MICHELIN SCA

COMPANY REPORT

CONSUMER VEHICLES PARTS

12 ABRIL 2017

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Rim Size Dilemma

"Tires they are a changing"

- **Strong cash flow conversion.** Michelin is expected to expand its **EBITDA to c. €4.7bn by 2023**, **up** approximately **€800m** from 2017, due to improvements in net working capital, favourable tax rate, additional trims in cost structure and a solid platform able to materialize volumes. Financial quality of product mix stays the main issue.

- **Except for HVA, negative market outlook.** The tire market remains substantially in a mature (to-decline, in the truck segment) steady state with **1.5 to 2% overall growth profile**, underlining a downtrend in US (market cycle) and China (competition). Only support is offered by HVA products and some subsegments of the Specialty business line.

- **Refocus is key to untap value.** Michelin future valuation depends on its ability to **capture this HVA trend** (CAGR at c. 10% for >17" products), offering higher margins vs standard products: 20% EBIT margin vs c. 6.5 – 7%.

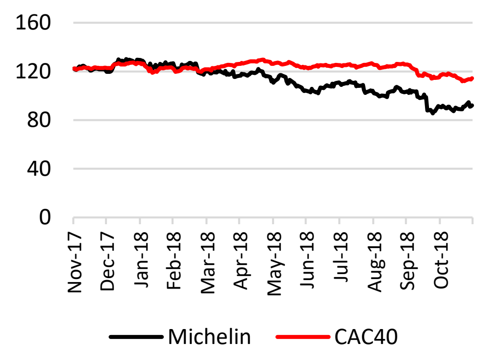
- **Valuation mismatch: market perception vs fundamental approach.** On a fundamental basis, Michelin ability to convert sales into cash flows seems still appealing, but market forces (macro, competitive landscape) are driving volatility and uncertainty.

Recommendation:	**BUY**
Vs Previous Recommendation	*HOLD*
Price Target FY19:	**100.00 €**
Vs Previous Price Target	*0.00 €*
Price (as of 1 Jan 19)	**85.7 €**
Bloomberg	

52-week range (€)	84.06 – 130.85
Market+ Cap (€m)	16,595
Outstanding Shares (m)	178.9m

Source: Company Information

MICHELIN vs CAC40: LAST YEAR



Source: Factset

Company description

Michelin (ML) engages in the manufacture, distribution and sale of tires. Its products and services include tires, mobility services, lifestyle products, Michelin solutions and Michelin engineering services. The company, headquartered in Clermont-Ferrand (France), operates through three distinct segments: passenger car and light vehicle tires, truck tires and specialty businesses. Michelin (ML) was founded in 1863 by Edouard Daubrée and Aristide Barbier.

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Executive summary

Michelin offers an insightful panoramic about the main issues and trends in the tire manufacturing industry, reflective the in company specific market and fundamental valuation. Holding a dominant market position and a diversified product mix, Michelin still lags some of its direct competitors in its high value added portfolio (higher EBIT per unit, resulting in improved cash conversion, *see Pirelli case*).

Positioning is key

Michelin current portfolio is comprised by roughly 15% of high value added products (>17" rim size), c. 1/3 of its passenger car offering. Standard products carry around 6.5% EBIT margin while HVAs see a 18-20% EBIT margin benchmarking against HVA competitors. Furthermore, market growth is expected to be substantially flat in non-HVA passenger segments while growing at c. 10% per annum in the premium opportunity segment. The combined effect margin expansion and high growth is redefining market perception in the industry, main reason why Michelin is penalized by market operators.

Valuation

Michelin trades at a substantial discount relative to its peers, due mainly to market expectations regarding its capacity to reshuffle its portfolio to HVA products. Given good marginality and strong cash conversion (EBITDA margin approximately at 19% above market averages of direct competitors around 17.5%), we see the discount implicitly suggesting a slower growth vs an industry which is changing its underlying value drivers, and a higher risk in relation to the volatility of its non-passenger car portfolio (truck segment regressing with EBIT margin at historical low 5% and specialty segments inevitably tied to the joint effect of overall market and market specific trends in the business served). Additionally, M&A strategy, seen as mainly defensive, signalling entrenching in the specialty business (Camso: 11.3x EV/EBITDA, upper end of transaction comps) rather than pursuing above market growth in HVA, and approx. €4bn in unfunded PBOs, acted as Michelin price depressing tools (now trading just 2% above its one-year minimum). On a fundamental basis, we see Michelin still solid in terms of financial structure going forward, as confirmed by target price at €100. It's no time to panic.

Company overview

Business description

Michelin (ML) is a worldwide leading tyre-maker operating in passenger cars, trucks and specialty (construction, mining, agricultural, aviation, two-wheel commercial vehicles) **segments**, producing more than 180 million tyres units per year. Michelin amounts 68 plants in 17 different countries and counts around 105,600 FTEs worldwide (data as of June 2018).

ML is the second largest player worldwide in the tyre market, with a **global market share of 14.0%**, trailing Bridgestone (14.5%). Michelin progressively lost ground in the market share ladder (down to 20.1% in 2002) due to its historical lower **exposure to emerging and fast-growing markets**. Nonetheless, Michelin holds **leadership positions in Passenger Car and Light Truck segment and in radial tyres in Truck, Agricultural, Aircraft and Earthmover across Truck and Specialty segments** *(company information)*. **Michelin sales mix in the Specialty business has been estimated to be around 60% in mining, 26% in agriculture, 8% in aircraft and 6% in 2-wheels.** Michelin is leveraging its domination in the Specialty segment by pursuing an active M&A strategy with the rational of further consolidate its leadership.

According to Modern Tire Dealer, Michelin is the world **co-leader** (alongside Bridgestone) in the **Passenger Car & Light Vehicle** segment, **worldwide leader in the Truck segment** and **in Agricultural, Aircraft and Earthmover business** part of its Specialty segment. Noteworthy is its leadership position in the Specialty business, oligopolistic by nature therefore managing to materialize higher margins than standard PC & LV segments.

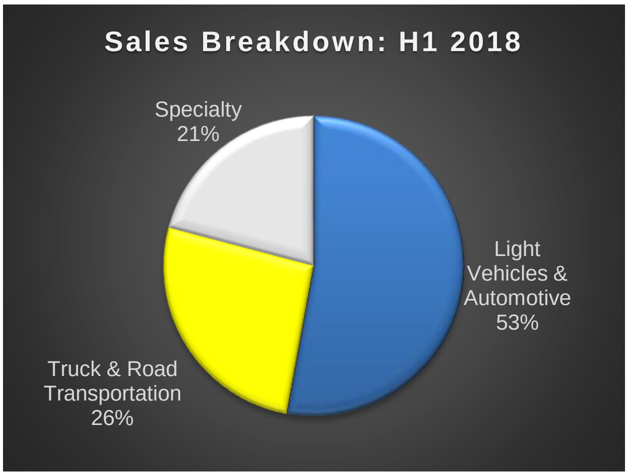
Thanks to its all-encompassing wide product offering and brand portfolio, Michelin leverages on a **strong brand awareness** (with 9 different brands offered) **especially among European consumers**, resulting in **premium pricing** (professed to be 10-15% versus direct high-end competitors and ≅ 50% against standard products as estimated by *Exane BNP Paribas*). Michelin's "premium-ness" is testified by the prestige of OEMs choosing Michelin as main partner: Tesla, M and AMG series (respectively BMW and Mercedes race divisions), Bugatti, Ford Performance, Corvette, Porsche and Ferrari.

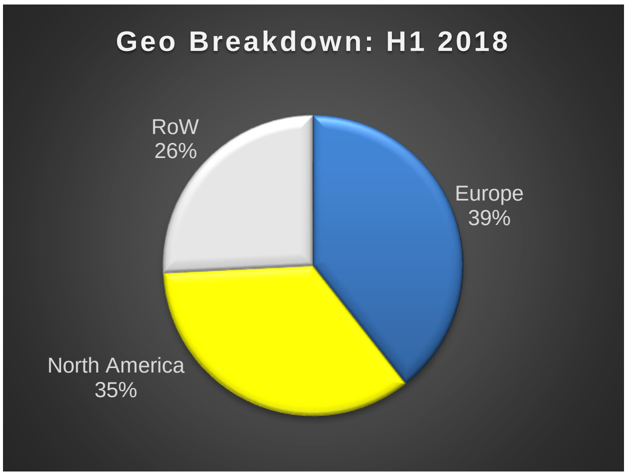
In the past Michelin has been trading at lower multiples in absolute value (in 2005-11 period average EV/EBITDA has been 4.5x) when compared to its peers, due to a **lower relative FCF generation** (high capital expenditures and a heavy cost structure), the declining and volatile performance of its Truck division and its status as partnership limited by shares, meaning that any shareholder gaining control of the capital and voting rights could not exercise control over the company without the unanimous approval of the General Partners.

