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INTRINSIC VALUE ASSESSMENT OF

THOR INDUSTRIES INC. (THO)

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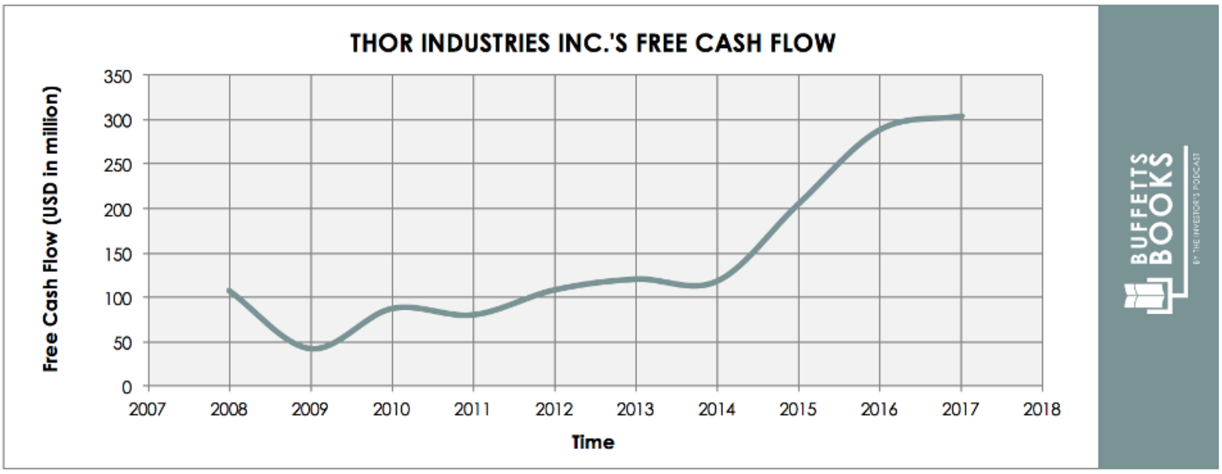
Introduction

Thor Industries Inc. is an American based manufacturing company whose principal business involves the manufacture and sale of recreational vehicles. The firm's market cap currently stands at around $5.06 Billion and its revenues and free cash flows for the previous financial year were about $7.25 Billion and $0.3 Billion respectively. The company's common stock has fluctuated between a high of $161 and a low of $88 over the past 52 weeks and currently stands at around $96. Is Thor Industries Inc. undervalued at the current price?

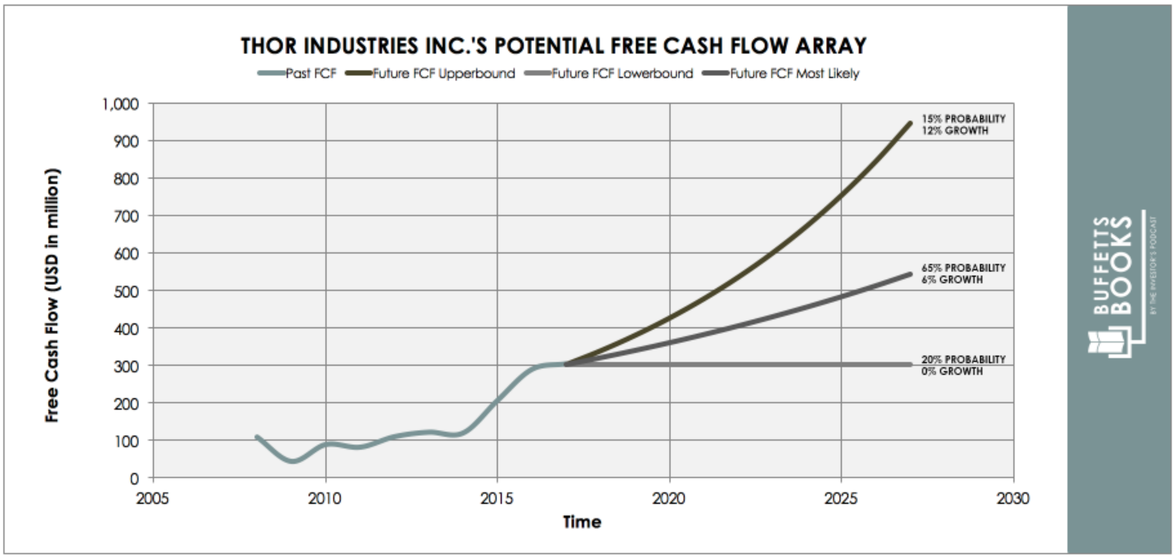
THOR INDUSTRIES

The Intrinsic Value of Thor Industries Inc.

