Applied Investment Management (AIM) Program

AIM Class of 2019 Equity Fund Reports
Spring 2018

Date**: Friday, April 27th* | ***Time:** See Schedule Below* | ***Location: AIM Research Room 488

2:45 PM Presenter	**Company Name**	**Ticker**	**Sector**	**Page**
Louisa Steinhafel	Central Garden & Pet Company	CENTA	Consumer Staples	2
Will McMahon	CAE, Inc.	CAE	International Industrials	5
Stephen Lane	Seven & I Holdings, Co., Ltd	SVNDF	International Consumer Staples	8
Connor Darrow	Mercer International Limited	MERC	International Materials	11
Mon 4/30 9:00 AM Presenter	**Company Name**	**Ticker**	**Sector**	**Page**
Charlie Maleki	Kennametal, Inc.	KMT	Industrials	14

These student presentations are an important element of the applied learning experience in the AIM program. The students conduct fundamental equity research and present their recommendations in written and oral format – with the goal of adding their stock to the AIM Equity Fund. Your comments and advice add considerably to their educational experience and is greatly appreciated. Each student will spend about 5-7 minutes presenting their formal recommendation, which is then followed by about 8-10 minutes of Q & A.

David S. Krause, PhD
Director, Applied Investment Management Program
Marquette University
College of Business Administration, Department of Finance
436 Straz Hall, PO Box 1881
Milwaukee, WI 53201-1881

mailto: AIM@marquette.edu

Website: MarquetteBuz/AIM AIM Blog: AIM Program Blog
Twitter: Marquette AIM Facebook: Marquette AIM

Central Garden & Pet Company Class A (CENTA)
April 27, 2018

Louisa Steinhafel — Domestic Consumer Staples

Central Garden & Pet Company (NASDAQ: CENTA) is a producer and distributor of private label and branded products for the lawn, garden, and pet supplies markets in the United States. They operate through two segments: Pet and Garden & Lawn. The Pet segment accounts for 61% of their total revenue and includes products such as bird and small animal food, aquarium products, flea, mosquito, tick, and other pest control products. Their Garden & Lawn segment accounts for the other 39% of revenue and consists of products such as grass seed, bird feeders, weed and insect control, wild bird feed, and patio appliances. Their products fall under the main categories of pet supplies, wild bird feed, garden controls and fertilizer products, other garden supplies, and grass seed. CENTA was founded in 1980 by William E. Brown and is headquartered in Walnut Creek, CA.

Price ($):	39.31
Price Target ($):	49.48
52WK H-L ($):	41.34 - 28.12
Market Cap (mil):	1949.00
Insider Holdings (%)	7.31
Avg. Daily Vol:	218498.60
Yield (%):	0.00
ESG Rating	B

Beta:	0.77
M-Term Rev. Gr Rate Est:	8.40%
M-Term EPS Gr Rate Est:	11.29%
Debt/Equity (%):	62.10
Debt/EBITDA (ttm):	1.99
WACC (%)	7.67
ROA (%):	6.34
ROE (%):	13.26
ROIC (%):	9.72

FY: Sep	09/31/2016	09/31/2017	09/31/2018	09/31/2019
Revenue (Mil)	1,829.02	2,054.48	2,267.35	2,457.72
% Growth	10.80%	12.33%	10.36%	8.40%
Oper Inc	129.36	156.11	158.69	173.25
% Growth	41.48%	20.68%	1.65%	9.18%
Op Margin	7.07%	7.60%	7.00%	7.05%
EPS ($)	0.87	1.52	1.71	1.92
P/E (Cal)	45.18	25.86	22.98	20.50
EV/EBITDA	9.44	11.96	10.85	10.11

Recommendation

Central Garden & Pet Company was founded in 1980 as a distribution company. Over time, they have been able to develop a strong portfolio of leading brands in the pet supplies and garden industries due to more than 50 strategic acquisitions over the past 25 years. Some of their top customers include Walmart, Lowe's Companies, Home Depot, Costco Wholesale, and PetSmart. CENTA's Garden & Lawn segment is comprised of Garden Controls/Fertilizers at 17% of revenues and other Garden Supplies at 22%. CENTA participates in $19 billion of the $28 billion gardening industry and their sales from this segment alone have seen an 8% organic revenue growth rate in 2017. Their leading brand name and private label products have helped them continue to achieve widespread market share gains. CENTA also participates in the pet supplies industry - which is comprised of their Dog and Cat Products at 20% of revenues and Other Pet Products at 41%. CENTA participates in $28 billion of the estimated $56 billion annual pet supplies industry. The Pet Supplies segment saw a 15% revenue growth rate in 2017 and a 5% organic growth rate. Both segments offer a broad, unique product portfolio. Over the last three years, CENTA's net sales have been growing at a CAGR of 9.5%, while their diluted EPS have grown at a three-year CAGR of 65.7%. Due to generational changes, the pet industry has been booming over the past decade, with household pet ownership hitting 68% in 2016. Overall pet expenditures have hit $99 billion, up 35% from 2009. Today's owners are now spending more per pet than they ever have before. In 2014, pet food sales were around $22 billion, nearly doubling what they were in 2000. Although packaged foods are expected to grow at a five-year CAGR of 1.3%, pet food sales are expected to grow at 2.5%. With the Baby Boomers, Generation Xers, and Millennials all moving towards increased humanization of pets and higher per pet spending levels, CENTA stands to benefit significantly. For the above reasons, it is recommended that Central Garden & Pet be added to the AIM Equity Fund with a price target of $49.48, which represents a 25.86% upside. The firm does not presently pay a dividend.

Investment Thesis

- **Clear as a Bell.** In March 2018, CENTA announced that it would be acquiring Bell Nursery Holdings, LLC, which is the largest commercial grower of live plants and flowers in the mid-

Atlantic region. Although the financial terms related to the deal have not yet been announced, they are expected it to be accretive in FY 2018. This as an exciting opportunity for the firm to expand into the live plant area. The addition of Bell Nursery closely aligns with CENTA's existing garden products such as pottery, soil, and fertilizer and presents them with the ability to cross sell the live plants with their own brands. Bell Nursery is known for their strong customer service and management team which will be staying on with CENTA in order to grow their profitability in the coming years.

- **Midwest Expansion.** CENTA also announced in March 2018 that they intend on acquiring General Pet Supply, a leading Midwest region supplier of pet supplies and food. The deal is expected to go through in April 2018. Having previously partnered together within regions of the country, CENTA will strength their presence in this area of the U.S. via their General Pet Supply acquisition. Through this acquisition, the firm will obtain increased distribution capabilities, further exposure to the veterinary channel, and a stronger presence in the Midwest where it previously had limited channels.
- **Store Within-a-Store.** Another interesting growth opportunity lies with CENTA's store within-a-store initiative with Kroger that the firm is currently in the process of rolling out. They have signed on with Kroger to control their entire pet products section, including merchandising, inventory, and distribution. In creating their own Central Garden & Pet section within another major store, they have increased opportunities for higher margins and profitability. Upon successful integration with Kroger, CENTA is expected to make similar agreements with other major retailers.

