

Industrial

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Industry Brief

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Infrastructure & Construction

CAT Makes First Sale of BUCY Distribution Rights to Dealer; Readthrough for FTT and TIH

- ◆ Last night, Caterpillar announced the sale of a portion of the Bucyrus rights for \$360 mln to Hastings Deering the operator of the CAT dealerships in Queensland and Northern Territory of Australia, Papua New Guinea and New Caledonia (see Appendix 1). Hastings Deering is part of the Industrials division of Malaysia-based conglomerate Sime Darby Berhad (note that Sime Darby's Industrial division also owns CAT dealers based in China, Hong Kong, and Singapore, but they have been excluded from this transaction).
- ◆ Hastings Deering is a private company and therefore limited information is available; as well, the news sources did not provide any deal metrics. Based on the company's geographic exposure we assume that the majority of its sales are mining related. As a result of the transaction, its total workforce will now include an incremental 400 former Bucyrus employees bringing its headcount up to 4,000.
- ◆ CAT reported that it was negotiating the sale of product distribution and support for Bucyrus machinery with its largest dealers first and indicated that announcements were imminent. As a result, this deal marks the first of several to come.
- ◆ We can try and deduce what Finning or Toromont's future payment will be for the rights by looking at the breakdown of BUCY's revenues in 2010 (See Exhibit 1). If Hastings Deering is ~12% of the BUCY's region (about half of Australia and a point for the Pacific Islands), we estimate the total value of the payment from dealers to CAT would be ~\$3.0 bln.
- ◆ Based on our assumed share of sales, Finning's (17%) payment would be ~\$500 mln while Toromont's (2%) would be around \$60 mln (see Exhibit 1). Note that this is consistent with Toromont's comments that the BUCY deal would not be as significant to them (as it would be to Finning) given the more hard rock nature of their mining operations.
- ◆ A multiple of sales analysis is highly dependent upon the margin that gets negotiated between the OEM and the dealer. The more margin that gets transferred to the dealer, the higher the price tag it must pay. An EBITDA margin in the range of 8% – 10% implies an EV/EBITDA multiple in the range of 6.0x – 7.5x 2012 EBITDA. Note that CAT paid ~10.0x EV/EBITDA for its purchase of Bucyrus.
- ◆ Toromont's balance sheet has plenty of room to allow for this small potential payment with MRQ debt-to-TTM EBITDA of 0.5x and debt-to-equity of 0.3x. In our view, Finning is harder pressed with 2.5x debt-to-TTM EBITDA and 1.2x debt-to-equity. As of Sep-30, Finning reported \$625 mln available under their recently renewed credit facilities and ~\$100 mln in cash. We expect more credit to become available as its ERP systems issues get resolved. We are attending Finning's investor day tomorrow and expect that they may provide more clarity around deal negotiations then.

Exhibit 1: Back of the Envelope Calculation Based on % of Sales Valuation

BUCY Sales by Region in 2010 (US\$mIns)		
US	710	19%
Africa	186	5%
Australia	756	21%
Chile	361	10%
Canada	296	8%
Germany	77	2%
Other foreign	1,266	35%
	3,651	100%
Price per % Sales (Hasting Dealer Payment \$360/12%): \$ 30		
Total Implied Payment from Dealers to CAT: \$ 3,000		
Total BUCY Sales, 2012E: \$ 5,000		
FTT Calculation		
		Implied BUCY Sales 2012 (mIns)
Canada	6%	\$ 300
Chile	10%	\$ 500
UK	1%	\$ 50
	17%	\$ 850
Implied FTT Payment	\$ 510	
Valuation Range:		
Assumed EBITDA margin (%):	8.0%	10.0%
Assumed EBITDA margin (\$mIns):	\$ 68	\$ 85
Implied EV/EBITDA multiple (x):	7.5	6.0
TIH Calculation		
		Implied BUCY Sales 2012 (mIns)
Canada	2%	\$ 100
Implied TIH Payment	\$ 60	
Assumed EBITDA margin (%):	8.0%	10.0%
Assumed EBITDA margin (\$mIns):	\$ 8	\$ 10
Implied EV/EBITDA multiple (x):	7.5	6.0

Source: Bucyrus International, Raymond James Ltd.