To determine the intrinsic value of Thor Industries Inc, we'll begin by looking at the company's history of free cash flow. A company's free cash flow is the true earnings which management can either reinvest for growth or distribute back to shareholders in the form of dividends and share buybacks. Below is a chart of Thor Industries Inc.'s free cash flow for the past ten years.



As one can see, the company's free cash flow has grown over the past decade at an annualized rate of around 12%. In order to determine Thor Industries Inc.'s intrinsic value, an estimate must be made of its potential future free cash flows. To build this estimate, there is an array of potential outcomes for future free cash flows in the graph below.



When examining the array of lines moving into the future, each one represents a certain probability of occurrence. The upper-bound line represents a 12% growth rate which represents the company's growth rate for the last ten years. This growth rate has been assigned a 15% probability of occurrence to account for a number of factors including the cyclicality of the company's business and the increasingly likely risk and a recessionary environment emerging in the near to mid-term future.

The middle growth line represents a 6% growth rate which is based upon the market's current assumption of future growth. This scenario has been assigned a 65% probability of occurrence since the market is pricing the risks above into its assumptions about future growth for the company.

The lower bound line represents a 0% rate in free cash flow growth and assumes that the company's revenues and earnings growth stagnates in the face of recessionary pressure and weakening consumer spending. This growth rate has been assigned a 20% probability of occurrence.

Assuming these potential outcomes and corresponding cash flows are accurately represented, Thor Industries Inc. might be priced at an 8% annual return if the company can be purchased at today's price. We'll now look at another valuation metric to see if it corresponds with this estimate.

Based on Thor Industries Inc's current earnings yield, which is the inverse of its EV/EBIT ratio, the company is currently yielding 13.49%. This is above the firm's 10-year historical median of 9.63%. In comparison, the Global Recreational Vehicles Industry median average of 6.33% is suggesting that the company may be undervalued relative to its historical and industry comparisons. Finally, we'll look at Thor Industries Inc.'s free cash flow yield, a metric which assumes zero growth and measures the firm's trailing free cash against its current market price. At the current market price, Thor Industries Inc. has a free cash flow yield of around 6%.

Taking all these points into consideration, it seems reasonable to assume that Thor Industries Inc. is currently trading at a slight discount to fair value. Furthermore, the company may return around 8% at the current price if the estimated free cash flows are achieved. Now, let's discuss how and why these estimated free cash flows could be achieved.

The Competitive Advantage of Thor Industries Inc.

Thor Industries Inc. has various competitive advantages outlined below.

- **Scale Advantages.** Thor Industries Inc. is currently the largest RV manufacturer in the world and holds the No.1 market position across numerous segments which can be seen in the chart below.

Industry Leading Market Position
Industry-leading market share in all main RV product categories for calendar 2017
Travel Trailers - #1 Position with 49.6% share
Fifth Wheels - #1 Position with 53.3% share
Motorhomes (Class A and C) - #1 Position with 41.2% share

Figure 1: Thor Industries Inc., Investor Presentation; March 2018

The size of the company's operations provides it with economies of scale meaning it can outperform the industry on a number of key metrics which can be seen below.

	Thor Industries Inc.	Global Recreational Vehicles Industry Med. Average
ROA (ttm)	16.87%	4.19%
ROE (ttm)	27.93%	9.51%
Operating Margin % (ttm)	8.30%	5.80%
Net Profit Margin % (ttm)	5.38%	3.96%

- **Flexible Cost Structure.** Thor Industries Inc. operates a low fixed-cost structure which enables the company to rapidly shift production when economic conditions change and allow it to cyclical weather changes in the market. The company also minimizes the inefficient allocation of capital by limiting finished inventory opting instead to produce vehicles to dealer orders. This flexible cost structure has allowed Thor Industries Inc. to remain profitable in every year since its founding in 1980.
- **Decentralized Operating Structure.** Each subsidiary of Thor Industries Inc. is responsible for its product development, production, and maintenance of its dealer networks. By allowing each subsidiary to operate independently, they can:
  a) Develop products that specifically meet the needs of their customers
  b) Entrust the decision-making process to those closest to the customer
  c) Avoid the cloning of products and minimize inefficiency

d) Motivate managers who share in the success of their subsidiary by way of variable compensation plans

Thor Industries Inc.'s Risks

Now that Thor Industries Inc.'s competitive advantages have been considered, let's look at some of the risk factors that could impair my assumptions of investment return.

