

# Exco Technologies Limited (TSX: XTC)

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Industry: Auto-Parts

Rating: Buy

Target: \$24.52

Date: March 09, 2015



## Executive Summary

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### Business Summary

Exco Technologies is a machine tools and accessories company that specialized in supplying technology to the die-cast, extrusion and automotive industries. The company supplies a wide range of automotive manufacturers including high and low end car companies.

### Business Drivers

Exco technologies, as well as all automotive manufacturing businesses are stringently subject to the rise and fall in demand for cars. Currently, a combination of explosive growth in the developing world, as well as falling oil prices have caused the demand for cars to increase significantly. Luxury cars specifically have seen a massive boom in sales driven mainly by Asian buyers.

### Business Risks

The business risks, like the drivers, are focused around the demand for cars. The close correlation between demand for cars and oil prices provides a good measure for potential risk. A steep rise in the price of crude oil caused either by a change in the current oil surplus or geo-political risks associated with oil in the Middle East, could slow the demand for cars. This however, is somewhat mitigated by the advent of fracking, which provides a large surplus and keeps supply high.

### Valuation Summary

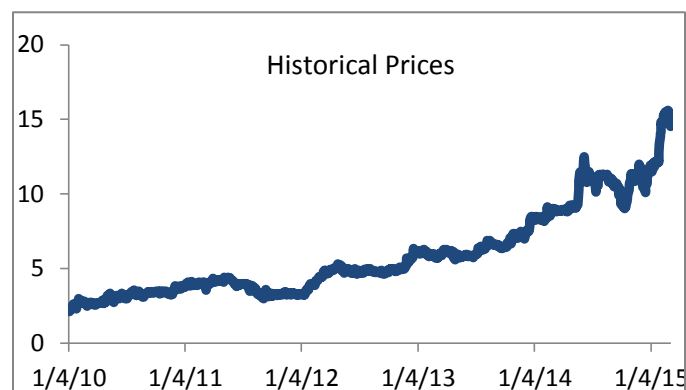
The valuation places an approximate growth expectation of 75% over the next three years based on a combination of valuation methods including but not limited to: discounted cash flow analysis, comparable company analysis, forward multiples and a high chance of expanding contracts through newly acquired subsidiaries.

## Key Statistics

|                       | Current        |                    | 2012     | 2013     | Current  |
|-----------------------|----------------|--------------------|----------|----------|----------|
| Price                 | \$14.01        | Price              | \$10     | \$10     | \$593.62 |
| Date                  | 03 09, 2015    | Price / Earnings   | 0.60x    | 0.58x    | 0.74     |
| 52 Week Range         | \$8.75-\$15.77 | Debt / Equity      | 0.24x    | 0.19x    | 0.43x    |
| Shares Outstanding    | 42.18M         | Price / Book Value | 1.17     | 2.21     | 2.77     |
| Market Capitalization | \$590.96M      | Price / Sales      | 1.15     | 1.04     | 1.38     |
| Enterprise Value      | \$611.76       | Cash               | \$31.20M | \$26.07M | \$31.24M |

| Balance Sheet (\$CAD, thousands) | 2010            | 2011            | 2012            | 2013            | LTM             |
|----------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Cash & Cash Equivalents          | \$20.19         | \$15.38         | \$31.24         | \$26.07         | \$31.20         |
| Current Assets (Excluding Cash)  | \$56.93         | \$81.75         | \$82.04         | \$90.94         | \$129.80        |
| <b>Total Assets</b>              | <b>\$143.95</b> | <b>\$160.85</b> | <b>\$175.86</b> | <b>\$194.95</b> | <b>\$291.09</b> |
| Current Liabilities              | \$25.63         | \$29.07         | \$30.21         | \$28.17         | \$80.50         |
| Total Debt                       | \$0             | \$0             | \$0             | \$0             | \$23.76         |
| <b>Total Liabilities</b>         | <b>\$29.65</b>  | <b>\$32.59</b>  | <b>\$33.90</b>  | <b>\$30.97</b>  | <b>\$87.90</b>  |
| <b>Total Equity</b>              | <b>\$119.20</b> | <b>\$130.33</b> | <b>\$143.75</b> | <b>\$164.53</b> | <b>\$203.01</b> |

