WESTPEAK RESEARCH ASSOCIATION

Finning International Inc. (TSX: FTT)

Industrial Equipment Wholesale and Servicing

Finning Is Winning

September 06, 2019

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Equity Research	Canada
Price Target	**CAD$ 30.00**
Rating	Buy
Share Price (Sep. 06 Close)	CAD$ 22.90
Total Return	31%

Key Statistics	
52 Week H/L	$33.02/$21.34
Market Capitalization	$3.74B
Average Daily Trading Volume	$526k
Net Debt	$1.70B
Enterprise Value	$5.90B
Net Debt/EBITDA *FY18*	1.7x
Diluted Shares Outstanding	163M
Free Float	99.8%
Dividend Yield *FY18*	2.7%

WestPeak's Forecast

	2018E	2019E	2020E
Revenue	$6.99B	$7.71B	$8.56B
EBITDA	$610M	$686M	$771M
Net Income	$232M	$227M	$303M
EPS	$1.38	$1.39	$1.85
P/E	21.2x	18.3x	13.7x
EV/EBITDA	9.8x	8.2x	7.0x

1-Year Price Performance

Finning International, or the Company, is the world's largest Caterpillar equipment dealer delivering service to customers for 85 years, with operations in Canada, the UK & Ireland, and South America. The Company provides sales, rental, parts, and support services for Caterpillar equipment, engines, and complementary equipment across various industries including mining, forestry, agriculture, construction, power systems, and paving.

Thesis

Finning is among the largest equipment wholesalers in the world, with a globally renowned reputation and presence. The Company's recent South American ERP implementation struggles have resulted in a 1 year 20%+ share price drop. However, it's proven strong cost control and industry leading ROIC have positioned it well to pursue growth initiatives, specifically in the growing industrial landscape of Western Canada.

Drivers

Upcoming multi billion-dollar opportunities relating to Liquified Natural Gas (LNG) in northern British Columbia present a critical opportunity for Finning. Moreover, the alleviation of South American troubles, coupled with the region's new state-of-the-art ERP system, will drive growth moving forward as Finning continues to establish itself as an industry leader.

Valuation

Our target share price is $30.00 based on our EV/EBITDA exit multiple and the perpetuity growth multiple from our DCF as well as the PE/EBITDA and the EV/EBITDA multiple from our company comparables analysis, all weighted at 25%. We initiate a buy rating on Finning International Inc.

Business Overview/Fundamentals

Company Overview

Finning is the world's largest Caterpillar equipment dealer delivering service to customers for 85 years. The Company sells, rents, and provides parts and service for equipment and engines to customers in various industries, including mining, construction, petroleum, forestry, and a wide range of power systems applications. Finning aims to consistently deliver solutions that enable customers to achieve the lowest equipment owning and operating costs while maximizing uptime.

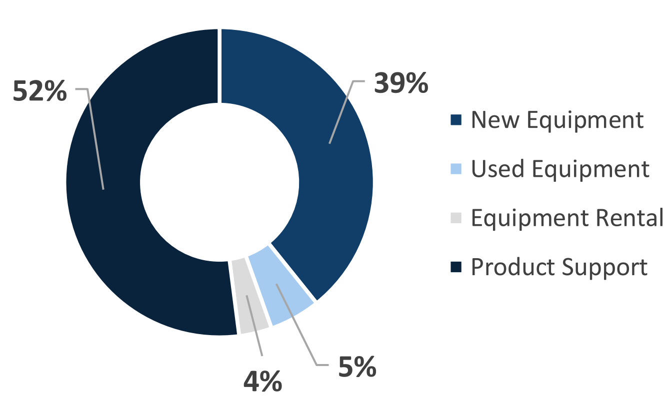
Segments

Finning operates primarily in one principal business: the sale, service, and rental of heavy equipment, engines, and related products in various markets worldwide as noted below. Finning's reportable segments are as follows:

Canadian Operations (CAD)

The Canadian reporting segment includes Finning (Canada), OEM (OEM Remanufacturing Company Inc.), and a 25% interest in PLM (PipeLine Machinery International) as well as 4Refuel since the acquisition date of February 1, 2019. The Canadian operations sell, service, and rent mainly Caterpillar equipment and engines in British Columbia, Alberta, Saskatchewan, Yukon, the Northwest Territories, and a portion of Nunavut, and also provide mobile refueling operations in British Columbia, Alberta, Saskatchewan, Ontario, Quebec, New Brunswick, Nova Scotia, and in Texas, US. The Canadian operations' markets include mining, construction, oil and gas, forestry, and power systems.

Revenue Segmentation
FY18



Source: Company Filings

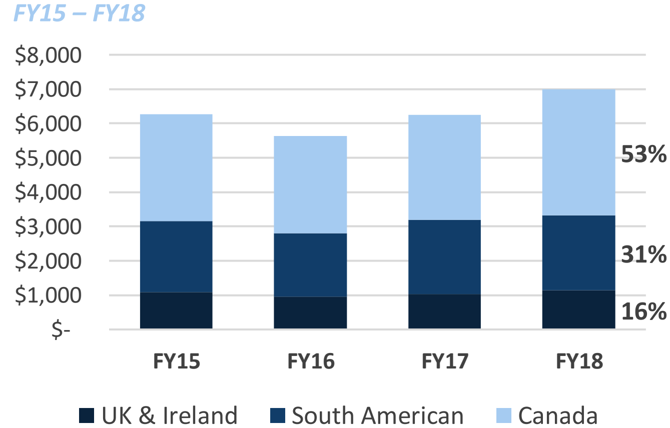
South American Operations (SA)

Finning's South American operations sell, service, and rent mainly Caterpillar equipment and engines in Chile, Argentina, and Bolivia. The South American operations' markets include mining, construction, forestry, and power systems.

UK & Ireland Operations (UK&I)

The Company's UK & Ireland operations sell, service, and rent mainly Caterpillar equipment and engines in England, Scotland, Wales, Northern Ireland, and the Republic of Ireland. The UK & Ireland operations' markets include quarrying, construction, power systems, and mining.

Geographical Segmentation
FY15 – FY18



Source: Company Filings

Subsidiaries

OEM Remanufacturing Company Inc.

OEM Remanufacturing (OEM) is one of North America's most advanced engine and powertrain component remanufacturing companies, serving the railway, natural gas, and diesel sectors. It operates from a 310,000 square foot facility in Edmonton and is a premier remanufacturing partner for Caterpillar Equipment and Finning in Western Canada.

PipeLine Machinery International

PipeLine Machinery International (PLM) is a global Cat® equipment dealer. Based in Houston, Texas, the Company supplies new and used equipment including pipe layers, tractors, excavators, wet decks, and other related machinery. Pipeline Machinery International operates worldwide.

4Refuel Canada LP

4Refuel is a provider of route-based mobile on-site refueling and fuel management services in British Columbia, Alberta, Saskatchewan, Ontario, Quebec, New Brunswick, and Nova Scotia as well as Texas, USA. Mobile on-site refueling (MOR) is the process of delivering fuel to a client's location and fueling each piece of equipment directly. 4Refuel pioneered mobile on-site refueling and has built an unmatched market presence across Canada, employing about 600 people and serving over 3,400 customers.