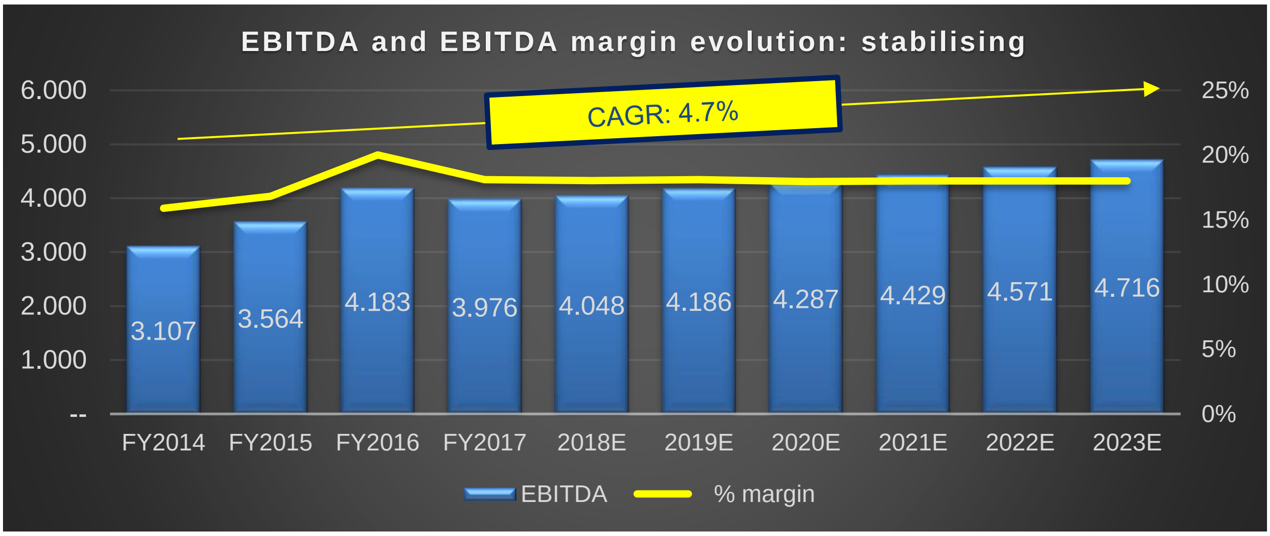
The strategy pillars entering 2019 are:

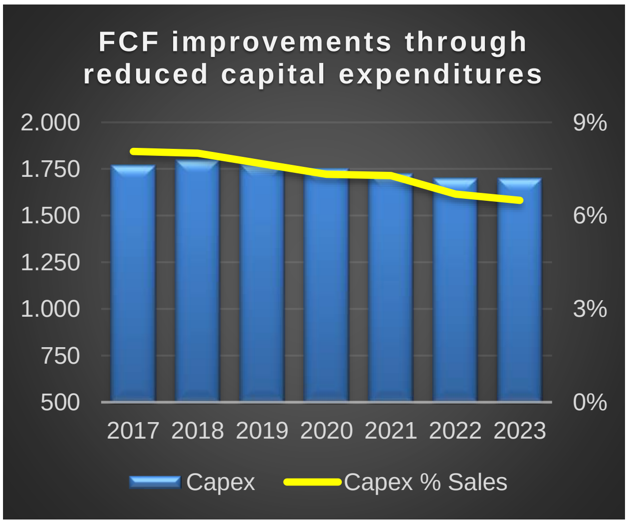
- **Focus on premium (high value added, HVA) car tyres**, usually larger than 17", predicted to generate superior return on sales and further improve margins. The closure by 2020 of Dundee plant, dedicated to below 16" products is a strong indicator in this direction. This pattern is sustained by auto demand in SUV and CUV markets, booming since 2012 and expected to maintain a high-profile pace in the next few years, demanding larger tires
- **ROIC improvement to reach organic 15%** thanks to **lower tax rate** (marginal tax rate to be 28.1% starting 2019, *company information*), **working capital optimization** and **increase in capacity utilization rate**, as to promote **structural FCF conversion enhancement**, expected to achieve c. €2bn by 2023
- **Reiterated cost streamlining** program finalised to achieve **€1.2bn gross savings** throughout the 2017-20 timespan, mainly through personnel costs (reduction of corporate position by 1,420 units by 2020) and capacity optimization
- **Geographical expansion** towards **emerging markets** (China, Latin America) as to achieve **sustained revenue growth in the long-term**, despite fierce price competition. Penetration in China may be sustained by strong brand awareness in the region
- **Keep grinding in the specialty business**, where Michelin holds a dominant position is several opportunity segments, as testified by the latest acquisitions of **Fenner** (leading British-based manufacturer of industrial belting and other polymer-based products with approximately €600m in total revenues for 2018E) and **Camso** (global US-based player engaging in the manufacturing of construction and agriculture tire products, c. €900m sales for 2018E)

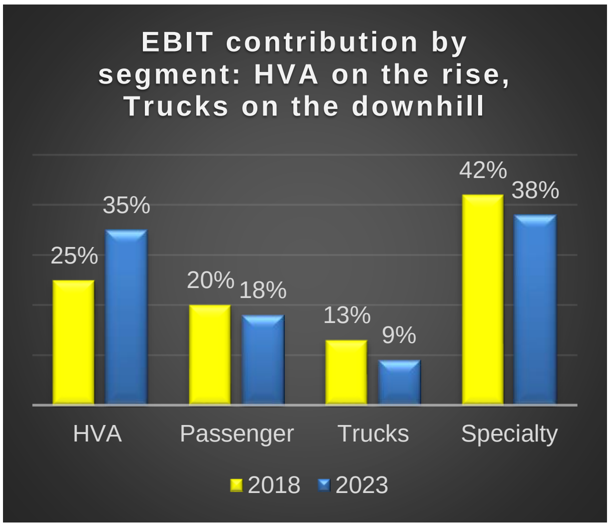
Michelin Overview: Financial Analysis











M&A Activity: Camso Acquisition

On July 12th Michelin announced the **acquisition of the Quebec-based Camso**, a leading worldwide manufacturer and supplier of **off-road tires and mobility solutions**, to further strengthen its Specialty business. The closing is expected by January 2019 and Michelin is agreeing to pay an **equity value of c. €1.3bn (implying an EV at €1.5bn)**.

Camso counts 7,700 employees in 26 countries, of whom 5,500 in Sri Lanka and 300 in Magog, Quebec. Camso operates through 17 plants and 3 R&D centres. A competitive cost structure in terms of personnel costs in relation to Sri Lanka and Vietnam facilities has been disclosed as one of the main investment rationales for the transaction.

Michelin estimates **Camso to be generating c. €875m in net sales** (4% of Michelin total sales) with an **EBITDA margin of 14%** (diluting current ML margins in the Specialty business). If confirmed, that would imply a **3% CAGR in the 2012-2017** period, outpacing Michelin Specialty in the same time span. Michelin announced c. **€50m in synergies by 2021**. We **did model Camso acquisition** impact in our consolidated DCF reflecting sales growth and EBITDA margin dilution in the Specialty segment.

Michelin paid an implied 11.3x EV/EBITDA multiple, expensive if we take into consideration the latest comparable deals in the tire specialty industry:

Target	Buyer	Date	EV/EBITDA
CGS Tyres (MITAS brand)	Trelleborg	2015	9,9x
Alliance Tire Group (ATG)	Yokohama	2016	11,9x
Dunlop Aircraft Tyres	Liberty Hall PE	2017	10,8x
Camso	**Michelin**	**2018**	**11,3x**

Summing up the acquisition of Fenner and the adjustments to get 50% of the distribution JV in the United States with Sumimoto **Michelin spent c. €3.1bn YTD** approaching 1,0x net debt / EBITDA, five times increase vs 2017.

We consider Michelin recent **M&A activity as predominantly defensive**, in the attempt to entrench and defend its leading market position in the non PC & LV segments. Nevertheless, we do **not expect any other major move in the foreseeable future**, as the management reiterated the unlikeliness to purchase any "Tier3" (mass market tire maker) in the Asian markets, due to valuation discounts that may be applied to Michelin following the operation, in line with Michelin strategy to **pursue higher margins in the HVA segment** and be recognized as a major manufacturer in the high-value added competitive landscape.

Financials

Figure 1. Income Statement and EBIT bridge, key data.

Income Statement - €m	FY2014	FY2015	FY2016	FY2017	2018E	2019E	2020E	2021E	2022E	2023E
Passenger tyres standard	10.498	12.028	12.105	12.479	7.909	8.028	8.188	8.352	8.519	8.689
HVA	--	--	--	--	3.532	3.885	4.274	4.680	5.101	5.535
Truck tyres	6.082	6.229	5.966	6.123	5.570	5.581	5.586	5.592	5.597	5.603
Specialty	2.973	2.942	2.836	3.358	5.458	5.649	5.818	5.993	6.173	6.358
Sales	19.553	21.199	20.907	21.960	22.469	23.143	23.867	24.617	25.390	26.185
YoY growth	*n.a*	*8%*	*-1%*	*5%*	*2%*	*3%*	*3%*	*3%*	*3%*	*3%*
COGS	(13.299)	(14.238)	(13.810)	(14.815)	(15.054)	(15.506)	(15.991)	(16.493)	(17.012)	(17.544)
Gross Profit	6.254	6.961	7.097	7.145	7.415	7.637	7.876	8.124	8.379	8.641
SG&A	(3.147)	(3.397)	(2.914)	(3.169)	(3.367)	(3.451)	(3.589)	(3.694)	(3.807)	(3.925)
EBITDA	3.107	3.564	4.183	3.976	4.048	4.186	4.287	4.429	4.571	4.716
D&A	(1.116)	(1.357)	(1.392)	(1.345)	(1.427)	(1.453)	(1.474)	(1.490)	(1.502)	(1.513)
EBIT Passenger standard	--	--	--	--	514	522	573	585	596	608
ebit % of sales	*0%*	*0%*	*0%*	*0%*	*7%*	*7%*	*7%*	*7%*	*7%*	*7%*
EBIT HVA	--	--	--	--	653	719	855	936	1.020	1.107
ebit % of sales	*0%*	*0%*	*0%*	*0%*	*19%*	*19%*	*20%*	*20%*	*20%*	*20%*
EBIT Trucks	--	--	--	--	362	363	279	280	280	280
ebit % of sales	*0%*	*0%*	*0%*	*0%*	*7%*	*7%*	*5%*	*5%*	*5%*	*5%*
EBIT Specialty	--	--	--	--	1.092	1.130	1.106	1.139	1.173	1.208
ebit % of sales	*0%*	*0%*	*0%*	*0%*	*20%*	*20%*	*19%*	*19%*	*19%*	*19%*
EBIT	1.991	2.207	2.791	2.631	2.621	2.733	2.813	2.939	3.069	3.203
Interest expenses	(149)	(212)	(209)	(177)	(300)	(300)	(265)	(248)	(248)	(248)
PBT	1.651	1.869	2.464	2.354	2.321	2.433	2.547	2.691	2.821	2.955
Income taxes	(620)	(706)	(797)	(661)	(652)	(683)	(715)	(756)	(792)	(830)
Net Income	1.031	1.163	1.667	1.693	1.669	1.750	1.832	1.935	2.029	2.126

Source: Analyst

Figure 2. Balance sheet, key data.

