LCI Industries (LCII)

Baird Facts

Please refer to Appendix - Important Disclosures and Analyst Certification.

<table>
<thead>
<tr>
<th>Price ($) (5/28/20):</th>
<th>99.79</th>
</tr>
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<tbody>
<tr>
<td>52WK H-L ($) :</td>
<td>117 - 55</td>
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<tr>
<td>Market Cap (mil):</td>
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</tr>
<tr>
<td>Shares Out (mil):</td>
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<tr>
<td>Float (mil):</td>
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<tr>
<td>Avg. Daily Vol (mil):</td>
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<tr>
<td>Dividend ($) :</td>
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<tr>
<td>Yield (%):</td>
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<tr>
<td>Rating:</td>
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<tr>
<td>Suitability:</td>
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<td>Price Target ($) :</td>
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<td>L-Term EPS Gr Rate Est:</td>
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<td>Debt/Cap:</td>
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<td>FY Dec</td>
<td>Q1 1.31A</td>
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<tr>
<td></td>
<td>Q2 (0.45)E</td>
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<tr>
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<td>Q3 1.05E</td>
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<tr>
<td></td>
<td>Q4 0.73E</td>
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<td>Total 2.45E</td>
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<td>FY P/E 5.00E</td>
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<tr>
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<td>2020E 40.7x</td>
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<td>2021E 20.0x</td>
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<td>2022E</td>
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Headquartered IPO/Founded
Elkhart, IN 1985 / 1956

Management
CEO & Director Jason Lippert
CFO Brian Hall

Company Description
LCI is a key partner to OEMs involved in making recreation vehicles and other products with a growing RV aftermarket business and an expanding presence beyond RVs. For the RV market, LCI manufactures and distributes chassis, axles, suspensions, slide-outs, windows, leveling systems, doors, furniture, awnings, electronic systems and other components. LCI is a leading consolidation platform in the recreation vehicle industry, aftermarket, and other adjacent industries. Since 2012, the company has over 20 businesses representing over $600 million in annualized revenue.

Revenue Profile

LCII Revenue Mix - 2019

Source: Company data, Baird research
**Competition**

LCI has increased content per unit in towables and motorhomes since 2011. Through strategic acquisitions and product innovation, LCI often comes to dominate product categories after establishing a position. Management has estimated its share at between 50% and 90% in many important product lines, a market position that creates scale advantages and supports R&D investments. LCI expects the trend to continue, and has identified $960 million in new content opportunities within the RV industry alone (part of the $6.2 billion total addressable market management has identified).

![LCI Industries Addressable Market](image)

1. Amounts represent management’s estimate of the size of the addressable market, excluding LCI’s current net sales and market share.
2. Source: Company presentation, Baird research

**Quick Summary**

2020 started well but trends collapsed as the virus forced shutdowns. Revenue dropped 76% in April as LCI and OEM customers paused operations, causing LCI to burn $15 million in cash. Stronger May orders coupled with aggressive cash management leave management hopeful the business will generate close to $15 million in May, neutralizing the April cash burn. Based on our industry conversations, we believe RV retail demand fell by over 50% since the outbreak, although declines have moderated recently. We anticipate further volatility as the market reacts to coronavirus headlines and believe LCI has the resources to weather the storm and consider consolidation opportunities that arise from the crisis.
Investment Thesis

Price target. Our $105 price target for LCI Industries is based on 17-18x our forward EPS estimate one year from now, above the five-year average (15-16x) as interest in outdoor recreation grows in the wake of the pandemic - and also takes into account solid FCF (~7% yield).

- **Key RV supplier.** LCI is a key partner to OEMs involved in producing RVs, with a focus on structural components, comfort features, and innovative technology. Located in Elkhart, IN, the RV capital of the world, LCI is strategically positioned to engage OEMs and bring fresh ideas to the marketplace. The collaboration between LCI and OEMs drives sticky relationships and ensures that investments in innovation lead to in-demand products – driving solid returns on research and development.

- **End markets.** LCI manufactures and distributes a broad array of components and products to the RV industry, aftermarket, and other adjacent industries (including the manufactured housing and marine markets). RVs represent LCI’s most important end market, representing over 65% of revenue in 2018. Beyond cyclical factors, we believe secular trends including improved affordability and increased towing capacity have helped to attract younger demographics to the RV lifestyle – supporting demand beyond prior peak levels. Meanwhile, our analysis of dealer inventory suggests dealers are reducing inventory entering the off-season.

