KeyStone's
Small-Cap Stock Report

Editor: Ryan Irvine, BBA (Finance)
Senior Analyst: Aaron Dunn, CFA

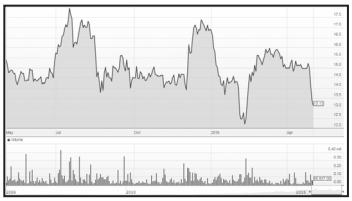
Independent Equity Advisors

Exco Technologies Limited (XTC:TSX)

Current Price (May 3/2016): $13.19

RECOMMENDATION: BUY

EXTRUSION & AUTOMOTIVE MANUFACTURER REPORTS Q1 REVENUE GROWTH, EARNINGS LOWER DUE TO ONE-TIME COSTS, RECENT ACQUISITION WILL REIGNITE GROWTH IN Q3 - BUY



Focus BUY Portfolio

Industry: Manufacturing – Extrusion & Automotive
Recommended: June 2011
Recommendation Price: $3.90
Current Price: $13.19
Market Cap: $557,985,610
Shares Outstanding: 42,497,000
Fully Diluted: 42,713,000

SELECTED QUARTERLY DATA

Income Statement	Q2 2016	Q2 2015
Revenues:	$133,383,000	$125,484,000
Earnings:	$8,989,000	$10,872,000
EPS:	$0.21	$0.26
Fully Diluted EPS:	$0.21	$0.25

RATINGS

VALUE

P/E (TTM)	13.53
P/S (TTM):	1.08
P/B:	2.17
Current Ratio:	3.22
D/E:	0.29

With roots that date back to 1952, Exco is a global supplier of innovative technologies servicing the die-cast, extrusion and automotive industries. Through 19 strategic locations in 10 countries, the company employs 5,362 people and service a diverse and broad customer base.

FINANCIAL HIGHLIGHTS & KEY AREAS OF GROWTH

Exco Technologies was recommended in June 2011 at $3.90 and has been in our Focus BUY Portfolio ever since. In our December 2015 update with the shares trading above the $17.00 range, we ranked the company as a near-term HOLD and a long-term BUY and it remained in our Focus BUY Portfolio. The stock was a near-term HOLD based purely on valuations with the stock then trading with a trailing price-to-earnings multiple of 17.86 based on the last 12 months and up over 330% (not including dividends) since our original recommendation. In early February, we updated the stock to a BUY once again with the shares in the $12.77 range. Today, following the release of the company's second quarter 2016 results we review the numbers and update our rating on the stock.

Consolidated sales for the second fiscal quarter were $133.4 million compared to $125.5 million in the same quarter last year, an increase of 6%. Year-to-date sales were $264.3 million compared to $245.4 million, an increase of 8%. Over the quarter, the average USD/CAD exchange rate was 7% higher ($1.35 versus $1.26 last year) contributing $4.1 million to sales while the year-to-date average USD/CAD exchange rate was 13% higher ($1.35 versus $1.20 last year) contributing $13.5 million to sales. The average EUR/CAD exchange rate was 6% higher in the quarter ($1.49 versus $1.40 last year) and 4% higher year–to-date ($1.47 versus $1.41 last year) contributing an additional $2.7 million and $3.6 million to sales in the respective periods. Consequently, $6.8 million and $17.1 million of the consolidated sales growth in the quarter and year-to-date periods, respectively, is explained by favorable foreign exchange movements.

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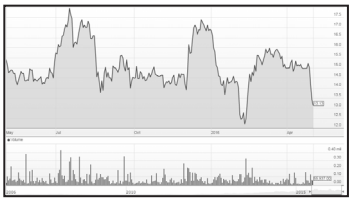

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The Automotive Solutions segment reported sales of $86.3 million in the second quarter, an increase of $9.6 million, or 13%, from the same quarter last year. Year-to-date, the segment reported sales of $164 million, an increase of $14.9 million, or 10%, over last year. Sales in the quarter and year-to-date were higher at each of Polytech, Polydesign, Neocon and ALC with roughly half of the overall increase in the quarter and 70% of the increase year-to-date being explained by favorable foreign exchange movements. Polydesign, in particular, recorded very strong top line results, registering sales growth of 25% and 21% in the quarter and year-to-date periods, respectively, as several new programs were launched.

The Casting and Extrusion segment reported sales of $47.1 million in the quarter, a decrease of 4% from the same quarter last year. Year-to-date, the segment reported sales of $100 million, an increase of 4% over last year. Excluding foreign exchange movements, this segment's sales were down $3.8 million, or 8%, in the quarter and down $2.9 million, or 3%, year-to-date. Reduced activity for new moulds and spare parts within the large mould business drove the sales decline in the quarter. This reflected lower demand in the quarter for moulds for certain engine blocks following a period of heightened activity, launch inefficiencies associated with the development of several moulds on new programs that are expected to drive future volumes, and operational challenges from the installation of new machinery associated with the sizeable capex project at the Newmarket large mould facility. Foreign exchange adjusted sales at the Extrusion and Castool groups were each 3% higher in the quarter while year-to-date Extrusion was up 3% and Castool group was flat on this same basis, with additional contributions provided by foreign exchange movements.