Appendix 1: Hastings Deering Dealership Territory



Source: Hastings Deering, Raymond James Ltd.

Company	Ticker Primary	Ticker Secondary	Current Price	Rating
Original Equipment Manufacturers				
Caterpillar Inc.	CAT-NYSE		US\$87.82	Outperform 2
Equipment Distributors				
Finning International	FTT-TSX		C\$23.99	Market Perform 3
Toromont Industries	TIH-TSX		C\$20.29	Strong Buy 1

Raymond James Ltd.

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Aggressive Growth (AG) Medium or higher risk equities of companies in fast growing and competitive industries, with less predictable earnings and acceptable, but possibly more leveraged balance sheets.

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Venture Risk (VR) Companies with a short or unprofitable operating history, limited or less predictable revenues, very high risk associated with success, and a substantial risk of principal.

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	RJL	RJA	RJ LatAm	RJL	RJA	RJ LatAm
Strong Buy and Outperform (Buy)	71%	59%	45%	49%	14%	23%
Market Perform (Hold)	28%	36%	48%	25%	5%	3%
Underperform (Sell)	1%	6%	7%	0%	6%	0%

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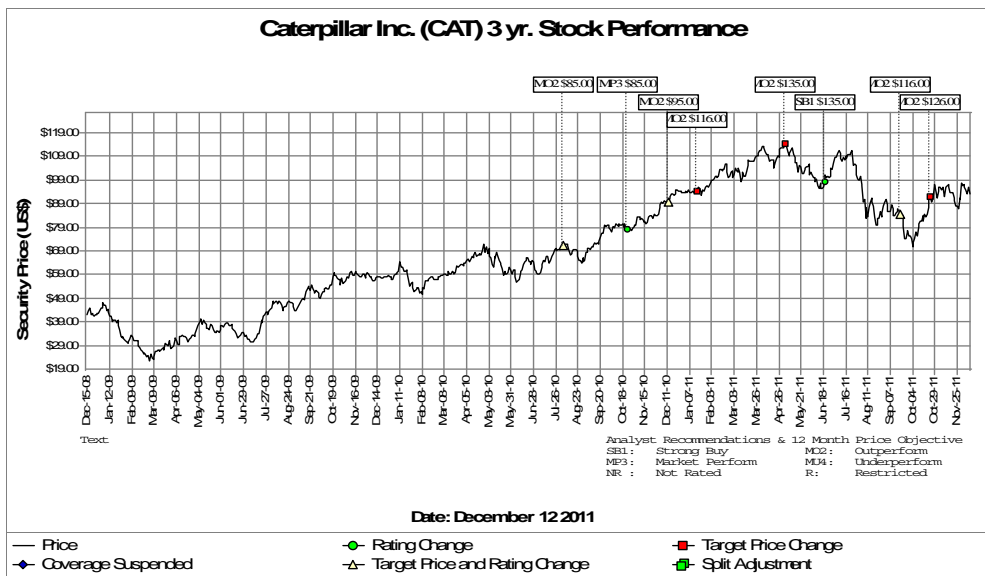
