

# PALOS

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## Weekly Commentary

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## Martinrea International Inc. – With Record Q1 Revenues the Tide May Be Turning

**Martinrea International (TSX: MRE)** is a Canadian based manufacturer of parts and assemblies primarily for the automotive manufacturing industry. The company specializes in propulsion systems, frame assemblies, fluid supply systems, brake lines and the light weighting of parts. Martinrea has operations in North America, Europe, Brazil and Asia. Martinrea supplies automotive OEM's that include GM (its largest customer), Ford, Stellantis (Chrysler), Daimler, Honda, Mazda and Volkswagen. The company also supplies the agriculture machinery industry including Deere and Caterpillar.

The company released its first quarter 2022 results on May 5. Record adjusted earnings came in at \$0.31 per share on adjusted operating income of \$44 million. Production sales came in at \$1.1 billion, up 19 % from the same period in 2020. EBITDA was up year-over-year and higher by roughly 80% compared to Q4/2021. These were big improvements over the two most recent quarters.

Headwinds in the automotive manufacturing sector have been well documented. Supply chain disruptions that resulted from pandemic related shutdowns was the primary culprit. This was particularly evident in semiconductors or “chips” as shortages plagued production schedules industry wide. The impact was felt in labour (shortages), production (halts), higher costs and delayed launches of new programs. On the earnings call with analysts, Executive Chairman Rob Wildeboer disclosed that some key Martinrea programs, including the Chevrolet Equinox, Silverado, and Sierra lines, are beginning to ramp up. “While the current environment remains challenging, it is improving as you can tell by our first quarter performance. Results in the back half of the year should demonstrate steady improvement over the first half” according to Mr. Wildeboer.

As supply chain issues get resolved and new product launches resume, Mr. Wildeboer expects the stage is set for “a multi-year period of strong production volumes, margin, and free cash flow” accompanied by “plants basically running at full capacity” and further supported by unwavering demand. The company “continues to launch on the largest book of business we have had” and includes “traditional customers”, “core products” and electric vehicle (EV) programs. Notable is the fact that as new vehicle programs are launched, capital expenditures associated with a new product cycle moves into the rear-view mirror.

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Martinrea continues to actively pursue new technologies related to EVs. The company is a significant shareholder in **NanoXplore Inc. (TSX: GRA)** which is the largest manufacturer of graphene, a revolutionary material with applications related to weight reduction, superior strength, durability, and conductivity. The company currently uses graphene in brake lines, autobody parts and lightweight solutions. Recently, Martinrea was nominated for an automotive news PACE award for its graphene enhanced **GrapheneGuard™** brake line products.

Martinrea's relationship with NanoXplore includes **VoltaXplore**, a joint venture (JV) graphene-enhanced lithium-ion battery program that uses graphene to significantly improve the capacity (driving distance), safety, charging speed and life cycle of EV batteries. VoltaXplore held a Battery Day for investors on April 5, which we attended. The VoltaXplore facility, located in suburban Montreal and in close proximity to NanoXplore's graphene plant, is described as a "demonstration facility". The facility is currently producing batteries. With the technology validated, expectations are that a 2-Gigawatt battery manufacturing facility could receive a final investment decision this year, dependent on arranging satisfactory financing, availability of government incentives or tax credits, and validated economics. The final step would be site selection. If the project receives a green light, VoltaXplore could be a significant source of future growth.

As investors in Martinrea, we periodically meet with company management and industry analysts. Without doubt, the consensus is that the automotive industry will continue to face a plethora of challenges. However, as pandemic headwinds are addressed and resolved, the combination of improving supply chains, pent-up demand and vehicle shortages will turn the headwinds into tailwinds. In our view, the worst is behind us, and better days lie ahead. The tide may be turning.

Martinrea boasts an impressive dedication to excellence as demonstrated by management's philosophy of "entrepreneurship and ownership" that is pervasive from the boardroom to the plant floor. We hold a high degree of confidence in the company's management team. As forward-looking investors, we believe Martinrea is well positioned to capitalize on improving economics in the automotive industry and that patient investors will be well rewarded.

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Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) <sup>1</sup>	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	\$9.01	-6.55%
Palos Equity Income Fund - RRSP	PAL101	\$6.76	-6.38%
Palos Merchant Fund L.P. (Dec 31, 2021) <sup>2</sup>	PAL500	\$1.16	24.67%
Palos WP Growth Fund - RRSP	PAL213	\$14.51	-23.33%
Palos-Mitchell Alpha Fund <sup>3</sup>	PAL300	\$8.72	-15.23%
S&P TSX Composite (Total Return with dividends reinvested)			-4.37%
S&P 500 (Total Return with dividends reinvested)			-15.13%
S&P TSX Venture (Total Return with dividends reinvested)			-25.81%
Chart 2: Market Data <sup>1</sup>			Value
US Government 10-Year			2.92%
Canadian Government 10-Year			2.96%
Crude Oil Spot			US \$110.49
Gold Spot			US \$1,808.20
US Gov't10-Year/Moody BAA Corp. Spread			219 bps
USD/CAD Exchange Rate Spot			US \$0.7745

<sup>1</sup> Period ending May 13th, 2022. Data extracted from Bloomberg

<sup>2</sup> Fund is priced annually

<sup>3</sup> Fund is priced weekly on Tuesdays

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