Valuation

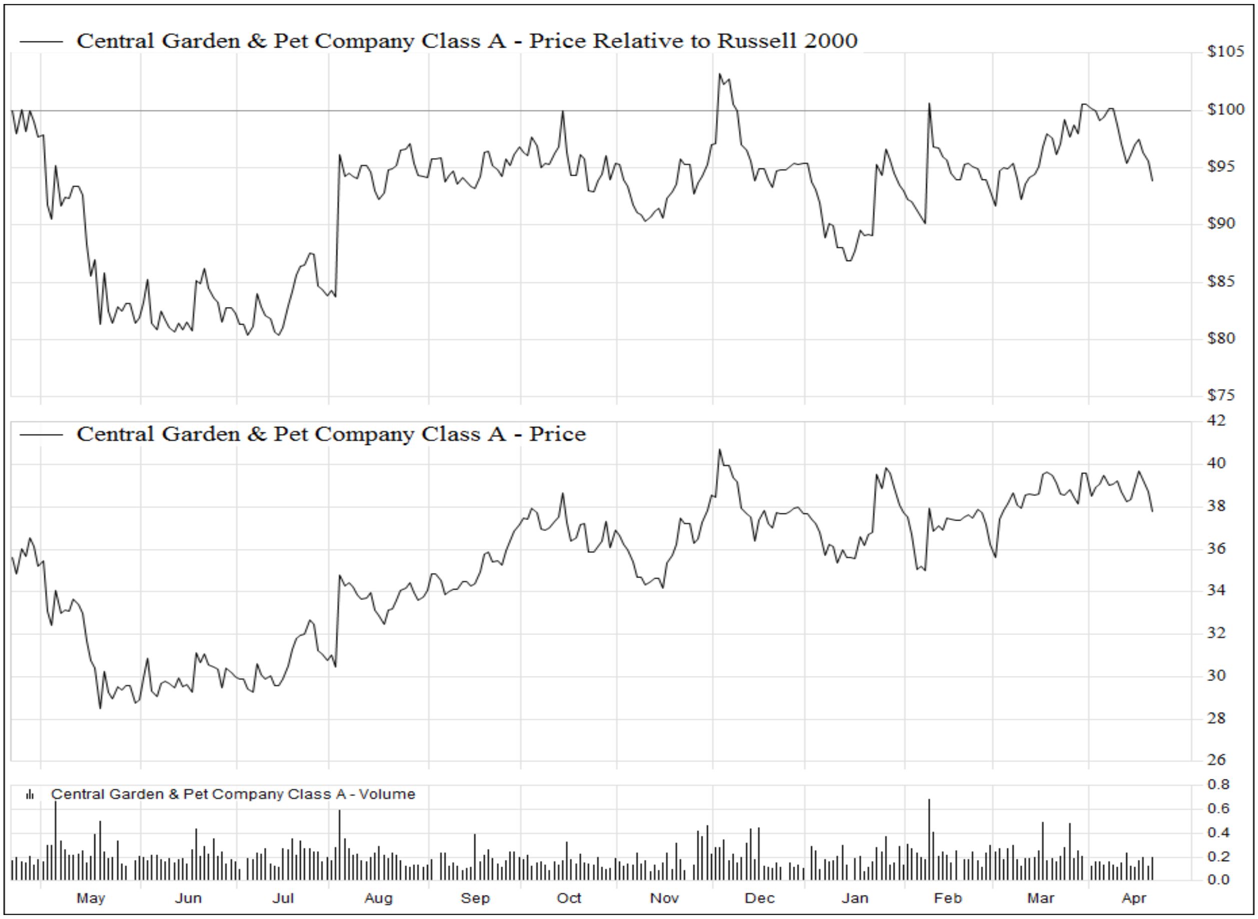
In order to reach an intrinsic value for CENTA, a five-year DCF model was constructed. Using a terminal growth rate of 2.5% and a WACC of 7.67%, an intrinsic value of $49.64 was reached. A sensitivity analysis on the terminal growth rate and the WACC +/-.50% resulted in a range from $46.84 - $52.56. Next, a P/E multiple valuation was created using a peer average of 32.69x and a 2017 EPS of $1.52. An intrinsic value of $49.70 was reached. Additionally, an EV/EBITDA multiple valuation was calculated. A peer average EV/EBITDA multiple of 14.08x was used, resulting in an intrinsic value of $48.77. By weighting the three models 60/20/20, a price target of $49.48 was reached resulting in a 25.86% potential upside. The firm does not pay a dividend.

Risks

- **Commodity Product Volatility:** CENTA's financial performance is partially dependent on the cost of raw materials and their ability to pass along price increases to their customers. This particularly effects commodity seeds and grains that are used to make bird feed. To mitigate this risk, they have entered into purchase contracts for bird feed, grass, and grains.
- **Seasonality.** Although CENTA's Pet segment sees sales year-round, their lawn and garden sales tend to be highly seasonal and susceptible to adverse weather. Lengthened winters during their prime selling months have the ability to slow down revenues.
- **Customer Dependence:** Home Depot, Costco, Lowe's, and PetSmart in combination with Walmart make up about 44% of CENTA's net sales. Should anything happen to any one or several of these relationships, CENTA could take a large hit to their revenues.

Management

George C. Roeth has been the President and CEO of Central Garden & Pet Company for the last three years. He previously was the EVP and Chief Operating Officer- Household & Lifestyle for The Clorox Co. and received his MBA from the Kellogg School of Management. Nicholas Lahanas is the CFO of CENTA. He was previously employed as a Vice President at YA Global Investments and Yorkville Advisors LLC. Michael A. Reed and Kay Schwichtenberg both act as Executive Vice Presidents.



Source: FactSet

Peer Fundamentals

Name	Ticker	Revenues	ROE	ROA	Debt/Equity	Est 5 yr NI Growth (%)
Central Garden & Pet Co.	CENTA	2,054	13.26	6.34	62.10	3.98
Spectrum Brands Holdings, Inc.	SPB	5,007	16.26	4.08	208.97	9.00
Scotts Miracle-Gro Company Class	SMG	2,642	29.00	7.12	215.95	-1.30
Abaxis, Inc.	ABAX	227	10.31	8.99	0.12	7.70
PetMed Express, Inc.	PETS	249	31.58	27.43	*	0.90
Peer Averages		2,031	21.79	11.91	141.68	4.08

*Excluded due to lack of long-term debt

Source: FactSet

Peer Valuation

Name	Ticker	Market Cap (mil)	P/S	P/E	EV/EBITDA	P/B
Central Garden & Pet Co.	CENTA	1949	0.94	25.86	11.96	3.03
Spectrum Brands Holdings, Inc.	SPB	5499	1.25	19.81	11.54	3.32
Scotts Miracle-Gro Company Class	SMG	4750	2.22	26.64	13.86	8.72
Abaxis, Inc.	ABAX	1644	4.50	60.37	18.14	3.66
PetMed Express, Inc.	PETS	713	2.58	23.96	12.79	6.55
Peer Averages		3151	2.64	32.69	14.08	5.56