| Income Statement (\$CAD, Millions) | 2010           | 2011           | 2012           | 2013           | LTM            |
|------------------------------------|----------------|----------------|----------------|----------------|----------------|
| Revenue                            | \$166          | \$202.63       | \$242.52       | \$244.61       | \$368.26       |
| <b>EBITDA</b>                      | <b>\$22.47</b> | <b>\$53.86</b> | <b>\$42.78</b> | <b>\$43.42</b> | <b>\$53.86</b> |
| Depreciation & Amortization        | \$8.37         | \$10.05        | \$8.66         | \$8.6          | \$12.38        |
| Interest                           | \$0.16         | \$0            | \$0            | \$0            | \$0            |
| Foreign Exchange                   | \$0            | \$0            | \$0            | \$0            | \$0            |
| <b>Net Income</b>                  | <b>\$10.1</b>  | <b>\$13.26</b> | <b>\$24.45</b> | <b>\$23.63</b> | <b>\$30.66</b> |



## Company History

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Exco Technologies is a machine tools and accessories company that specialized in supplying technology to the die-cast, extrusion and automotive industries. The father of the current President, Chief Executive Officer and Director Brian Robbins, founded Exco Technologies in 1952 in his Scarborough, Ontario basement. The company started out building tools for aluminum extrusion, which were primarily used for storm windows and doors. The company then moved into the lucrative area of automobile interiors. Although the company had humble beginnings, it expanded quickly during the turn of the century. The company has acquired many subsidiaries and now boasts 18 locations, which employ approximately 4600 workers.

## Management

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The Management team at Exco Technologies is strong due to its experience, fair compensation and strong leadership.

## Executives

The team is lead by the founder's son Brian Robbins. The second in command, Paul Riganelli, has been with the company since 2004. He is the acting C.O.O. and has proven his loyalty with the company through his time spent working at the firm. Amy Nguyen, who as an experienced accountant has helped raised sales in the third quarter of 2014 substantially, has recently filled the Chief financial officer role. Her initial time spent at the company has proven successful, which is impressive granted that this is her first C.F.O. position. These Executives, along with many others combine their years of experience in order to create a large wealth of overall knowledge regarding all aspects of the field.

## Management

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### Compensation

Exco technologies compensates their employees at a very fair level. There are no substantial differences in executive pay. The C.E.O. president and director, Brian Robbins, was paid \$1,312,150 in 2013 and carries 234,102 exercisable shares. Robbins is paid roughly double what the current C.O.O. is paid, which is reasonable when scaled with the competition. All top executives at Exco are paid with a salary plus a mix of exercisable and non-exercisable stock options. The D.S.U. severance pay builds a sense of moral hazard within the executives and creates a more stable management team.

### Leadership

Perhaps the important point regarding the management is the solid leadership stemming from the head of the company, Brian Robbins. The rigidity of upward gains since 2009 can be largely attributed to the Director himself. He holds much of the power within the company, which allows him to lead through the sometimes-volatile ebbs and flows that come with being largely connected to the auto industry.

## Industry Overview

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The auto parts industry focuses on two main areas: Natural resources and the emerging markets.

### Natural Resources

The auto parts industry is heavily correlated with price of resources, namely steel, aluminum and oil. Over the past year U.S. cold rolled steel has risen, but over the last few months it has lost its mid year gains and is down to around \$.388/LB. This is good news for auto parts makers, which depend on a slow growth of steel prices to keep margins at a reasonable rate. China has kept aluminum prices on a steady upturn, however prices have fluctuated between \$.74/LB and \$.96/LB in the last year. Lastly, oil is crucial in the demand for cars and therefore, the demand for car parts. Oil has been on a sharp decline recently, and has increased demand for cars in North America and Europe. This is good news in two ways; The Poli-tech plastic components are cheaper to produce as they use oil in production as well as the demand for cars generally increases as oil prices decline.



## Industry Overview

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### The Emerging Markets

The emerging markets play a growing role in the auto parts industry. China recently became the largest consumer of cars in 2010, surpassing the long standing U.S. Demand for cars. In China, India and southern America, the demand for cars is growing quickly. Rolls Royce had record sales in 2013, mainly fuelled for the Chinese demand for ultra luxury vehicles. Although China has had a large increase in demand, china still has only 188 cars per 1000 people, compared to the U.S., which has 809 vehicles per 1000 people. This shows considerable room to grow. India's car market continues to thrive in the low cost sector, with Nissan and Tata selling well in the sub-continent. Auto parts makers are making the jump to strategically locate them selves in this area of extreme manufacturing growth. Many companies are setting up shop where the labour is cheap and there the margins are high.

## Major Products

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Exco Technologies has three major product solutions branches: Automotive solutions die Cast solutions and extrusion solutions.

