Brunswick Corporation (BC) Memo

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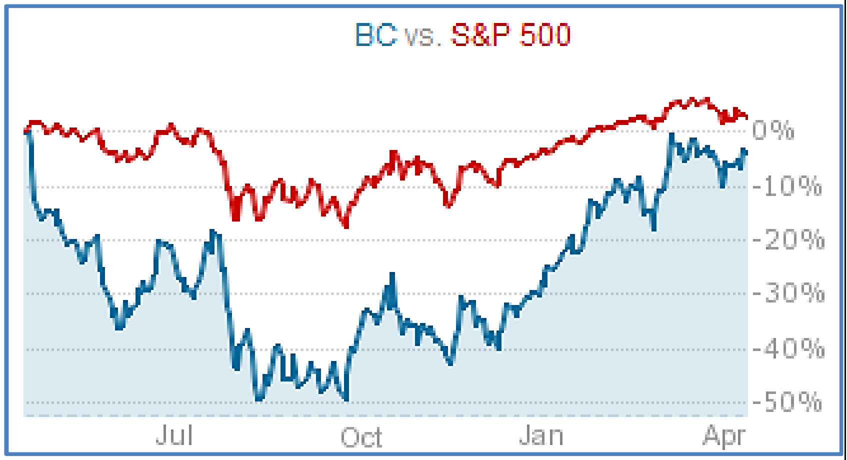
Important Company Financial Data

Key Financials			
Current Price		Sales	3.75 Bil
Previous Close	25.80	Income	71.90 Mil
Open	25.80	Net Profit Margin	1.92%
Day's High	26.21	Debt/Equity Ratio	22.42
Day's Low	25.69	Beta	3.03
Volume	274,229	EPS	0.77
Avg Daily Vol (13 Wks)	1.41 Mil	Forward P/E	13.40
52-Wk High	27.70	P/E	33.33
52-Wk Low	13.19	Market Cap	2.32 Bil
Dividend Rate	0.05	Shares OST	89.24 Mil
Yield	0.19		



Consensus Estimates Summary

	2009A	2010A	2011A	Q12012E	Q22012E	Q32012E	Q42012E
Earnings Per Share	-6.22	-1.25	0.78	0.37	0.86	0.39	-0.16
Revenue	2,776.10	3,403.30	3,748.00	953.58	1,178.30	952.30	857.90
EBITDA	-413.20	145.60	296.90	85.50	144.00	85.13	30.20

Thesis / Key Points

- **Over the years, due to lack of innovation, Brunswick Corporation has become overextended, indifferentiable, and aimless**
  Brunswick Corporation stretches itself across four completely different segments. It is a jack-of-all-trades, but a master at none. Lacking in a strong core competency, Brunswick Corporation does not have a sustainable competitive advantage in any of the sectors in which it deals. A Porter's Five Forces Model in Exhibit 1 shows that threat of competitors seems quite high, since Brunswick's competitors are much more specialized, giving them a solid niche market for their products. However, Brunswick has general and broad knowledge rather than specific expertise. This allows its products to be easily substituted by competitors and newer entrants into the market, and has caused the company to become bloated, unable to rid itself off its deadweight.

- **Brunswick Corporation, being a serial acquirer, has lost its potential for organic growth**
  The company has fallen from grace because of its long existence, and resulting complacency. The company was started as an informal family business by John Brunswick, and from the start, never had a structured goal. It shifted from being a carriage maker to a billiards equipment manufacturer, and made several other non-adjacent moves. In the early 1900s, Brunswick was the quintessence of a Chandler organizational structure, intent on empire building. Although fairly innovative in its peak during the mid-1900s, Brunswick gave little thought to growth strategy, acquired random businesses, producing unrelated products, and thus, cancelled out any possibility for economies of scope or scale. Large-scale, permanent shifts in the leisure and recreation industry at the advent of advanced technology like the Wii and other virtual/online games, bowling alleys and foosball tables will be rendered less popular in the future. With major fixed assets investments in this industry and a poor quick ratio of 0.84, Brunswick will not be able to execute a clean, profitable exit strategy.

  It is also very concerning that several key insiders are selling portions of their shares recently. For example, Kevin Grodzki, VP and President of Mercury Marine Sales sold off a portion of his BC shares on March 27th, 2012, which could mean that this may be the peak of BC stock performance.

