

QC INVESTMENT MEMO

To: Queen's Capital Executive Board
From: Jason Kim and Keira Crook
Date: January 16, 2015
Re: **Company Name**

COMPANY PROFILE

Industry: Tires & Rubber Products
 Main Asset(s): PP&E, Inventory

Market Capitalization: 7.64B
 Debt: 5,591mm
 Cash: 1,690mm
 Enterprise Value: 12,758.7mm

NTM(E) Revenue: 16,556.34mm
 NTM(E) EBITDA: 2,657.08mm
 NTM(E) UFCF: 634.9mm

INVESTMENT PROFILE

Current (Proposed) Investment Size: \$2000
 Position Cost Basis:
 Current Share Price: \$27.55
 Life to Date Profit (Loss):
 Life to Date Percentage Return: 224.12%

Base Case Valuation: 35.78
 Downside Case Valuation: 15.91
 Upside Case Valuation: -

COMPANY DESCRIPTION

Goodyear Tire & Rubber Company (GT) is a global manufacturing company founded in 1898 that manufactures tires for automobiles, commercial trucks, light trucks, SUVs, racecars, airplanes, farm equipment and heavy earthmover machinery. After starting in 1898 with only 13 workers, the company has since grown to be one of the world's largest tire companies. The company currently employs ~66,000 employees around the world, and has a strong management team and corporate social responsibility. Outside of tires, Goodyear also produces other well-known brand products such as Dunlop, Fulda, and Debica. Their revenue as of December 31, 2014 was ~18 billion with a net income of ~2.5 billion. Goodyear has recently seen a lot of growth in other regions of the world such as Latin America and Asia, further increasing their profitability.

VALUATION

Company Name	TEV/Total Revenues LTM - Latest	TEV/EBITDA LTM - Latest	TEV/EBIT LTM - Latest	P/Diluted EPS Before Extra LTM - Latest	P/TangBV LTM - Latest	NTM TEV/Forward Total Revenue (Capital IQ)	NTM TEV/Forward EBITDA (Capital IQ)	NTM Forward P/E (Capital IQ)
Cooper Tire & Rubber Co. (NYSE:CTB)	0.6x	3.7x	4.8x	8.6x	2.5x	0.62x	4.09x	10.42x
Johnson Controls Inc. (NYSE:JCI)	0.8x	8.3x	11.1x	15.9x	11.0x	0.76x	7.19x	9.18x
Pep Boys - Manny, Moe & Jack (NYSE:PBYY)	0.6x	15.5x	104.3x	NM	1.9x	0.60x	14.78x	98.04x
Sumitomo Rubber Industries Ltd. (TSE:5110)	0.8x	4.9x	7.9x	6.1x	1.0x	0.77x	5.21x	7.10x
Bridgestone Corp. (TSE:5108)	0.8x	4.4x	6.1x	11.4x	1.5x	0.77x	4.13x	9.33x
The Yokohama Rubber Company, Limited (TSE:5101)	0.7x	5.1x	7.8x	7.9x	0.9x	0.68x	5.06x	7.61x
Compagnie Generale DES Etablissements Michelin SCA (ENXTPA:ML)	0.8x	4.9x	7.7x	13.4x	1.8x	0.78x	4.30x	9.95x

Summary Statistics	TEV/Total Revenues LTM - Latest	TEV/EBITDA LTM - Latest	TEV/EBIT LTM - Latest	P/Diluted EPS Before Extra LTM - Latest	P/TangBV LTM - Latest	NTM TEV/Forward Total Revenue (Capital IQ)	NTM TEV/Forward EBITDA (Capital IQ)	NTM Forward P/E (Capital IQ)
High	0.8x	15.5x	104.3x	15.9x	11.0x	0.78x	14.78x	98.04x
Low	0.6x	3.7x	4.8x	6.1x	0.9x	0.60x	4.09x	7.10x
Mean	0.7x	6.7x	21.4x	10.6x	3.0x	0.71x	6.39x	21.66x
Median	0.8x	4.9x	7.8x	10.0x	1.8x	0.76x	5.06x	9.33x