### Automotive Interior Components

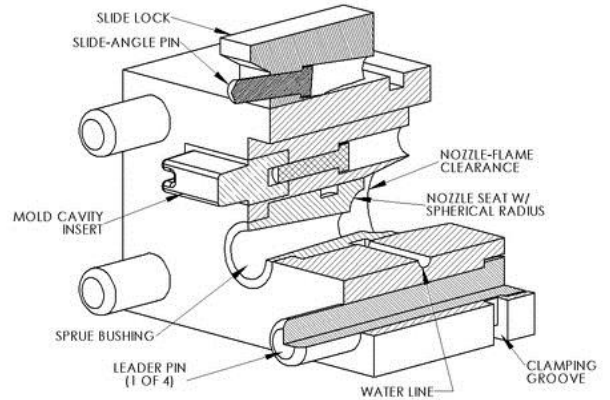
Within their automotive solutions there are four branches of products. First off, is their leather subsidiary company A.L.C. or Automotive Leather Company. They have six leather production facilities, which are located across the globe. In total A.L.C. has 2000 employees and is industry renowned for quality. They are utilized by many high-end German automakers. Their second branch is Polytech, a global distributor of miscellaneous car interior parts such as tire covers; seat nets and transmission cover plates. The third branch is Neocon, which produces plastic pieces of interior trim. Plastic is a cheaper alternative to traditional aluminum and wood trim. Much of the plastic manufacturing is for storage components such as “Stow and go” in minivans. Finally, the last branch is Polydesign systems, which like Polytech is responsible for the creation of car nets and other misc. parts, however Polytech is the design branch, which comes up with innovative solutions to design challenges within car interiors.



## Major Products

### Die-Casting

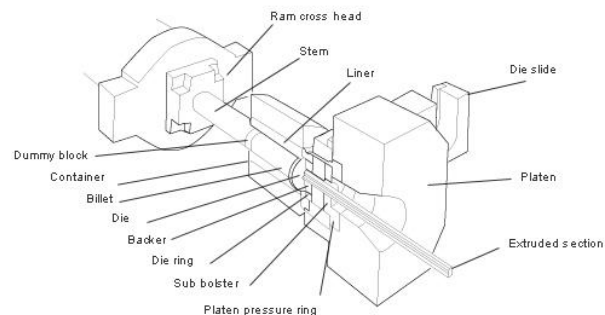
Exco technologies was founded on die cast solutions and as such, has a large part of their company invested in this area. Die-casting is a metal casting process that is characterized by forcing molten metal under high pressure into a mould cavity. The mould cavity is created using two hardened tool steel dies, which have been machined into shape and work similarly to an injection mould during the process.



They have three major facilities, all of which are run separately under separate names. The first, Edco, is located in Toledo, Ohio. The facility boasts 50,000 square foot facility and prides itself on exceptional dimensional accuracy and repeatability. The second branch of die-casting is Exco Engineering in Newmarket Ontario. It is the flagship location with a 150,000 square foot facility, which has an industry leading 3500-ton high pressure Die Cast Machine. The third and final branch is Castool in Uxbridge, Ontario. Castool has a European subsidiary in Switzerland that provides Die cast tooling to European markets.

### Extrusion

Extrusion is a process used to create objects of a fixed cross-sectional profile. A material is pushed or drawn through a die of the desired cross-section. The two main advantages of this process over other manufacturing processes are its ability to create very complex cross-sections, and to work materials that are brittle, because the material only encounters compressive and shear stresses. It also forms parts with an excellent surface finish. Exco has two main subsidiaries that deal with extrusion. The first being Extrusion tooling solutions, the largest extrusion tooling producer in North America. Extrusion tooling solutions has three facilities located in Ontario, Michigan and Columbia. The Columbian facility services the South American markets. The second Extrusion subsidiary is Castool (mentioned above), which along with Die Casting, shares its facility with the extrusion division.



## Acquisitions

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Exco Technologies is essentially a large conglomerate of highly specialized companies and this emphasized the vitality of acquisitions to the company. The most significant large-scale acquisition that Exco has done in recent history is undoubtedly American Leather Company. On March 3<sup>rd</sup> 2014, Exco Technologies announced the acquisition of the leather firm that services many automakers. This is a major move in expanding from more basic trim pieces in the interior to the actual seating cover. On October 16<sup>th</sup> 2014, Exco announced a major seating cover program that will designate Exco as the sole OEM leather producer for BMW's light compact vehicle segment. This will result in an increase of sales estimated at 35 million dollars. The leather production for this project will begin around January 2016. This deal showcases the value of Exco's most recent acquisition and is a major catalyst come second quarter earnings, 2016.