Source: FactSet

CAE, Inc. (CAE)
April 27, 2018

William McMahon — International Industrials

CAE, Inc. (NYSE: CAE) provides simulation and modeling technologies and training services to the civil aviation, defense, healthcare, and mining markets. With the recent release of the CAE 7000XR Series FFSs and CAE Simfinity procedures trainers, the company is poised to take advantage of their strong competitive moat, which is defined by their extensive global training network, best-in-class instructors, comprehensive training programs, and strength in training partnerships with airlines and business aircraft operators. CAE operates through the following segments: Civil Aviation Training Solutions (57.6% of revenue), Defense & Security (38.3%), and Healthcare (4.1%). The company's leading position in the civil and defense markets and solid balance sheet should provide the potential for future cash-deployment opportunities. CAE was founded by Kenneth R. Patrick on March 17, 1947 and is headquartered in Montreal, Canada.

Price ($):	19.74
Price Target ($):	25.97
52WK H-L ($):	19.95 - 15.06
Market Cap (mil):	5,305
Insider Holdings	0.15%
Avg. Daily Vol (mil):	0.17
Yield (%):	1.41%
ESG Rating	AAA

Beta:	0.88
M-Term Rev. Gr Rate Est:	8.06%
M-Term EPS Gr Rate Est:	10.00%
Debt/Equity (%):	65.06
Debt/EBITDA (ttm):	2.52
WACC	8.58%
ROA (%):	6.02%
ROE (%):	15.69%
ROIC (%):	9.67%

FY: Mar	03/31/2017A	3/31/2018E	3/31/2019E	3/31/2020E
Revenue (Mil)	2,134.49	2,213.81	2,362.19	2,473.07
% Growth	7.64%	7.68%	6.00%	4.06%
Oper Inc	315.85	352.24	401.56	425.95
% Growth	9.82%	11.52%	14.00%	6.07%
Op Margin	14.80%	15.91%	17.00%	17.22%
EPS*	$0.76	$0.97	$1.03	$1.09
P/E (Cal)	25.5	20.0	18.91	17.76
EV/EBITDA	13.64	11.65	10.13	9.32

Recommendation

According to a forthcoming CAE internal market study, approximately 255,000 new airline pilots will be needed over the next ten years to sustain the growth of the commercial air transport industry and to support upcoming pilot retirements. In support of this growth, the aviation industry will require innovative solutions to match the learning requirements of a new generation, leading to an increase in demand for simulation-based training services and products. For civil (where CAE maintains a 70% market share despite strong competition), the pilot shortage and strong traffic growth remain a recurring theme. Civil EBIT margin has continued to improve since 2014 and has the potential to reach 19-20% in the long term based on further operating leverage and higher utilization rates. For defense, following some challenging years when defense budgets were under pressure, the outlook appears to be strong across all three key markets. First, Canada is expected to increase its funding over the next 10 years to C32.7b in 2026-27; secondly the US recently authorized a bill to boost federal spending by almost US$300b over the next two years; and finally NATO countries have committed to increasing their defense spending closer to 2% of GDP. While services tend to be less profitable, the market for services and training systems integrations is sizeable and requires lower risk and capital expenditures. While the healthcare division is not much larger than 4% of revenue currently, there is opportunity to double the sales volume and improve margins over the next five years. Management continues to see positive results and future opportunities spanning from its platform dedicated to nursing education, Juno. Alongside the technological advances the segment is making, CAE's recent partnerships with the American Heart Association and the American Society of Anesthesiologists, will help the company gain recognition for its products, which should translate into new business with other medical organizations. While these are all pragmatic characteristics for the investment theme, uniquely CAE has evolved over the years with less debt, improved profitability for the civil segment, and improved ROCE. EBIT margin has expanded to 18-19% well below management's optimal guided level of 35-45%. At the same time, net debt/capital has improved from 49% at the end of 2Q'13 to 25% at the end of 3Q'18. Despite CAE's impressive growth history, the company continues to demonstrate momentum with over C$4.0b of active proposals submitted and pending customer decisions. Driven by these factors it is recommended that CAE, Inc. be added to the AIM International Fund with a price target of $25.97, representing a 33.67% upside.

Investment Thesis

- **Strong Backlog Provides Clear Revenue Visibility.** CAE's backlog has persisted to C$7.4b (from C$6.7b), driven by an impressive book-to-bill in the civil segment (2.4x vs 1.4x LTM) while defense lagged (.7x vs 1.1x LTM). The defense segment slowdown was mostly related to normal budgetary timing issues and shows the continued demand for new orders. CAE also sold 26 Full Flight Simulators during 3Q'18 which provides CAE with three years of revenue visibility.
- **Increase in Utilization Rates of Synthetic Training.** Airlines, defense forces, and governments are increasingly adopting synthetic training for a greater percentage of their overall approach, because it improves training effectiveness, reduces operational demands on aircraft, lowers risk compared to operating actual airplane/weapon system platforms, and significantly lowers costs. The U.S. Navy reports that simulation-based training on existing aircraft platforms will increase to 50% by 2020, and programs for new aircrafts have been designed for approximately 70%.
- **Recovery of Operating Margins.** As CAE continues to recognize more revenues and execute on management guidance, the company will better be able to recover previously weakened margins. Management guides an expected recovery of civil operating margins to 19%, military operating margins to 12.5%; and healthcare operating margins to 7%.
- **As Baby Boomers Go, the Rooks Need Training.** In commercial aviation, the aerospace industry's widely held expectation is that long-term average growth for air travel will continue at 4.2% annually over the next decade. CAE generates a high degree of recurring business from its strong position on enduring platforms. Upgrades, updates, and life extension programs allow defense forces to leverage existing assets while creating a range of opportunities for simulator upgrades and training support services.