Balance Sheet - €m	FY2014	FY2015	FY2016	FY2017	2018E	2019E	2020E	2021E	2022E	2023E
Cash and Cash equivalents	1.167	1.552	1.826	1.773	688	936	1.267	1.689	2.497	3.400
Trade receivables	2.569	2.743	3.042	3.084	3.410	3.513	3.623	3.736	3.854	3.974
Inventories	4.203	4.289	4.480	4.508	4.821	4.965	5.121	5.282	5.448	5.618
Current financial assets	462	363	303	285	326	326	326	326	326	326
Other current assets	883	1.012	1.202	1.132	1.225	1.262	1.301	1.342	1.384	1.428
Total Current Assets	**9.284**	**9.959**	**10.853**	**10.782**	**10.470**	**11.001**	**11.638**	**12.375**	**13.509**	**14.746**
Deferred tax assets	1.149	1.259	1.191	890	890	890	890	890	891	892
Investment in Associates	189	309	309	356	943	943	943	943	943	943
Non-current financial assets	283	410	323	479	739	749	768	763	768	772
Net PP&E	10.081	10.532	11.053	10.883	12.496	12.818	13.094	13.329	13.527	13.714
Intangible assets	602	621	630	785	866	866	866	866	866	866
Goodwill	835	803	963	1.092	2.216	2.216	2.216	2.216	2.216	2.216
Total Non Current Assets	**13.139**	**13.934**	**14.469**	**14.485**	**18.150**	**18.482**	**18.777**	**19.007**	**19.211**	**19.403**
TOTAL ASSETS	22.423	23.893	25.322	25.267	28.709	29.483	30.415	31.013	32.255	34.149
Shareholders' equity	9.511	9.489	10.599	11.226	12.294	13.432	14.623	15.881	17.200	18.581
Non-controlling interest	12	53	47	35	31	31	31	31	31	31
TOTAL EQUITY	**9.523**	**9.542**	**10.646**	**11.261**	**12.325**	**13.463**	**14.654**	**15.912**	**17.231**	**18.612**
Trade payables	2.162	2.354	2.703	3.004	2.846	2.931	3.023	3.118	3.216	3.317
Other current liabilities	2.208	2.318	2.396	2.385	2.873	2.701	2.591	2.086	1.870	2.246
Bonds and commercial paper	419	212	903	172	1.918	1.618	1.318	1.018	1.018	1.018
Loans from financial institutions	251	282	320	272	541	541	541	541	541	541
Financial leases	9	16	16	20	21	21	21	21	21	21
Derivatives Instruments	47	38	81	29	84	84	84	84	84	84
Total Current Liabilities	**5.096**	**5.220**	**6.419**	**5.882**	**8.283**	**7.896**	**7.578**	**6.868**	**6.750**	**7.227**
Deferred tax liabilities	95	118	117	113	141	141	141	141	141	141
Provisions and non-current liabilities	1.476	1.681	1.604	1.676	1.567	1.567	1.567	1.567	1.567	1.567
Employee benefit obligations	4.612	4.888	4.763	3.969	3.904	3.904	3.904	3.904	3.904	3.904
Bonds	1.108	1.940	1.310	1.770	2.046	2.046	2.046	2.046	2.046	2.046
Loans from financial institutions	377	300	232	217	199	199	199	199	199	199
Financial leases	63	101	131	228	257	257	257	257	257	257
Derivative instruments	73	103	100	151	109	109	109	109	109	109
Total Non Current Liabilities	**7.804**	**9.131**	**8.257**	**8.124**	**8.101**	**8.124**	**8.183**	**8.233**	**8.275**	**8.311**
TOTAL EQUITY AND LIABILITIES	22.423	23.893	25.322	25.267	28.709	29.483	30.415	31.013	32.255	34.149

Source: Analyst

Figure 3. Cash flow statement, key data.

Cash Flow Statement - €m	FY2014	FY2015	FY2016	FY2017	2018E	2019E	2020E	2021E	2022E	2023E
Net Income	1.031	1.163	1.667	1.693	1.669	1.750	1.832	1.935	2.029	2.126
Income tax expenses	620	706	797	661	652	683	715	756	792	830
Interest expenses	327	355	322	291	300	300	265	248	248	248
Non-recurring income/expenses	179	370	(99)	111	(23)	--	--	--	--	--
Share of profit/loss from associates	13	(17)	5	(14)	23	--	--	--	--	--
Net D&A	1.116	1.357	1.392	1.345	1.427	1.453	1.474	1.490	1.502	1.513
EBITDA	3.286	3.934	4.084	4.087	4.048	4.186	4.287	4.429	4.571	4.716
Net interest paid/received	(144)	(143)	(146)	(373)	(300)	(300)	(265)	(248)	(248)	(248)
Income tax paid/received	(616)	(754)	(765)	(563)	(652)	(683)	(715)	(756)	(792)	(798)
Δ change in pensions provisions	(117)	(260)	(94)	(235)	--	--	--	--	--	--
Δ change in provisions and other cash items	(74)	(97)	(112)	(111)	--	--	--	--	--	--
Other non cash income/expenses	5	(9)	--	--	--	--	--	--	--	--
Changes in working capital	182	24	(202)	(64)	(908)	(165)	(177)	(173)	(179)	(183)
Cash Flow from Operating Activities	2.522	2.695	2.765	2.741	2.509	2.895	2.972	3.080	3.174	3.303
Capex	(1.883)	(1.803)	(1.811)	(1.771)	(1.800)	(1.775)	(1.750)	(1.725)	(1.700)	(1.700)
Proceeds from asset disposal	46	43	89	65	42	--	--	--	--	--
Payments related to M&A	(404)	(181)	(2)	(368)	(3.147)	--	--	--	--	--
Net financial investments	110	(30)	(173)	(89)	(113)	--	--	--	--	--
Reconciliation	44	29	(4)	103	--	--	--	--	--	--
Cash Flow from Investing Activities	(2.087)	(1.942)	(1.901)	(2.060)	(5.018)	(1.775)	(1.750)	(1.725)	(1.700)	(1.700)
Proceeds/Repayment of Debt	(320)	498	(82)	(51)	2.025	(300)	(300)	(300)	--	--
Dividends paid out	(464)	(463)	(515)	(584)	(601)	(612)	(641)	(677)	(710)	(744)
Proceeds from share issuance	46	64	99	17	--	--	--	--	--	--
Purchase of shares	(87)	(451)	(301)	(101)	--	--	--	--	--	--
Cash Flow from Financing Activities	(825)	(352)	(799)	(719)	1.424	(912)	(941)	(977)	(710)	(744)
FX effects	(6)	(16)	4	(15)	--	--	--	--	--	--
Net change in group cash	(396)	385	69	(53)	(1.085)	207	281	377	764	860
Cash at start of the period	1.563	1.167	1.757	1.826	1.773	728	986	1.312	1.733	2.541
Cash at period end	1.167	1.552	1.826	1.773	688	936	1.267	1.689	2.497	3.400

Source: Analyst

Shareholders Structure

Current Michelin **ownership structure** is comprised by a 98% of free floating shares, of which 38% is held by institutional investors. Top 10 groups with a relevant stake in Michelin are The Vanguard Group (3.07%), Norges Bank (2.63%), Oddo BHF Asset Management (1.77%), BlackRock (1.42%), Invesco (1.05%), Amundi Asset Management (1.02%), Wellington Management (0.97%), DNCA Finance (0.97%), Henderson Global Investors (0.72%) and DWS Investments (0.67%).

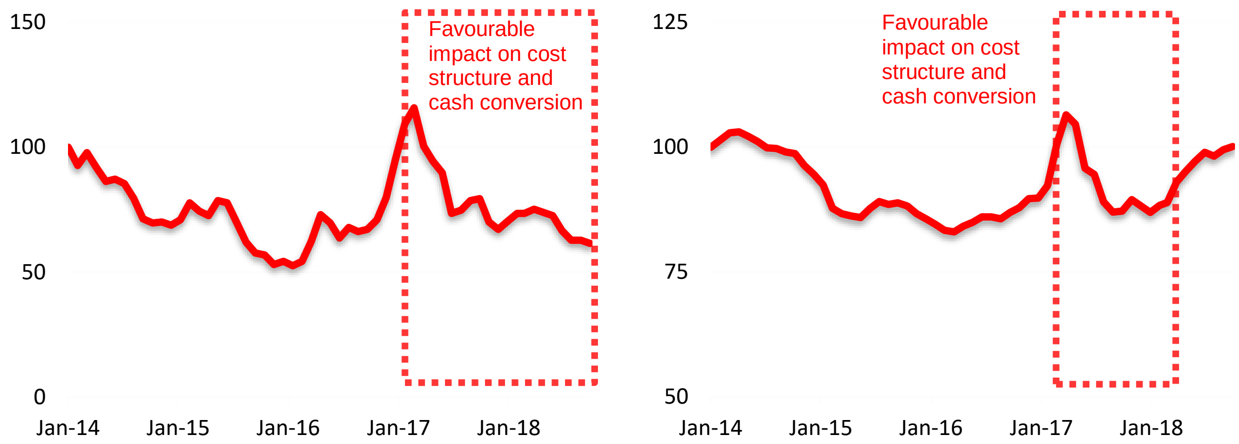
Insider holdings are represented by Michelin Sca ESOP (2.01%), Michelin employee stock ownership plan, mainly dedicated to all-level compensation purposes of ML’s employees.