Finning acquired 4Refuel from New York based Private Equity firm Kelso & Company for approximately $260 million at a 7.8x EV/EBITDA multiple, excluding synergies. The Company funded the transaction with cash on hand and from existing credit facilities. 4Refuel contributed approximately $110 million of revenue ($19 million of net revenue) in the three-month period ended March 31, 2019.

The acquisition is expected to generate meaningful synergies with opportunities to expand Finning's product and service offering to 4Refuel's customers across western Canada and grow the mobile on-site refueling business through Finning's customer network.

We believe this transaction has the opportunity to further diversify Finning's business model while adding yet another value-added service to its current customer base, as part of its customer-centric growth strategy. The investment will provide new and existing customers with additional services to improve productivity and decrease their total cost of equipment ownership, parallaly adding another revenue stream.

Source: Company Websites

Company Strategy

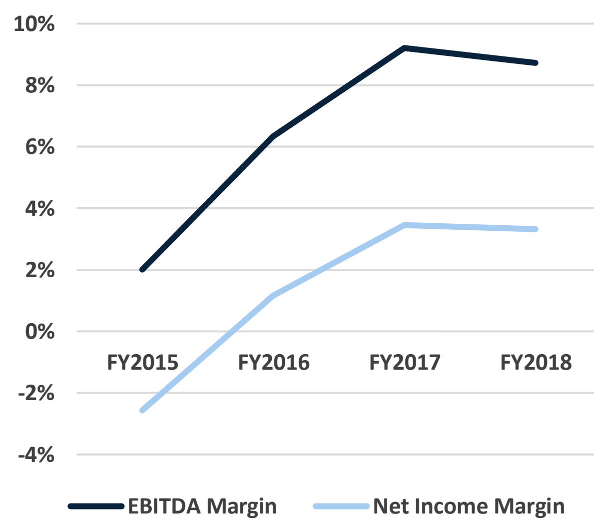
Fining focuses on a customer-centric growth strategy based on three pillars: Develop, Perform, and Innovate. Through customer centricity, lean & agile global operations, a strong supply chain, digital enterprization, and diversification, Finning aims to continue to grow its business as the worlds largest CAT distributor.

Cost Control

Over the last several years, management has taken out more than $300MM in costs out and improved the organization's capital efficiency. Management embarked on a significant overhaul of Finning's operations. The focus was on cost reduction, but more importantly streamlining the supply chain and maximizing capital deployment. Tangible improvements have begun to show up in inventory turnover and capital efficiency metrics.

As a result, margins have improved vastly, with EBITDA margins imrpoving from 2% in FY2015 to over 8% in FY2018. Net income margins have trailed closely, jumping from a negative 2.4% margin in FY2015 to 3.6% in FY18. Moving forward, management has expressed a continued focus on cost control and operational efficiency.

Margin Growth
FY15 - FY18



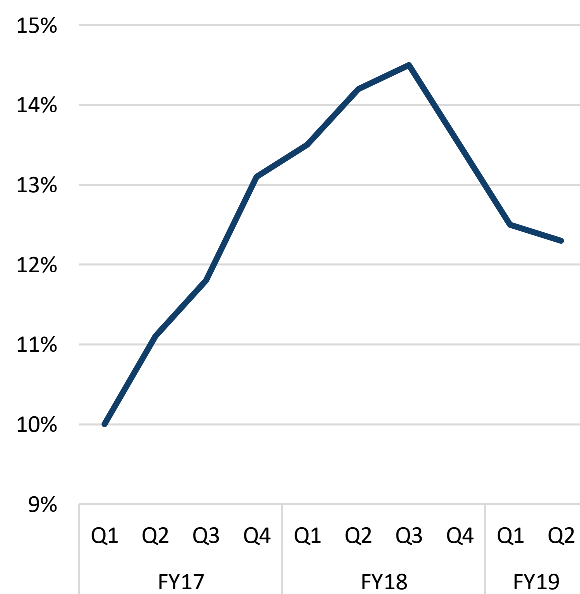
Source: Company Filings

Return on Invested Capital

Return on invested capital (ROIC) growth has been a critical component of the Company's strategy over the past five years. Finning has made strategic capital investments over the period to ultimately increase its ROIC from 10% in Q1 FY17 to nearly 15% by the end of FY18. Recent drops in ROIC have been due to South American operational difficulties, however Canadian ROIC remains at a high level of 16.6% as does UK & Ireland operations, at 14.2%.

Finning's ROIC is currently 5% greater than it's weighted average cost of capital (WACC), indicating remarkable value creation. As a benchmark, ROICs in excess of 2% of the firm's cost of capital demonstrate a company's efficiency at allocating the capital under its control to profitable investments. Finning's 5% premium show's its capital efficiency and ability to make wise and profitable investment decisions. Moving forward, management is focused on continuing to create value within the Company.

Historic Adjusted ROIC
FY17 – FY19



Source: Company Filings

Digital Offerings

Finning is currently testing and developing a state-of-the-art equipment monitoring solution called Finning Connectivity®. The tool is used for tracking important operating intelligence; this includes measuring the idle time of equipment as well as predictive maintenance through fleet management services and condition monitoring. Finning's digital offering is largely a customer enhancement tool right now.

As Finning continues to monetize this service, there is potential for the firm to create another strong recurring revenue stream with higher margins, further diversifying the business. Finning's digital transformation is a continual evolution, as we see the incremental value of growing beyond a transactional company to becoming a fully-integrated service company.

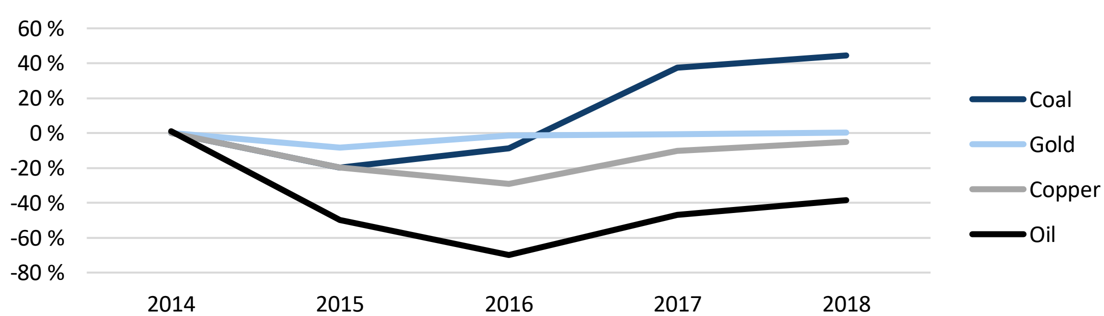
Industry Analysis

Finning operates primarily in two industries. The first is the Mining, Oil & Gas Machinery Wholesaling (MOGMW) industry (NAICS 41722). This industry does not include wholesalers of pumps, oil refining equipment or pipeline equipment, and is strictly related to complementary machinery such as agitators, crushers, classifiers, and other heavy machinery. The second industry that Finning operates in is the Heavy Equipment Repair Services (HERS) industry (NAICS 81131). This industry excludes automotive and electronic repair and strictly provides repair and maintenance (R&M) services for industrial sectors that use heavy machinery and equipment.