Valuation

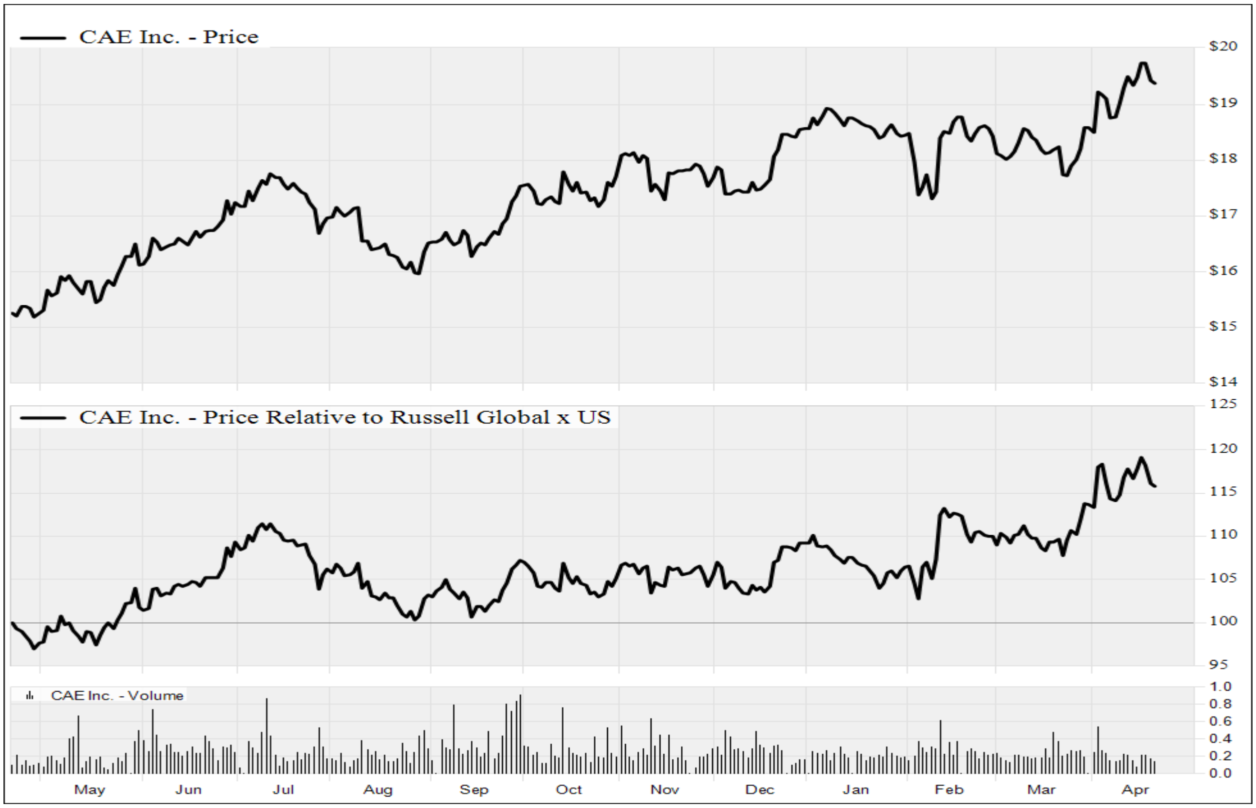
In order to reach an intrinsic value for CAE, a five year DCF model with a bull and bear scenario analysis was constructed. Using a terminal growth rate of 2% and a WACC of 8.58% for both scenarios, an instrinsic value of $27.66 was reached, representing a 42.34% upside for the bull. While, an intrinsic value of $22.19 was reached, representing a 14.20% upside for the bear. A sensitivity analysis on the terminal growth rate and WACC ranged from $17.43 – $33.80. Additionally, a P/E multiple valuation was calculated. Using a 2018 estimated EPS of $0.97 and utilizing a blended average P/E multiple of 26.08x, resulted in an intrinsic value of $25.28. Finally, an EV/EBITDA multiple valuation was conducted using an average EV/EBITDA multiple of 15.42x, resulting in an intrinsic value of $29.81. By weighing the valuation models 30/30/20/20, a price target of $25.97 was reached, which yields a nearly 34% upside. CAE paid a quarterly dividend of $0.28, which equates to a 1.44% yield.

Risks

- **Procurement.** CAE could struggle to find two or more sources for inputs which could lead to onerous licensing terms, high license fees, or even refusal to license the data, parts, and equipment packages that are often required to manufacture and operate a simulator based on an OEM's aircraft.
- **OEM Leverage.** OEM's may employ obstructive actions against CAE to block the product development for such aircraft. Such actions may cause CAE to incur material legal fees and/or may delay or prevent completion of the simulator development project or provision of training services, which may negatively impact our financial results.

Management

Marc Parent was appointed President and CEO. in 2009. Mr. Parent has more than 30 years of experience in the aerospace industry and before joining CAE in 2005, held numerous executive positions within Bombardier Aerospace, leading several facilities and product lines. Since appointment as CEO, the stock has appreciated from $6.58 per share to its current price, representing impressive momentum under his leadership.



Source: FactSet

Name	Ticker	Market Cap (mil)	P/S	P/E	EV/EBITDA	P/B
CAE Inc.	CAE	5,305	1.99	21.81	13.64	2.70
L3 Technologies Inc	LLL	16,793	1.65	23.23	13.87	3.03
Lockheed Martin Corporation	LMT	100,367	1.83	46.60	15.62	--
Northrop Grumman Corporation	NOC	62,377	2.09	26.76	15.23	7.58
Raytheon Company	RTN	65,225	2.16	27.03	14.57	5.44
Rockwell Collins, Inc.	COL	22,134	2.82	27.29	17.82	3.52
		61,191	2.11	30.18	15.42	4.89

Source: FactSet

Name	Ticker	Market Value	ROE	ROA	Debt/Equity	Est 5 yr NI growth
CAE Inc.	CAE	5,305	15.7	6.0	65.1	7.7
L3 Technologies Inc	LLL	16,793	15.6	6.1	65.8	-8.8
Lockheed Martin Corporation	LMT	100,367	465.9	4.1	--	6.7
Northrop Grumman Corporation	NOC	62,377	32.7	6.2	216.6	-2.3
Raytheon Company	RTN	65,225	20.1	6.6	50.7	0.3
Rockwell Collins, Inc.	COL	22,134	17.4	5.5	119.3	7.4
Peer Averages		53,379	110.4	5.7	113.1	0.7

Source: FactSet

Seven & I Holdings Co. Ltd. (SVNDY)
April 27, 2018

Stephen Lane — International Consumer Staples

Seven & I Holdings Co. Ltd. (OTCMKTS: SVNDY) is the world's largest convenience-store chain with over 60,000 stores globally. The company operates in Asia (~69% of 2018 revenue), North America (~29%) and other (~2%). The company is broken down into seven main segments: Convenience Store (~44% of 2018 revenue), Super Store (~35%), Department Store (~15%), Financial (~3%), Mail Order, Food Service, and Other. The Convenience Store segment directly operates and franchises convenience-stores under the name 7-Eleven. The Super Store segment operates general supermarkets and specialty stores. The Department Store segment operates their Sogo and Seibu department store brands. Seven & I Holdings Company was founded on September 1, 2005 and is headquartered in Tokyo, Japan.