The Tire Manufacturing Industry

General Overview and Outlook

In 2017 the tire market was estimated to be above 150 billion euros in size, peaking after the favourable market demand conditions in the post-crisis economic scenario, namely decent volume growth, raw material tailwinds and a strong recovery in the specialty segments.

Figure 4 and 5. Natural rubber price indexed, RSS3 listed on Singapore Commodity Stock Exchange; and Synthetic rubber prices indexed including styrene-butadiene and ethylene propylene.



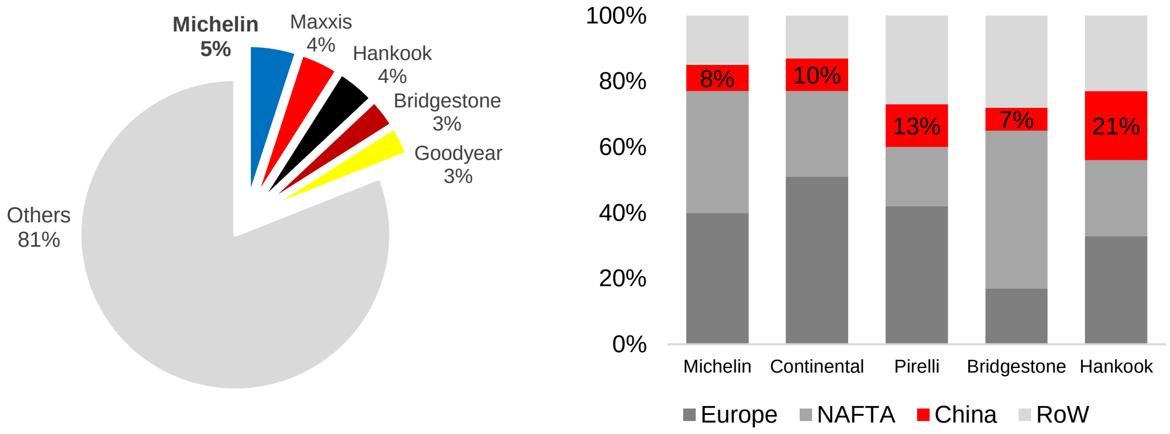
Source: Bloomberg, FRED of St. Louis

Nevertheless, we expect a significant slowdown in overall market conditions in the standard segment, slowdown that could hit significantly the most commodity/unsophisticated offering mix industry manufacturers in the coming years, resulting in an increased potential selectivity by investors that may alter demand and supply dynamics in an investor perspective, rewarding only best-in-class manufacturers. In the following lines we report global consensus market prospects for the tire industry:

- **Developed market growth slowdown:** the aggregate aftermarket and OE market growth is expected to enter a new mature phase, resulting in limited top-line upside for players exposed mainly in EU and US. Namely, US and European drivers are starting to drive less, reducing the number of yearly kilometres run per car. Said so, volumes growth in developed region for standard products should post CAGR in the 0-2% range. Value will be derived mainly through pricing, HVA ("premium") products exposition and FX effects.

- **China on the rise on exports, but with limited access:** China for obvious demographic reasons represents a captivating market landscape for major tire makers, as volume expansion is forecasted to be approximately in the 5-10% mark through 2020, with a stronger emphasis on standard products vs developed countries. Said so, Chinese markets remain difficult to operate within for occidental players, mainly due to price competition driven by China's competitive market structure and limited M&A activity upside due to relative impact on valuation.

Figure 6 and 7. Fragmented market structure in China in 2016 and main European players exposure to China in 2017 (LV + trucks).



Source: Analyst

- **Product positioning still a key driver for value creation:** given the pressure from lower-end and outside competitors, the key for EU tire makers is to aggressively focus on premium segments. With a minimum 2.0x average price premium against standard products, high-value tyres (above 18") can generate superior returns and are estimated to continue growing at a fast pace. In 2017 and through the first six months of 2018 they outpaced the <18" counterparts by an average 10% CAGR YoY. In 2013, at the beginning of the current market cycle, Pirelli disclosed EBIT% breakdowns per tire size with a 7% spread between 18" and 17" tires and a 15% spread between 18" and 16", sustaining the premium positioning rationale in the light vehicles segment (for more information see *Relative Valuation* below).

Despite the look-a-likeness of product offerings, tires do tend to widely differ in terms of features, manufacturing processes and complexity, resulting in a high-value added product with consequences in terms of competitive landscape and market structure.

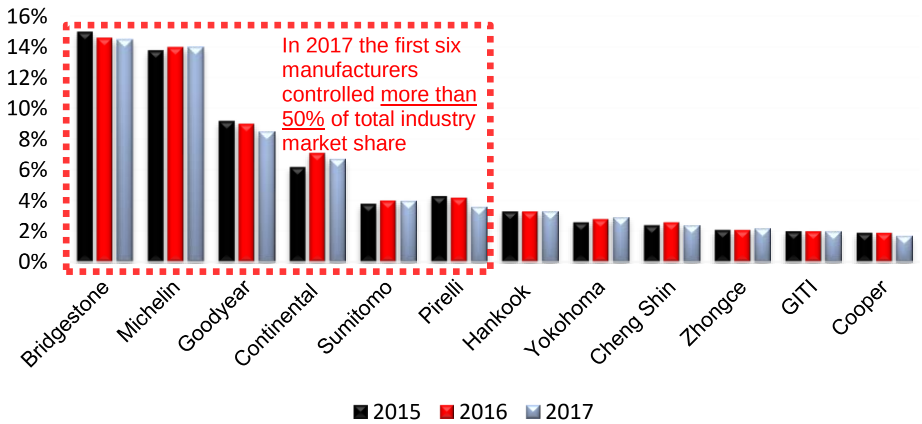
The industry is characterized by high barriers to entry, due to **high capital intensity** (capital expenditures usually range around 6% to 10% of sales mark depending on the stage of the product cycles and customers' appetite) and the related importance of scale economies; **brand awareness**; and product-specific **pricing power**, an opposite feature against other automotive components industries and sub-segments, usually positioned in hyper-competitive markets with extreme degrees of product substitutability and, especially for components manufacturers, with null to low brand recognition.

Why so? Tires do possess some critical characteristics that justify customers' higher propensity to pay premium prices, on average:

- Impact on **fuel consumption** and related savings, especially for truck users and owners
- **Safety**, as a consequence of product-specific road adherence, wet grip, rolling resistance and breaking distance

The result is a **consolidated industry and medium-to-high concentration dynamics**, with major relevant players worldwide enjoying **margins above the average of other automotive components industry participants**. The **key to profitability and strong cash flow conversion lies in tyre makers positioning** across different products mix offerings. As a result, the standard (<"17) tyres industry is very different from the premium one (approx. 17"+), the more tyre industry players manage to aggressively position themselves on superior ROIC opportunity segments, the higher the upside (with **higher risks**) and margins, having a substantial impact on valuation, as reported above and as we'll later consider (see *Comparables* paragraph and the related analysis).

Figure 8. Market Share evolution for main tire market players, 2015-2017.



Source: Bridgestone

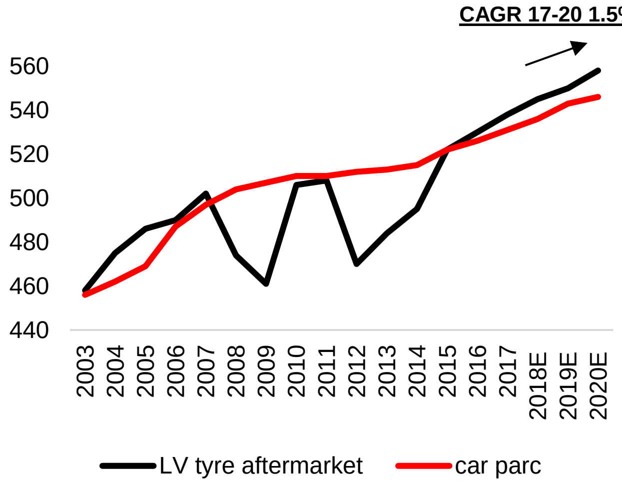
Michelin Segments Market Specifics: Overview

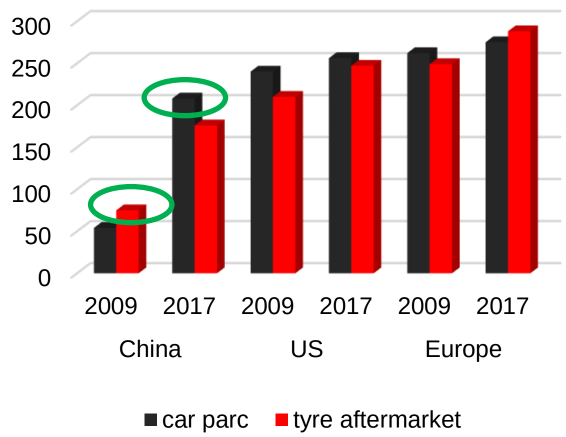
Introduction. In the first half of 2018, **global Passenger car/Light truck and Truck tire markets showed moderate growth overall**, with drops in the year-on-year first quarter versus the outstanding results of 2017 (reflecting dealer inventory accumulation ahead of the price increases in response to the surge in raw materials costs in 2017), trailed by a more vigorous second quarter due to more favourable comparatives in a generally buoyant economic environment. The **Specialty tire markets maintained their strong momentum**, led by the mining businesses.

