

## Brunswick Corporation

NYSE:BC

**Analyst:** Dylan Cirrilla

**Sector:** Consumer

Discretionary

**Buy**

**Price Target: \$56.00**

### Key Statistics as of 5/6/2016

Market Price: \$47.07

Industry: Recreational Vehicles

Market Cap: \$4,255m

52-Week Range: \$55.76 - \$36.05

**Levered Beta: 1.85**

### Thesis Points:

- Improvement to target market, economically and on a demographic basis
- Strong forward guidance
- Diversified product lines reduces risk beyond what the market believes

### Company Description:

Brunswick Corporation manufactures consumer products serving the outdoor and indoor active recreation markets. The Company's products include sterndrives, outboard and inboard marine engines, fitness, billiards, and bowling equipment. Brunswick also manufactures recreational, fishing, and high performance boats. Because of the nature of its products, the main target market for BC is the older, upper-middle to upper class consumer. 66% of BC's business is conducted in the US, 12% is conducted in Europe and the remainder being fairly evenly distributed between the Pacific Rim, Canada, Latin America, and Africa/Middle East. About 50% of the Company's revenue is generated by the production of marine engines, 31% by the sale of boats, and 19% from its fitness lines.



## Thesis

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Brunswick Corporation (BC) is a business that operates in a flashy industry: leisure goods. With products like speedboats, billiard tables, and other high-end products, the growth of this aging market is going to fuel the growth of this business. As the Baby Boomer generation ages and enters into the sweet spot for BC to take advantage of a large market, the economic tone is continuing to improve, as well. The US economy, specifically, is making a tremendous turn and is creating an environment for retirees and older citizens to take advantage of the leisure market. With a strong backdrop, forward guidance bolsters the improvement to top and bottom line growth in the future. Management has a strong direction for the business and forecasts high levels of growth across the board going into the future. Lastly, as a diversified business, deserves a lower discount rate than what is being offered by the market. Geographic and product diversity is allowing BC to enjoy more even cash flows than competitors in this cyclical industry. As a best-in-class firm, BC stands tall as a buy for the coming 18 months. With a 5/4/2016 market price of \$47.07 and a target price of \$56.00, there is a potential upside of about 19%.

## Business Model

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Brunswick is a leading global designer, manufacturer and marketer of recreation products including marine engines, boats, fitness and active recreation products. Brunswick concentrated on implementing its growth plan which included investing in innovative products, capacity expansion and focusing on both core businesses and strategic acquisitions in growing markets. In the long-term, Brunswick's strategy remains consistent: to design, develop and introduce high-quality products featuring innovative technology and styling; to distribute these products through a beneficial model for the firm and its customers, to maintain low-cost manufacturing processes, and to fuel organic growth. This mission is driven home by its business segments, headlined by the marine engine segment. Making up about 50% of the company's revenue, this is the core segment of the business. In recent years, however, BC has seen a shift from dependence on engines (59% of revenue in 2012) to a growing boat market (up to 31% of revenue in 2015 from 21% in 2012). BC operates in both a retail and

wholesale space. As part of cyclicalities these two segments peak at different points of the year but hold similar margins.

## Improvement to Target Market

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The target market of Brunswick Corporation is an aging, more affluent, high-class consumer. In the US, particularly, the Baby Boomer generation is developing into an incredibly strong consumer base that sees even further growth for the coming years. This target market for Brunswick will grow and gain accessibility to the high-end products of BC through demographic growth and economic improvement. In terms of demographic growth, it goes without much questioning that the Baby Boomer generation is still continuing to age. While not at its peak, the generation is still entering the target age for BC. This group is gaining access to the capital they need to make large individual capital purchases, such as a boat, because of economic shifts. Domestically, economic climate has greatly improved and will continue to improve. This makes access to capital easy, improves overall discretionary income, and improves sentiment of the market towards these large personal purchases. This target market is strengthened from a cost perspective, as well. Though trending back upwards, global petroleum prices are at incredibly manageable prices. With advents of US oil agreements, these prices are poised to stay far below 3-year averages for the foreseeable future.