Mining, Oil & Gas Machinery Wholesaling (MOGMW) Industry ***Canada***

The Mining, Oil and Gas Machinery Wholesaling industry in Canada has experienced mixed results over the five years to 2019. Domestic oil and gas extraction activity has grown steadily for most of the past decade, and production growth was further driven in the years leading up to the reporting period by high prices for both goods. However, commodity prices for both oil & gas and minerals such as copper, gold and coal have fluctuated wildly over the past five years. This has resulted in fluctuating capital expenditure budgets by most downstream industries and demand has been volatile. Oil has seen the largest drop, falling 38% from 2014 base year. Coal prices have seen rapid growth, mostly due to strong Chinese industrial growth which has led to a 44% increase in coal prices from 2014 base year.

Commodity Price Growth, Indexed, 2014 Base Year
2014 - 2018



Source: PwC Mining in BC 2018 Report

$12.2 billion
Industry Size

3.1%
Annual Growth 14-19

1.4%
Annual Growth 19-24

7.4%
Finning Market Share

836
Number of Businesses

Source: IBIS World

Heavy Equipment Repair Services (HERS) Industry ***Canada***

The HERS industry, which includes maintenance and repair services for heavy machinery within industrial, commercial, agricultural, and other sectors, has experienced moderate growth over the past 5 years. As opposed to the MOGMW industry, the competitive market is highly fragmented, with several small mom-and-pop shops servicing clients in remote areas of the country. Most of the HERS industry is concentrated in Alberta, historically due to province's large energy sector presence. However, as BC continues to establish itself as an industrial leader through large scale industrial opportunities (such as LNG), the proportions are likely to shift. Moving forward, industry revenue is expected to grow at a faster annualized rate of 2.3%, reaching $11.5 billion in 2024.

$10.0 billion
Industry Size

1.5%
Annual Growth 14-19

2.3%
Annual Growth 19-24

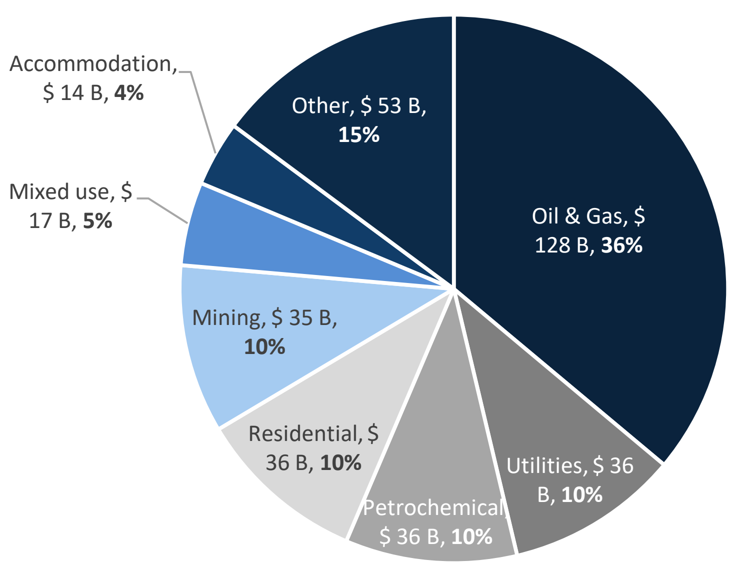
16,280
Number of Businesses

Source: IBIS World

Liquified Natural Gas (LNG) Opportunity

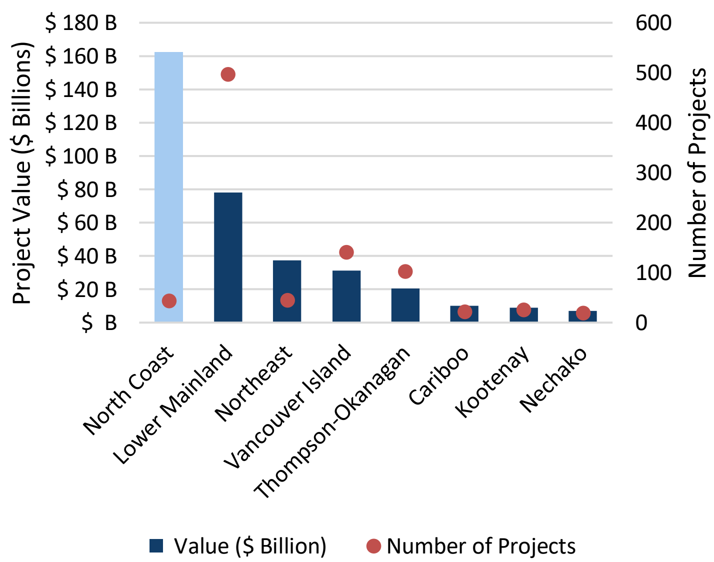
The BC's Major Projects inventory is a database with upcoming industrial projects over $15 million in estimated cost. Most of BC's large-scale projects relate to Oil & Gas, specifically, LNG. Oil & Gas projects range from pipelines to processing facilities, and jointly account for 36% of all upcoming major projects and a combined cost of $128 billion. Specifically, LNG accounts for 28% of all upcoming major construction projects, which translates to a $99 billion opportunity. 46% of project value is in the North Coast, specifically in Kitimat and Kitsault, however only 43 projects out of over 1000 are in the area. This is because of a small number of colossal projects such as the LNG Canada Facility, Kitsault LNG Facility and the Kitimat LNG Facility.

Major Projects by Type
As of Mar 2019



Source: BC Major Projects Inventory

Major Projects by Location
As of Mar 2019



Source: BC Major Projects Inventory

Catalysts

LNG Investment in BC

According to the British Columbia Registry of Major Construction Projects, there is $99 billion in LNG construction either proposed, on-hold or under construction in BC. In other words, 28% of all construction value in the province is directly related to LNG gas. Major projects include the $36 billion LNG Canada facility in Kitimat where construction has already begun, the $34 billion Kitsault LNG Facility in Kitsault which is currently permitting, and the $22 billion Kitimat Clean Oil Refinery in Kitimat that is under pre-application.

As Finning is Western Canada's largest CAT heavy machinery wholesaler, renter and repairer of industrial machinery, specifically for the oil & gas industry, we see the upcoming large-scale LNG project to present a significantly large recurring revenue opportunity in both the short and long term.

In November 2017, Caterpillar announced ir will offer its dynamic gas blending retrofit kit for the Cat® 785C Mining Truck. Cat Dynamic Gas Blending™ (DGB) technology allows engines to run on both diesel and liquefied natural gas (LNG). DGB lowers fuel cost while maintaining diesel power and transient performance. Caterpillar strategically implemented this new technology due to growing interest and demand for LNG and, moving forward, Caterpillar expects this technology to soon be adopted across several machinery lines, presenting a key opportunity for Finning.

End of South American ERP Troubles

In FY18, Finning began the implementation of its ERP in its South American operations. The implementation experienced several obstacles, most notably long delays. This strongly affected its South American operation's top line, specifically product revenues. Overall, South American top line fell by 4% from 2017 to 2018, compared to 20% growth in Canadian revenue and 12% growth in UK & Ireland revenue.