Price ($) (4/23/18):	$21.86
Price Target ($):	$25.49
52WK H-L ($):	$22.36-19.18
Market Cap (Mil):	39,246
Insider Holdings	0.53%
Avg. Daily Vol:	58,884
Yield (%):	1.60%
ESG	BBB

Beta:	0.68
WACC:	7.35%
M-Term Rev. Gr Rate Est:	4.07%
M-Term EPS Gr Rate Est:	10.40%
Debt/Equity:	0.27
Debt/EBITDA (ttm):	1.58
ROA:	3.30%
ROE:	7.46%
ROIC:	7.71%

FY: Mar.	FY2018	2019E	2020E	2021E
Revenue (Mil):	$56,151.68	$58,987.34	$61,541.49	$64,046.23
% Growth:	3.46%	5.05%	4.33%	4.07%
Gross Margin:	34.13%	34.38%	34.63%	34.86%
Operating Margin:	6.49%	6.48%	6.73%	6.96%
Net Margin:	3.00%	3.20%	3.44%	3.66%
EPS (Cal):	$1.90	$2.13	$2.39	$2.65
EV/EBITDA:	6.05x	6.34x	5.95x	5.66x
P/E:	21.78x	19.55x	17.21x	16.10x

Recommendation

Since 2013, Seven & I Holdings Co. has established themselves as the largest convenience-store chain and a leader in the ready-to-eat market. They are currently the market share leader in the convenience-store business in Japan, with about 44% of industry sales and 34% of total store sales nationwide. While convenience-stores have stayed relative similar, the world has changed, and SVNDY is well positioned to capitalize on these changes. In Japan, there is an increasing number of single-person households. The average age of marriage has increased, women have begun taking over the workforce and there is aging population. These trends will help drive the demand for prepared foods which is where 7-Eleven excels against its peers. The world has become a fast pace environment and individuals no longer have the time, or desire to make homemade meals every night. In addition, the Japanese society has seen recent trends toward living a healthier lifestyle. The shift in consumer routine and diet creates an opening for 7-Eleven. 7-Eleven provides a quick healthy alternative to fast food and quick service food. 7-Eleven stores are making it a priority to ease the lives of those in their community and to provide them options to live the way in which they want to live. In addition to prime economic trends, the company has made several acquisitions, investments and external partnerships that have improved net margin from 1.66% in FY2017 to 3% in FY2018. SVNDY has also received favorable tax changes and have lowered their cost of goods sold as a percentage of sales. These two factors have allowed the company to carry their increased revenue down to their bottom line. With great economic conditions and prime current internal trajectory, it is recommended that Seven & I Holdings Co. Ltd. be added to the AIM International Equity Fund with a price target of $25.49, which is an upside of 16.61%.

Investment Thesis

- **Upgraded.** For the last several years SVNDY has only focused on expansion, adding over 5,000 stores in just five years. While this has been a key factor in gaining market share it has not allowed them to improve margins. Moving forward, management will shift its focus from quantity back to quality. Management has emphasized that fixing the large variance in store performance is the focus of their mid-term (FY2020) plans. They will be implementing better methods for new location placement and closing or improving underperforming stores. They have lowered their new-store opening target and have increased the amount of store closures. They will reallocate the invested capital to their higher-margin convenience-stores. These performing stores will see a new store layout that will introduce new equipment, increased sales space and new merchandise items. The company aims to add new frozen items such as: fruits, vegetables and meat. In addition, they will be revamping the over-the-counter items. Test stores have already been seeing benefits. The store layout change alone is expected to boost sales per store by ¥15,000 per day. Management has increased their FY2020 target return on invested capital (ROIC) from 11% to 15% because of the consolidation and upgrades. Historically, SVNDY has struggled to keep their ROIC above their cost of capital. With more strategic growth that allows for better returns, achieving a double digit ROIC is likely according to experts. The company will see a boost in per-store sales growth, margins and overall earnings.

- **International Opportunity.** According to Morningstar, the North American convenience-store industry is fragmented, allowing for strong growth opportunities for SVNDY. While the company is already the largest player in the U.S. they only have 5% of total market share. Currently around half of convenience stores in North America are operated by individual or small-business owners (mom-and-pop stores). The company has established a strong presence in North America with logistic and operational efficiency advantages. SVNDY is able to offer differentiated products without direct price competition. Their expected future success will draw these mom-and-pop stores to operate under the 7-Eleven brand. With strategic acquisitions and the conversion of local stores the company will see accelerated overseas growth.
- **From Gorillas to Cyborgs.** The company has plans to release its Seven-Eleven App in June of this year. The App will serve as their mobile reward program. This will allow them to enhance their relationships with customers and make each store visit more customized. They have teamed up with Amazon Cash as well as Nanaco. SVNDY has also started to introduce delivery in Japan to cater to the aging population. In addition, they have introduced new self-check-out technology that will reduce employee costs and improve efficiency. These technological changes will give SVNDY a better way to increase customer contact and marketing accuracy. The company is increasing its consumer base as it moves from pure retail to Omni-channel retail.

Valuation

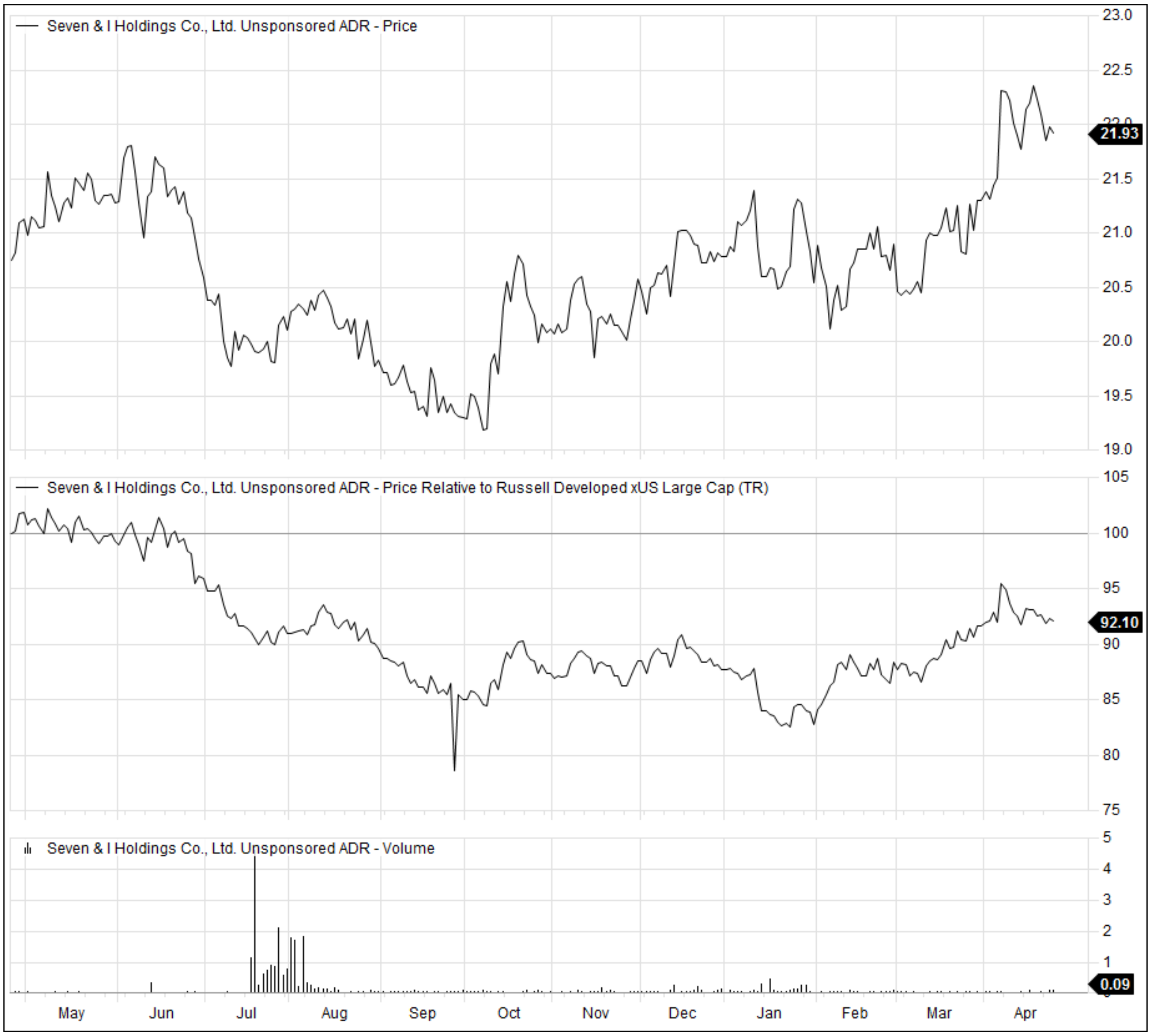
In order to reach an intrinsic value for SVNDY, a five year DCF model was constructed. Using a terminal growth rate of 2.25% and a WACC of 7.35%, an intrinsic value of $23.92 was reached. A sensitivity analysis on the terminal growth rate and WACC ranged from $20.52-26.72. Additionally, a P/E and EV/EBITDA multiples valuation was used. Using a 2019E EPS an intrinsic value of $26.12 was found. Using a peer weighted average multiple of 9.19x resulted in an intrinsic value of $26.44. By weighing the three models equally, a price target of $25.49 was reached, resulting in a 16.61% potential upside. SVNDY pays a dividend yield of 1.6%.