- **Increasing content per unit.** LCI has increased content per unit by 6% (CAGR) in towables and 21% (CAGR) in motorhomes since 2011. Through strategic acquisitions and product innovation, LCI often comes to dominate product categories after establishing a position. Management has estimated its share at between 50% and 90% in many important product lines, a market position that creates scale advantages and supports R&D investments. LCI expects the trend to continue, and has identified $1.8 billion in new content opportunities within the RV industry alone (part of the $4.2 billion total addressable market management has identified). Over the next few years, key content opportunities include: 1) distributing Furrion products, 2) increased adoption of travel trailer leveling, and 3) higher penetration of its My RV technology platform.

- **Leading consolidator in growing addressable market.** Since 2012, LCI has completed over 20 acquisitions with acquired revenues exceeding $600 million. LCI consistently has expanded the scope of its addressable market, an essential strategic driver to sustainable growth. Since 2011, LCI has grown its total addressable market to over $6 billion today – providing ample opportunity to apply a winning consolidation formula to new markets. Beyond the $1 billion RV content opportunity, LCI sees opportunities in international markets ($2.5 billion), adjacent markets ($1.8 billion), and the aftermarket ($1 billion). We believe the expanding addressable markets will fuel growth and add diversity to a cyclical portfolio.

- **Talented management team.** We have a long history with CEO Jason Lippert and the LCI leadership team. Mr. Lippert has been with LCI for over 20 years, ascending to his current role in 2013. CFO Brian Hall joined LCI in 2013 after over 16 years in public accounting. Investors familiar with the private equity investment approach will recognize that mindset in the LCI leadership team – except that LCI also brings strategic advantages to acquisitions in the form of purchasing scale, innovation know-how, and customer relationships. Operationally, the team has leveraged lean manufacturing processes and entered higher-margin businesses to drive revenue EPS growth (CAGR).
Risks & Caveats

- **Economic cycles.** Demand for RVs, MH, and marine industry products is sensitive to economic conditions, especially wealth, credit, employment, consumer confidence, demographic trends, and tax policy. The current RV cycle has exceeded prior peak volume. An industry slowdown could cause channel partners to destock inventory.

- **Competitive market.** The RV and MH housing industries are highly competitive with low barriers to entry. Part of LCI’s growth strategy relies on increasing its content per unit, whether organically by gaining market share in existing product lines or through acquisition. However, given the competitive nature of the industry, there is no guarantee LCI will continue to increase its market share position.

- **Acquisitions.** In the past, LCI has executed a successful acquisition strategy, supplementing organic growth in the business and expanding LCI’s total addressable market. However, there is no guarantee the company will be able to continue sourcing acquisitions at attractive valuations – especially in a healthy market. As the company grows, it may need to execute more deals in a year or acquire larger targets in order to sustain the same growth rate in acquired revenue. Additionally, there is execution risk associated with acquiring and integrating larger, more complex businesses. Finally, there is additional risk as the company pursues acquisitions in adjacent industries, given that management may not be as familiar with market dynamics in that particular industry.

- **Access to credit.** Consumer demand for RVs, MH, and marine products is sensitive to availability of consumer credit.

- **Customer concentration.** LCI’s two largest customers (Thor and Forest River) represented a combined 54% of consolidated net sales in 2018. Loss of a major customer could materially impact revenue. Additionally, further industry consolidation may increase the purchasing power of customers – potentially impacting margins.

- **Labor costs.** LCI may experience higher labor costs related to labor shortages in its manufacturing facilities in Elkhart County as the RV industry grows and employee turnover is high. The Elkhart County unemployment rate was just 2.7% in December 2019 – near cycle lows. Low unemployment in the Elkhart area may result in higher labor costs.

- **Raw material costs.** LCI sources large quantities of raw materials, including steel, aluminum, glass, fabric, and foam, among others, as key inputs for its products. Steel and aluminum are the most significant components of raw materials purchases, representing 45% and 15% of 2016 raw materials purchases – and we estimate that LCI purchased over $800 million of raw materials in 2016. LCI only hedges a portion of its steel exposure (does not hedge any other commodities). Prices for these inputs can be volatile and the company may not be able to pass along higher raw material costs to its customers.
Appendix - Important Disclosures and Analyst Certification

Approved on 29 May 2020 08:31EDT/ Published on 29 May 2020 08:36EDT.

Covered Companies Mentioned
All stock prices below are the 5/28/2020 closing price.

Patrick Industries, Inc. (PATK - $53.62 - Outperform)
(See recent research reports for more information)

Rating and Price Target History for: LCI Industries (LCII) as of 05-28-2020

Rating and Price Target History for: Patrick Industries, Inc. (PATK) as of 05-28-2020

1 Robert W. Baird & Co. Incorporated makes a market in the securities of LCII and PATK.
3 Robert W. Baird & Co. Incorporated and/or its affiliates have received investment banking compensation from Patrick Industries, Inc. in the past 12 months.

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