- While Thor Industries Inc.'s products are currently carried by around 2,300 dealerships through the U.S. and Canada, a significant portion of the firm's revenues come from FreedomRoads LLC. This dealer accounted for 20% of continued consolidated net revenues in 2017, 20% in 2016, and 17% in 2015. Should Thor Industries lose the agreement in place with FreedomRoads LLC, the firm would likely see its revenues and earnings adversely affected.
- The recreational vehicle industry is generally characterized by low barriers to entry and fierce competition. This competition is based on price, design, value, quality, and service. Thor Industries Inc. must ensure that it remains focused upon these competitive factors in order to maintain its market share and competitive position within its market.
- Thor Industries Inc.'s business is cyclical, and as such, the company's fortunes are closely tied to the ebb and flow of the wider economy. The emergence of a recessionary environment and tightening consumer spending would likely have an adverse effect on the company's future growth prospects leading to a decline in revenues and earnings.

Opportunity Costs

Whenever an investment is considered, one must compare it to any alternatives to weigh up the opportunity cost. At present, 10-year treasuries are yielding 2.97%. If we take inflation into account, the real return is likely to be closer to 1%. The S&P 500 Index is currently trading at a Shiller P/E of 32.1 which is 89.9% higher than the historical mean of 16.8. Assuming reversion to the mean occurs, the implied future annual return is likely to be -2.8%. Thor Industries Inc., therefore, appears to offer a much better return for investors at present, but other individual stocks may be found which offer a similar return relative to the risk profile.

Macro Factors

Investors must consider macroeconomic factors that may impact economic and market performance as this could influence investment returns.

At present, the S&P is priced at a Shiller P/E of 32.1. This is 89.9% higher than the historical average of 16.8 suggesting markets are at elevated levels. U.S. unemployment figures are at a 30-year low suggesting that the current business cycle is nearing its peak. U.S. private debt/GDP currently stands at 199.6% and is at its highest point since 2009 when the last financial crisis prompted private sector deleveraging.

Summary

Thor Industries Inc. is currently in a strong financial position carrying minimal debt and a robust liquidity position. The firm also appears well prepared for the future with ample capital to deploy for organic growth and strategic acquisitions.

Strong Financial Position

	Key Ratios	**FY17**	**FY16**
Profitable every year since our founding in 1980: - 37 years of continuous annual profitability.	Cash & Equivalents	$223 M	$210 M
Solid balance sheet: - Consistent history of returning cash to shareholders - Limited and prudent use of debt	Total Assets	$2.6 B	$2.3 B
	Working Capital	$399 M	$365 M
Cash Priorities: - Funding our growth, whether organically or through acquisition - Growing the regular dividend over time - Debt reduction - Stock buybacks or special dividends as decided by the Board	Debt to Total Assets	0.06	0.15
	Debt Availability	$353 M	$114 M
	Operating Cash Flow	$419 M	$341 M

Figure 2: Thor Industries Inc., Investor Presentation; March 2018

Regarding future drivers of growth, there are multiple trends which appear favorable for the company's business as people are increasingly adopting a healthy lifestyle and looking for affordable ways to spend their vacation time with family or to attend lifestyle and sporting events.

Over 3.4 Million new households have started camping since 2014	Latino, African American, Asian, and other ethnicities represented 29% of new campers in 2016; 26% of all campers	**MORE POTENTIAL RV BUYERS**
Gen X and Millennials made up 72% of campers in 2016		Population: +159% Drivers: 2X
Younger campers looking for affordable recreation experiences	RV camping viewed as an attractive way to spend time with families and friends	
Interested in trying different accommodations, including RVs		Since 1970

Figure 3: Thor Industries Inc., Investor Presentation; March 2018

Demand also appears strong at present with orders in the towable and motorized segment rising to a backlog of 37.3% and 28% respectively in Q2 2018. Consolidated RV backlog increased nearly 34% to $2.8 billion as of January 31, 2018, versus $2.1 billion as of January 31, 2017. The company also just logged a record 2^{nd} Quarter revenues & profit with double-digit growth in both segments – Towables (+26.9%) and Motorized (+17.9%).

With regards to Shareholder friendliness, Thor Industries Inc. has a strong record of returning value to shareholders in the form of dividends and share repurchases. Since the company's founding, it has returned over $1 Billion to shareholders and has grown dividends at an annualized rate of over 20% for the past ten years.

In summary, Thor Industries Inc. is in a strong financial and market position with numerous competitive advantages. While there are numerous demographic and consumer trends at play which appear favorable to the company, investors should be aware that the firm's business is cyclical in nature and the emergence of a recessionary environment may impair the future growth estimates discussed in this article. Based on the conservative assumptions used in the free cash flow analysis, Thor Industries Inc. may return around 8% at the current market price.

Disclaimer: The author does not hold ownership in any of the companies mentioned at the time of writing this article.