- **Profitability is highly dependent on external macro-economic factors while internal operations suffer due to inefficiencies**
  The Company is constantly subject to competitive pressures, particularly in the outboard engine market, in which predominantly Asian manufacturers often have pursued a strategy of aggressive pricing particularly during periods when the Japanese yen weakens versus the U.S. dollar, such as currently. The Japanese yen has been weakening steadily this year, and is forecasted to do so until late summer.[i]

  Brunswick's internal operations suffer as a lack of an efficient business process system. It faces repeated recalls for its products due to compromised quality, which at one point, was its core competency. For example, Brunswick Bowling and Billiards Corporation, a subsidiary of Brunswick Corp. issued a recall, as ordered by the U.S. Consumer Product Safety Commission, for several models of its swivel chairs due to their fall hazard.[ii]

  Unlike its competitors, Brunswick manufactures many of its products in the US, specifically in Illinois, Kentucky, and Minnesota, instead of outsourcing this process, which exacerbates its cost-side problems. It does not take advantage of international arbitrage opportunities. The US economy has steadily been venturing farther away from the manufacturing sector, and closer to the services sector. The high levels of fixed costs of operating marine production plants can put pressure on profit margins. Thus, Brunswick Corporation will face a major dilemma due to its huge fixed investments in labor and capital, in terms of manufacturing facilities and personnel in the US, especially since almost all of the industries in which Brunswick dabbles, are very labor-intensive. Brunswick's billiards sector especially, continues to experience competitive pressure from low-cost billiards manufacturers outside the United States. Brunswick will lose out in the long-run, since many of its products are not inimitable, and thus, if it cannot compete on price, it will not be able to secure a stronghold in the market.

Additionally, some components used in Brunswick's manufacturing processes, including engine blocks and boat windshields, are available from a sole supplier or a limited number of suppliers. Operational and financial difficulties that these or other suppliers currently face or may face in the future could adversely affect their ability to supply Brunswick with the parts and components it needs, which could significantly disrupt Brunswick's operations, just as it has in the past.

Brunswick Corporation has also constantly battled inefficient inventory turnover rates. On a trailing-12-month basis, finished goods inventory was the fastest-growing segment, up 5.5%. On a sequential-quarter basis, finished goods inventory was also the fastest-growing segment, up 3.3%. Basically, over the sequential quarterly period over the past year revenue dropped 10.0%, while inventory grew 0.7%, which seems ominous since it could mean that Brunswick's products are not moving as well as planned.

- **Highly unionized workforce places pressure on cost structure and lack of a meritocracy hurts innovation and employee productivity**
  Due to the high labor intensity of Brunswick's manufacturing operations, it faces constant struggles to manage its workforce efficiently. Its workers are unionized, forcing Brunswick into negotiating inflexible bargaining agreement with several influential trade unions, such as the International Association of Machinists, and the International Brotherhood of Boilermakers. Competitors such as Marine Products Corp. do not face this problem as much, since they have higher percentages of their production facilities in developing countries, where they can exploit cheap, plentiful labor.

  In addition, Brunswick Corporation's subsidiaries do not pay their workers a competitive salary. They lag behind the industry average by $2000-$9000. For example, its subsidiary Kellogg Marine Supply pays average salaries of $27,000 to its workers, while the industry average happens to be $36,000. This lack of positive reinforcement restricts workers' self-efficacy in their work and in the company, and thus, reduces productivity, eventually hurting bottom-line profitability.[iii]

  On a different note, as one of the VAR contacts admitted, most of Brunswick's subsidiaries have a stringent hierarchy, and lack of a meritocracy. There is low mobility up the ranks of the organization and a barrier in communication between the different stages of middle management and workers; this induces low motivation amongst lower level employees, and sheer ignorance and heedlessness within management.