Risks

- **Food Prices.** The global food market has been on the rise due to increased demand. In Japan, more than 60% of the food supply is imported, and any volatility will impact the company.
- **Aging Population.** The Japanese population is aging and causing challenges for the pool of employees available to maintain their 24-hour operation model. In addition, the Japanese population is expected to decline in the next several years lowering the TAM in Japan.
- **Competition.** Consolidation of the domestic convenience-store industry may stir up competition and pressure pricings. This could prompt an increase in marketing costs required by the company.

Management

Ryuichi Isaka has been the President and Representative Director for the last 9 years and has also served on the board of directors. The board contains 24 members 31% of which are independent and has an average tenure around 6 years.



Peer Valuation

Name	Ticker	Market Cap (mil)	P/S	P/E	EV/EBITDA	P/B
Seven & I Holdings Co.	SVNDF	39,246	0.78	21.78	6.05	1.88
Woolworth Group Ltd.	WOLZY	26,877	0.59	22.89	10.42	3.43
Yaoko Co. Ltd.	8279-JP	2,232	0.48	19.40	9.26	2.16
Lawson	LWWLY	6,668	1.11	26.07	7.35	2.54
Sun Art Retail Group	SURRY	9,632	0.67	23.72	7.61	2.94
FamilyMark UNY Holdings	FYRTY	11,765	0.84	30.43	11.30	1.88
Peer Averages		11,352	0.74	24.50	9.19	2.59

Source: Bloomberg

Peer Fundamentals

Name	Ticker	Revenues	ROE	ROA	Debt/Equity	Est 5 yr NI growth
Seven & I Holdings Co.	SVNDF	54,197	7.46%	3.30%	0.27	2.70%
Woolworth Group Ltd.	WOLZY	43,305	15.76%	6.03%	0.29	2.80%
Yaoko Co. Ltd.	8279-JP	2,920	13.78%	6.16%	0.57	2.60%
Lawson	LWWLY	5,900	9.55%	2.98%	0.61	5.90%
Sun Art Retail Group	SURRY	15,140	12.60%	4.63%	0.00	2.80%
FamilyMark UNY Holdings	FYRTY	11,447	6.23%	1.94%	0.78	-0.20%
Peer Averages		15,742	11.58%	4.35%	0.45	2.78%

Source: Bloomberg

Mercer International Limited, Inc. (MERC)
April 27, 2018

Connor Darrow | International Materials

Mercer International, Inc. (NASDAQ: MERC) is a publicly traded pulp mills company that provides sourced fibers, renewable energy, bio-materials and chemicals. Mercer operates primarily in three segments: Pulp (83.80% of 2017 revenue), Energy (8.63%), and Wood (7.57%). Mercer International, Inc. engages in the manufacture and sale of pulp. It operates through Pulp and Wood Products segments. The Pulp segment consists of the manufacture, sales, and distribution of NBSK pulp, electricity, and other by-products at three pulp mills. MERC only produces Northern Bleached Softwood Kraft, NBSK, which is used in the production of tissues, fine writing paper, and specialty and others. NBSK is a pulp of premium grade because of its strength and generally obtains the highest price relative to other kraft pulps. Mercer International Limited, Inc. was founded in 1968 and is headquartered in Vancouver, Canada.

Price ($) (4/24/2017):	13.55
Price Target ($):	16.08
52WK H-L ($):	15 - 10.45
Market Cap (mil):	883.07
Insider Holdings	4.08%
Short Interest	0.3%
Avg. Daily Vol (mil):	0.12
Yield (%):	3.69
ESG Rating	BB

Beta:	1.11
M-Term Rev. Gr Rate Est:	7.86%
M-Term EPS Gr Rate Est:	22.01%
Debt/Equity:	123.94%
Debt/EBITDA (ttm):	390.00%
WACC	7.90%
ROA (%):	4.89%
ROE (%):	15.16%
ROIC (%):	6.27%

FY: Dec	12/31/2016	12/31/2017	12/31/2018	12/31/2019
Revenue (Mil)	931.62	1,169.15	1,317.62	1,360.32
% Growth	-9.83%	25.50%	12.70%	3.24%
Oper Inc	113.74	167.92	184.47	195.34
% Growth	-31.35%	47.63%	9.85%	5.89%
Op Margin	12.21	14.36	14.36	14.45
EPS*	$0.54	1.37	$1.40	1.46
P/E (Cal)	19.72	13.24	9.68	9.28
EV/EBITDA	6.42	5.76	5.44	5.38

Recommendation

Mercer International completed their IPO in 1988 and has since developed into an increasingly diversified pulp company. MERC operates three pulp mills, two in Germany and one in Western Canada which have a total production capacity of 1.5 million tons of NBSK pulp and 305 MW of electrical generation. MERC annually supplies around 10% of the 15 million market share of NBSK pulp. Demand for NBSK Pulp has historically grown close to 1.7% a year. As one of the largest NBSK mills in Germany, Mercer International has made over 62% of revenues in Europe while one of their largest mines in Canada allows for efficient exportation to China. Over the past few years, Mercer has experienced a 5-year sales CAGR of 1.76% on a leveraged balance sheet. Mercer International acquired in April 2017, Friseau, one of the largest lumber mills in the world. Friseau was acquired for $62 million in order to increase cost savings with in-house sourcing of raw materials which led to $6.9 million in operating sales synergies last year. All four of MERC's pulp/lumber mills are strategically located close to excellent fiber sources and key global markets, including China. In addition to pulp, MERC's generates excess electricity and pulp byproducts which the company resells as chemicals and green energy. Recent capital investments in biochemical and bioenergy production provide a safeguard against NBSK volatility such as MERC's joint venture with Resolute Forest Products to form Performance BioFilaments. Given Mercer's strong market position, expected global growth, increased savings, and predictable results, it is recommended that Mercer International Limited, Inc. be added to the AIM Equity Fund with a price target of $16.08, representing a potential upside of over 18.64%. They pay a modest annualized dividend of $.50 that yields 3.65%.

