

December, 8, 2017

Dana, Inc.: DAN

Michael Vitale

**Sector: Consumer Discretionary** 

Industry: Automotive Current Price: 31.87 Target Price: 42.61

**Company Description:** Dana Incorporated, based in Maumee, Ohio, is a world leader in highly engineered solutions for improving the efficiency, performance, and sustainability of powered vehicles and machinery. Dana supports the passenger vehicle, commercial truck, and off-highway markets, as well as industrial and stationary equipment applications. Founded in 1904, Dana employs nearly 29,000 people in 34 countries on six continents who are committed to delivering long-term value to customers.



#### **BUY**

Current Price:	\$31.87	ROIC(TTM):	23.90%
Target Price:	\$42.61	WACC(Q3):	9.9%
Market Cap:	4.6B	EBITA Margin(TTM):	9.17%
Beta:	1.67	Gross Profit Margin(Q3):	14.49%

#### Thesis:

Dana Inc. has strong growth factors due to further market expansion in growing regions like China. They are an industry leader, launching new products, which follow the current industry trends towards electric vehicles. With further acquisition synergies on the 2018 horizon, Dana Inc. should see increased efficacies with multiple growing end markets.

## **Catalysts:**

- Short Term(within the year): Achieving synergies and growth in Chinese market.
- Mid Term(1-2 years): Further diving industry leading innovation sparking organic growth.
- Long Term(3+): Increasing global trend of electric vehicle sales.





## Company/Business Overview:

Dana, Inc. is a global manufacture of car parts. The majority of their products are driveline products including rear and front axles, driveshafts, and transmissions, and power technologies (sealing, thermal-management products) as well as service parts. The markets they supply to include light, medium and heavy (commercial) vehicle market, as well as off-highway markets. They divide their operations into three major business segments: Light vehicle (52% of sales), commercial (29%), and off-highway (19%). Power Technologies is a growing segment for them.



Light Vehicle Driveline (LVD): North American sales remain strong based off the Q3 earnings report. Demand for key light-truck platforms are driving organic growth. Vehicles inventories are remaining low with a high inventory turnover rate. 40% of customer sales in LVD are to Ford with Fiat Chrysler coming at second with 16%. Of their regional sales in this segment, they are heavily invested in North America as 67% of their sales are in this region. Asia Pacific is their second largest region at 16%, and they are expanding production further in this region through new facilities. Their EBITA Margin in this segment has increased by 0.9% to 11.5% year to date in 2017. Sales realized a 23.8% growth year to date from 2016-2017. The new Chongqing Light Vehicle Driveline facility in China is producing new products for the growing SUV market in China which is contributing to further penetration in the world's largest vehicle market.

Off-Highway Drive and Motion: Demand remains strong in construction markets. They are realizing a steady recovery in the mining markets in North America and Asia. Synergies from their recent consolidation of Brevini manufacturing sites in China into one facility. This facility is on track to for completion in 2018, which will increase efficiencies in this segment. Their largest presence is in Europe, which composes about 75% of their regional sales. Asia Pacific is their second largest region at 14%. EBITA Margin for this segment grew 0.2% to 14.2% YTD from 2016-2017. They realized a sales growth of 60% TYD.

Commercial Vehicle Driveline: There is a continued strong demand for light vehicle trucks in North America. Their class 8 market share has been improving into 2017, and is estimated to carry into 2018. According to their Q3 report, 58% of their regional sales were in North America with Asia Pacific being the smallest segment. They have realized a .3% EBITA Margin growth from 2016-2017 YTD to 8.6% in the Commercial Vehicle segment.





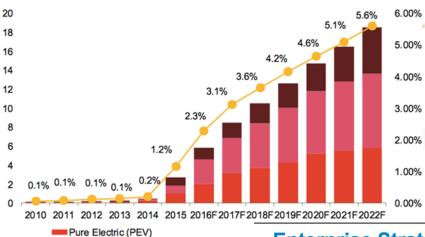


Power Technologies: Demand for light and medium trucks remains strong and driving higher sales volume in this segment. Two new facilities have broken ground in China to support new business growth in that region. The two new facilities bring the total to 15 facilities in China. The Yancheng Power Technologies facility utilizes the former Brevini facility and shows further investment for growth in that region. The further investment in China should help grow the regional sales of which only amounted to 5% of total regional sales as of Q3. North America had the largest share at 55%. Dana realized a

.7% EBITA Margin growth from 2016 - 2017 YTD to 15.7%. Power Technologies has the largest EBITA Margin across all segments for the company, and their further investment in this segment should drive an increase in overall company performance.