## Forward Guidance

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In the previous earnings call, BC missed EPS by 3% and sales by less than 1%. This resulted in a negligible change to share price because of aggressive and optimistic forward guidance by management. Management has a year-end sales growth of 9%-11% in its core markets of Europe and America. The high-margin segment of "marine" products is forecast to continue its historical growth without changes moving forward. However, Boat revenue growth is projected in the mid-to-high single-digit percentage range with an improvement to operating margins of over 1%. Management also has stated that they will continue to pursue new product introductions to achieve a 6%-7% operating margin on their Boat segment. The exciting story is the newly revitalized fitness segment, headlined by the Cybex acquisition. Management targets mid-to-high 20% revenue growth, bringing the

segment to \$1b in revenue by the end of '16 fiscal year. This will be helped by improvements to the fitness segment, as a whole. Containing both Cybex and Life Fitness products, management explains that Cybex margins have historically been lower than Life Fitness' because of a higher operating cost base. As a result of the acquisition and an expansion of the fitness segment, economies of scale will continue to be realized and will achieve efficiency by 2018 due to the cost reduction and revenue growth of the segment. The segment will also likely show lower operating margins moving forward for at least the next quarter of 2016 because of unrealized efficiencies, though it should provide a net benefit of \$.08 EPS. This further holds the price down and allows for a very effective entry point on a stock that has optimistic guidance on its margins, revenue growth, and EPS growth.

### **Diversified Product Lines**

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From a few angles, BC is a diversified firm. With operations spanning the globe, economic risk is mitigate through a strong mix of emerging and world power markets. From a product mix standpoint, the same is true. As a somewhat vertically integrated firm, BC reduces their risk of vendor price changes in their production of engines for their own boat products. Delving into the fitness industry through successful M&A activity such as Cybex, has resulted in efficient market diversification between the leisure market and the fitness industry. These industries also split seasonality. The fitness industries downturn is typically at the boating industries peak, resulting in cyclical cash flows leveling out to create a more predictable environment. While these are examples and evidence for reducing the effective discount rate on BC's cash flows, there is very limited coverage of the stock. The limited volume and general coverage of the stock has led to an overlook of the value of this diversification. It is crucial in the market's valuation of the company to achieve an accurate discount rate. The market has not achieved this and the cheap market price reflects this.

### **Potential Risks**

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BC carries some potential risks with it, largely due to its business model and the products it sells. Firstly, and it is a large risk, is seasonality. On the leisure side, mostly focused on boating, there is a large presence of

seasonality for the sales and the types of sales. For example, wholesale will increase around Q4 while retail increases around Q1. This makes revenue difficult to predict and if guidance is off, could result in an overestimation of revenue or margins. There is a similar story for the fitness segment of BC. Wholesale tends to peak in Q3 while retail peaks in Q4 for the fitness segment. This carries similar seasonality risk but is significantly less dramatic because of the size of the segment. The second notable risk that Brunswick Corporation faces is that they focus primarily on an affluent market. This can typically be problematic as this target market relies heavily on economic growth of their respective country. Because BC is involved with business around the world, assessment of global economic trends is the only way to mitigate such a risk; a difficult task. Despite the potential downsides and potential risks, BC carries a significant upside that outweighs its potential flaws.

### **Financials**

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BC is a firm with a bright future, held down by its past mediocrity, specifically on margins. As previously stated, margins are projected to hold steady on the higher margin segment, marine products, and improve on the lowest margin segment, fitness. This should cover the issue of margins being historically low. In terms of proforma analysis, revenue growth was projected at its modest 6.6% until it tapers into the continuing period to 2.1%. The value of the company is seen in its decrease of operating costs. As previously mentioned, economies of scale will begin to take effect throughout 2016 and into 2017. This should drive operating costs down from the historical 89% to a predicted 85% into the continuing period; a very conservative estimate. I believe PPE and will remain at its lower-than-industry average as the historical levels have been fairly consistent. In terms of capitalization, the small amount of R&D was left uncanceled with a full 100% of SG&A being capitalized as it is nearly all marketing and directly needed for the operations of the firm. The valuation of a company that sells tangible, high profile items is typically fairly simple. The value for this stock is found on the growth potential, underestimation of the public, and forward guidance.

