.5	67.4%
Bridgestone Corporation	20651.36	33295.7	62.0%
Apollo Tyres Limited	1339.75	2308.0	58.0%

Source: CAP IQ

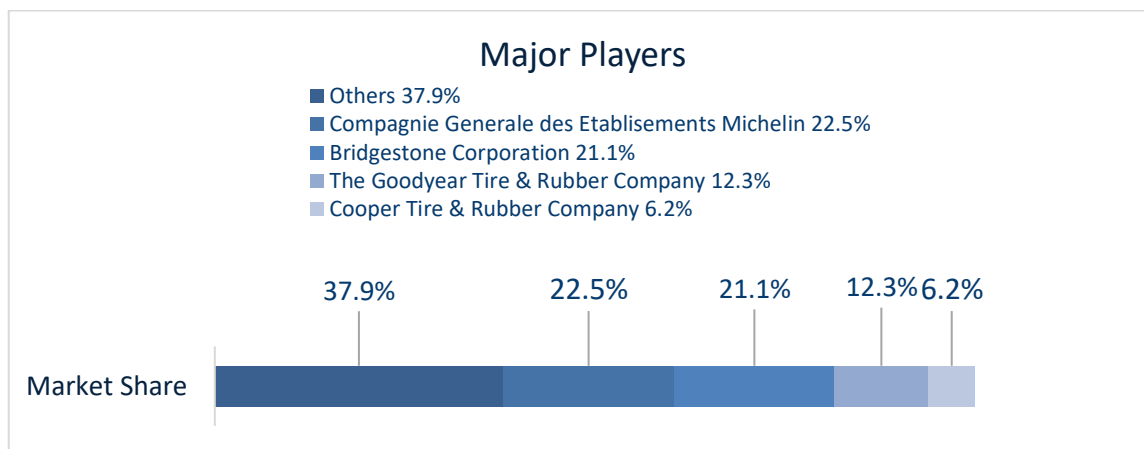
Build Organizational Capabilities

Product capabilities are improved from the introduction of advanced manufacturing technologies. The advanced mixing and controls system, smart quad/quintuplex extrusion lines, automated tire building machines, and automated storage and retrieval system are examples of technologies used in Cooper’s plants.

Cooper has been continually improving its organizational capability to stand out among competitors and obtain a competitive advantage to drive top line growth. One of their approaches is elevating the company’s design and production capabilities according to consumers’ needs. The innovation in tire designs, driven by consumer preferences, has led Cooper to win the 2018 Good Design award. CTB’s net promoter score beats the majority of leading players as the third highest in the industry. A score of 21% indicates consumers are highly willing to recommend Cooper’s products, which also leads to an increase in net sales.

Industry Analysis

The top four players in the U.S. tire manufacturing industry are Compagnie Generale des Etablissements Michelin, Bridgestone Corporation, The Goodyear Tire & Rubber Company, and Cooper Tire & Rubber Company. The four companies approximately contribute 62.1% of the annual industry revenue in 2018. This shows that the industry has a medium level of market share concentration.