However, as of Q2 FY19, management has expressed that South American capacity is now running at normal run rate, and revenues are expected to come back to prior levels. In addition, the Company will be able to leverage its new ERP system to improve efficiencies and velocity, increase workforce productivity, and reduce the cost to serve. Management expects these efficiencies to boost EBIT margins from 8.5% to 9.0% in its South American operations by the end of 2019.

Overall, the turbulence has scared investors, causing its stock to drop 28% over the past year. As capacity returns to normal levels, and the ERP continues to add efficiencies and begins to improve operations, we expect stronger top-line growth and improvements in the bottom line.

Management Team

Mr. L. Scott Thomson – President, Chief Executive Officer, Director

Mr. L. Scott Thomson is President, Chief Executive Officer, Director of Finning International Inc. He joined Finning as President and CEO in June 2013. Prior to joining Finning, Mr. Thomson was Chief Financial Officer of Talisman Energy Inc. with responsibility for finance, tax, treasury, investor relations, marketing, business development and strategy, planning, and performance management from 2008 to 2013. Prior to Talisman, Mr. Thomson held several executive positions with Bell Canada Enterprises from 2003 to 2008 including the role of Executive Vice President, Corporate Development. Prior to Bell, Mr. Thomson was a Vice President at Goldman Sachs. Mr. Thomson currently serves as a director of the Bank of Nova Scotia. Mr. Thomson formerly served as a director of Interfor Corporation. Mr. Thomson holds a Bachelor of Arts degree in Economics and Political Science from Queen's University and a Master of Business Administration degree from the University of Chicago.

Source: Company Filings

Over the past five years of Mr. Thomson's tenure at Finning, he has focused on operational efficiency. This has involved reducing the Company's cost structure, improving it's supply chain, improving service excellence, optimizing its asset footprint, and recovering market share and customer loyalty.

Mr. Thomson's total compensation for FY18 was $5.6 million CAD, a 0.35% decrease from 2016. This breaks down into $973 thousand (17% of total) in base salary, $895 thousand (16% of total) in short-term incentives, $2.25 million (40% of total) in performance share units, $750 thousand in stock options (13% of total) in stock options and $750 thousand (13% of total) in restricted share units. Mr. Thomson is measured on several key performance indicators, including continuing to improve Finning's ROIC (35% of incentive), improving profitability and more specifically EBIT margins (35% of incentive), customer loyalty measured through % of referrals (15% of incentive) and safety measured through number of injuries (15%).

Mr. Steven Nielsen – Chief Financial Officer, Executive Vice President

Mr. Steven Mathew Nielsen is Chief Financial Officer, Executive Vice President of Finning International Inc., with effect from 10 March 2015. His executive spans leadership experience in finance and operation roles across diverse industries. Previously, Mr. Nielsen was CFO for Univar, a global distributor of chemicals, where he led the organization to higher growth and profitability. Prior to Univar, Mr. Nielsen gained significant executive experience in various senior positions at Sprint Nextel Corporation, a U.S. telecommunications company. During his career at Sprint, Mr. Nielsen's roles included CFO of Sprint's wireless division, Chief Transition Officer responsible for the Sprint – Nextel merger, Executive Vice President and Chief Service Officer, and Executive Vice President and CFO of corporate initiatives. Mr. Nielsen is a Chartered Global Management Accountant and member of the American Institute of Certified Public Accountants and holds a Bachelor of Arts degree.

Source: Company Filings

Mr. Nielsen's total compensation for FY18 was $1.9 million CAD, a 9.6% decrease from 2016. This breaks down into $561 thousand (30% of total) in base salary, $337 thousand (17% of total) in short-term incentives, $600 thousand (32% of total) in performance share units, $200 thousand (11% of total) in stock options and $200 thousand (11% of total) in restricted share units.

Marcello Marchese – President, Finning South America

Mr. Marcello Marchese is President - Finning South America of the company since June 2012 with overall responsibility for Finning's operations in Chile, Argentina, Bolivia, and Uruguay. His previous role was Senior Vice President, Construction and Power Systems of Finning South America, a role he held from 2008. Mr. Marchese joined Finning in 1998 as Manager of the Power Systems Division in Chile. In 2002, he was transferred to Finning International, Vancouver, Canada where he held the positions of Business Development Manager, Power Systems and International Marketing Manager, Power and Energy. Mr. Marchese returned to Chile in January of 2006 as Vice President of Customer Support Services, Finning South America and in October 2006, he assumed the position of Vice President, Operations for the region. Mr. Marchese has over 18 years of experience in progressively senior roles in the aviation and power systems industries, in addition to the various roles he has held at Finning. Educated in Chile, Mr. Marchese holds a Civil Mechanical Engineering degree from Federico Santa Maria University and an MBA from Adolfo Ibáñez University.

Source: Company Filings

Mr. Marchese's total compensation for FY18 was $1.4 million CAD, a 4.5% decrease from 2016. This breaks down into $650 thousand (46% of total) in base salary, $146 thousand (11% of total) in short-term incentives, $363 thousand (26% of total) in performance share units, $121 thousand (8% of total) in stock options and $121 thousand (8% of total) in restricted share units.

Shareholder Base and Liquidity

Finning currently has 163 million shares outstanding, with free float currently at 162.95 shares, translating to an impressive 99.8% free float. Its ten largest shareholders are listed in the table below. Insider ownership makes up 0.80% of ownership.

Shareholder	Shares Owned	% of Shares Outs.	Equity Assets ($MM)	Country
Beutel, Goodman & Company Ltd.	8,339,911	5.11%	18,185	Canada
RBC Global Asset Management	4,989,955	3.06%	71,597	Canada
CI Investments Inc.	4,527,758	2.77%	38,038	Canada
The Vanguard Group	4,322,722	2.65%	3,591,612	USA
Mawer Investment Management Ltd.	4,171,259	2.55%	32,087	Canada
Leith Wheeler Investment Counsel Ltd.	3,430,052	2.1%	3,106	Canada
Norges Bank Investment Management	2,485,621	1.52%	643,294	Norway
TD Asset Management Inc.	1,832,422	1.12%	70,856	Canada
CIBC Asset Management Inc.	1,696,398	1.04%	26,065	Canada
QV Investors Inc.	1,519,630	0.93%	5,222	Canada

Source: Thomson One

The table below shows the share turnover ratio, number of shares traded by average number of shares outstanding, for Finning and its main competitors. As shown, Finning has a share turnover ratio of 311.66, well below the industry mean of 703.90. This indicates low liquidity for Finning stock when compared to competitors.

Company	Avg. 12 Month Volume	Shares Outs. (MM)	Turnover Ratio
Finning International	524,003	163.31	311.66
Toromont Industries	143,919	81.52	566.43
Rocky Mountain Equipment	25,334	19.26	760.24
Wajax Corp	43,846	20.16	459.79
Cervus Equipment	7,653	15.32	2,001.83
Titan Machinery	179,668	22.18	123.45
Industry Mean *(based on comparables)*	**154,071**	**53.63**	**703.90**

Source: Thomson One

Valuation

Comparable Company Analysis

The companies listed below have a comparable business model. They share similar operating activities including distribution, rental and servicing of heavy machinery. Their primary end consumer markets are in Canada or the United States and all companies share similarly sized market capitalizations.