Q3 was disappointing in the non-Specialty segments given the first half year premises and impacted negatively tyre makers growth profile and FY2018 expectations, mainly driven by a sensible slowdown especially in Asian markets, favoured by **currency depreciation in emerging markets**.

Passenger car/Light truck (now "automotive" related segment). In the first half of 2018, the global OE and aftermarket (replacement) **PC and LV** tire market increased by **1% in number of tires sold**. It declined by 1% in the first quarter off high prior-year comparatives (reflecting the surge in buying in first-quarter 2017 ahead of the price hikes introduced by most tiremakers), before turning upwards and gaining 3% in the second quarter. Third quarter numbers revealed a slight contraction in the <17" tires and sustained growth (around 8-10%) in the HVA >18" products. **The outlook reveals a stationary, flat market for standard products and promising numbers for HVA tires**, reflecting the mentioned importance to focus on the products mix. Russia and China were supposed to offer some momentum extra developed countries, but these opportunities did not materialize due to **currency effects and trade tensions**. For these reasons, **we model an implied 1.5% growth for H2 in the LV segments, HVA excluded, in line with market demand, and a 2% going forward** assuming a revamping in Asian market conditions in the long run (confirmed by Michelin in its last guidance update). **For HVA tires**, we stay very bullish keeping the **10% mark constant**, keeping in mind that 10% CAGR equals loosely the market growth expectations for 2018 and 2019, trailing more HVA focused players as Pirelli and Goodyear, which should be closer to the 15% mark rather than to the 10%. We keep the 10% benchmark going forward to 2023, as we trust Michelin strong brand recognition once fully established as a glamour premium producer, above the current market expectations which should gradually slow down beyond 2020.

Figure 9 and 10. US + Europe LV aftermarket historical trends highlighting stagnation (vs car parc figures, in million units); China still "developing" tire LV aftermarket and its underperformance: stay bullish or accept the bear?

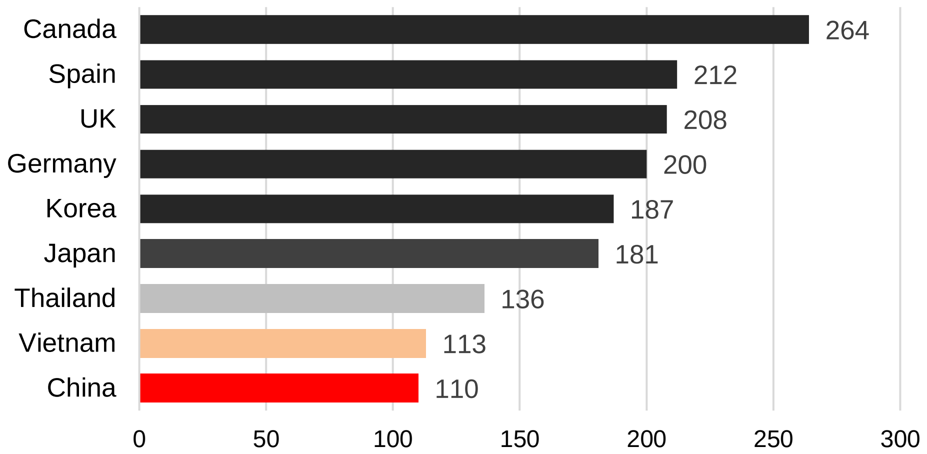




Source: Analyst, Exane BNP Paribas

Truck. Global demand for new original equipment and replacement Truck tires rose by 2% in number of tires sold in the first-six-months of 2018, led by the solid 6% increase in OE markets, predominantly in North America and India. Q3 marked a sudden stop, due to a **slowdown in China**. The main reason for this stoppage is the increased and intense competition in EU and US marketplace exercised by China importers, favoured by **lower prices** in an industry segment in which quality and brand does not always take the first places in terms of required KPIs. **ETRMA researchers showed that since 2007 local producers has lost approximately 17% of market share in terms of million units sold, while imports from China have gained c. 30%**, weighing on incumbent truck tires makers (mainly Michelin and Continental). Donald Trump tariff policies against China has not proven effective, shifting the imports from the Xi Jinping country to other ASEAN nations (Korea, Thailand and Indonesia). For these reasons, and the consequent pressure on Michelin margins for truck products, we consider the experience of the French manufacturer in this opportunity segment at its peak, with **no further potential to participate actively in the growth profile of Michelin**. The industry consensus is that there's enough truck tyre capacity in China to supply the whole world, although only half it's currently utilised (*Exane report*), evidencing once more the enormous pricing power of Chinese – ASEAN manufacturers. **We model a c. 0% growth for the truck tire segment in Michelin, lowering its marginality progressively to a 5-6%, down from the current 7% as a result of increasing competition**.

Figure 11. 2017 commercial truck tire ASP in USD of imports in the United States: China puts its foot down, and there are alternatives: growth unlikely for Michelin.



Source: Analyst, Modern Tire Dealer

Specialty. Overall market in the specialty tire making is sub-divided in several standalone categories, with **distinct market trends and competition dynamics**. Michelin provides a synthetic overview about the situation of the markets to which is exposed, namely mining, agricultural and construction, two-wheels and aircraft tires.

- **Mining tires:** The mining tire market chased its vivacious recovery that started back at the end of 2016, when inventory drawdowns came to an end among international mining companies, oil companies and regional mines. Fenner acquisition devoted to entrenching Michelin market position in the mining industry and expected sustained vivacity between 2018 and 2019 make us keep a bullish profile on this Michelin sub-segment, expecting **growth between the 4-6% mark until 2020 then normalizing around 2.5-3%**. Caterpillar and mining machinery sales boomed in 2017 (30% sales growth YoY) and the overall mining cycle seems in good shape to support ML decision to foster its exposure to the industry.
- **Agricultural and Construction tires:** OE markets remained robust, while replacement demand showed signals of an upturn. Demand for construction equipment tires remained firm, except in South America, Eastern Europe and Australia. The industrial Truck tire segment declined from prior-year levels, which were boosted by early buying ahead of price increases. **Construction tires are expected to grow 3% a year until 2021**, while **the material handling sub-segment supported by the Camso acquisition**

(and the competitiveness of its Sri Lanka facilities) **should produce a 4.5% growth p.a. in the same time window**. **Agricultural business keeps its strong momentum (3.5% expected CAGR through 2021)** as innovation in the agri-tech industry stimulates agricultural machinery demand.

- **Two-wheel tires:** Dampened by weather conditions early in the first half, the motorcycle tire markets saw a rebound in demand for both motorcycle and scooter tires late in the period in Europe, and a decline in North America. Demand in the commuting segment continued to trend upwards in the new markets.
- **Aircraft tires:** Led by the increase in passenger traffic, commercial aircraft tire markets continued to grow, with stronger gains in the radial segment

Overall, **we model a 7% CAGR through Q4 in 2018 and 2019 then progressively stabilizing at 3% as market cycles will start to play in less favour to Michelin exposure in the specialty segment**, that still proves to be a relevant value driver in terms of marginality and cash conversion (approximately 20% EBIT margin, comparable to HVA products in the LV and PC segment). As to validate the approach, **Yokohama** is undertaking the same road (see below).

Comparables: Introduction

As to mitigate potential mis-estimations incurring using the discounted cashflow (DCF) approach, it has been agreed to blend the target price through a relative valuation based on market multiples outstanding. The resulting target price is 50% based on DCF findings and 50% on relative pricing through multiples. In order to isolate to different capital structure decisions, the valuation is based on 2019E EV/EBITDA multiples based on broker consensus expectations for a selected pool of comparable companies operating in the tire industry. Multiples are revealing about market expectations about cash flow conversion, growth and risk profile, focusing our attention on the first two to position Michelin in the competitive landscape of the tire industry.

Methodology. Forward looking metrics have been based on averages of the forecasts of accredited investment banks' equity research department. Consequently, these figures should be taken as a reference point to gather insights about how the market views and prices companies operating in the tire manufacturing industry. Based on consensus estimates, we later develop an explicit target price built on our in-house operating model estimates (see *Comparables: Valuation*)

Comparables: Peers Presentation

This section illustrates the peers selected to build up Michelin-s market valuation, and comprises both large-scale diversified global tire manufacturers, competing with Michelin on its complete product offerings; and smaller/speciality players competing on just a subset of Michelin product mix.

Continental AG (Germany). Hannover based leading automotive manufacturing company specialising in tires, braking systems, electronics, automotive safety, powertrain and chassis components. The tire segment covers around 40% of the group total **sales totalling €11.3bn**, first Continental's segment in terms of revenue contribution. 83% of the tire segment sales locates in **Europe** and in **North America**, highlighting limited exposure to emerging markets. Continental operates **almost exclusively within PC&LT and Commercial Vehicles** opportunity segments, focusing on **winter tires**.

Bridgestone Corporation (Japan). Tokyo based tire and automotive diversified products manufacturer, worldwide market leader in the tire business with more than **€23bn in sales**. Tires comprise 80%+ of the group total revenues. Japan (19%), North America and EMEA represent 84% of group sales, evidencing limited exposure to emerging markets. Bridgestone operates in **PC&LT, Commercial Vehicles, Motorcycles and Speciality opportunity segments**.

Goodyear Tire & Rubber Company (USA). Ohio based tire manufacturing company, serving PC&LT, Commercial and Specialty segments with **over €13bn in net sales**. 86% of the total sales are located in North America and EMEA regions. Lately Goodyear is increasingly focusing on >17" products trying to capture relevant market share in the US and EMEA regions for premium products, resulting in **above the market growth rates in the category in the first three quarters of 2018**.