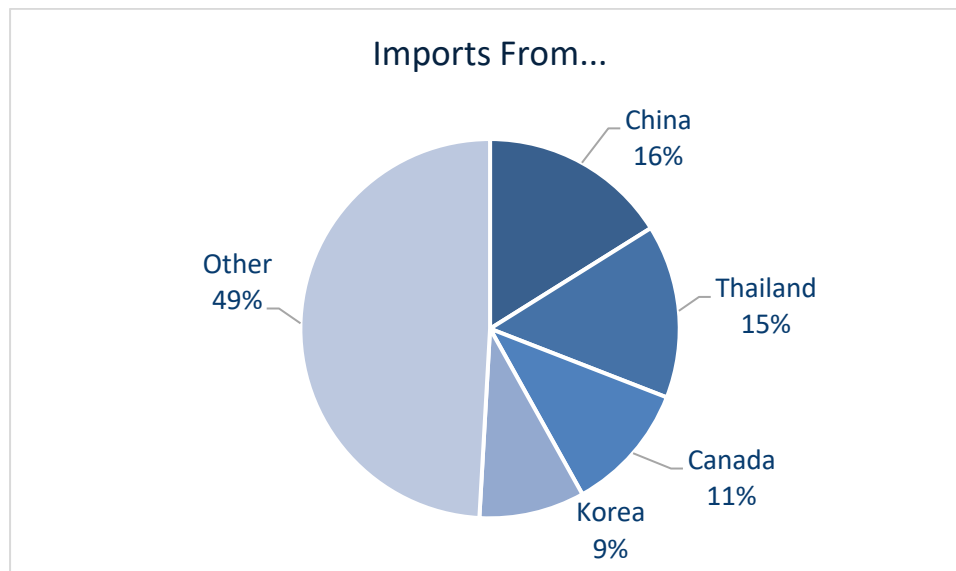
Source: IBISWorld.com

The Macro Environment

The use life of tires start to decrease as they hit the road. Nevertheless, demand for tires is influenced by the per capita disposable income of consumers. As disposable income decreases, consumers are less likely to replace their tires and will stretch the use life of each tire. Consumers are more likely to commute by public transportation and decrease the number of vacations taken by cars. The demand for tires is also greatly influenced by the demand for cars, as the two products are complementary goods.

Disruption by Imports

The market share concentration of the U.S. tire manufacturing industry has been declining for the past five years, due to major players of the industry losing market shares. The primary reason is the disruption of inexpensive imports causing consumers to substitute for lower-priced products. China is the largest tire import origin for the United States with 16.1% of the industry's imports. Consumers' demand for inexpensive Chinese imports has caused great threat for domestic providers and has forced them to engage in price competition. Foreign competitors also caused the average industry profit margin, EBIT, to fall from 4.2% in 2013 to 2.6%. However, the tariffs limiting Chinese Import has decreased the amount imported and is expected to continue in future years. It is fair to say that the second largest exporter, Thailand, would catch up to China and increase its percentage while China's import percentage decreases from tariff limitations.