Toromont Industries

Toromont Industries Ltd is a Canadian-based company, which operates through two segments: Equipment Group and CIMCO. The Company's Equipment Group is involved in supply of specialized mobile equipment and industrial engines. Its customer base includes infrastructure contractors, residential and commercial contractors, mining companies, forestry companies, pulp and paper producers, and other organizations. CIMCO is involved in the design, engineering, fabrication, and installation of industrial and recreational refrigeration systems with operations in Canada and the United States.

Wajax Corporation

Wajax Corp is a Canadian-based distributor engaged in the sale and service support of mobile equipment, power systems, and industrial components. The Company's Equipment business is engaged in distribution, rental, modification, and servicing of mobile equipment from manufacturers. Its Power Systems business is engaged in distribution, sales, service of heavy-duty engines, transmissions, and power generation product sales, service, and rentals across Canada. Its Industrial Components business is engaged in the distribution, servicing, engineering, custom design, and assembly of industrial components for in-plant customers and original equipment manufacturers.

Cervus Equipment Corporation

Cervus Equipment Corp is a Canadian-based company that acquires and operates authorized agricultural, construction, material handling, and transportation equipment dealerships. The Company has interests in 63 dealerships in Canada, New Zealand, and Australia. It operates through three segments: Agriculture, Transportation, and Industrial. The primary equipment brands represented by the Company include John Deere agricultural equipment; Peterbilt transportation equipment; and Clark, Sellick, Doosan, JLG and Baumann material handling equipment.

Rocky Mountain Dealerships

Rocky Mountain Dealerships Inc. is Canadian-based agriculture equipment dealer with a network of full-service agriculture and industrial equipment stores across the Canadian Prairie Provinces. The Company operates in two segments: agriculture segment and industrial segment. The agriculture segment primarily includes sales of agricultural equipment, parts and services, and the industrial segment includes sales of industrial equipment, parts and services. Through its subsidiaries, the Company sells, leases, and provides product and warranty support for a range of agriculture and industrial equipment in Western Canada.

Titan Machinery Inc.

Titan Machinery Inc. owns and operates a network of service agricultural and construction equipment stores in the United States and Europe. The Company engages in four principal business activities: new and used equipment sales; parts sales; repair and maintenance services, and equipment rental and other activities. It provides in-store and on-site repair and maintenance services. It also rents equipment and provides ancillary services, such as equipment transportation, global positioning system signal subscriptions, and finance and insurance products.

Ritchie Bros Auctioneers Inc.

Ritchie Bros Auctioneers Inc is a Canadian-based holding company. The Company is an industrial auctioneer and used equipment distributor, selling used equipment, and other assets. It offers subscriptions to equipment dealers, brokers, exporters and equipment manufacturers to list equipment available for sale at a listed price. The Company also, through Mascus, provides online advertising services, business tools and solutions.

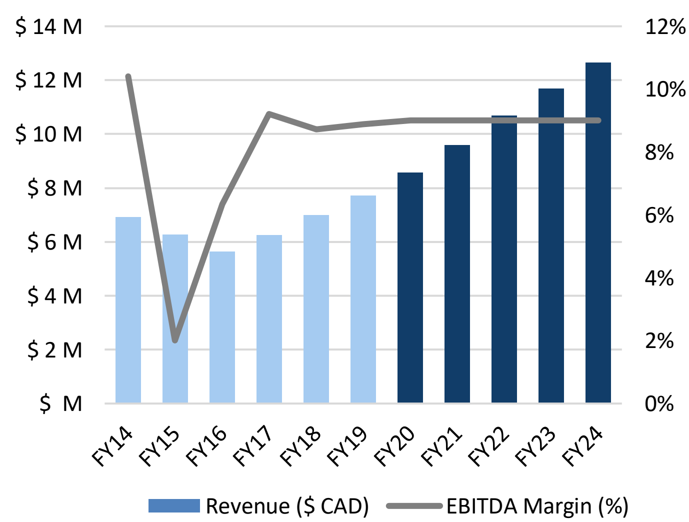
Discounted Cash Flow

Revenue

We expect Finning's revenue to gradually increase overtime, as they continue to grow in their respective geographies, continue to acquire smaller players as well as take advantage of Western Canada's large LNG opportunity. We have driven their New Equipment segment's growth through backlog growth in which we project backlog to grow by 100 million units, with dollar per unit of backlog remaining steady at historic average of $0.70 CAD per quarter ($2.80 CAD per year). This growth in backlog is forecasted due to expected growth in Finning's markets and continuous expansion of equipment lines from CAT. Other segments have been driven by historic growth averages as Finning reports very few sales metrics.

Historic and Forecasted Revenue and EBITDA Margin

2014 - 2024



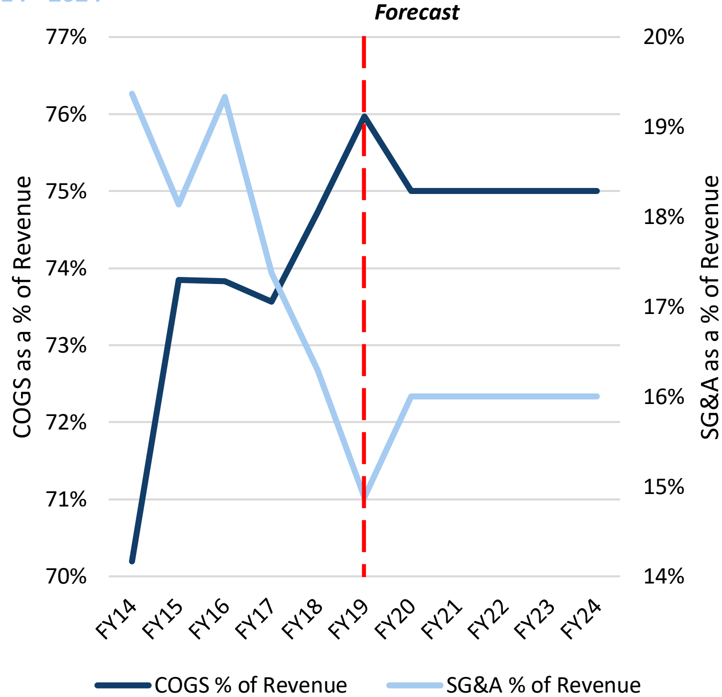
Source: Company Filings and BDC Analysis

Costs

Finning's COGS as a percentage of revenue have seen an increase over the past 5 years, from 70.2% in FY14 to 74.7% in FY18. This has mostly been due to falling commodity prices over the past 5 years which has put a strain on Finning sales volume and in turn, has increased COGS. Hence, we have decided to maintain a conservative approach and have forecasted COGS as a percentage of revenue to be 75% over the next 5 years, higher than the past 5-year average. In addition, as opposed to COGS, SG&A as a percentage of revenue has seen a decrease over the past 5 years, falling from 19.4% in FY14 to 16.3% in FY18. Falling SG&A has mostly been due to strong cost control by management regarding overhead costs and other indirect expenses. Moving forward, we have forecasted SG&A as a percentage of revenue to remain at 16%, as per Finning's last year average SG&A as a percentage of revenue.