Investment Thesis

- **Growth in China.** Currently, Chinese buyers represent about 31% of MERC's current production capacity. Recently, China announced a five-year plan to enhance green development by sharply reducing the imports of waste materials including recovered or waste paper. This will lead to an increase in demand for pulp. As a result, MERC estimates that by 2020, China will represent about 35% of the total annual NBSK demand.

- **Chinese Tariffs on US Pulp.** China has recently threatened a 15% tax on imports of US pulp sales. If implemented, China will need to fill its needs elsewhere, with Canadian pulp potentially benefitting. Assuming a 5% increase in Canadian sources, Mercer should benefit by an incremental $.30 in earnings per share**.**
- **Increased Tissue Demand.** Tissue sales make up 45% of the company's NBSK demand. Tissue demand in China in particular has increased at a CAGR of 7.8% in China from 2007-2017. This trend will likely continue to mirror Chinese growth which is expected to remain between 6-7% over the next years. In addition, MERC's tissue capacity grew by 2.6 million tons in 2017 and is likely to grow by an additional 2.2 million tons in 2018.

In order to reach an intrinsic value for MERC, a five year DCF model was constructed. Using a terminal growth rate of 1.70% and a WACC of 7.90%, an intrinsic value of $17.16 was reached. A ± .5% sensitivity analysis on the terminal growth rate and ± 1% on the WACC ranged from $13.68-$21.88. Additionally, a P/E multiple valuation was calculated. Using a 2018E EPS of $1.40 and a forecasted 2018 blended average P/E multiple of 9.91x, an intrinsic value of $13.87 was reached. Finally, an EV/EBITDA multiple valuation was conducted. Using a 2018E EBITDA of 267.36 and a forecasted 2018 blended average EV/EBITDA multiple of 5.61x, an intrinsic value of $15.03 was reached. By weighing the three models 60/20/20, a price target of $16.08 was reached, resulting in a 18.64% potential upside.

Risks

- **Decrease in Chinese Demand**. Mercer's financial performance is significantly influenced by Chinese demand. If demand were to decrease in China MERC's stock price would be depressed given their reliance on Chinese demand which often drives the direction of global pulp prices.
- **Increased competition.** Greater than expected growth in new market pulp capacity, or restart of idled capacity, could negatively impact pulp price projections. Latin America is of particular concern regarding global pulp capacity. If Latin America were to have substantial increases in global pulp capacity there would be likely be downward pressure on global pulp prices.
  Economic downturn. Historically, economic downturns have negatively affected the demand for NBSK. Increased production capacity could be rendered useless with decreased demand. Additionally, MERC depends on a strong US dollar. For every $0.01 increase in the value of the US dollar relative to the value of the Euro and Canadian dollar results in operating cost savings of $8M.

Management

David Gandossi has been the President, CEO, and director of Mercer International Limited since July 2015. Prior to his role as CEO he served as the CFO and secretary at Mercer from 2003. Gandossi previously worked at Pacifica Papers Inc. and Formation Forest Products. David Ure has been the CFO and secretary of Mercer since July 2015. Ure has been with MERC since 2006. Prior to Mercer he worked for Sierra Wireless Inc., Catalyst Paper Corp, and Pacifica Papers Inc.

Source: FactSet

Peer Fundamentals

Name	Ticker	Revenues	ROE	ROA	Debt/Equity	ROIC
Mercer International Inc.	MERC	1,169	15.16%	4.89%	123.94%	6.27%
Resolute Forest Products Inc.	RFP	3,513	-5.10%	-1.99%	49.34%	-3.47%
International Paper Company	IP	21,743	38.85%	6.30%	171.07%	12.87%
Canfor Corporation	*CFP	923	19.30%	11.40%	0.00%	18.50%
Stora Enso Oyj Class R	507267	11,356	10.58%	5.19%	49.62%	7.57%
Peer Averages		9,384	15.91%	5.22%	67.51%	8.87%

Source: Factset

Peer Valuation

Name	Ticker	Market Cap (mil)	NTM P/S	NTM P/E	NTM EV/EBITDA	NTM P/B
Mercer International Inc.	MERC	883.07	0.67	9.68	5.44	1.71
Resolute Forest Products Inc.	RFP	898.63	0.24	6.15	3.28	0.53
International Paper Company	IP	21,847.60	0.95	10.79	7.05	2.89
Canfor Corporation	*CFP	3,893.48	0.93	7.69	3.55	1.69
Stora Enso Oyj Class R	507267	13,481.00	1.29	15.01	8.57	2.03
Peer Averages		10,030	0.85	9.91	5.61	1.79

Source: Factset

Kennametal, Inc. (KMT)
April 27, 2018

Charlie Maleki | Domestic Industrials

Kennametal, Inc. (NYSE: KMT) specializes in the manufacturing and development of standard and customized technologies for metalworking applications. They operate in three main segments: Industrial (55% of 2017 revenue), Infrastructure (37%), and Widia (9%). The Industrial segment delivers metalworking tools for specified purposes to customers in the transportation, aerospace, general engineering and defense sectors as well as the machine tool industry. The Infrastructure segment is involved in the earthworks and energy market sectors that support many primary industries. The Widia segment offers metal cutting solutions, both standard and custom, to general engineering, aerospace, energy and transportation customers. Kennametal operates globally with 56% of their 2017 revenue derived from international customers and 44% domestically. The company was founded by Philip M. McKenna in 1938 and is headquartered in Pittsburgh, Pennsylvania.