<u>Misperception</u>

- **Investors believe that since Brunswick's profitability is less negative this quarter, that it has successfully risen out of its downward streak**
  However, as per the VAR on this subject, it is apparent that Brunswick's boat segment is driving Brunswick's performance currently since it is reaching its peak of its seasonal cycle. This means that profitability will go back down, unlike investors' misperceptions of its permanent comeback from the recession. In addition, since Brunswick operates in Europe as well, it relies on customer demand in the EU. However, unemployment rates, resulting from serious long term economic turmoil, as shown in Exhibit 2, will stifle consumer demand for Brunswick's luxury goods for the rest of 2012.
- **Investors believe that Brunswick's diverse portfolio may help it hedge risk between industries**
  Brunswick does have a diverse portfolio, but doesn't have a sustainable niche market within any industry, unlike its specialized competitors. Despite its diverse portfolio, the company still carries exceedingly high business risk, as depicted by its beta of 3.03, which shows that it is still very susceptible to industry-wide systematic risks despite its diversity.

<u>VAR</u>

Name of VAR Contact	Angle/Key Quote
Name withheld on request – *Past Employee of Life Fitness, Schiller Park, IL, US. Communicated via Email.*	"Virtually no career advancement opportunities. Lack of training is apparent. Overall a cheap company that spends most of its money on marketing and sales. Misguided at most times."
Mary Meyer – *Current Employee of Life Fitness, Seattle, WA.*	"Lack of communication between top management and employees, not much room for advancement in your career, isolation between different departments with in the company."
Dan Kubera - *Brunswick Investor Relations Phone: 847-735-4617*	"Domestic demand for the Marine Engine segment's products is seasonal, with sales generally highest in the second calendar quarter of the year."

<u>How It Plays Out</u>

BC should be initiated as a short at the peak of the 2nd quarter of this year, when the price would likely be the highest. By Q4-2012, or Q1-2013, the market will catch on to Brunswick Corporation's loose foothold in the market due to its lack of long-term goals and niche market expertise, due to its paltry revenues, and its stock performance will sink as a result, at which point the position should be covered.

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Risks / What Signs Would Indicate We Are Wrong?

- A lower PEG ratio would indicate that the company may not actually be overvalued. Currently, Brunswick Corp has a higher PEG ratio than its peers do, which has been the case since it lost its footing 3-5 years ago.
- If the revenues for the boat and marine engine industries are upheld to the same (or better) degree even after the second quarter of this year, then the company may have risen from its cyclical business cycle, and may have real potential for longer term profitability.
- The cost-side restructuring efforts that Brunswick is trying to undertake may pay off, making its operations more efficient. However, they still have a high fixed cost base and tensions with labor unions, which may cancel out the benefits from lower costs.

Signposts / Follow-Up

- Recently, major shareholders have been selling off their shares. Continued activity may be a sign that insiders may not see potential for this company.
- Debt to Equity ratio is exceedingly high. Must look out whether the management adjusts its capital structure to a more balanced ratio.
- The company's debt is rated four notches below investment-grade territory by Moody's[iv] and other credit rating agencies due to the discretionary nature of Brunswick's business. The company's debt rating must be monitored in order to gauge its financial health.

Company Description

Brunswick Corporation is a player in the following industries:

- Boat Building
- Transportation Equipment Manufacturing
- Consumer Products Manufacturing
- Sporting Goods Manufacturing
- Fitness Equipment Manufacturing

NYSE: BC

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Exhibit 1: Dynamics of Brunswick's Industries Explain its Inability to Compete Effectively