## Conclusion

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Brunswick Corporation is a business that operates in an easy to understand market. Leisure items intended for the aging and wealthy consumer; items like billiards and boats. With a reinvention of the business model in the Cybex acquisition, BC has been able to achieve a level of diversification that is not seen in the industry. Diversification on the geographic front with global sales improving to diversification with product lines, BC is experiencing improved mitigation of risk. The firm deserves a lower discount rate than the market has been willing to give, proving its undervaluation. The target market's improvement, both in terms of size and economic access will prove to bring organic growth to the underpriced firm in the coming years. This, paired with strong and optimistic forward guidance from management, will prove to bring BC to the lists of must-buys. Improvements to margins, a growing customer base, and improved mitigation of risk mean that Brunswick Corporation is a strong buy at the current market price of \$47.07. At a target price of \$56.00 there is a 19% upside.

**Brunswick Corporation (BC)**

**CENTER FOR GLOBAL FINANCIAL STUDIES**

**BULLISH**

Analysis by Dylan Cirrilla  
5/6/2016

Current Price: **\$47.07**  
Divident Yield: **1.2%**

Intrinsic Value: **\$44.28**  
Target Price: **\$55.95**

Target 1 year Return: **20.06%**  
Probability of Price Increase: **96%**

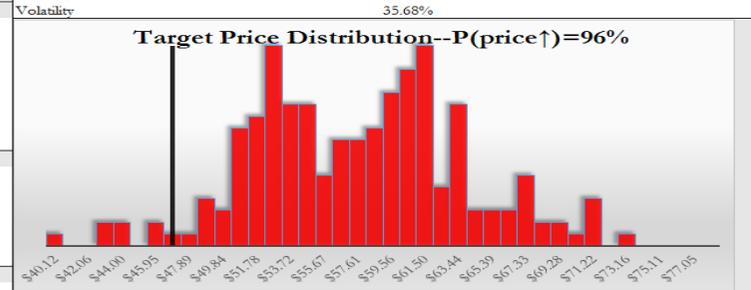


Description	General Information
Brunswick Corporation designs, manufactures, and markets recreation products worldwide.	Sector: Consumer Discretionary
	Industry: Leisure Products
	Last Guidance: November 3, 2015
	Next earnings date: July 28, 2016
	Estimated Country Risk Premium: 4.73%
	Effective Tax rate: 30%
	Effective Operating Tax rate: 53%

Market Data	
Market Capitalization	\$4,302.45
Daily volume (mil)	0.39
Shares outstanding (mil)	90.77
Diluted shares outstanding (mil)	93.70
% shares held by institutions	78%
% shares held by investments Managers	84%
% shares held by hedge funds	10%
% shares held by insiders	0.71%
Short interest	6.18%
Days to cover short interest	4.81
52 week high	\$55.76
52-week low	\$36.05
Levered Beta	2.02
Volatility	35.68%

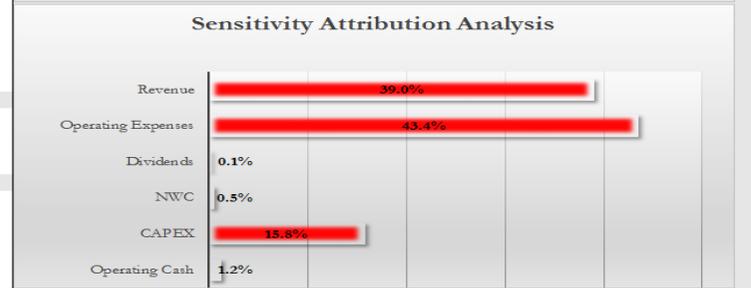
Past Earning Surprises		
Quarter ending	Revenue	EBITDA
4/4/2015	-3.04%	-10.08%
7/4/2015	-1.72%	-3.01%
10/3/2015	-1.75%	-0.79%
12/31/2015	-2.79%	-22.49%
4/2/2016	-2.48%	-3.69%
Mean	-2.36%	-8.01%
Standard error	0.3%	3.9%

Peers	
Total compensations growth	25.92% per annum over 5y
Total return to shareholders	2.62% per annum over 5y
	7.54% per annum over 2y
	5.85% per annum over 2y
	31.19% per annum over 1y
	-0.29% per annum over 1y



Management	Position
Schwabero, Mark	Chairman, Chief Executive Of
Metzger, William	Chief Financial Officer and
Pfeifer, John	Vice President and President
Foulkes, David	Chief Technology Officer, Vi
Byots, Bruce	Vice President of Investor R
Dekker, Christopher	Vice President, General Coun