### **Growth Strategy:**

Dana inc. year over year revenue growth for Q3 is 26.36% compared to an industry 2.23% for the industry. This is their third consecutive quarter with achieved double-digit year-over-year organic growth. Their strong sales backlog, combined with recent acquisitions and improved end market demand, continue to drive



profitable growth. They have realized progress in their electric vehicle program developments and their expansion in China where they are leveraging our core assets and technology. Chinas passenger vehicles sales have been growing at a CAGR rate of 10% from 2010-2016. The current industry trend in China is heavily leaning towards the advance of alternatively powered vehicles. Policies on carbon emission restriction and carbon emission trading accelerated this

# **Enterprise Strategy Execution**









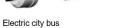
process and contributed to the 2% market share growth alternatives. Their Luxgen7 MPV electric vehicle is currently in production in China. This vehicle utilizes Spicer electrified drive unit. This electric SUV has been in the market for a couple years and is their first light vehicle EV platforms. Their new electric Royal Mail Truck that uses a Spicer drive shaft in a central electric

Hybrid (Mild + Full)



- Electric drive unit for shuttle vans
- Weight reduction and improved efficiency
- Manufactured in United States





- Fully-integrated motor and gear box
- Manufactured in China



- SUV and Car PHEV programs
- Battery and power electronics cooling
- Manufactured in China

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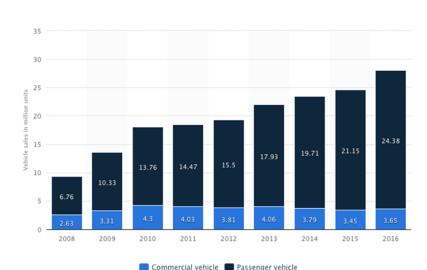


motor configuration and has a range of 100 miles, perfect for the mail delivery application. As for their off highway segment, Caterpillar contrition equipment, specifically the Compaq wheel loader, utilizes Dana transmission and axles. These products demonstrate the diversity of Dana's product reach and their leveraging of core technologies across multiple end markets. Another facet for their enterprise strategy is accelerating hybridization and electrification. Their product brand for electric driveline products is serviced by Spicer Electrified. This helps represent Dana's comprehensive strategy to leverage their controls, software and electric engineering expertise and product knowledge. An example for this is their electric drive unit for electric vans, which manages speed and torque from the electric motor to the wheels. This design allows for vehicle systems integration, and reduces weight while improving efficiency. Planned for launch in 2018 in China is a new E Axle for electric transit buses and city delivery vehicles. This axle features a fully integrated motor and gearbox. Lastly, their advanced battery and power electronics cooling technology will help them realize strong organic growth in the adjusting industry trends towards electric vehicles. Their Power Technologies team has made further progress to expand their smallest region (Asia Pacific) which shows the strongest industry growth moving into 2020. They have had significant new business wins in China with major OEM for both electric SUV and passenger car programs. These products will be manufactured in their new Wuxi, China facility and will be their first battery coolers domestically produced. This service will serve as a platform to accelerate and support growth of their EV market share in that important region.

### **Industry Outlook:**

Dana focuses their business in four main regions, Europe, North America, South America, and Asia-Pacific. In North America, the U.S. economic growth continues to be a positive indicator for our end markets. Light truck production is expected to remain strong through the rest of the year while their key platforms continue to see stable demand. Class 8 truck production is now forecast to be higher in the range of 245,000 to 255,000 units this year in North America. And the steady improvements they have seen in construction and mining end markets continued during Q3, with the expectation to continue through 2018. In Europe, they expect economic growth will continue through the remainder of 2017, and their currency expectations have improved as the euro has strengthened against the U.S. dollar. The commercial vehicle market has shown a solid 2% growth, with the off-highway markets remaining strong. As for South America, in Brazil, they saw continued slow recovery during this quarter and expect this to carry on into next year. Off a low base, medium and heavy truck production has increased more than 20% year-to-date, while bus production

continues to stabilize. In Argentina, they expect the economy to remain stable. Lastly and most importantly, in Asia-Pacific, the Chinese economy is expected to maintain a growth rate of mid-single digits over the next few years. Economic growth in India also remains stable despite a strong but a short-term disruption of tax reform. Overall, in Asia, late demand remains stable within the region. The Chinese market reached 23 mio units sold in 2016 and accounted for around 30% of global passenger car sales, which makes China the largest global automotive market. China has remained the







world's largest automotive market and automotive manufacturing country since 2009. There was a compound annual growth rate (CAGR) of 18,1% from 2005 to 2012. In 2016, the official China Association of Automobile Manufacturers (CAAM) reported that China's auto industry enjoyed rapid growth, with its sales and production both achieving new records. The production and sales of automobiles (passenger & commercial vehicles) were 28,119.000 and 28,028,000 units respectively, up 14.5% and 13.7% year on year, 11,2% and 9.0% higher than in 2015. The automotive sales market is expected to climb 5% in 2017 to 29.4 million vehicles, still triggered by a tax cut policy starting in 2015. After strong growth for nearly a decade (CAGR of 18,1%), the Chinese automotive market is reaching a critical point in its development.

