
Thoughts From the Desk

March 20, 2024

Hello from the Desk,

While it is hard to believe that we are already well into March, one of my favorite things about this time of year is the number of conferences, analyst calls, and management meetings that have begun filling our calendars.

One of my father's favorite quotes is, "There is no substitute for experience." These meetings not only offer our team the benefit of communicating with the stewards of our investment dollars, but the institutional knowledge of the other participants we connect with between meetings.

Over the past two years, one of the most common questions that I find myself being asked at the end of Management meetings, has been, "Why do you think our stock price is trading where it is*?"

In reality, this answer can be a multifactorial "who knows", but when face-to-face with the teams we entrust, that answer is never *actually* suffice.

Until recently, valuation multiples have been the easiest culprit for our small-mid cap Canadian equity names. Regardless of the stability or recovery in fundamentals, overarching sentiment has acted as a prohibitive ceiling to historical levels - rightfully so, to some extent.

However, in many cases, the Management team has likely been placed in a 'prove it' zone – sometimes deserved, sometimes not.

One name that we believe has been unfairly stuck in that box has been Linamar (LNR-CN).

While we only invest in Management teams we trust, there are few within their space that we afford as much deference to than Linda Hasenfratz and her team.

Since I joined Aventine, Linamar has persevered through an extremely difficult operating environment, leveraging the diversity and superiority of its portfolio to overcome protracted challenges in automotive production, wariness over EV programs, and risks from normalization in underlying dynamics in the global agriculture and construction markets. Having the benefit of numerous meetings and company events, I can positively say that this management team has proven their ability to forecast what their businesses need and their ability to effectively allocate capital to build a product offering with supportive infrastructure to intercept demand where it inflects.

Auto Production and EVs

Linamar's R&D capabilities and focus on innovation have led to a material component per vehicle (CPV) growth profile across its segments, which has also yielded attractive consolidated project returns for years. These initiatives have helped the company bridge equipment evolutions and cycles and have created a sufficient track record to expect ongoing projects to have established safeguards to adjust flexibly to industry trends. While automotive manufacturers have tempered expectations on EVs in the past few quarters, we note that (a) LNR is engine agnostic, with an impressive ICE portfolio that would benefit from outsized economic leverage in the case of prolonged application; (b) LNR is highly impressive at building modular manufacturing processes that enable the company to transform production cells and shift capacity with extraordinary efficiency; and (c) the nature of their projects are for core products that are essential in the manufacturing process, ensuring they capture a significant portion of the underlying production upside. While the latter point remains in contention as it relates to EVs and giga casting, we believe that EVs will still comprise a meaningful portion of new vehicle TAM and that LNR's current exposure remains reasonable, even if market sentiment underpinning these trends is not.

Non-automotive Diversification

We believe that Management has proven the benefit to diversifying their portfolio in the non-automotive sector, and despite challenging conditions for construction and normalizing crop prices, the secular trends underpinning these businesses will continue to benefit results over the long term. LNR's current first-in-class portfolio, bolstered by ongoing acquisitions and strategic capital allocation, will continue to build out its market share and bolster cross-selling opportunities over the medium-long term.

Giga Casting

Somewhat analogously to when LNR expanded into Ag and Construction, we believe that investors are concerned about the demand dynamics for giga casting and question why the company would seek to diversify its auto segment in this area. We believe that, in theory, the underlying drivers and trends supporting the transition to OEM-led production in this area are sound. We believe that the EV market will continue to adopt and utilize this manufacturing system, and that from a return/floor space perspective, it can be attractive for conventional users to shift production downstream to LNR.

Conclusion

On balance, while it is impossible to look into the future with absolute certainty on how trends will play out, investors ought to trust in Management teams with experience and established track records to know how to position their companies to adjust to industry demand. In the case of LNR, we believe that Management has continuously positioned the company to capture long-term secular trends with sufficient flexibility to adjust to shorter duration movements and will continue to do so moving forward.

Best from the Desk,
James, Jim, David, Shannon, and Nicho

*so low