Price ($):	37.29	Beta:	1.46
Price Target ($):	50.23	M-Term Rev. Gr Rate Est:	8.67%
52WK H-L ($):	52.52 - 32.23	M-Term EPS Gr Rate Est:	5.0%
Market Cap (mil):	3,350	Debt/Equity:	68.41
Insider Holdings	3.44%	Debt/EBITDA (ttm):	2.35
Avg. Daily Vol (mil):	0.8	WACC	10.63
Yield (%):	2.1%	ROA (%):	2.06
ESG Rating	BBB	ROE (%):	4.96
Short Interest	7.3%	ROIC (%):	3.02

FY: June	06/30/2016	06/30/2017	06/30/2018	06/30/2019
Revenue (Mil)	2,098.44	2,058.37	2,284.80	2,467.60
% Growth	-20.73	-1.91	11.00	8.00
Oper Inc	123.83	188.56	270.50	292.50
% Growth	-48.49	52.27	43.45	8.13
Op Margin	5.9	9.2	11.84	11.85
EPS*	-1.36	1.25	2.08	2.30
P/E (Cal)	#N/A	61.34	17.93	16.21
EV/EBITDA	9.7	12.1	9.13	8.45

Recommendation

Since its inception, Kennametal, Inc. has been transformed from a small level manufacturer of tungsten carbide metal cutting tooling into a global leader in the development and application of tungsten carbides, ceramics, super-hard materials and solutions used in metal cutting and mission-critical wear application. Their products are utilized to combat extreme conditions associated with metal wear fatigue, corrosion, and high temperatures. KMT's leading position in their primary markets is a result of the company's deserved reputation for material technology and metal cutting application knowledge, as well as expertise and innovation in the development of custom solutions and services. 2017 was a year of development and restructuring for KMT. The firm improved their commercial execution by implementing customer classification and customer relationship management software to improve sales efficiency. They simplified the business by implementing minimum economic order quantities to improve manufacturing efficiency. These activities led to a top-line organic growth rate of 4% in 2017 with year-over-year growth in all segments. KMT also lowered their costs to improve future operating margins by reducing run-rate employment costs by approximately $80 million and by reducing employment levels across all levels of the organization. Finally, KMT launched modernization and end-to-end process improvement programs for their manufacturing facilities that will lead to larger savings over the next five years. These restructuring programs delivered incremental benefits of approximately $72 million in 2017. Savings from these programs are expected to evident in the calendar year ending December 31, 2018. Quarter 1 in 2018 saw top-line growth of 14%, which was followed by a growth rate of 17% in Quarter 2. KMT management continually seeks to strengthen their competitive position through their commitment to developing new and innovative technologies and products in all of their business segments. Due to KMT's efforts to increase their efficiency that have already yielded positive results, the overall positive trend of the industry, and the lowering of KMT's effective tax rate due to reform, it is recommended that Kennametal, Inc. be added to the AIM Equity Fund with a target price of $50.23 representing a potential upside of 34.69%, KMT pays a dividend yielding 2.1%.

Investment Thesis

- **Process Improvement Programs.** The end-to-end process improvement programs are anticipated to generate $200 to $300 million of additional annual savings over the next three years. This change should further improve return on equity and may reward a higher multiple.
- **Positive Macro Trends.** The industrial production and services market has been strong and should get even stronger moving forward. Demand for industrial manufacturing is projected to increase in 2018. If the economy expands in excess of 2% annually, their customers' inventories will need to grow by about $50 billion per year to keep pace with demand. Inventory growth ran below that level in 2017, which suggests there will be an increased demand for industrial machinery moving forward to catch up. KMT has positioned themselves effectively within the industry and will look to capitalize on this positive trend leading to higher volume and higher prices fueling fast pace growth into the coming years.
- **Extreme Condition Solutions.** KMT specializes in the production and application of metallurgical powders to combat extreme conditions associated with wear fatigue, corrosion, and high temperatures. As the exploration of the human race evolves further into space and deep ocean exploration, their services will garner an even higher demand which will provide increased revenue streams that are not available to their competitors. The area of space exploration specifically has become global as more nations are now within reach of space than ever before.

Valuation

In order to reach an intrinsic value for KMT, a five year DCF model was constructed. Using a terminal growth rate of 3.0% and a WACC of 10.63%, an intrinsic value of $45.36 was reached. A sensitivity analysis on the terminal growth rate and WACC ranged from $53.99-$39.45. Additionally, a P/E multiple valuation was calculated. Using a TTM EPS of $1.76 and utilizing a blended average peer P/E mutiple of 31.84x, an intrinsic value of $56.05 was reached. Finally, an EV/EBITDA multiple valuation was conducted using a blended average EV/EBITDA multiple of 14.074x resulting in an intrinsic value of $61.99. By weighing the three models 60/30/10, a price target of $50.23 was reached, resulting in a potential upside of 34.69%. The dividend yield is 2.1%

Risks

- **Business Cycle Downturn.** The recent rumors of a recession pose a threat to KMT. Their business has historically been cyclical and subject to significant impact from economic downturn. Global economic downturn coupled with global financial and credit market disruptions would have a negative impact on sales and profitability.
- **Potential of Trade War.** KMT needs to be wary of the Trump Administration's continued threats of a trade war with China. KMT operates in China and generated 10.7% of their top-line revenue from that region in 2017. If the trade war does happen, it could negatively affect KMT's performance.
- **International Operations Risk.** KMT has manufacturing operations and assets located outside of the U.S. These international operations are subject to a number of special risks that need to be accounted for.

Management

Christopher Rossi has been the President and CEO of Kennametal, Inc. since August of 02017. Prior to his appointment, Mr. Rossi served as the CEO of Dresser-Rand at Siemens. Judith L. Bacchus, Alexander Broetz, Robert J. Clemens, Peter A. Dragich, Jan Kees van Gaalen, Michelle R. Keating, Thomas F. McKee, Jr., Ronald L. Port, and Patrick Watson makeup the committee of Vice Presidents that work under Mr. Rossi.

Source: Factset

Peer Valuation

Name	Ticker	Market Cap (mil)	P/S	P/E	EV/EBITDA	P/B
Kennametal, Inc.	KMT	3,350	1.48	23.20*	12.20*	2.97
Alamo Group, Inc.	ALG	1,374	1.45	29.78	12.24	2.90
ITT, Inc.	ITT	4,554	1.84	41.70	11.11	2.95
Woodward, Inc.	WWD	4,641	2.35	24.56	14.99	3.45
Donaldson Company, Inc.	DCI	5,936	2.68	27.29	16.12	7.30
Astec Industries, Inc.	ASTE	1,343	1.14	35.89	15.91	1.96
		4,126	1.89	31.84	14.07	3.71

*TTM P/E and EV/EBITDA used for accurate valuation purposes

Source: Factset

Peer Fundamentals

Name	Ticker	Revenues	ROE	ROA	Debt/Equity	ROIC
Kennametal, Inc.	KMT	2,058	5.0	2.1	68.4	2.9
Alamo Group, Inc.	ALG	912	10.6	7.4	13.4	9.2
ITT, Inc.	ITT	2,585	2.7	3.2	10.8	7.6
Woodward, Inc.	WWD	2,099	15.5	7.4	44.7	10.7
Donaldson Company, Inc.	DCI	2,372	28.8	12.4	71.9	18.6
Astec industries, Inc.	ASTE	1,185	5.7	4.4	0.6	5.6
Peer Averages		1,831	12.7	6.9	28.3	10.3

Source: Factset