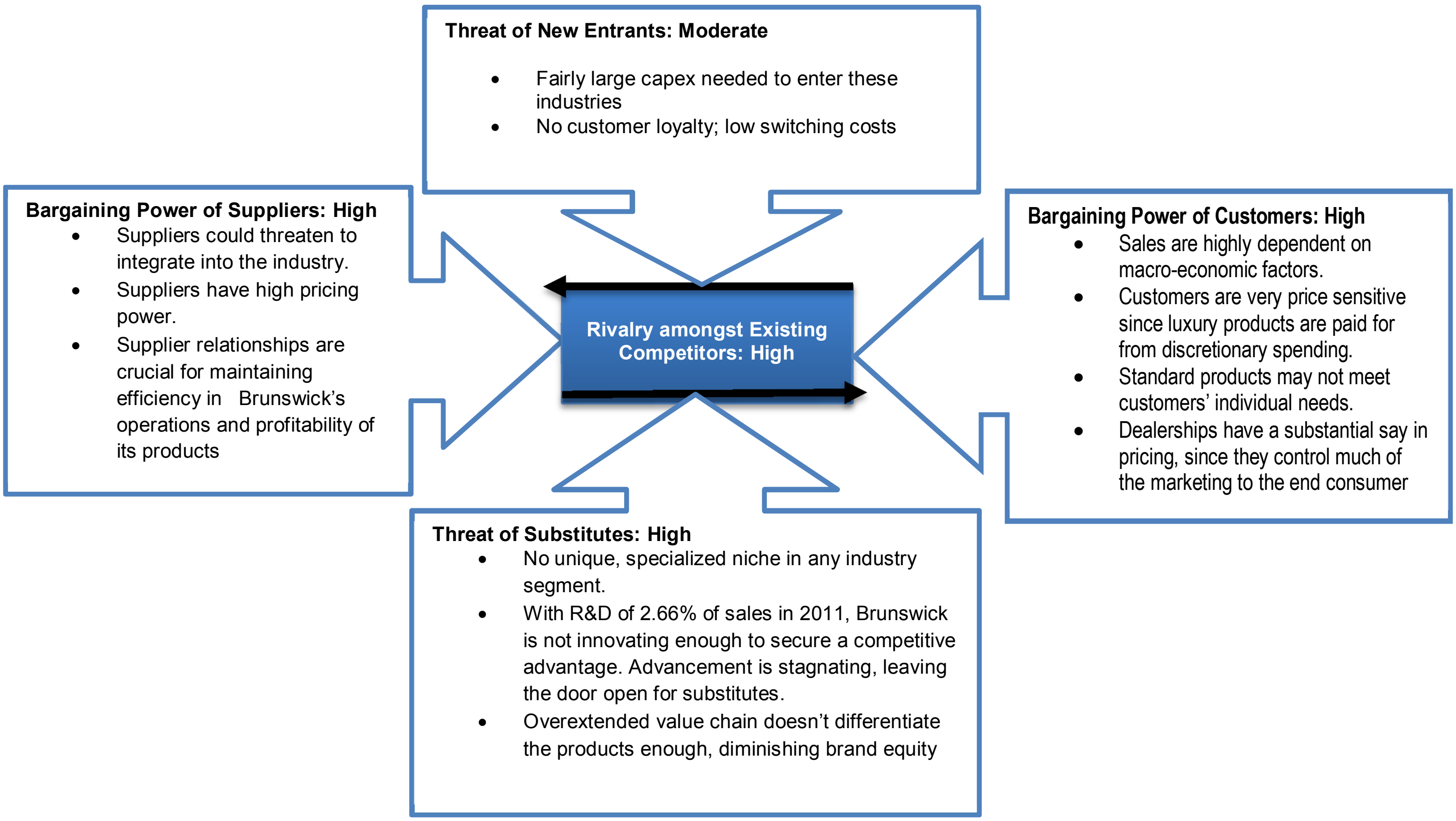

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Exhibit 2: Worldwide Macro-economic, Political, Social and Technological trends will stifle Brunswick Corporation's consumer demand for its luxury goods, and will keep US consumers more price sensitive in the near future.

Political

- Frequent government intervention based on nature of acquisitions
- EPA is a strong watchdog. Brunswick will need to comply with EPA emission standards.

Economic

- In the case of a recession, consumer demand will drop sharply. Very elastic demand for products
- Highly susceptible to exchange rate and inflation risk due to geographically scattered manufacturing facilities
- Increases in the price of raw materials will have direct effect on top line growth.

Sociocultural/ Demographic

- Image of a "soulless" corporation due to nature of its products and employee dissatisfaction
- Union struggles pose a major obstacle for Brunswick Corp.
- Leisure and recreational activities are facing a major shift worldwide with advancement of technology and Brunswick may not be able to adapt , facing the possibility of eventual obsolesence in this industry.

Technology

- R&D spending very low. 2.6% of sales revenue 3-yr average. Lower than industry average.
- Technology is key differentiator in all of Brunswick's segments

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[i] http://forex.tradingcharts.com/forex_news/japanese_yen_weakens_major_rivals_03292012_1162.html
[ii] http://www.cpsc.gov/cpscpub/prerel/prhtml10/10738.html
[iii] VAR #1
[iv] http://www.marketwatch.com/story/moodys-lifts-brunswick-ratings-on-boat-demand-2011-07-13