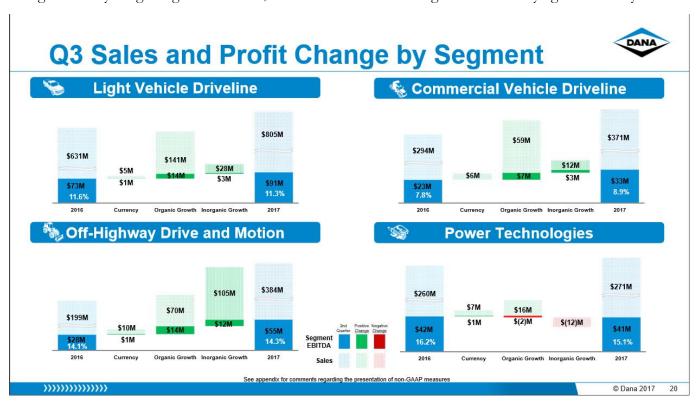
## Third Quarter Performance:

Sales of \$1.8b grew \$447m since the same period last year showing a 32% growth. Sales are up by about \$1b compared to the first nine months of last year on a YTD basis. The majority of Dana's growth in Q32 was organic as they continue to convert their sales backlog and benefit from strong end market demand. They ended Q3 with organic growth of 21%. YTD adjusted EBITDA was \$638m, which is up \$144m over the last year. Net income was \$69m, which was \$12m better that the same period last year. For the first nine

# **Q3 Highlights**

- Continued Strong Financial Results
  - Sales of \$1.8 billion
    - 32% YOY sales growth, 21% organic
  - Adjusted EBITDA of \$216 million
    - 11.8% margin
  - Diluted Adjusted EPS of \$0.59
    - 20% increase over prior year
  - Free Cash Flow of \$99 million
- Raised Full-Year Financial Guidance
- Advancing Enterprise Strategy Execution
  - Electric vehicles and expansion in China

months, net income was \$60m better than year as higher EBITDA was partially offset by higher depreciation expenses due to the increase in CAPEX, higher tax expenses from stronger earnings, and higher acquisition expenses. This growth can be attributed to three key factors: organic growth, business acquisitions, and foreign currency. Organic growth added \$286m in sales due to strong demand for key light and heavy vehicle







programs as well as a growing demand for off-highway products. This growth produced an incremental \$37m in profit. Business acquisitions of Brevini and the USM Warren plant added \$133m in sales and \$15m in adjusted EBITDA. Foreign currency was a decent tailwind for Q3 giving sales a boost of about \$28m and adjusted EBITDA by \$3m due to relative strength of foreign currencies against the USD. Broken down by segment, organic growth was the leading driver for sales and profit changes across all segments expect power technologies. Light Vehicle Driveline saw a YoY Q3 growth in sales of about \$174m and an adjusted EBITDA increase of \$18m. The largest contributor was organic growth, which supplied \$141m and \$14m of sales and adjusted EBITDA increases respectively. Commercial Vehicle Driveline realized a sales increase of about \$77m and adjusted EBITDA of \$10m. This YoY growth was again controlled by organic growth in sales of which was \$59m, contributing a larger percentage than the light vehicle segment. Off-Highway Drive and Motion pulled in the largest sales growth of \$185 YoY in Q3 and a \$27m increase in adjusted EBITDA. However, this growth, unlike the previous two segments came from a majority of Inorganic growth. Inorganic growth contributed \$105m in sales and \$12m in adjusted EBITDA. Lastly, Power Technologies realized a \$11m increase in sales but a \$1m decrease in adjusted EBITDA. The largest contributor to this loss was -\$12m from inorganic growth. This decrease in adjusted EBITDA can be attributed to their recent acquisitions and expansion in this sector in the Asia Pacific region. This subpar performance will recover and profits will be realized due to increase in efficiencies, synergies, and exposure moving into 2018.

# Earnings & Estimates:

Improving end markets and new program acceleration should drive sustainable revenue and profit growth for Dana into 2018. Converting \$300m of backlog can continue to generate high organic growth. Operating profit conversion of 18% on the backlog this year highlights improving operations. New product launch costs





in the near term may put a slight downward pressure on margins. However, North America's (their largest market) heavy-truck production (their largest margin segment) is expected to rise 10% in 2017, expanding a key end market for them. Revenues have been increasing steadily over the past four quarters, consistently outpacing estimates since Q4 2016. Their revenues YoY growth is a healthy 22.5%. History has shown a strong





correlation with revenue increase and a positive reaction to the stock price. Estimates are set to increase to around \$2b into 2018 with past actuals consistently higher. Diluted adjusted EPS, which excludes the impact of nonrecurring items, was \$0.59 per share in the third quarter, an improvement of \$0.10 per share compared with last year, and on a year-to-date basis, was up \$0.54, driven primarily by higher earnings. Adjusted EPS has been consistently outpacing estimates each quarter for the past YTD. Estimates moving into 2018 are expected to reach upwards of \$0.75.

#### **Conclusion:**

Dana has taken steps to increase their presence in the Chinese market. Pacific Asia having the smallest percentage of regional sales in the past, further expansion in this market is key given the Chinese economic and industrial outlooks. Increased efficiencies and production in the Chinese market with help further bolster already positively trending organic growth across all segments. New contracts in place surrounding their Power Technology segment will help revitalizes their subpar Q3 performance in the segment. Increased industry trends and end market growth moving into 2018 will continue to spur sales growth while innovation in key markets such as electric vehicles will produce higher margin products in the near future.