Pirelli SpA (Italy). Milan based tire manufacturing company, specialized in **high value consumer tyres** after a series of divestitures (electronics, optic cables, commercial tires) in the 2000s. The company went private in 2015 after accepting a buyout from ChemChina, and IPO-ed in 2017 after a major restructuring in its value proposition. Pirelli generates more than **€5.3bn revenues**. Within the Passenger Car segment, Pirelli **focuses on supercars and premium cars (> 18")**, maximising the exposition to high growth opportunity segment. More than 75% of its revenues are generated in EMEA and North America.

Hankook Tire Group (South Korea). Seoul based tire manufacturer, totalising approximately **€5bn sales**. Revenues are located 77% in EMEA and North America, and 21% in China, making Hankook the **best top tier tire manufacturer in terms of Chinese market exposition**. In line with the other major manufacturers, Hankook is shifting its focus to >17" tires, sustained by signing strategic partnerships with premium car manufacturers (Audi, BMW, Mercedes) experiencing a 15% growth rate in high value products between 2016 and 2017. Hankook product mix involves only PC, LT and CV segments.

Nokian Renkaat Tyres (Finland). Nokia based tire manufacturer focusing on eco-friendly **passenger (68% of its sales mix), trucks, buses and heavy-duty equipment products**, with a relevant specialisation **in winter tires**. Additionally, Nokian serves almost **exclusively vehicle tyre replacement products** vs OE supplied to automakers, given the higher profitability in this opportunity segment. The group totalizes **more than €1.5bn sales** (+13% from 2016). 40% of Nokian revenues come from European Nordic countries, while 49% is spread across Central and Eastern Europe. By 2020 Nokian will expand its production to United States thanks to a new production facility in Dayton, Tennessee.

Yokohama Rubber Company (Japan). Tokyo based tire manufacturer with more than **€5bn in revenues**. In 2016 it affirmed the strategic plan to increase its exposure to high-value added products, testified by acquisitions of Alliance Tire Group and Aichi Tire Industry, both tire manufacturers for forestry and industrial machinery. More than 70% of its tire revenues are generated in Japan and North America. Yokohama is relentlessly **refocusing on commercial tires opportunity segment (ATG)**, currently 20% of its sales mix, with the objective to **reach 30% by 2020** due to higher operating margin vs standard PC products.

Cooper Tire & Rubber Company (USA). Ohio based parent company of a global family of companies that specializes in the design, manufacture and sale of passenger car, light and medium truck, motorcycle and racing tires, totalising around **€2.5bn turnover**. It is the fifth largest manufacturer in the United States (**85% of its sales mix generated in US and LATAM**), and it's strongly focused on the replacement market. Cooper Tires is a **pure PC & LV** player with limited portfolio flexibility, highly depending on SUV/CUV demand to strengthen its operating profitability.

Figure 11. Comps table: consensus estimates as of 08/12/2018.

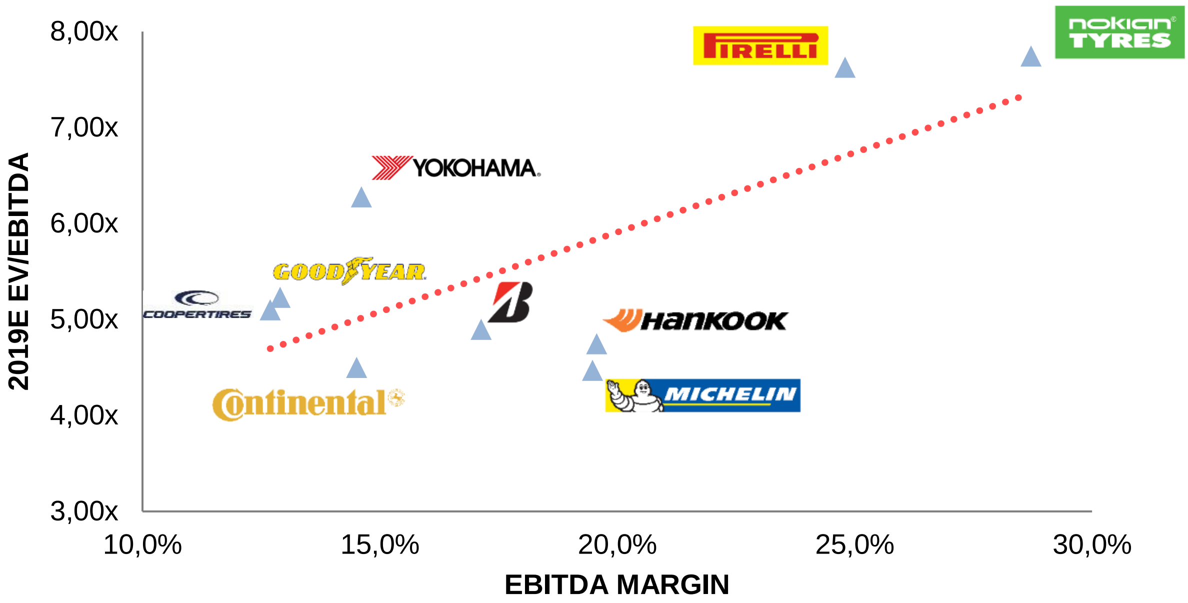
Company	Price	TP	Upside	Market Cap in €	EV	SALES 2018	SALES 2019	SALES 2020	EBITDA 2018	EBITDA 2019	EBITDA 2020	EBITDA margin 2018	EBITDA margin 2019	EBITDA margin 2020	EV/SALES 2018	EV/SALES 2019	EV/SALES 2020	EV/EBITDA 2018	EV/EBITDA 2019	EV/EBITDA 2020
MICHELIN	90,74	115,95	28%	15940	20125	21693	23119	23793	4095	4503	4761	18,9%	19,5%	20,0%	0,93x	0,87x	0,85x	4,91x	4,47x	4,23x
GOODYEAR	18,59	21,72	17%	4570	9528	13755	14134	14328	1711	1822	2057	12,4%	12,9%	14,4%	0,69x	0,67x	0,66x	5,57x	5,23x	4,63x
	34,12	36,07	6%	25541	24839	28751	29616	30446	4837	5073	5283	16,8%	17,1%	17,4%	0,86x	0,84x	0,82x	5,14x	4,90x	4,70x
Continental	145,95	174,02	19%	27091	30590	44720	46876	49059	6235	6801	7382	13,9%	14,5%	15,0%	0,68x	0,65x	0,62x	4,91x	4,50x	4,14x
Hankook	32,06	41,66	30%	4209	5196	5351	5598	5784	1020	1095	1154	19,1%	19,6%	19,9%	0,97x	0,93x	0,90x	5,09x	4,75x	4,50x
nokian TYRES	28,08	32,83	17%	3753	3778	1614	1699	1801	470	488	519	29,1%	28,7%	28,8%	2,34x	2,22x	2,10x	8,04x	7,75x	7,28x
PIRELLI	6,49	7,38	14%	6208	10416	5225	5507	5860	1218	1365	1506	23,3%	24,8%	25,7%	1,99x	1,89x	1,78x	8,55x	7,63x	6,92x
COOPERTIRES	27,26	30,19	11%	1502	1642	2471	2537	2666	292	322	356	11,8%	12,7%	13,4%	0,66x	0,65x	0,62x	5,62x	5,10x	4,61x
YOKOHAMA	17,14	21,29	24%	3090	4918	5194	5363	5570	740	783	831	14,3%	14,6%	14,9%	0,95x	0,92x	0,88x	6,64x	6,28x	5,92x
MEDIAN												0,17x	0,17x	0,17x	0,93x	0,87x	0,85x	5,57x	**5,10x**	4,63x
MEAN												0,18x	0,18x	0,19x	1,12x	1,07x	1,02x	6,05x	**5,62x**	5,21x

Source: Analyst, Factset, Bloomberg

Comparables: Positioning is key

The comparables snapshot based on consensus' estimates illustrates pricing dynamics and expectations in the tire industry. By looking at the comparables table it's striking the fact that **markets discount Michelin with respect to a vast majority of its competitors by approximately a 20% markdown**, a huge discount for a leading company in a mature industry.

Figure 12. EV/EBITDA – EBITDA margin relationship.

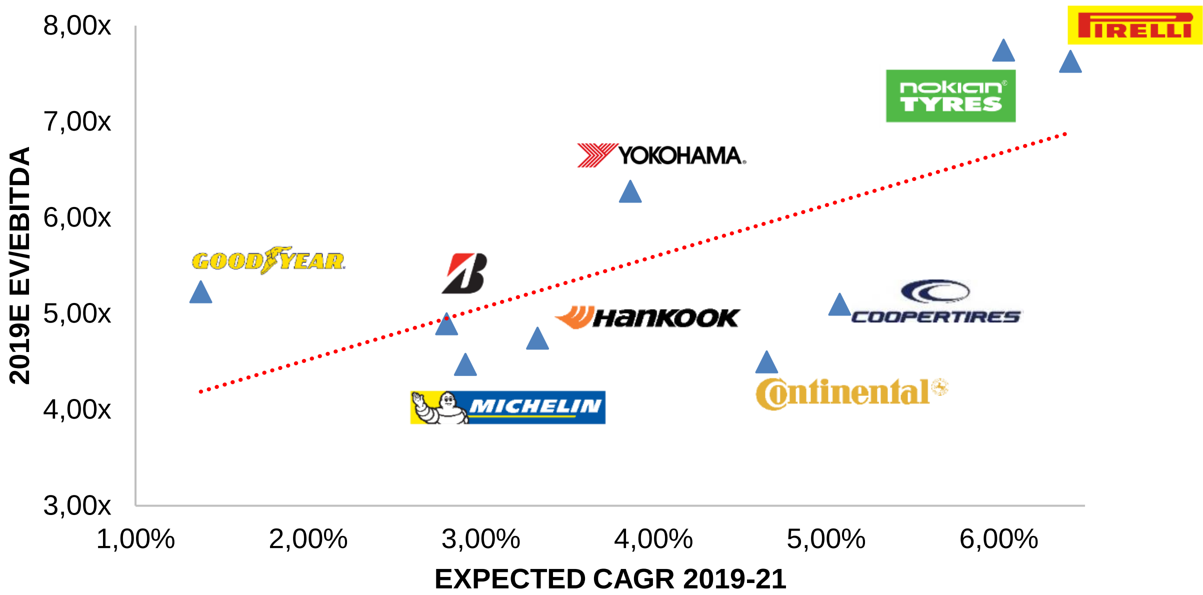


The main driver for it? It **doesn't seem operating profitability and resulting cash flow conversion from operations**, as Michelin appears to be a midpoint in the expected EBITDA margin league table, close to the 20% mark, considerably **better shaped than its bulge bracket competitors** (Bridgestone, Continental and Goodyear), which trade within the 4,50x – 5,50x 2019E EV/EBITDA mark, even if endowed with lower marginality.