Historic and Forecasted COGS and SG&A

2014 - 2024



Source: Company Filings and BDC Analysis

Capital Expenditures

We believe Finning will continue to grow inorganically in the future, as it expands in its geographic regions and continues to acquire smaller brands. Thus, we have forecasted CAPEX as a percentage of PP&E to be 20% in the upcoming years. This slightly higher number than the 5-year average is in place due to our belief that there is still large room for growth in Finning's underdeveloped markets and thus, the Company will continue to expand inorganically.

Weighted Average Cost of Capital

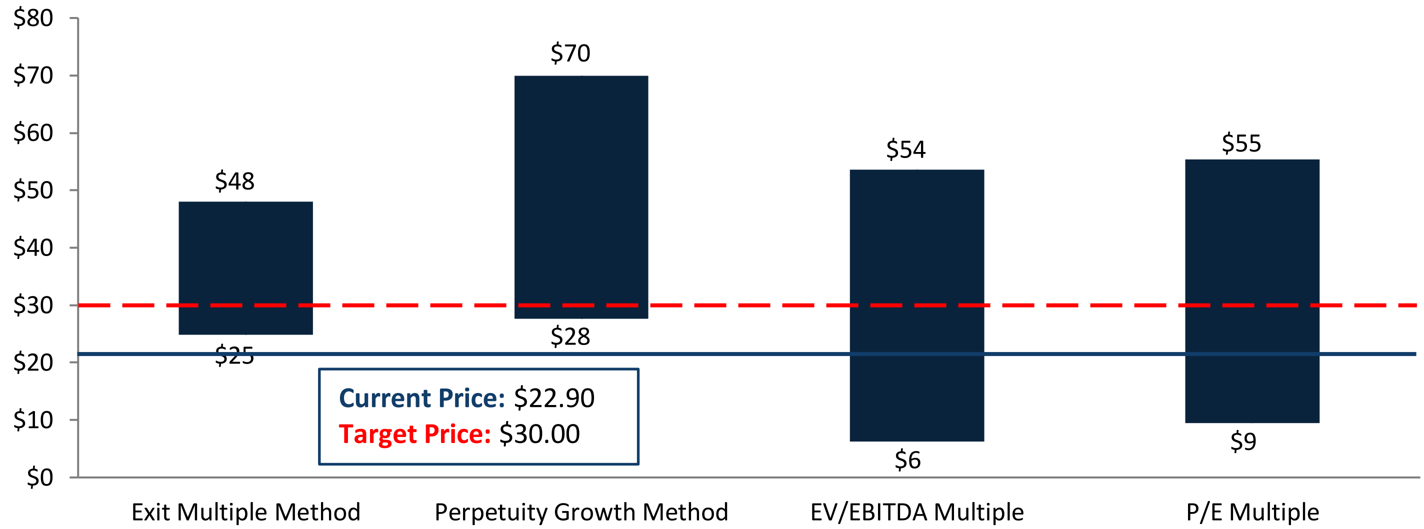
In determining Finning's weighted average cost of capital (WACC), numbers were taken from Bloomberg. Cost of equity was determined by using a risk-free rate of 1.28% and an expected market return of 9.19%. A beta of 1.19 was used to calculate the calculate an overall cost of equity of 10.7%. In determining the cost of debt, a pre-tax cost of debt of 2.79% was used as per the interest rate the firm currently has on their long-term-debt, while the effective tax rate used was 28.99% as per Bloomberg. This concluded with a 1.99% cost of debt and an overall 7.36% WACC.

Dividend Policy

Finning has increased dividends by an average of $0.03 CAD per year. Due to future macro economic uncertainty and the potential for finning to spend more on CAPEX to expand in its underdeveloped markets as well as grow in the LNG space, we believe this increase will not continue at its current pace. Thus, we have increased dividends at a smaller rate compared to historic levels, at only $0.01 increases through 2020 to 2024.

Weighted Price Target

We have chosen to weigh our implied share price based on the EV/EBITDA basis multiple and the perpetuity growth multiple from our DCF as well as the PE/EBITDA multiple and the EV/EBITDA multiple from our comps, all weighted at 25%. This results in a share price of $30.00 per share. We initiate a **buy** rating on Finning International.



Source: BDC Analysis

Recommendation

We believe that Finning is currently slightly undervalued by the market. It's strong ROIC growth and cost control has been overshadowed by South American ERP troubles, resulting in a 20%+ 1-year share price drop. However, with a large upcoming multi billion-dollar LNG opportunity in western Canada, and its south American operations once again operating at full capacity, Finning presents a long-term opportunity for investors looking to add stable and solid industrial exposure into their portfolio.

Based on our Discounted Cash Flow model and our Comparable Companies Analysis, we determine a fair share price of $30.00. We initiate a **buy** rating on Finning International Inc.

Risks

Distributed Agreements

More than 90% of Finning's business involves Caterpillar products. We note that the dealership agreements with Caterpillar can be terminated on 90 days' notice in Canada and South America and six months' notice in the UK. We note that Finning has had a long-standing relationship with Caterpillar (since 1933 or 80+ years), and hence, we expect the distributor arrangement to continue going forward. However, there is always a possibility that turbulent business conditions could aversely affect Caterpillar and Finning relationships. If this were to occur, Finning could face a large concentration risk and potential client adversity.

Commodity Prices

Finning's customers principally exist in the natural resources and construction industries, where commodity prices strongly impact company operations. In Canada, the Company's customers are exposed to the price of oil, mostly in the oil sands in Northern Alberta. In South America, the Company's customers are primarily exposed to the price of copper and, to a much lesser extent, the prices of gold, other metals, and natural gas. In the UK & Ireland, the Company's resource sector customers operate in thermal coal and off-shore oil & gas. Significant fluctuations in these commodity prices could have a material impact on the Company's financial results.

Foreign Exchange Risk

The Company is geographically diversified, with significant investments in several different countries. The Company transacts business in multiple currencies, the most significant of which are the CAD, USD, GBP, CLP, and ARS. Political uncertainty can strongly impact company operations, such as recent fluctuations in the GBP due to BREXIT uncertainties.