Source: USITC

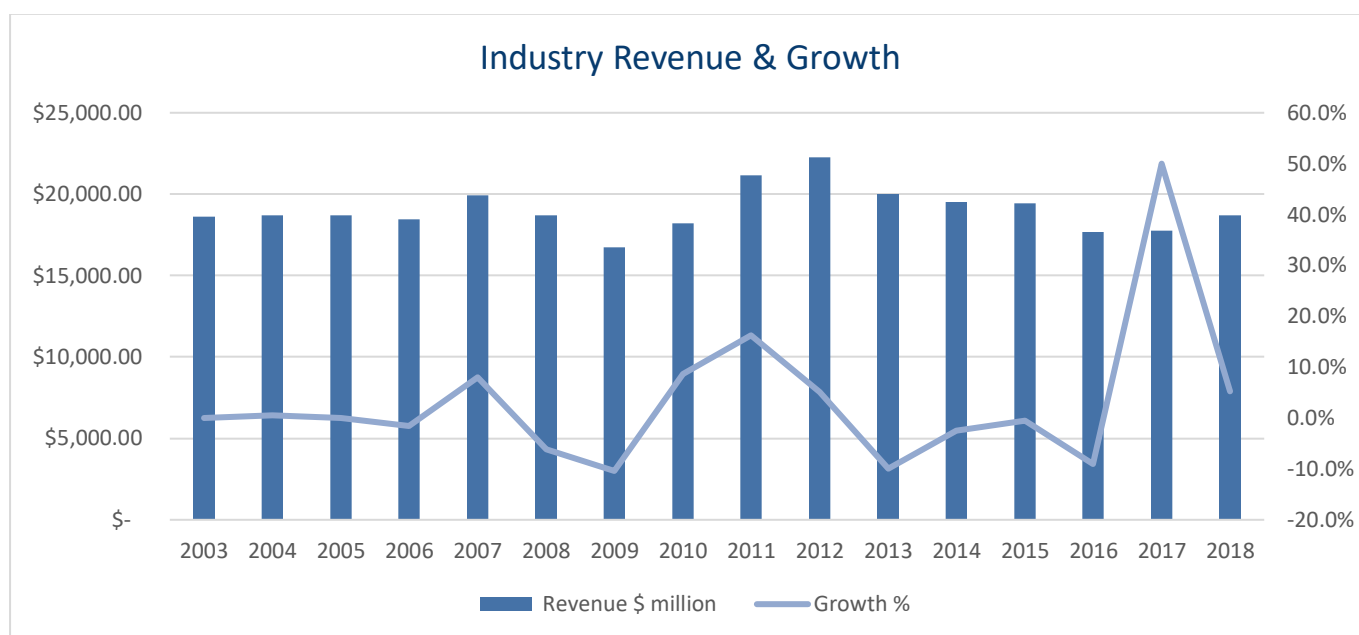
Capital Intensity

The capital intensity of the U.S. tire manufacturing industry is fairly low. According to the statistics provided on IBISWorld for 2018, the industry spends \$0.13 on capital for every dollar they spend on labour. Although the tire manufacturing industry requires a great amount of capital investment, it heavily relies on labour skills in production processes. The industry is more labour intensive than capital intensive. Under the condition of acquiring highly skilled labour and capital, there is a

relatively high barrier for entry. In the past five years, the industry's allocation of capital expenditure has changed significantly. Initially, companies invested substantial amounts of capital towards the expansion of manufacturing facilities in lower-cost countries to maintain their competitiveness. However, the depletion in profit margins, caused by volatile raw material costs and changes in energy efficiency regulations, halted this vast amount of capital investment in the industry.

Input Price Volatility

The industry's growth is heavily impacted by the fluctuations of input prices. Purchases take up 51.7% of the industry's total revenue in 2018 with raw material purchases as the greatest portion out of all purchases. The rising of emerging economies has driven up raw material costs and global commodity prices. However, commodity prices have been decreasing in the current period due to overproduction and the fall in speed of major economies.



Source: IBISWorld.com

Catalysts

Acquisition of Joint Ventures

In the International Tire Operations segment, Cooper secures its medium truck tire supplies from the two joint ventures, PCT and GRT. The company also signed an off-take agreement with a joint venture to increase its suppliers, yet the agreement is only short term, which expires in December 2020. Cooper claims that the newly established joint venture in Vietnam, announced in December 2018, is expected to start producing tires at the beginning of 2020. However, there are no promises towards the starting date of production in the Vietnamese joint venture. There would be a negative impact on Cooper's share price if the company fails to keep its promises in starting production in the newly established joint venture.

after the current off-take agreement expires. On the other hand, any new agreements signed or acquisitions acquired would fluctuate the intrinsic value of the company as well.

Growth in Delivery and Transportation Industries

With the innovation in technology, the delivery and transportation industries have been growing immensely in the past years. Many new services and jobs are created, such as food delivery services, online retailing, and transportation services through websites and applications. Tires are necessities in all the services that require the use of cars. Therefore, the demand for tires will increase as the delivery and transportation services grow.

Management Team

Bradley Hughes – President, Director, & Chief Executive Officer

Bradley Hughes joined Cooper Tire & Rubber Company as the Vice President and Chief Financial Officer in November 2009, after serving at Ford Motor Co. for twenty-three years. Hughes also served as the Senior Vice President and Chief Operating Officer before he was named to his current position as the President, Director, and Chief Executive Officer on September 1, 2016. Prior to his participation to CTB, Hughes served as the CFO in different companies, including Ford Motor Co. and Fruehauf Finance Corp., for almost thirty years, which shows his strong background and extensive experience in finance. As the greatest shareholder of CTB, Hughes holds 253,775 shares, which is 0.51% of the total shares outstanding.