The second potential symptom for the embedded Michelin discount should be investigated in the **French company growth profile** going forward. As shown by the snapshot below, Michelin **lags several competitors in consensus compounded average growth profile for the 2019+ period**. This results in a contraction in multiples and the outstanding valuation, but why so?

Again, the tire industry is experiencing a **radical shift in terms of product mix and** the **related opportunity segments characteristics**, and **positioning seems to be the most crucial aspect financial markets and operators are valuing in terms of prospects** and **valuation patterns**. Being able to increase the focus on **HVA products**, resulting in exposure to higher growth subsets of the tire industry with higher pricing power and better margins, is nowadays the "facing page" investors expect to see in any tire-maker agenda, **rewarding HVA-focused players with higher equity values**.

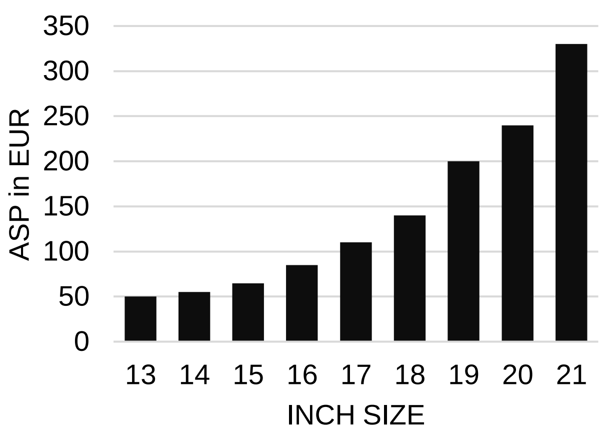
Figure 13. EV/EBITDA – CAGR relationship.

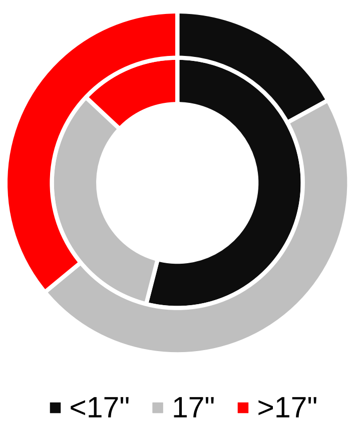


Simply**, premium, high-value added tire makers** (namely **Pirelli**, **Nokian Renkaat** and **Goodyear** in the North American market in the subset analysed in the comparables table) **entail better cost-adjusted pricing opportunities in a less competitive environment** (higher average selling prices) **and better growth exposition** when compared to smaller or small-to-mid size products**, resulting both in top-line and cash flow conversion expansion**.

Michelin is trapped, alongside Bridgestone and Continental, in a **utilisation paradox**: the capacity and the volume dependency to standard products does not allow bulge bracket players to **radically** refocus on HVA.

Figure 14 and 15. Average Selling Price in Eur (Germany) per inch size and Share of Growth by inch size in 2009-2014 (inside) vs 2010-2018 (outside) and 2015-2018 breakdown.





Source: Analyst, Tire Dealer, Exane BNP Paribas

Figure 16. Tire market inch market (both OE and aftermarket) evolution in a nutshell.

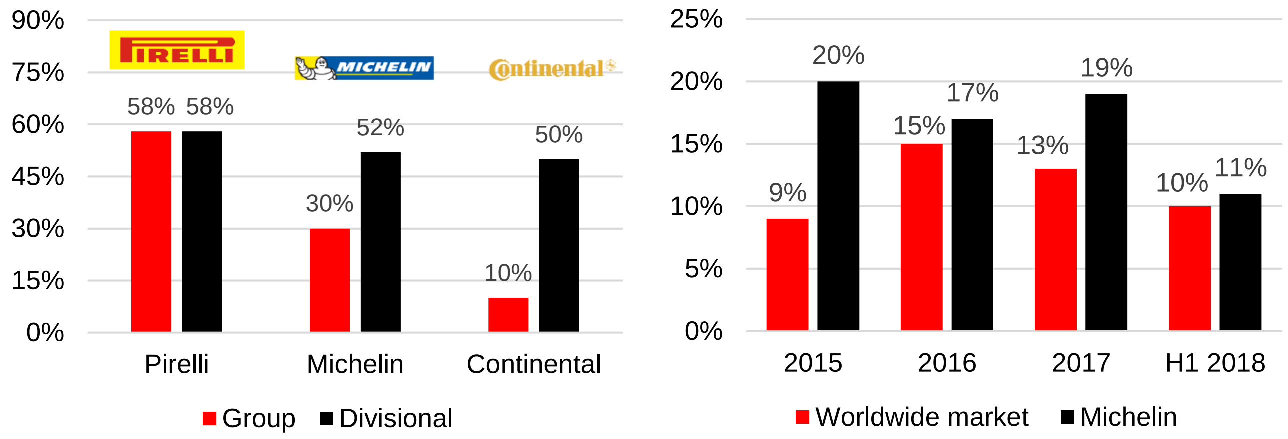
Inch Size	2015	2016	2017	2018E	2015-18 CAGR
<17" growth	1%	1%	0%	0%	0%
<17" mkt share	83%	81%	79%	76%	
17" growth	7%	15%	12%	11%	13%
17" mkt share	12%	14%	15%	16%	
18" growth	37%	19%	20%	20%	20%
18" mkt share	4%	4%	5%	6%	
>18" growth	17%	28%	13%	18%	20%
>18" mkt share	1%	1%	1%	2%	

Source: Analyst, Tire Dealer

Given the size of Michelin (and Bridgeston and Continental) turnover, the <17" still represents the natural fishing spot for main global diversified tire makers, limiting the pure upside or, at least, the capacity to persuade markets they're gonna outperform their HVA-focused peers in the long game.

On the brightside, we believe **Michelin is in a good fundamental place to compete on HVA segments** even if markets are still pricing the company as pure standard product mix offerer (reflected in the same 2019E EV/EBITDA as Continental, which is comparable to Michelin in the HVA run to the tire El Dorado). That's one of the main rationales why we consider Michelin an outperforming stock on a qualitative and quantitative basis:

Figure 17 and 18. 2017 group and divisional revenue % incurred from HVA products (≥17") and Michelin YoY growth pace in HVA conversion (≥18") in the OE market (no aftermarket).



Source: Analyst, Tire Dealer

We see Michelin in an overall interesting position to starting to capitalize on HVA segments, and the company itself is starting to disclose more and more information about sales number about the premium segments operations, reason why **we remain moderately supportive of Michelin potential in the Light Vehicle & Passenger Car tire industry**.

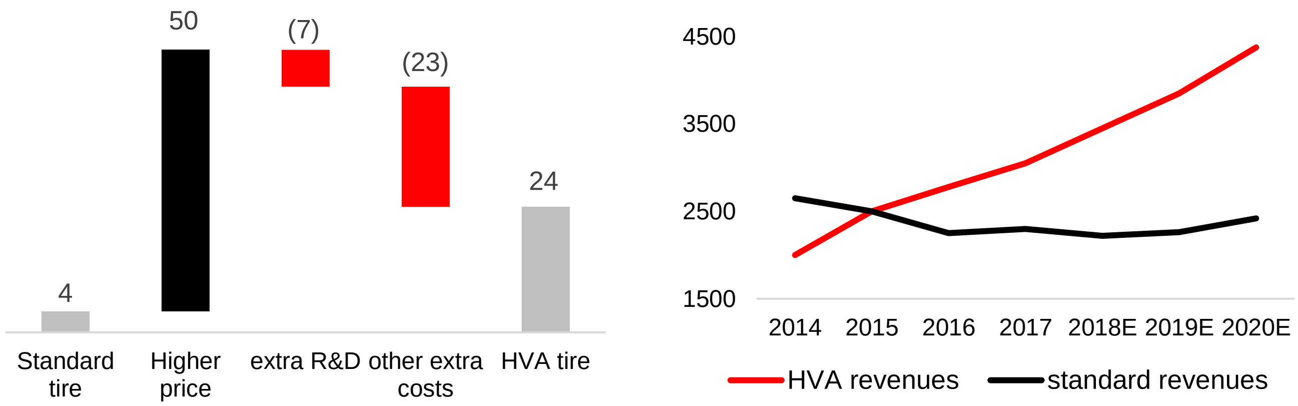
Brief case study: Pirelli (and Michelin)

Pirelli represents an interesting case about making it right in the tire market. While other tire makers are trying to increase their focus in the HVA segment, Pirelli already has set a **full dedicated business model to this high-growing niche**. Eventually, Pirelli will exhaust this first mover advantage as competition will ramp up, but markets seem supportive of Pirelli's landing spot at the end of this rally. For sure, Pirelli took advantage of its de-listing, restructuring and re-listing, disposing non-core non-value adding businesses (read: truck business), and that would not be possible without the support of foreign investors, still teaches a lesson on **how radical changes are more market- and value- oriented than slow incremental changes preserving the status quo**.