Legal Disclaimer

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Appendix 1: Model Summary

	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18	Dec-19	Dec-20	Dec-21	Dec-22	Dec-23	Dec-24
(Figures in mm CAD)	**FY2014**	**FY2015**	**FY2016**	**FY2017**	**FY2018**	**FY2019**	**FY2020**	**FY2021**	**FY2022**	**FY2023**	**FY2024**
Income Statement											
Revenue	**6,918.0**	**6,275.0**	**5,628.0**	**6,256.0**	**6,996.0**	**7,712.9**	**8,564.7**	**9,588.3**	**10,673.9**	**11,692.2**	**12,643.8**
EBITDA	**720.0**	**126.0**	**357.0**	**576.0**	**610.0**	**685.9**	**770.8**	**862.9**	**960.7**	**1,052.3**	**1,137.9**
Net Income	**318.0**	**(161.0)**	**65.0**	**216.0**	**232.0**	**226.7**	**302.5**	**379.6**	**466.9**	**547.9**	**622.8**
Earnings Per Share	**1.84**	**(0.94)**	**0.38**	**1.28**	**1.38**	**1.39**	**1.85**	**2.32**	**2.86**	**3.35**	**3.81**
Cash Flow Statement											
Capital Expenditures	**(81.0)**	**(76.0)**	**(92.0)**	**(121.0)**	**(201.0)**	**(150.1)**	**(165.5)**	**(154.0)**	**(136.7)**	**(121.3)**	**(107.7)**
Acquisitions	**(14.0)**	**(243.0)**	**-**	**-**	**-**	**(229.0)**	**-**	**-**	**-**	**-**	**-**
Divestitures	**18.0**	**22.0**	**22.0**	**3.0**	**19.0**	**2.0**	**-**	**-**	**-**	**-**	**-**
Dividend Payment	**(118.0)**	**(124.0)**	**(123.0)**	**(125.0)**	**(133.0)**	**(131.3)**	**(130.6)**	**(132.3)**	**(133.9)**	**(135.5)**	**(137.2)**
Dividend Per Share	**0.69**	**0.73**	**0.73**	**0.75**	**0.79**	**0.81**	**0.80**	**0.81**	**0.82**	**0.83**	**0.84**
Dividend Payout to Earnings	**37.1%**	**-77.0%**	**189.2%**	**57.9%**	**57.3%**	**57.9%**	**43.2%**	**34.8%**	**28.7%**	**24.7%**	**22.0%**
Dividend Payout to Core FCF	**18.3%**	**32.7%**	**36.6%**	**26.5%**	**23.6%**	**23.5%**	**18.0%**	**17.1%**	**16.4%**	**15.8%**	**15.3%**
Dividend Yield	**2.4%**	**3.4%**	**3.3%**	**2.6%**	**2.7%**	**3.4%**	**3.5%**	**3.5%**	**3.6%**	**3.6%**	**3.7%**
Balance Sheet											
Current Assets	3,477.0	3,460.0	3,378.0	3,531.0	3,924.0	4,326.7	4,807.7	5,378.3	6,040.6	6,758.0	7,525.4
Non-Current Assets	1,796.0	1,648.0	1,532.0	1,538.0	1,772.0	2,205.3	2,112.2	2,025.6	1,948.7	1,880.4	1,819.8
Assets	**5,273.0**	**5,108.0**	**4,910.0**	**5,069.0**	**5,696.0**	**6,532.0**	**6,919.9**	**7,403.8**	**7,989.3**	**8,638.4**	**9,345.2**
Current Liabilities	1,372.0	1,243.0	1,233.0	1,545.0	1,992.0	2,597.6	2,813.6	3,050.3	3,302.7	3,539.4	3,760.7
Non-Current Liabilities	1,770.0	1,815.0	1,776.0	1,550.0	1,595.0	1,837.0	1,837.0	1,837.0	1,837.0	1,837.0	1,837.0
Liabilities	**3,142.0**	**3,058.0**	**3,009.0**	**3,095.0**	**3,587.0**	**4,434.6**	**4,650.6**	**4,887.3**	**5,139.7**	**5,376.4**	**5,597.7**
Shareholders' Equity	**2,131.0**	**2,050.0**	**1,901.0**	**1,974.0**	**2,109.0**	**2,097.4**	**2,269.3**	**2,516.6**	**2,849.6**	**3,261.9**	**3,747.5**
Cash	**450.0**	**475.0**	**593.0**	**458.0**	**454.0**	**628.4**	**698.3**	**818.5**	**1,000.4**	**1,267.2**	**1,613.5**
Debt	**1,425.0**	**1,665.0**	**1,489.0**	**1,314.0**	**1,508.0**	**2,322.0**	**2,322.0**	**2,322.0**	**2,322.0**	**2,322.0**	**2,322.0**
Net Debt	**975.0**	**1,190.0**	**896.0**	**856.0**	**1,054.0**	**1,693.6**	**1,623.7**	**1,503.5**	**1,321.6**	**1,054.8**	**708.5**
Minority Interests	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Debt/EBITDA	**1.4 x**	**9.4 x**	**2.5 x**	**1.5 x**	**1.7 x**	**2.5 x**	**2.1 x**	**1.7 x**	**1.4 x**	**1.0 x**	**0.6 x**
Operating Metrics											
Return on Equity (ROE)	**14.9%**	**-7.9%**	**3.4%**	**10.9%**	**11.0%**	**10.8%**	**13.3%**	**15.1%**	**16.4%**	**16.8%**	**16.6%**
Return on Assets (ROA)	**6.0%**	**-3.2%**	**1.3%**	**4.3%**	**4.1%**	**3.5%**	**4.4%**	**5.1%**	**5.8%**	**6.3%**	**6.7%**
Return on Invested Capital (ROIC)	**10.3%**	**-5.2%**	**16.2%**	**3.7%**	**2.7%**	**2.7%**	**3.5%**	**3.6%**	**14.1%**	**16.5%**	**19.1%**
Valuation Metrics											
Stock Price (High)	33.39	25.64	27.48	32.62	35.56	26.40	22.90	22.90	22.90	22.90	22.90
Stock Price (Low)	23.09	17.58	16.75	23.98	22.84	21.34	22.90	22.90	22.90	22.90	22.90
Stock Price (Average)	28.24	21.61	22.12	28.30	29.20	23.87	22.90	22.90	22.90	22.90	22.90
Diluted Shares Outstanding (Average)	173.0	171.1	169.1	168.5	168.5	163.5	163.4	163.4	163.4	163.4	163.4
Market Capitalization (Average)	4,884.6	3,698.4	3,740.5	4,769.8	4,921.5	3,902.4	3,740.9	3,740.9	3,740.9	3,740.9	3,740.9
Enterprise Value (Average)	5,859.6	4,888.4	4,636.5	5,625.8	5,975.5	5,596.0	5,364.6	5,244.4	5,062.5	4,795.7	4,449.4
P/E	**15.4 x**	**n/a**	**57.5 x**	**22.1 x**	**21.2 x**	**17.2 x**	**12.4 x**	**9.9 x**	**8.0 x**	**6.8 x**	**6.0 x**
EV/EBITDA	**8.1 x**	**38.8 x**	**13.0 x**	**9.8 x**	**9.8 x**	**8.2 x**	**7.0 x**	**6.1 x**	**5.3 x**	**4.6 x**	**3.9 x**
FCF Yield to Market Capitalization	**10.6%**	**4.2%**	**11.9%**	**6.5%**	**3.9%**	**4.7%**	**7.0%**	**8.4%**	**10.1%**	**12.5%**	**14.7%**
FCF Yield to Enterprise Value	**8.9%**	**3.2%**	**9.6%**	**5.5%**	**3.2%**	**3.3%**	**4.9%**	**6.0%**	**7.5%**	**9.7%**	**12.3%**

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Appendix 2: Discounted Cash Flow Analysis