John Bollman – Senior Vice President & Chief Human Resources Officer

John Bollman joined Cooper Tire & Rubber Company in March 2017 and was appointed to his current position as the Senior Vice President and Chief Human Resources Officer. Prior to his addition to the company, Bollman served as the Chief Human Resources Officer at Sequa Corporation for nine years and at Whirlpool Corporation for eighteen years in various human resources positions. Bollman's involvement in human resources for the past years, especially at a manufacturing company, Whirlpool Corporation, guarantees his ability to succeed in his current position. The tire manufacturing industry heavily relies on labour skills in production processes, thus having an experienced Chief Human Resources Officer is vital to Cooper's operations. Bollman currently holds 0.05% of the company's total shares outstanding, which is 24,282 shares.

Christopher Eperjesy – Senior Vice President & Chief Financial Officer

Chris Eperjesy joined Cooper in December 2018 as his current position, the Senior Vice President and Chief Financial Officer. As the newest member of the management team, Eperjesy is also responsible for Cooper's corporate financial strategic planning and business information systems. Before joining CTB, Eperjesy served as the CFO for IMAGINE Group, Arctic Cat, Inc., and Twin Disc, Inc. Eperjesy currently holds 0.05% of CTB's total shares outstanding, which is 24,569 shares.

Shareholder Base, Liquidity, Market Depth

Cooper Tire & Rubber Company currently has 50,071,633 shares outstanding. 0.88% of its shares are held by insiders, with CEO Bradley Hughes as the greatest inside holder at 0.51% of the total shares outstanding. The short interest ratio of the company is 10.43% with an average daily trading volume of 721,065, which suggests little liquidity risk.

Top Holders			
Holder	Position	% Out	File Date
BlackRock Inc.	7,480,493	14.94	12/31/18
Vanguard Group Inc. (The)	5,031,749	10.05	08/31/18
Dimensional Fund Advisors LP	4,248,425	8.48	12/31/18
DePrince Race & Zollo Inc.	2,718,552	5.43	12/31/18
LSV Asset Management	2,513,311	5.02	12/31/18
Royce & Associates LP	2,265,913	4.53	12/31/18
Fairpointe Capital LLC	2,039,956	4.07	12/31/18
Wellington Management Group LLP	2,029,055	4.05	12/31/18
Teachers Insurance & Annuity Association of America	1,623,942	3.24	01/31/19
State Street Corp	1,574,507	3.14	12/31/18

Source: Bloomberg

Valuation

Comparable Company Analysis

The companies used in our comparable company analysis are similar in products produced and customers served by CTB. All of the companies selected below sell their products worldwide with a major business segment in the U.S. tire manufacturing market, except Apollo Tyres Ltd. Companies that hold major market shares of the industry are also selected, as CTB holds the fourth largest market share. We used the expected 2019 mean EV/EBITDA of 5.4 as our terminal multiple in the exit multiple method. CTB's EV/EBITDA of 3.8 is less than the mean EV/EBITDA, which suggests that the market has yet to realize its value.

The Goodyear Tire & Rubber Company (NASDAQ: GT)

Similar to CTB, The Goodyear Tire & Rubber Company was founded in 1898 and is also headquartered in Ohio. It comprises 12.3% of the market share in the U.S. tire manufacturing industry. Goodyear Tire manufactures, distributes, and sells tire and related products, such as tread rubber and chemicals, worldwide.

Apollo Tyres Ltd. (NSE: APOLLOTYRE)

Apollo Tyres is an Indian tire manufacturing company founded in 1972. It manufactures and sells automotive tires, tubes, and flaps in India and worldwide. Brands under Apollo Tyres include the Apollo, Kaizen, Regal, and Vredestein.

Compagnie Generale des Etablissements Michelin (ENXTPA: ML)

Michelin was founded in 1863 and is headquartered in France. It is currently the major player in the U.S. tire manufacturing industry that acquires the largest market share of 22.5%. The company also sells, distributes, and manufactures tires worldwide.

Titan International Inc. (NYSE: TWI)

Titan International Inc. was founded in 1890 and is headquartered in Illinois, United States. The company manufactures and sells tires and wheels in the United States and Internationally. It specializes in off-the-road tires and wheel technology in its three operating segments: Agricultural, Earthmoving/Construction, and Consumer.

