

April 13, 2018

Dear clients and colleagues,

Factory automation has been a trending topic in recent years. This industry has tremendous growth potential as the need for effective and precision manufacturing surges. Also, a shortage of workers as a result of a global aging population will drive the demand. Japan Machine Tool Builders' Association (JMTBA) data show that in February 2018 total machine tool orders in Japan hit a second monthly record high of 155.2 billion yen. This is a 40% year-over-year increase on a global basis. The growth was driven by an increase in overseas orders, especially from China which were up 74%. This upward phase of the global orders cycle began with the recovery in China at the end of 2016. At the same time, as products are becoming more complex, the market has seen increased demand for direct sales support.

Our portfolio will continue to benefit from this favourable trend.

In January 2017 we profiled THK, one of our portfolio holdings. THK's stock price increased 64% in 2017, approaching the upper limit of index, so we replaced it in our portfolios with another machine tool company, DMG MORI Co Ltd. We have met the management of DMG MORI a few times, and this March we visited their showroom in Tokyo, which is very impressive. Our guide was a member of their R&D staff who spoke fluent English. Over 60 machines covering turning, milling and molding are displayed in this 1,300 square metre space, and more than 60 companies and 120 people visit the showroom every month.

DMG MORI (6141 JP – ¥1,915)

<https://www.dmgmori.co.jp/>

Business Overview

Founded in 1948, DMG MORI is Japan's, and the world's, largest machine tool company. It produces machining centres, multifunction machine centres, lathes, laser cutting tools and laser sintering 3D printers.

Investment Theme

Innovation: automation, laser tech, 3D printers, Internet of Things (IoT)

Target Market

The worldwide machine tool market is expected to be EUR73.2B (+3.6%) in 2018, according to VDW/Oxford Economics (a research company recommended by DMG MORI). The market was +4.5% in 2017 and -2.6% in 2016. Growth drivers are 5-axis, multi-function and automation.

Management

Masahiko Mori, son of the founder of the company, has been President since 2003. The Mori family owns 8% of the company shares.

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ESG

DMG MORI has very good ESG practices, certified by ISO14001 Environment Management and ISO9001 Quality Management. The company strives to improve the energy-saving performance of each machine tool it uses. Board structure is transparent, with 4 out of 9 directors being independent.

Market Data

Market Cap ¥241B, Net Debt/EBITDA 2.5x, Dividend Yield 2.1%, P/E (2018/12) 11.3x, Ev/Sales 0.9x, Ev/EBITDA 7.4x, EBITDA Margin 11%, Profit Margin 3.5%, ROE 14.6%.

Competition

Main competitors include Yamazaki Mazak (a privately owned company) with 4%-5% global market share and Okuma with 4% global market share.

Competitive Advantages

- World's largest machine tool company with 9% market share
- 3D sensing technology integrated into the machine tools
- Direct sales in the US and Europe

Growth Strategy

- Product: new product launches
- Distribution: direct sales focus on Europe and US markets

Risks

- Yen appreciation
- Cyclical downturn

Have a great weekend.

The Global Alpha team

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