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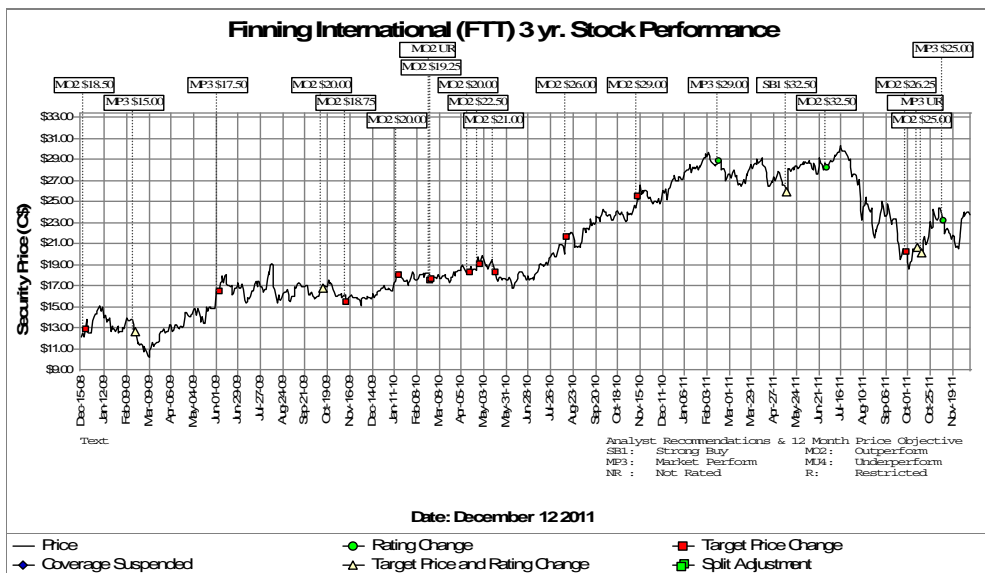
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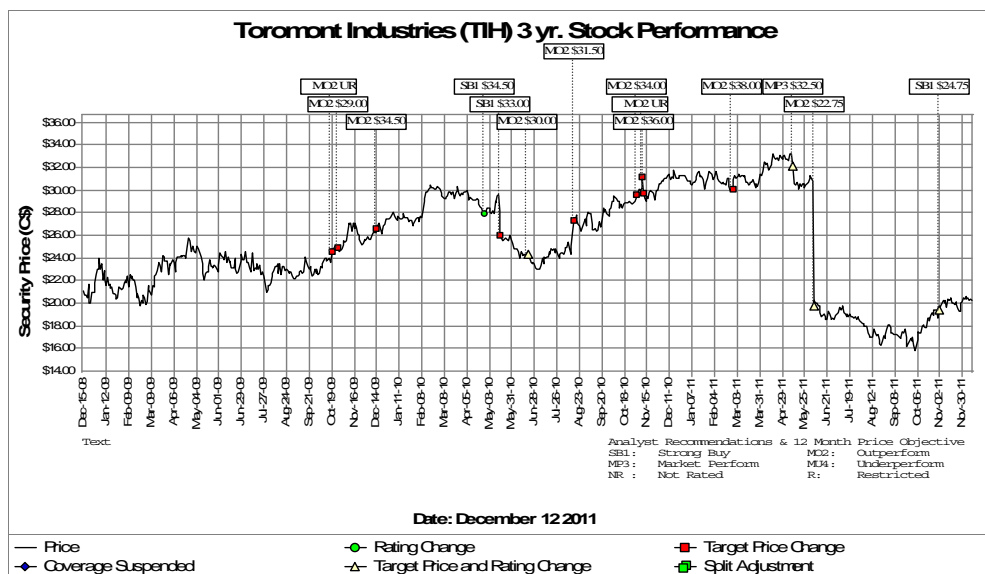
Update Date	Closing Price	Target Price	Rating
Oct-25-11	91.77	126.00	2
Sep-20-11	84.60	116.00	2
Jun-21-11	98.18	135.00	1
May-03-11	114.37	135.00	2
Jan-18-11	94.01	116.00	2
Dec-11-10	89.67	95.00	2
Oct-22-10	78.33	85.00	3
Aug-04-10	71.12	85.00	2

Valuation Methodology: Our valuation methodology for Caterpillar includes peer group multiples and historical trading range comparisons.



Update Date	Closing Price	Target Price	Rating
Nov-08-11	23.22	25.00	3
Oct-14-11	20.04	25.00	2
Oct-13-11	20.66	UR	3
Sep-30-11	20.26	26.25	2
Jun-29-11	28.27	32.50	2
May-12-11	25.88	32.50	1
Feb-17-11	28.85	29.00	3
Nov-11-10	25.48	29.00	2
Aug-13-10	21.60	26.00	2
May-17-10	18.25	21.00	2
Apr-27-10	19.01	22.50	2
Apr-14-10	18.31	20.00	2
Feb-25-10	17.70	19.25	2
Feb-24-10	17.46	UR	2
Jan-14-10	18.05	20.00	2
Nov-11-09	15.48	18.75	2
Oct-13-09	16.80	20.00	2
Jun-04-09	16.55	17.50	3

Valuation Methodology: We value Finning on a comparative basis to historical P/E multiples.