The Goodyear Tire & Rubber Company (NasdaqGS:GT)	0.7x	5.3x	7.4x	2.7x	2.1x	0.78x	4.58x	7.26x
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Discounted Cash Flow

Base Case

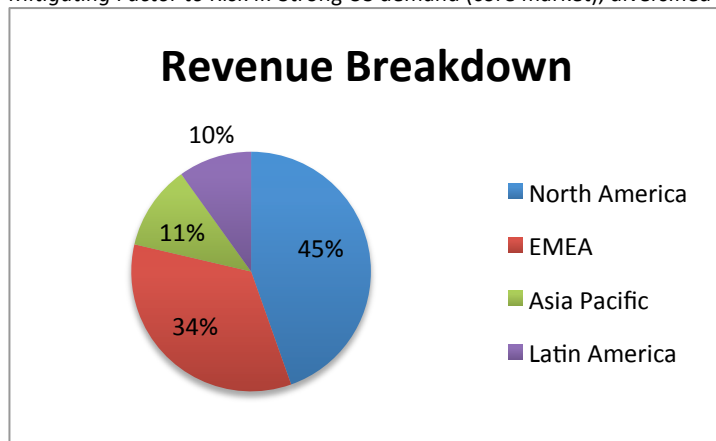
Goodyear Tires	Historical		Projected						Goodyear - DCF Assumptions & Output	
	2012	2013	2014	2015	2016	2017	2018	2019		
Revenue:	20,992.00	19,540.00	18,138.00	16,409.98	16,841.56	17,009.98	17,180.08	17,351.88	Effective Tax Rate:	40.0%
Revenue Growth Rate:	-7.80%	-6.90%	-7.20%	-9.53%	2.63%	1.00%	1.00%	1.0%	Use Multiples Method?	No
Operating Income:	1,819.00	2,105.00	2,251.00	2,461.497	2,657.08	2,709.70	2,577	2,603	Discount Rate (WACC):	7.1%
Operating Margin:	8.70%	10.80%	12.40%	15.00%	15.00%	15.00%	15.00%	15.00%	Terminal EBITDA Multiple:	10.0 x
Less: Taxes, Excluding Effect of Interest:	(546)	(632)	(675)	(738.45)	(797.12)	(812.91)	(773.10)	(780.83)	Terminal Growth Rate:	2.0%
Net Operating Profit After Tax (NOPAT):	1,273	1,474	1,576	1,723	1,860	1,897	1,804	1,822	Terminal Value:	\$ 15,653
Adjustments for Non-Cash Charges:									PV of Terminal Value:	11,096
Depreciation & Amortization:	684	719	730	656.3992	673.6625	680.3991	687.2031	694.0751	Sum of PV of Cash Flows:	3,643
% Revenue:	3.3%	3.7%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	Enterprise Value:	\$ 14,739
Impairment Charges:									EV	\$ 14,739
Equity-Based Compensation:									Less: Debt	6000
% Revenue:	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	Less: Minority Interest	809
Deferred Income Taxes:	12.4	-7.7	3.2	-29.9	-5.5	-9.975	-10.54375	-13.97969	Less: Prefs	0
% Revenue:	0.1%	(0.0%)	0.0%	0.0%	(0.0%)	0.0%	0.0%	0.0%	Add: Cash	1690
(Gain) / Loss on PP&E Disposal:	(25)	(8)	(3)						Equity Value	\$ 9,620
Changes in Working Capital:									S/O	268.9
Other Amortization	67.0	18.0	14.0	8.0					Implied Value per Share	\$ 35.78
(Gain) Loss From Sale Of Assets	(25.0)	(8.0)	(3.0)	2.0					Current Price	\$28
Asset Write-down & Restructuring Costs	69.0	(14.0)	(131.0)	(63.0)					Upside Potential	29.9%
Other Operating Activities	(462.0)	(974.0)	(2,982.0)	(1,918.0)						
Change in Acc. Receivable	291.0	79.0	75.0	106.0						
Change In Inventories	619.0	366.0	(35.0)	94.0						
Change in Acc. Payable	(453.0)	(30.0)	(41.0)	61.0						
Change in Other Net Operating Assets	33.0	150.0	259.0	109.0						
Net Decrease / (Increase):	139	(413)	(2,844)	(700)	(1,200)	(1,200)	1,000	(700)		
% Revenue:	0.7%	(2.1%)	(15.7%)	(4.3%)	(7.1%)	(7.1%)	5.8%	(4.0%)		
Less: Capital Expenditures	(1,127)	(1,168)	(923)	(1,000)	(1,000)	(1,000)	(1,000)	(1,000)		
% Revenue:	5.4%	6.0%	5.1%	6.1%	5.9%	5.9%	5.8%	5.8%		
Unlevered Free Cash Flow				\$ 650	\$ 328	\$ 367	\$ 2,481	\$ 802		
Present Value of Free Cash Flow				606	286	299	1,884	569		

