

Barnes Group [NYSE: B]

Initiate at BUY at 5% | PT: \$53.10

September 11, 2023



CIMG Investment Research

Another Boring Industrials Company v2

Barnes Group (“Barnes” or “The Company”) is a global provider of highly engineered products, differentiated industrial technologies, and innovative solutions, serving a wide range of end markets and customers. The company specializes in products and services that are used in far-reaching applications including healthcare, automation, packaging, aerospace, mobility, and manufacturing. The company operates in two segments: Industrial and Aerospace. The Industrial segment offers precision components, products, and systems used by a wide variety of customers in diverse end markets. The Industrial segment has three areas of focus: Molding Solutions, Automation, and Motion Control Solutions. Molding Solutions provides plastic injection tools, Automation provides robotic grippers and vacuum grippers for clients mostly in Europe, and Motion Control Solutions provides solutions to overcome challenges in metal forming. The Aerospace segment has two areas of focus: OEM and Aftermarket. Of the two, Aftermarket has higher margins.

Investment Thesis

Acquisition of MB Aerospace enhances product variety and efficiency. In June, Barnes announced an agreement to acquire MB Aerospace for approximately \$740M. MB Aerospace, much like Barnes’s existing aerospace business, serves major aerospace and defense engine OEMs, Tier 1 suppliers, and MRO providers. MB Aerospace shares similar clients to Barnes’ existing aerospace business, such as GE Aerospace, Pratt & Whitney, and Boeing. OEM partners have already commented favorably on the combination of the two companies. Barnes Aerospace now has a more diverse aerospace offering, with old Barnes Aerospace primarily levered to the GE LEAP engine, and MB Aerospace having some more exposure to the V2500. As far as profitability, MB Aerospace shares similar margins as Barnes’ existing Aerospace business, with a lower margin OEM business that drives a higher margin aftermarket business. MB Aerospace has a significant footprint in Europe, which filled a previous gap in Barnes’ aerospace segment. The acquisition was purchased at a reported multiple of 11.4x EBITDA, but when factoring in an estimated \$18M in cost synergies, this brings the multiple down to 8.9x. Barnes financed the acquisition with leverage, increasing net leverage to around 3.8x, with management committed to bringing it down to 3.0x in 12 months and 2.5x in 24 months. The acquisition just recently closed on August 31st.

Aerospace segment is ready for growth after a rough few years. As a natural result of the COVID-19 pandemic, the Aerospace segment had a revenue decline of 32% from 2019-2020. However, the Aerospace still had positive EBIT, boasting margins of 16%. While this was lower than it had been historically, it was still positive, while larger aerospace players, like Pratt & Whitney, Boeing, and Airbus, all experienced negative operating income. As we see a continued rebound in travel, aftermarket revenues should see continued strength, which as the higher margin portion of the Aerospace segment, should result in favorable revenue mixes into the future. In addition, Barnes provides parts for the engines of the 737 MAX, which has seen orders continue to grow. Barnes’ presence as a supplier of the LEAP engine is seeing a plurality of airline’s future plane orders due to its presence on the 737 MAX. As a result, we believe the Aerospace segment should see large growth into the next few years.

Europe is coming back, and that could be good news for Industrials. While Europe contributes 36% of total industrial revenues, it consists of over 80% of the automation segment’s revenue. Barnes’ automation business started with the acquisition of Gimatic, which is headquartered in Italy. The business suffered after the Russo-Ukrainian Conflict and the European Industrial Shock that happened afterward, but there are signs that the Industrial segment is coming back. As a result of heightened tensions with China and the supply chain crisis caused by COVID, there has been an increase in demand for industrial space and land in Europe.

Industrials and Energy

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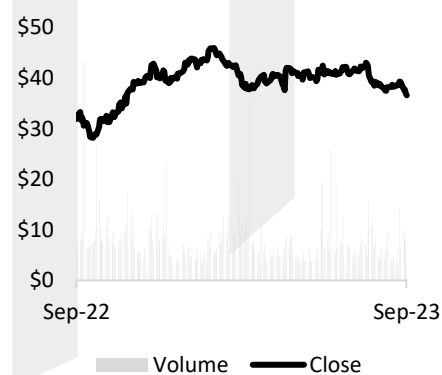
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Figure 1: LTM Stock Chart & Volume



Price	\$36.55
Dividend Yield	1.75%
PT	\$53.10
Upside	45%
52-Week Range	\$27.93 – \$47.36
Dil Shrs Outstand	51 M
Mkt Cap	\$1.86 B
Ent Value	\$2.42 B
NTM P/E	16.88x
NTM EV/EBITDA	9.28x

European industrial giants have communicated to suppliers that they would much rather their parts come from Europe than Asia. This is further exemplified by Mercedes-Benz's decision to build its first EV factory in Poland and BMW's decision to boost car battery production in Hungary. In order to accommodate their requests and keep costs low, automation must follow, which Gimatic can capitalize on. According to BCI Global, highly automated manufacturing processes will increase from 18% in 2021 to 46% in 2024 in Europe and the US.

Valuation

We used a DCF with a 10% discount rate and a 2% long-term growth rate to reach a price target of \$53.10, implying an upside of 45% from today's close. We have modeled margins for Aerospace and Industrials to reach pre-COVID levels in 2024.

Company Overview

Barnes Group ("Barnes" or "The Company") is a global provider of highly engineered products, differentiated industrial technologies, and innovative solutions, serving a wide range of end markets and customers. The company specializes in products and services used in far-reaching applications including healthcare, automation, packaging, aerospace, mobility, and manufacturing. The company operates in two different segments: Industrial and Aerospace. Of the two, Aerospace has traditionally had the higher margins of the two, with aftermarket services driving this difference. Between the two, Industrials contributes 66% of total revenues and Aerospace contributes 34% of revenue. However, after the company's acquisition of MB Aerospace, management has guided for Industrials to contribute 52% of pro forma revenues, with Aerospace contributing 48%. Geographically, the company derives a majority of their revenues from the Americas (53%), with the rest coming from Europe (30%) and Asia (17%). The company has a highly regarded track record within their respective industries, winning Supplier Performance Awards from GE and Safran and Trusted Supplier Letter of Recommendations from Rolls-Royce, Boeing, and Northrop Grumman.

Industry Overview

Barnes competes in a wide variety of end markets and is exposed to several different industries. The Industrial segment serves a variety of end markets, with the largest being General Industrial, Medical & Personal Care, and Auto. This business tends to be more cyclical, but some end markets, such as Medical & Personal Care, tend to be more recession resistant. The fastest growing segment is the Automation segment, which derives a majority of their revenue from Europe. Europe has seen an industrial slowdown due to the Russo-Ukrainian Conflict, but Industrial activity is expected to pick back up due to an increasing interest in reshoring supply chains. The Aerospace segment is exposed to the general ups and downs of the industry. The domestic aerospace industry is expected to recover to pre-COVID levels sometime this year, with international travel lagging behind. As passenger travel picks back up, that should naturally allow for aftermarket revenues to follow suit. As for OEMs, the 737 MAX has deliveries picking up, which uses the LEAP engine. Orders are expected to continue to increase as airlines have an aging fleet. Over the long term, aviation has historically been a resilient industry, and Barnes has been increasing their presence in the space.