Update Date	Closing Price	Target Price	Rating
Nov-01-11	19.38	24.75	1
Jun-03-11	19.82	22.75	2
May-11-11	32.09	32.50	3
Feb-25-11	30.11	38.00	2
Nov-10-10	29.73	36.00	2
Nov-09-10	31.20	UR	2
Nov-02-10	29.62	34.00	2
Aug-16-10	27.36	31.50	2
Jun-18-10	24.37	30.00	2
May-17-10	26.00	33.00	1
Apr-27-10	27.94	34.50	1
Dec-14-09	26.64	34.50	2
Oct-27-09	24.95	29.00	2
Oct-19-09	24.60	UR	2

Valuation Methodology: We value Toromont on a comparative basis to historical P/E multiples.

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General Risk Factors: Following are some general risk factors that pertain to the projected target prices included on Raymond James research: (1) Industry fundamentals with respect to customer demand or product / service pricing could change and adversely impact expected revenues and earnings; (2) Issues relating to major competitors or market shares or new product expectations could change investor attitudes toward the sector or this stock; (3) Unforeseen developments with respect to the management, financial condition or accounting policies or practices could alter the prospective valuation.

Risks - Caterpillar Inc.

a) CAT's future growth is sensitive to economic volatility in the global economy and the general outlook for economic activity; b) our financial forecasts assume CAT will continue to be able to identify appropriate markets to expand. Failure to do so would likely have negative implications on the company's earnings; c) our financial forecasts also assume CAT will be able to successfully integrate acquired businesses. Failure to realize potential business synergies may negatively impact CAT's earnings; d) CAT is exposed to various political and economic risks associated with the company's global operations. As such, imposition of government regulations or policies in any one of CAT's operating jurisdictions may negatively impact its business; e) currency fluctuations, particularly increases and decreases in the U.S. dollar against other currencies could affect CAT's performance either favourably or adversely; f) CAT's operations are influenced by commodity price fluctuations; and h) interest rate fluctuations may adversely affect demand for the company's product.

Risks - Finning International

a) Several sources of foreign exchange risk could affect either favourably or adversely Finning's financial performance. Finning sources most of its products from the U.S., and records the results of its U.K., Chilean, Argentinean and Uruguayan operations in Canadian dollars. As a result, changes in any of the aforementioned country's currencies directly affect the company's performance. To mitigate the foreign exchange risk, Finning uses a combination of derivative strategies; b) our financial forecast assumes that Finning will continue to be able to identify appropriate markets in which to expand. Failure to do so would likely have negative implications on the company's earnings; c) Finning's business is reliant on agreements with several equipment manufacturers and distributors, the most significant being Caterpillar; d) Finning's operations are also influenced by commodity price fluctuations, however, we believe that the company's broad operations in the forestry, metals, petroleum and thermal coal sectors help minimize commodity-related risks; and e) interest rate fluctuation may adversely or favourably affect the company's ability to raise capital in the form fixed or floating rate debt.

Risks - Toromont Industries

a) Toromont's future growth is sensitive to the general level of economic activity and the company's ability to identify suitable acquisition candidates and/or appropriate markets in which to expand; b) Toromont's business is reliant on agreements with several equipment manufacturers and distributors, the most significant being Caterpillar; c) Toromont sources products and generates revenues from the United States. As a result, fluctuations in the C\$/US\$ exchange rate directly affect the company's financial performance; d) Toromont's operations are also influenced by commodity price fluctuations, especially natural gas; e) demand for the Caterpillar/Toromont products and services may be significantly impacted by fluctuations in commercial and industrial construction, infrastructure spending and the level of economic activity; f) labour agreements could subject the company to greater risks of work interruption and impair Toromont's ability to achieve cost savings; and g) interest rate fluctuations may adversely or favourably affect the company's ability to raise capital in the form of fixed or floating rate debt.

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