Consolidated net income for the second quarter was $9 million, or basic earnings of $0.21 per share, compared to $10.9 million, or basic earnings of $0.26 per share, in the same quarter last year, a decrease of 17%. Consolidated net income year-to-date was $20.8 million, or basic earnings of $0.49 per share, compared to $20.5 million, or basic earnings of $0.49 per share, for the prior year period. Earnings in the quarter were adversely impacted by several factors. First, lower sales volumes and reduced

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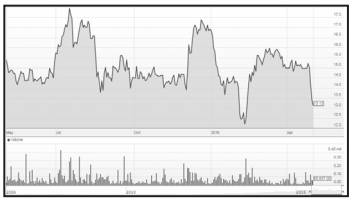

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profitability within the Casting and Extrusion segment as described above impacted earnings. Second, about $1 million of foreign exchange losses compared to a similar sized gain in the prior year quarter eroded earnings by $0.03 per share. In addition, approximately $1 million of transaction-related costs (year-to-date $1.3 million) associated with the acquisition of AFX Industries LLC reduced earnings by $0.03 per share in the quarter and year-to-date. The acquisition closed on April 4, 2016. The effective tax rate was 30% in the quarter compared to 31% in the prior year period while the effective tax rate year-to-date was 31% compared to 29% in the prior year period.

The Automotive Solutions segment reported pretax profit of $11.1 million in the second quarter, an increase of 28% over the same quarter last year. Year-to-date the segment reported pretax profit of $20.2 million, an increase of 22% over the prior year period. The increase in the quarter and year-to-date periods were driven by both higher sales and margin expansion resulting from improved production efficiencies and better overhead absorption. Polytech, Polydesign and Neocon each contributed to the segment's higher pretax profit while the ALC group experienced modestly higher losses in both the quarter and year-to-date periods versus a year ago. During the second quarter, ALC's South African operations were permanently closed as planned which contributed to production inefficiencies and disruption caused by moving inventory to other locations. Combined losses at ALC's South African and Lesotho operations amounted to $1.6 million in the quarter and $2.9 million year-to-date, representing $0.04 per share and $0.07 per share respectively. The closure of the South African operations is expected to substantially improve ALC's operating results going forward.

The Casting and Extrusion segment reported lower pretax profit of $5.1 million in the second quarter, a decrease of $3.9 million, or 43%, from the same quarter last year. Year-to-date the segment reported pretax profit of $15.1 million, or $1.4 million below the prior year period. Most of this reduction occurred in the large mould business which had significantly lower absorption rates and was negatively impacted by

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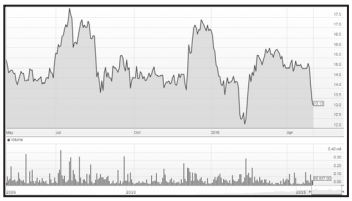

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unfavorable mix variance and new product launch inefficiencies in the second quarter. Lower quarterly earnings within the Extrusion business were offset by a similar increase from the Castool group when comparing year-over-year results while the extrusion business had relatively flat earnings year-to-date over the prior year with Castool group recording a slight increase on this basis.

GROWTH OUTLOOK

The outlook for Exco over the rest of the year continues to be fundamentally strong. The North America automotive sector is robust and although production volumes are not growing at recent historical rates, volumes remain steady at elevated levels. The European automotive market seems to be improving, although also at a gradual pace. Exco looks to gain market share for future short-term growth. OEMs also continue to refresh/redesign and/or launch entire new models which should drive strong long-term demand as well. Management expects this trend to benefit Exco's businesses. The large mould business has a very strong order backlog and continues to be awarded new business. The inclusion of the AFX business in the third quarter and the closure of ALC's South African operations are also expected to add significantly to earnings going forward.

Canadian dollar weakness is a net benefit to Exco; however, recent foreign exchange volatility is introducing an element of variability around sales and margins, necessitating continued focus on cost and operational excellence. While some initiatives are currently underway – such as those which have impacted earnings in the large mould and extrusion die businesses – others are contemplated. The raw material environment continues to be favourable with little upward pressure on pricing and abundant availability of most input commodities.

CONCLUSION

While Exco's second quarter was a bit of a hiccup near term in terms of earnings,

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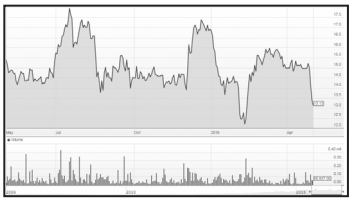

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the pause in growth was not unexpected and with the acquisition of the AFX business, growth is projected to resume in upcoming quarters. Given the approximately $2 million in one-time type affects on earnings in the quarter, the earnings drop is justifiable as near-term pain for long-term gains.