Bridgestone Corporation (TYO: 5108)

Bridgestone Corporation is one of the leading companies in the U.S. tire manufacturing industry with 21.1% of the market share. It was founded in 1931 and is headquartered in Tokyo, Japan. The company manufactures and sells tires and diversified rubber products worldwide. Bridgestone Corporation also values CSR and publishes annual sustainability reports on its website.

Discounted Cash Flow Analysis

Revenue for Americas Tire Operations

We decided to drive revenues for the Americas Tire Operations and International Tire Operations separately by the change in net sales. We forecasted the revenue growth for the Americas Tire Operations segment to decrease at a constant rate of 2.2%. The company's strategy of expanding distribution channels and e-commerce platforms will decrease the contraction in revenue growth compared to previous years.

Revenue for International Tire Operations

The revenue for this segment is expected to grow more compared to the Americas Tire Operations segment, due to the expansion plans of the OE market in China. A newly established joint venture in Vietnam in December 2018 is expected to start selling and producing tires in 2020, which will add another revenue stream for this segment.

Capital Expenditures

Capital expenditure is expected to grow due to the expansion plans of the OE market in China and the research projects conducted to seek alternative raw materials. Therefore, a 0.2% annual growth rate is forecasted.

Dividend per Share

The dividend per share has been constant at an annualized price of \$0.42 since 1999 and the company has no further plans in changing it. Thus, we projected the dividend per share to be \$0.42 each year.

Cost of Goods Sold

The cost of raw material to produce tires has been a great portion of the company's spendings. According to IBISWorld, the commodity price of rubber, the main component of tire production, has been decreasing since its highest price in 2011. Therefore, we forecasted the percentage of the cost of goods sold of revenue to decrease by 0.1% each year.

Weighted Average Cost of Capital

The calculated weighted average cost of capital is 9.6%. The cost of equity of 10.1% is derived from a market risk premium of 7.5% and a beta of 0.97 from Bloomberg. The cost of debt of the company is 2.1%, which accounts for the pre-tax cost of debt of 3.0% and an effective tax rate of 30.0%.

Recommendation

We believe that Cooper Tire & Rubber Company is currently undervalued by the market due to its poor performance in the Americas Tire Operations segment. However, improvements are made in the segment by Cooper's strategic implementations. We expect substantial future growth for the company, driven by its expansion in the International Tire Operation segment. With an implied share price of \$37.44 and upside of 30.6%, we recommend a **buy** rating for Cooper Tire & Rubber Company.

Risks

Supply Chain Risk

Cooper Tire & Rubber Company currently sources medium truck tires from PCT, a previous joint venture, through an off-take agreement and from GRT, a joint venture that Cooper has 65% ownership of. Both suppliers, PCT and GRT, are located in China, which increases Cooper's risks of engaging in businesses outside of the United States. Any changes in foreign laws, regulations, limitations to imports and exports, such as tariffs, or political and economic issues will impact Cooper directly, especially because both PCT and GRT are operating in the same country.

Raw Material Costs

According to IBISWorld, purchases take up 51.7% of the industry's revenue in 2018 with raw material costs making up the greatest portion. Raw materials including natural rubber, synthetic rubber, carbon black, chemicals, and steel reinforcement components are essential purchases for Cooper to produce tires. Even though Cooper has been investing in research projects to seek for alternative raw materials that are cheaper and environmentally-friendly, there are no signs of development in the research. Changes in raw material costs directly affect the company's top line growth, as mentioned in the section "revenue analysis of business segments".

Highly Competitive Industry

Cooper has the fourth largest market share in the tire manufacturing industry in the U.S., following Compagnie Generale des Etablissements Michelin, Bridgestone Corporation, and The Goodyear Tire & Rubber Company. Cooper is smaller in size in comparison to its top competitors and is also threatened by lower-cost companies rising from disruption.

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Sunny Shee
Analyst

WestPeak Research Association
contact@westpeakresearch.com