

PALOS

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Weekly Commentary

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Martinrea International Inc. – Taking a Long-Term Perspective

Martinrea International (TSX/MRE) is a Canadian manufacturer that manufactures an expanding portfolio of assembled parts, propulsion systems, lightweight parts, fluid delivery systems and vehicle chassis for the automotive manufacturing industry. MRE supplies manufactured products to multiple OEM manufacturers including Ford, GM, Volkswagen, Daimler, Mercedes, Nissan, Volvo and Stellantis (Fiat-Chrysler-Jeep). The majority of MRE's revenues are North American based (80%).

Management held its Q3/2021 earnings call on November 4. Global shortages in semiconductors were cited as a major headwind and this has been broadly evidenced across the auto industry. Inflationary forces in labour, materials, and energy costs, combined with production disruptions and increased launch-related costs, further challenged the quarter. For Q3, MRE realized an adjusted operating loss of \$16 million (\$0.21/share) on sales of \$797 million (-15% year-over-year). Bottom line: chip shortages and rising costs are creating a 'perfect storm' that's impacting margins, volumes and new product launches.

On the earnings call, management commented that Q3 results while disappointing, were directly correlated to chip shortages: Q2 faced similar issues. Taking a longer-term perspective, we are confident that given the time to resolve the chip shortages problem, the future looks bright. Current and projected demand for new vehicles is strong and current inventories are historically low. This is not a demand problem; it is a supply chain problem. While difficult to estimate precisely when chip shortages will abate, recent indications suggest the issue is slowly but surely being resolved. Once chip supplies are normalized, we expect production lines to run at full capacity for the foreseeable future – good news for the auto industry.

There's more to the MRE story. The company is driven by a culture of innovation, manufacturing expertise, and a commitment to excellence. The **Martinrea Innovation Development** initiative (MiND) aims to develop innovative technologies 'in-house'. A significant driver of the MiND program is the company's investment in **NanoXplore (TSX/GRA)**, the world's leading producer of graphene currently supplying roughly 40% of global supply. Graphene is rapidly garnering attention as a 'revolutionary' material with a multitude of industrial applications including the light weighting and electrification of vehicles (automotive industry), consumer plastics recycling, concrete reinforcement (less rebar), and electric vehicle (EV) battery manufacturing.

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Last May, **Martinrea** and **NanoXplore** announced a 50/50 joint venture (**VoltaXplore**) to build a 1GWh electric vehicle (EV) battery production plant. The plant is intended for use as a demonstration facility for graphene enhanced, lithium-ion (Li-ion) EV batteries. Research conducted to date indicates graphene enhanced Li-ion batteries could reduce charging speeds and production costs while offering longer battery life, reduced costs of production, and improved safety. If successful, this initiative could potentially be the precursor to a 10GWh manufacturing facility based in Canada. Currently, we do not believe that MRE's investment in NanoXplore and the potential profitability for VoltaXplore are priced into the stock.

Further enhancing our optimistic view is MRE's stated commitment to ESG principles. Sustainability is central to the company's core values. Light weighting, waste reduction initiatives, and Li-ion battery technology is indirectly beneficial to reducing CO₂ emissions. Social initiatives pertaining to diversity (including suppliers), promoting women in automotive career building, monitoring and improving employee health and safety, a worker bill of rights and encouraging communication through an open-door policy. The board is fully independent and prioritizes a commitment to exemplary social/community involvement and business ethics.

We recently met with management and in our view, recent weakness in MRE presents a long-term investment opportunity. The company is well positioned for significant multi-year growth once supply chain issues are resolved, likely in 2022. Further, investments in innovative technologies like graphene enhanced parts and systems, light weighting, and battery technology places MRE in a competitively advantageous position. Important to note, the Martinrea product portfolio is 80% agnostic to ICE (internal combustion engines) propulsion versus electric (EV). While present times are clearly challenging the future looks bright.

The **Palos Equity Income Fund**, **Palos Income Fund LP**, **Palos-Mitchell Alpha Fund**, and **Palos WP Growth Fund** are presently invested in shares of Martinrea.

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Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) ¹	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	\$10.00	21.60%
Palos Equity Income Fund - RRSP	PAL101	\$7.68	21.49%
Palos Merchant Fund L.P. (Dec 31, 2020) ²	PAL500	\$1.35	-21.15%
Palos WP Growth Fund - RRSP	PAL213	\$24.34	52.51%
Palos-Mitchell Alpha Fund ³	PAL300	\$10.69	28.14%
S&P TSX Composite (Total Return with dividends reinvested)			24.06%
S&P 500 (Total Return with dividends reinvested)			23.89%
S&P TSX Venture (Total Return with dividends reinvested)			7.94%
Chart 2: Market Data ¹			Value
US Government 10-Year			1.47%
Canadian Government 10-Year			1.61%
Crude Oil Spot			US \$68.15
Gold Spot			US \$1,784.30
US Gov't10-Year/Moody BAA Corp. Spread			177 bps
USD/CAD Exchange Rate Spot			US \$0.7817

¹ Period ending November 26th, 2021. Data extracted from Bloomberg

² Fund is priced annually

³ Fund is priced weekly on Tuesdays

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