INVESTMENT THESIS

1. Long-standing market leader in tire industry
2. Decreasing oil prices resulting in margin improvement
3. Value-oriented capital allocation with strong free cash flow generation; bought back \$450 million in stock last year and plans to expand plant capacity for HVA tires

KEY INVESTMENT RISKS

- RISK I** Description of Risk I: High Debt Management Risk
- Goodyear has a high debt to equity ratio of 1.448 quarterly, and many analysts say that the company is at a high risk for debt management, making it hard for them to borrow money.
- Mitigating Factor to Risk I:*
- Although their level of debt is high for their industry, management has been paying down debt recently and Goodyear has since increased its credit rating from Ba3 to Ba2. Accounts Payable has been improved by \$206 million, and Long Term Debt has decreased by \$470 million, showing strong signs for the future.
- RISK II** Description of Risk II: Softening demand from China, Venezuela, and Brazil; declining top-line growth for the past three years
- Mitigating Factor to Risk II:* Strong US demand (core market), diversified end market exposures



EPS growth at 206.9% and 287.0% (company focusing on margin improvement)

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KEY INVESTMENT STRENGTHS

STRENGTH I

Description of Strength I: Strong Management Team

- Richard J. Kramer appointed CEO in 2010 has lead to company to successful growth and profitability over the past few years despite the global recession. He also has a strong background in finance after working at PricewaterhouseCoopers for 13 years and 6 years as Goodyear's CFO
- On January 1, 2016 Goodyear restructured their management by combining its North America and Latin America businesses into one American business unit to serve customers, thereby accelerating growth

STRENGTH II

Description of Strength II: Growth in Industry

- Cheap raw materials and high demand (low oil prices results in lower costs of raw materials; low oil prices results in more driving, which increases demand for tires)
- The Asia/Pacific market is remaining very dominant in terms of emerging markets, as it is growing at a very fast rate and accounted for around 60% of global demand in 2010

STRENGTH III

Description of Strength III: Innovation and "Lean" processes

- Goodyear is staying ahead of their competition by constantly innovating their products, with new futuristic concepts like Triple Tube (inflate or deflate based on road conditions) and BH03 technology (actively producing electricity while the car is driving)
- They recently adopted "lean" processes, which is a philosophy that eliminates waste and continually improves work and processes. They have already cut R&D time by 70%, cut warranty costs, and increased on-time delivery from 30% to 98%.

STRENGTH IV

Description of Strength IV: Hedge against oil volatility

- As oil prices decline, raw materials decline and boost the margins of tire producers (effectively serving as an oil hedge)

INDUSTRY DETAILS

Key players in the tire industry include Goodyear (15.5% market share), Michelin (12% market share), and Bridgestone (8% market share).

Lower oil prices -> reduced manufacturing costs, increase in miles driven, greater demand for higher-quality tires

Strong US economy -> higher new car purchases

Strong US dollar -> reduced cost of foreign investment

● Dow Jones -8.69% ● BRDCY -15.38% ● MGDDY -6.04% ● GT +10.98%