Profitability	BC (LTM)	BC (5 years historical average)	Industry (LTM)
ROIC	6.3%	16.91%	11.79%
NOPAT Margin	3%	6.85%	9.8%
Revenue/Invested Capital	1.88	2.47	1.20
ROE	5.8%	16.73%	13.24%
Adjusted net margin	3%	5.82%	8.9%
Revenue/Adjusted Book Value	2.08	2.87	1.49



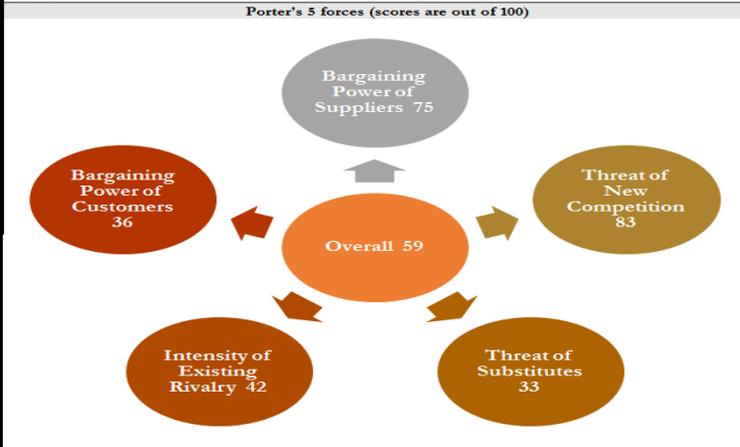
Invested Funds	BC (LTM)	BC (5 years historical average)	Industry (LTM)
Total Cash/Total Capital	13.7%	23.1%	24%
Estimated Operating Cash/Total Capital	13.6%	18.3%	N/A
Non-cash working Capital/Total Capital	21.0%	15.8%	21%
Invested Capital/Total Capital	99.0%	93.5%	76%

Capital Structure	BC (LTM)	BC (5 years historical average)	Industry (LTM)
Total Debt/Common Equity (LTM)	0.11	0.12	0.18
Cost of Existing Debt	7.17%	9.70%	5.32%
Estimated Cost of new Borrowing	1.96%	2.04%	5.32%
CGFS Risk Rating	AA	AA	BB
Unlevered Beta (LTM)	1.89	2.39	0.88
WACC	12.91%	15.59%	7.84%

Porter's 5 forces (scores are out of 100)
Bargaining Power of Suppliers: 75
Bargaining Power of Customers: 36
Threat of New Competition: 83
Intensity of Existing Rivalry: 42
Threat of Substitutes: 33
Overall Score: 59

Period	Revenue growth	Valuation
Base Year	6.6%	NOPAT margin
4/2/2017	8.3%	3.3%
4/2/2018	5.1%	11.1%
4/2/2019	6.0%	11.4%
4/2/2020	6.5%	11.5%
4/2/2021	4.5%	11.7%
4/2/2022	2.1%	11.6%
4/2/2023	2.1%	11.5%
4/2/2024	2.1%	11.4%
4/2/2025	2.1%	11.4%
4/2/2026	2.1%	11.4%
Continuing Period	2.1%	11.3%

Period	Invested Capital	Net Claims	Price per share
Base Year	\$928.70	\$543.71	\$44.50
4/2/2017	\$1,275.77	\$28.16	\$56.53
4/2/2018	\$1,919.34	-\$378.20	\$65.23
4/2/2019	\$1,989.89	-\$799.50	\$74.14
4/2/2020	\$2,229.25	-\$1,305.41	\$84.07
4/2/2021	\$2,046.53	-\$1,804.26	\$93.33
4/2/2022	\$2,569.85	-\$2,327.62	\$102.46
4/2/2023	\$2,867.68	-\$2,853.93	\$111.51
4/2/2024	\$3,175.78	-\$3,381.30	\$120.55
4/2/2025	\$3,512.29	-\$3,909.13	\$129.53
4/2/2026	\$3,791.55	-\$4,436.80	\$138.43
Continuing Period			



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4/2/2018	5.1%	11.1%
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4/2/2020	6.5%	11.5%
4/2/2021	4.5%	11.7%
4/2/2022	2.1%	11.6%
4/2/2023	2.1%	11.5%
4/2/2024	2.1%	11.4%
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