## Expansion Strategies

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The largest driver of growth, with the exception of large-scale mergers, is the expansion of their all ready existent locations and subsidiaries. Exco has two major expansions currently underway to expand their presence in the developing world. These expansions are designed to set up permanent shop in places where the labour is expected to stay cheap for long periods of time.

### Brazil Expansion

In November 2012, Exco Technologies announced a ten million dollar die casting facility to be built in Brazil. Car manufacturing is moving to Latin America in a big way. The cheaper cost of labour combined with less political risk than perhaps China or parts of Africa makes Latin America a great candidate for manufacturing. The move from Exco is most likely in order to avoid heavy import taxes. Having the parts made and readily available where the cars are actually being assembled saves major shipping cost and again lowers prices for manufactures. Exco plans to capitalize on this opportunity.



## Expansion Strategies

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### Thailand Expansion

A seven million dollar Castool facility in Thailand was announced in January of 2013. With the Japanese labour market becoming expensive and limited due to labour controls as well as an aging population, Thailand is the obvious choice. Thailand's location allows ease of access to many of the Asian markets. According to Exco executive, Brian Robbins "The facility has already attracted remarkable customer interest and order activity." The facility and shipment infrastructure is also designed to service many European markets.

## Appendix

### Comparisons Model

| Company                   | Trading Comps    |                 |                 |               |                | Shares       |            |
|---------------------------|------------------|-----------------|-----------------|---------------|----------------|--------------|------------|
|                           | Mkt Cap          | Price           | EBITDA          | P/E           | EPS            | Outstanding  | Dividend   |
| Martinrea International   | \$ 1,070.00      | \$ 148.55       | \$ 194.81       | 148.55        | 0.08           | 84.93        | \$ 0.03    |
| Uni-Select Inc.           | \$ 888.31        | \$ 14.72        | \$ 101.20       | 14.72         | 2.84           | 21.22        | \$ 0.15    |
| Westport Innovations      | \$ 391.90        | \$ 9.31         | -\$ 11.60       | n/a           | -2.37          | 63.48        | n/a        |
| Schnitzer Steel Ind. Inc. | \$ 432.58        | \$ 49.92        | \$ 99.22        | 49.92         | 0.32           | 26.48        | \$ 0.19    |
| Commercial Metals Comp.   | \$ 1,690.00      | \$ 1.00         | \$ 357.17       | 15.92         | 0.91           | 117.42       | \$ 0.12    |
| Mean                      | \$ 894.56        | \$ 44.70        | \$ 148.16       | 57.28x        | \$ 0.36        | 62.71x       | \$ 0.12    |
| Median                    | \$ 888.31        | \$ 14.72        | \$ 101.20       | 32.92x        | \$ 0.32        | 63.48x       | \$ 0.14    |
| <b>Exco Technologies</b>  | <b>\$ 595.91</b> | <b>\$ 14.11</b> | <b>\$ 16.90</b> | <b>17.74x</b> | <b>\$ 0.80</b> | <b>42.23</b> | <b>n/a</b> |

### W.A.C.C. Calculation

| WACC Calculation                   |              |
|------------------------------------|--------------|
| <b>Target Capital Structure</b>    |              |
| Debt-to-Total Capitalization       | - %          |
| Equity-to-Total Capitalization     | 100.0%       |
| <b>Cost of Debt</b>                |              |
| Riskfree                           | 2.8%         |
| Default Risk                       | 0.7%         |
| Country Risk                       | - %          |
| Cost of Debt                       | 3.5%         |
| Tax Rate                           | 25.0%        |
| <b>After-tax Cost of Debt</b>      | <b>2.6%</b>  |
| <b>Cost of Equity</b>              |              |
| Risk-free Rate <sup>(1)</sup>      | 2.8%         |
| Market Risk Premium <sup>(2)</sup> | 5.6%         |
| Levered Beta                       | 1.40         |
| Size Premium                       | 0.0%         |
| Lambda                             | 1.22         |
| <b>Cost of Equity</b>              | <b>10.6%</b> |
| <b>WACC</b>                        | <b>10.6%</b> |