We are **supportive of the markets views on Pirelli**, as the only strategic savvy choice to boost margins in an industry close to the descending parabola of this market cycle.

As to quantify Pirelli competitive advantage over non-pure HVA players as Michelin, **Pirelli disclosed that HVA products command c. 100% price premium versus standard products and c. 5.0x times EBIT/tire unit.**

Figure 19 and 20. Pirelli EBIT/tyre 2017 disclosure and Pirelli revenue split in EURm (historical + guidance).



Source: Analyst, Exane BNP Paribas, Pirelli

Pirelli HVA revenues accounted for 44% of revenues in 2014, grew at 15% CAGR and are estimated to account for c. 65% of group total sales by 2020. In terms of cash flow conversion, **HVA players usually post operating margins of c. 20% thanks to higher prices and lower competition**, while pure mass market competitors usually settle in the 0-10% range. Michelin group 2018E EBIT margin is projected to be c. 12.5%, as a joint result of its gradual switch to HVAs, its higher margins in some subsets of its Specialty business line, and a still remarkable dependency to volumes in the standard tire products landscape.

Valuation

Valuation methodology. We propose a blended valuation approach based on a standard DCF model (risk-free rate at 0.5%, WACC 7.8%, in line with consensus weighted average cost of capital estimations, and terminal growth rate 1.5%) and a comparable multiples valuation built on consensus 2019E EV/EBITDA of a selected list of peers engaging in the tire business. The subsequent target price is **€100 per share**, resulting in a **BUY recommendation** at the time of the analysis. **The target price reflects both Michelin's outstanding ability to consistently convert top-line into cash flows by Michelin, in line with the company's strategic pillar to improve FCF generation through cost streamlining, and market's perplexity regarding the current Michelin's positioning in terms of product mix (see *Industry*) and potential to gradually re-focus and convert its standard product leading position into HVA products**.

Main risks achieving the price target:

1. **Global auto production and aftermarket demand.** It's predicted that around 30% (*Exane BNP Paribas data*) of tire volumes is driven by global OE auto demand. Given the strong correlation between GDP growth and auto demand and **utilisation rates** (car parc historically estimated to predict at around 80% accuracy the tires units sold showing an interesting negative correlation pattern with oil prices, data from *Exane BNP Paribas*), any unexpected slowdown may materially impact Michelin ability to sustain its top line in relation to its degree of operating leverage

2. **Raw material prices.** Michelin is exposed to price fluctuations in its core raw materials purchased (rubbers, chemicals, oil) which accounts ≅ 40% of its total expenses. Any unexpected and/or unhedged change in prices may reduce drastically Michelin cash flow conversion.

3. **Restructuring/cost-savings measures enhancement.** Michelin does not provide any guidance about further and/or incremental severe in-place cost-savings activities. In case implemented, they may drive margin expansion beyond expected levels, boosting valuation and changing materially the resulting target price.

4. **Acquisition policy.** Michelin has been recently active in the M&A landscape, following the acquisitions of Fenner and Camso (pending approval) in mid-2018. Any misguidance in setting value-adding integration policies and

synergies extraction could impact negatively the financial performance of Michelin itself, given the relevance of the incurred transactions. We then rely on Michelin financial estimates for the newly acquired companies, given their private nature.

Valuation: Synthesis

The approach incurred to develop a target price for Michelin, as underlined in the previous section, revolves around a fundamental DCF valuation based on a forecasted operating model synthetizing main industry and company-specific trends and specificities; and a multiple-based valuation with 2019E EV/EBITDA as to capture current market sentiment and expectations that may differ from the analysts underlying comprehension of the company.

The **operating model** is structured to capture both Michelin historical market positioning and cash conversion in terms of growth, cost structure, investment strategy and dividend policy. The approach through which the model was built **assumes Michelin as a mature company competing in a structurally overall mature industry**. Michelin has already finalized many of its efforts to improve its EBITDA margin and we see plausible a slow improvement towards 19%, below the consensus estimate as to capture the increasing impact on R&D costs to reposition in the HVA segment, our main value driver and the core aspect considered in this initiating coverage. The cost structure has been estimated using guidance and historical performance, bridging towards our estimation of EBIT, based upon industry study about marginality in four different segments: HVA, standard PC, Trucks and Specialty. **The resulting EBIT is the heart of our operating model alongside our estimation of sales growth in each specific segment**. Progressive refocus on HVA will expand EBIT from 11.7 to 12.2% in a five-year period, driving FCF generation and justifying our DCF implied share price.

The **main and most critical assumptions** involved in the valuation process are the following:

1. **Capital expenditures** have been sourced from Michelin guidance as to be declining beyond 2018, with €1.7bn referred as the objective to further improve cash conversion in the 2018 - 2023 time window. We consider this plausible given the average capex sales % incurred by main competitors as to be in the 6-10% range depending on the business mix and the acquisition policy. Furthermore, Michelin contextual closing of Dundee plant in Ireland should decrease efforts to re-modernize its asset base at an above market pace.

2. The **WACC** has been estimated with a bottom-up betas approach (*see Damodaran, Applied Corporate Finance*) based on selected peers engaging in similar activities as Michelin (Continental, Bridgestone and Goodyear as to capture the extension of ML product mix; and Nokian and Pirelli to capture the development Michelin is trying to put in place to adequate gradually its proposal towards HVA products). The cost of equity is then estimated using the CAPM (0.5% risk-free rate and 8% MRP), and the cost of debt reflects the yield of newly issued bond by Michelin as to capture long term cost of financing given the current financial position based on ML synthetic rating (as a spread vs risk-free rate given **company's rating A3**, obtained from traded bonds of similar size companies). The target E/V ratio has been estimated based on Michelin guidance and our debt schedule in the operating model, given the huge differences among peers in the industry. The result is a **7.8% weighted average cost of capital (WACC)**, in line with broker consensus estimations for Michelin. Risk-free rate and market risk premium parameters have been sourced from Bloomberg and reflect current market expectations in a low interest rates scenario. An interesting takeaway is the **resulting asset beta (0.95)**, showing how the tire manufacturing industry is intrinsically linked to broader market cycles, which in turn are strong predictors of the overall automotive industry demand and performance.

3. **Terminal value growth has been estimated to be around 1.5%**, capturing the synchronized effect of fading opportunities in the HVA segment in which competition is expected to rise, the slowdown of specialty-related activities and the overall market expectations given the strong developed countries focus Michelin still has in its portfolio vs emerging economies.

Figure 21. DCF and Multiple (EV/EBITDA 2019E) output valuation and EV-EQ bridge to establish ML target price.

DCF Implied Equity Value and Share Price FY19	
Enterprise Value	€28.022
Less: Total Debt	(€ 4.875)
Less: Pension Plans	(€ 3.904)
Less: Noncontrolling Interest	(€ 31)
Plus: Cash and Cash Equivalents	€ 986
Implied Equity Value	**€ 20.198**
Number of Shares Outstanding	178,9
Implied Share Price	**€ 113**

Implied Equity Value and Share Price FY19	
EBITDA 2019	€4.186
Multiple to be applied - MEAN	**5,62x**
Enteprise Value	€23.531
Less: Total Debt	(€ 4.875)
Less: Pension Plans	(€ 3.904)
Less: Non controlling interest	(€ 31)
Plus: Cash and Cash Equivalents	€ 986
Implied Equity Value	**€ 15.707**
Number of Shares Outstanding	178,9
Implied Share Price	**€ 88**

Source: Analyst

Results diagnostics. The delta between the valuation techniques in mainly due to current Michelin market perception as extensively explained in the industry analysis. To be mentioned is the **heavy impact of unfunded PBO** with respected to competitors, which depresses the share price and it's often not considered in a relevant set of broker notes covering Michelin. The **implied EV/EBITDA** resulting from our DCF is **6.7x**, which places Michelin in the upper-end of the multiple league table, as result of its enhanced business mix positioning as predicted in the operating model. Furthermore, we see **markets currently discounting Michelin** by the means of demand and supply dynamics, following the below expectations result of its Q3 and corrected guidance, that sparked off a selling frenzy in October 2018.

Share Price

WACC \ Growth Rate	0,5%	1,0%	1,5%	2,0%	2,5%
6,8%	118	129	143	159	179
7,3%	106	115	126	140	155
7,8%	95	103	113	124	136
8,3%	86	93	101	110	121
8,8%	78	84	91	99	107

Key takeaways

Michelin has started, with some justifiable delay, its strategic journey to compete globally in the HVA environment, one of the main reasons why the French company valuation is penalized. But more than a numbers' problem, Michelin is dealing with a recognition problem. In the LV&PC segment, Michelin is still viewed as a premium mass market player. Furthermore, its 2017 EBIT exposure is 46% comprised by truck sales (by far the most unattractive opportunity segment in the whole industry, representing 27% of Michelin 2017 EBIT) and specialty sales, highly cyclical and depending on the status of the underlying served industry (c. 19% of Michelin EBIT in 2017, mainly due to the unexpected volume increase in the mining activity).

While market perception seems to indicate that Michelin is like a dinosaur in an industry re-populated by aggressive competitors, we fundamentally consider Michelin a cheap bargain *ceteris paribus*. **Michelin has an established leading position in EMEA and North America, a strong brand reputation, the in-house capability to serve different segments in different times leveraging on different market opportunities, and a solid fundamental structure that makes Michelin a real "cash machine" thanks to its unique combination of scale and scope.**

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Buy	Expected total return (including expected capital gains and expected dividend yield) of more than 10% over a 12-month period.
Hold	Expected total return (including expected capital gains and expected dividend yield) between 0% and 10% over a 12-month period.
Sell	Expected negative total return (including expected capital gains and expected dividend yield) over a 12-month period.

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