Q1 earnings were adversely impacted by several factors. First, lower sales volumes and reduced profitability within the Casting and Extrusion segment as described above impacted earnings – these appeared not to be systemic in nature and given the record backlog, should pick up again in upcoming quarters. There were three new programs running in a quarter which is very unusual for the large mold business. Typically, Exco would see one or less of these programs which can often initially lose money due to upfront costs. Moving forward, the number of these new programs will likely follow historical norms. Additionally, about $1 million of foreign exchange losses compared to a similar sized gain in the prior year quarter eroded earnings by $0.03 per share. In addition, approximately $1 million of transaction-related costs (year-to-date $1.3 million) associated with the acquisition of AFX Industries LLC reduced earnings by $0.03 per share in the quarter and year-to-date. The acquisition closed on April 4, 2016.

We see the recent drop in Exco's shares as an opportunity. AFX will begin contributing to earnings in the upcoming quarter, which we expect to produce meaningful growth once again. AFX had revenue of approximately C$115 million (equivalent) in 2015. Exco expects the acquisition will be highly accretive to its earnings per share. We expect the 12-month earnings run-rate (pro-forma) for the company with AFX included is in the range of $1.35 – the stock is now trading at and attractive 9.7 times that estimate. EV/EBITDA is approximately 6.3 based on pro-forma EBITDA – this is also relatively attractive.

While the company's industry is cyclical, we believe the current environment appears positive for the next 12 months. As such, we maintain our BUY recommendation and the company's place in our Focus BUY Portfolio.

BV (BV/Share): Book value (book value per share)

Book value per common share calculated as total shareholder's equity less preferred equity, and divided by the number of common shares outstanding. Should the company decide to dissolve, the book value per common share indicates the dollar value remaining for common shareholders after all assets are liquidated and all creditors are paid.

D/E: Debt-to-equity ratio

A measure of a company's financial leverage calculated by dividing long term debt by shareholders equity. It indicates what proportion of equity and debt the company is using to finance its assets.

Current ratio

One of many ratios designed to evaluate short-term liquidity of a company. Calculated as current assets divided by current liabilities, this ratio gauges the level of cash resources relative to current liabilities as a measure of cash obligations.

EBITDA

Earnings before interest, taxes, depreciation, and amortization. EBITDA is calculated as revenue minus expenses (excluding tax, interest, depreciation, and amortization).

EPS: Earnings per share

A company's earnings available to common shareholders, also known as net income or net profit, divided by the number of shares outstanding.

EV: Enterprise value

Enterprise value is calculated as market capitalization less cash and equivalents, plus debt. Evaluation of EV relative to the company's trailing EBITDA is used in identifying potential takeover targets.

FCF: Free cash flow

Capital expenditures are subtracted from cash flow from operating activities to arrive at free cash flow, which intends to measure the cash available to a company after making all cash outlays necessary to maintain existing productive capacity (as measured by capital expenditures on a company's cash flow statement).

Net working capital

A measure of the company's ability to carry on its normal business comfortably and without financial stringency, to expand its operations without the need of new financing, and to meet emergencies and losses. Calculated by deducting current liabilities from the current assets.

P/B: Price-to-book ratio

Calculated as a stock's market value (current closing price) divided by its latest quarter's book value. While a lower P/B ratio could mean that the stock is undervalued, it could also serve as a sign of weak fundamentals, and as with most ratios, this varies a fair amount by industry.

PEG ratio

The price/earnings to growth, or PEG ratio is calculated as P/E ratio divided by a company's annual EPS growth. The PEG ratio is used to determine a stock's value while taking into account earnings growth.

P/FCF: Price-to-free cash flow ratio

Calculated as a company's current share price divided by its free cash flow per share (i.e., free cash flow divided by the number of company's shares outstanding) over the last four quarters (called "TTM," or "trailing 12 months" calculation). It is a measure of the market's expectations regarding a firm's future financial health.

P/S: Price-to-sales ratio

It is calculated as a stock's current market price divided by its sales (revenue) per share. When calculating this ratio, we use the company's revenue from its latest four quarters, or on a TTM basis.

ROE: Return on equity

A measure of a corporation's profitability, calculated as net income divided by shareholder's equity. ROE is often useful in comparing the profitability of a company to other firms in the same industry.

Featured companies in KeyStone's Small-Cap Stock Report are evaluated on a scale of 1 to 5 on each of the following criteria:

Value: 1 - poor investment value
5 - excellent investment value

Growth: 1 - poor growth potential
5 - excellent growth potential

Risk/Liquidity: 1 - high exposure to liquidity concerns
5 - low exposure to liquidity concerns

Overall: 1 - poor fundamental characteristics
5 - excellent fundamental characteristics

Disclosure					
Stock Holding				Other	
Companies	KeyStone	KeyStone Employees	Related Companies	Investment Banking Client	Related Company Business Relationship
Exco Technologies Limited	YES	YES	NO	NO	NO