Appendix

Discounted Cash Flow Analysis

**Exco Technologies**  
 Discounted Cash Flow Analysis  
 (\$ in millions, fiscal year ending December 31)

Operating Scenario:  Midyear Convention:

|                                       | 2010   | 2011   | Historical Period |        |        | 2014  | 2015  | Projection Period |       |       | 2019 | CAGR        |
|---------------------------------------|--------|--------|-------------------|--------|--------|-------|-------|-------------------|-------|-------|------|-------------|
|                                       |        |        | 2012              | 2013   | 2014   |       |       | 2017              | 2018  | 2019  |      | (2011-2015) |
| Sales                                 | 148.72 | 165.51 | 222.69            | 248.61 | 388.30 | 465.1 | 455.5 | 457.3             | 475.6 | 489.8 | 4.5% | 4.5%        |
| % growth                              | n/a    | 12.2%  | 22.9%             | 20.7%  | 50.9%  | 10.0% | 7.5%  | 3.0%              | 4.0%  | 3.0%  | 4.9% | 4.9%        |
| Cost of Sales                         | 112    | 132    | 140               | 159    | 87     | 232   | 240   | 256               | 266   | 278   | 5.9% | 5.9%        |
| Gross Profit                          | 36.72  | 33.51  | 82.69             | 89.61  | 301.30 | 233   | 215.5 | 201.3             | 209   | 211.8 | 4.9% | 4.9%        |
| % margin                              | 24.7%  | 20.2%  | 37.2%             | 36.4%  | 77.6%  | 50.1% | 47.3% | 44.2%             | 44.1% | 43.2% | 4.9% | 4.9%        |
| SG&A                                  | 21     | 24     | 27                | 28     | 36     | 32    | 35    | 37                | 38    | 39    | 4.9% | 4.9%        |
| R&D                                   | 0      | 0      | 0                 | 0      | -      | 8     | 9     | 9                 | 10    | 10    | 4.9% | 4.9%        |
| EBITDA                                | 108    | 115    | 141               | 179    | 66     | 211   | 226   | 242               | 252   | 260   | 5.4% | 5.4%        |
| % margin                              | 74.0%  | 69.6%  | 63.3%             | 73.3%  | 18.0%  | 45.2% | 50.1% | 53.0%             | 53.0% | 53.0% | 5.4% | 5.4%        |
| Depreciation & Amortization           | 8.4    | 8.0    | 8.7               | 8.6    | 12.4   | 28    | 30    | 32                | 33    | 34    | 4.9% | 4.9%        |
| EBIT                                  | 98     | 107    | 132               | 171    | 54     | 182   | 196   | 210               | 219   | 225   | 5.4% | 5.4%        |
| % margin                              | 68.1%  | 64.8%  | 60.3%             | 69.7%  | 14.6%  | 45.0% | 45.0% | 46.0%             | 46.0% | 46.0% | 5.4% | 5.4%        |
| Taxes                                 | 5      | 8      | 10                | 10     | 10     | 45.6  | 49.0  | 52.6              | 54.7  | 56.3  | 5.4% | 5.4%        |
| EBIAT                                 | 93     | 100    | 123               | 161    | 44     | 137   | 147   | 158               | 164   | 169   | 5.4% | 5.4%        |
| Plus: Depreciation & Amortization     | 8.4    | 8.0    | 8.7               | 8.6    | 12.4   | 28.4  | 30.5  | 32.0              | 33.3  | 34.3  | 4.9% | 4.9%        |
| Less: Capital Expenditures            | 5.2    | 8.1    | 7.7               | 22.0   | 25.7   | 48.6  | 56.6  | 59.4              | 61.9  | 63.7  | 7.0% | 7.0%        |
| Less: Increase in Net Working Capital | n/a    | (6)    | (6)               | (3)    | (3)    | (17)  | (3)   | (2)               | (1)   | (1)   | 8.6% | 8.6%        |
| Unlevered Free Cash Flow              | 93.8   | 92.8   | 117.7             | 144.6  | 27.19  | 99.8  | 117.6 | 128.2             | 134.8 | 138.9 | 8.6% | 8.6%        |
| WACC                                  |        |        |                   |        |        | 0.5   | 1.5   | 2.5               | 3.5   | 4.5   |      |             |
| Discount Period                       |        |        |                   |        |        | 0.95  | 0.86  | 0.78              | 0.70  | 0.63  |      |             |
| Discount Factor                       |        |        |                   |        |        | 94.7  | 101.3 | 98.7              | 94.1  | 87.9  |      |             |
| Present Value of Free Cash Flow       |        |        |                   |        |        |       |       |                   |       |       |      |             |

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