(Figures in mm CAD)	*Dec-14* FY2014	*Dec-15* FY2015	*Dec-16* FY2016	*Dec-17* FY2017	*Dec-18* FY2018	*Mar-19* Q1-2019	*Jun-19* Q2-2019	*Sep-19* Q3-2019	*Dec-19* Q4-2019	*Dec-19* FY2019	*Dec-20* FY2020	*Dec-21* FY2021	*Dec-22* FY2022	*Dec-23* FY2023	*Dec-24* FY2024
WACC Calculations															

Cost of Equity	
Risk-free rate	1.3%
Expected market return	9.2%
Market Risk Premium	**7.9%**
Beta	1.19
Cost of Equity	**10.7%**

Cost of Debt	
Pre-tax cost of debt	2.8%
Effective tax rate	29.0%
Cost of Debt	**2.0%**

WACC	
Market value of equity	3,741
Market value of debt	2,322
Total Capitalization	6,062.9
Cost of equity	10.7%
Cost of debt	2.0%
WACC	**7.4%**

Free Cash Flow	FY2014	FY2015	FY2016	FY2017	FY2018	Q1-2019	Q2-2019	Q3-2019	Q4-2019	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024
EBIT	504.0	(105.0)	165.0	392.0	423.0	62.0	137.0	95.6	102.5	397.1	512.2	622.3	747.0	862.7	969.7
Less: Tax expense	(101.0)	29.0	(15.0)	(76.0)	(115.0)	(10.0)	(22.0)	(27.7)	(29.7)	(115.1)	(148.5)	(180.4)	(216.6)	(250.1)	(281.1)
Add: Depreciation and amortization	216.0	231.0	192.0	184.0	187.0	72.0	76.0	71.4	69.4	288.8	258.6	240.7	213.6	189.6	168.3
Less: Capital expenditures	(81.0)	(76.0)	(92.0)	(121.0)	(201.0)	(23.0)	(37.0)	(45.7)	(44.4)	(150.1)	(165.5)	(154.0)	(136.7)	(121.3)	(107.7)
Less: Change in net working capital	(18.0)	76.0	196.0	(67.0)	(103.0)	(372.0)	(236.0)	418.4	(46.1)	(235.7)	(195.1)	(213.8)	(228.0)	(213.8)	(199.8)
Unlevered Free Cash Flow	**520.0**	**155.0**	**446.0**	**312.0**	**191.0**	**(271.0)**	**(82.0)**	**511.9**	**51.7**	**185.0**	**261.7**	**314.7**	**379.4**	**467.0**	**549.3**
Discount factor						-		0.25	0.50	0.50	1.50	2.50	3.50	4.50	5.50
Present Value of Unlevered Free Cash Flow						**-**		**502.9**	**49.9**	**552.9**	**236.8**	**263.6**	**295.9**	**339.3**	**371.8**

Discounted Cash Flow Valuations

Perpetuity Growth Method	
Perpetuity Growth Rate	2.0%
PV sum of unlevered FCF	2,060
Terminal value	6,953
Enterprise Value	**9,014**
Add: Cash	160.0
Less: Debt	2,322
Less: Other EV adjustments	
Equity Value	**6,852**
Shares outstanding	163.4
Implied Share Price	**$ 41.94**
Current Price	$ 22.90
Implied Price	**$ 41.94**
Total Return	**83.2%**

Exit Multiple Method	
Terminal EV/EBITDA Multiple	7.9 x
PV sum of unlevered FCF	2,060.3
Terminal value	6,106.7
Enterprise Value	**8,167.0**
Add: Cash	160.0
Less: Debt	2,322.0
Less: Other EV adjustments	-
Equity Value	**6,005.0**
Shares outstanding	163.4
Implied Share Price	**$ 36.76**
Current Price	$ 22.90
Implied Price	**$ 36.76**
Total Return	**60.5%**

Perpetuity Growth Rate \ WACC	8.36%	7.86%	7.36%	6.86%	6.36%
1.00%	$ 28.51	$ 31.63	$ 35.25	$ 39.49	$ 44.53
1.50%	$ 30.66	$ 34.18	$ 38.31	$ 43.22	$ 49.14
2.00%	$ 33.14	$ 37.16	$ 41.94	$ 47.71	$ 54.81
2.50%	$ 36.05	$ 40.71	$ 46.33	$ 53.24	$ 61.96
3.00%	$ 39.51	$ 44.98	$ 51.71	$ 60.20	$ 71.23

Terminal EV/EBITDA Multiple \ WACC	8.36%	7.86%	7.36%	6.86%	6.36%
5.9 x	$ 25.62	$ 26.46	$ 27.33	$ 28.22	$ 29.14
6.9 x	$ 30.10	$ 31.06	$ 32.05	$ 33.06	$ 34.11
7.9 x	$ 34.58	$ 35.65	$ 36.76	$ 37.90	$ 39.07
8.9 x	$ 39.06	$ 40.25	$ 41.47	$ 42.74	$ 44.03
9.9 x	$ 43.54	$ 44.85	$ 46.19	$ 47.57	$ 49.00

Appendix 3: Company Comparables Analysis

(Figures in mm CAD)

Company	Ticker	Equity Value	Enterprise Value	2018A EV/EBITDA	2019E EV/EBITDA	2020E EV/EBITDA	2018A P/E	2019E P/E	2020E P/E
				EV/EBITDA Multiple			P/E Multiple		
Toromont Industries Ltd.	(TSX: TIH)	5,151.0	5,675.0	10.9 x	9.9 x	9.2 x	20.6 x	18.4 x	16.3 x
Wajax Corp.	(TSX: WJX)	313.0	695.0	8.1 x	5.4 x	5.3 x	8.8 x	7.7 x	6.9 x
Cervus Equipment Corp.	(TSX: CERV)	143.0	311.0	5.3 x	4.6 x	4.3 x	5.4 x	6.8 x	5.8 x
Rocky Mountain Dealerships Inc.	(TSX: RME)	129.0	190.0	4.2 x	5.9 x	5.0 x	7.7 x	12.8 x	8.7 x
Titan Machinery Inc.	(NASDAQ: TITN)	334.0	724.0	13.4 x	13.9 x	11.7 x	25.9 x	16.3 x	12.9 x
Ritchie Bros Auctioneers Inc.	(TSX: RBA)	4,273.0	4,661.0	17.7 x	15.9 x	14.3 x	48.2 x	40.0 x	34.4 x
Finning International Ltd.	**(TSX: FTT)**	**3,740.9**	**5,902.9**	**9.7 x**	**8.6 x**	**7.7 x**	**16.6 x**	**16.5 x**	**12.4 x**
Median					**7.9 x**	**7.2 x**		**14.6 x**	**10.8 x**
Mean					**9.3 x**	**8.3 x**		**17.0 x**	**14.2 x**
High					**15.9 x**	**14.3 x**		**40.0 x**	**34.4 x**
Low					**4.6 x**	**4.3 x**		**6.8 x**	**5.8 x**

	EV/EBITDA Implied Price		P/E Implied Price	
Median	$ 20.06	$ 20.88	$ 20.19	$ 20.06
Mean	**$ 25.76**	**$ 25.93**	**$ 23.56**	**$ 26.21**
High	$ 53.56	$ 54.44	$ 55.42	$ 63.66
Low	$ 6.26	$ 7.15	$ 9.45	$ 10.65

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