

Allison Transmission (ALSN)

\$45.00 (As of 01/27/20)

Price Target (6-12 Months): **\$48.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 10/14/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:C

Value: B

Growth: C

Momentum: D

Summary

Shares of Allison Transmission have underperformed the broader industry over the last twelve months. The company anticipates year-over year decline in net income and adjusted EBITA in 2019. Declining demand for hydraulic fracturing applications in the North America Off-Highway end market is likely to affect the firm's margins. Allison has also been bearing the brunt of rising R&D costs and the trend is likely to continue. However, the firm's strategic acquisitions including the buyout of Walker Die and C&R Tool bode well. The firm is increasing the pace of development of products that cater to electrification and fuel cell markets for commercial vehicles. Investor-friendly moves are buoying shareholders' confidence. That said, investors are recommended to wait for a better entry point, in consideration of the headwinds.

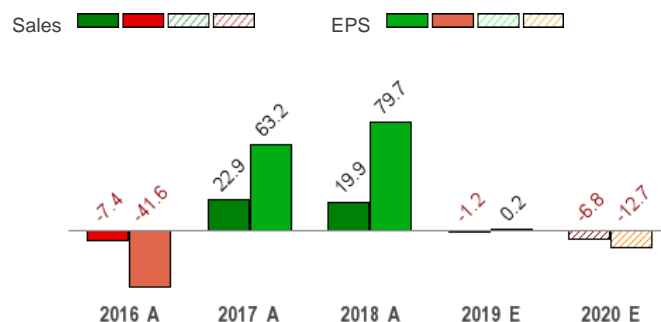
Price, Consensus & Surprise



Data Overview

| | |
|----------------------------|---|
| 52 Week High-Low | \$52.67 - \$41.26 |
| 20 Day Average Volume (sh) | 768,650 |
| Market Cap | \$5.4 B |
| YTD Price Change | -6.9% |
| Beta | 1.37 |
| Dividend / Div Yld | \$0.60 / 1.3% |
| Industry | Automotive - Original Equipment |
| Zacks Industry Rank | Bottom 29% (180 out of 255) |

Sales and EPS Growth Rates (Y/Y %)



| | |
|---------------------------|------------|
| Last EPS Surprise | 8.9% |
| Last Sales Surprise | 0.8% |
| EPS F1 Est- 4 week change | -0.7% |
| Expected Report Date | 02/24/2020 |
| Earnings ESP | -13.7% |

Sales Estimates (millions of \$)

| | Q1 | Q2 | Q3 | Q4 | Annual* |
|------|-------|-------|-------|-------|---------|
| 2020 | 617 E | 666 E | 620 E | 588 E | 2,499 E |
| 2019 | 675 A | 737 A | 669 A | 598 E | 2,681 E |
| 2018 | 663 A | 711 A | 692 A | 647 A | 2,713 A |

EPS Estimates

| | Q1 | Q2 | Q3 | Q4 | Annual* |
|------|----------|----------|----------|----------|----------|
| 2020 | \$1.10 E | \$1.16 E | \$1.06 E | \$0.88 E | \$4.18 E |
| 2019 | \$1.32 A | \$1.46 A | \$1.23 A | \$0.78 E | \$4.79 E |
| 2018 | \$1.08 A | \$1.29 A | \$1.27 A | \$1.14 A | \$4.78 A |

*Quarterly figures may not add up to annual.

| | |
|---------|------|
| P/E TTM | 8.7 |
| P/E F1 | 10.8 |
| PEG F1 | 1.1 |
| P/S TTM | 2.0 |

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/27/2020. The reports text is as of 01/28/2020.

Overview

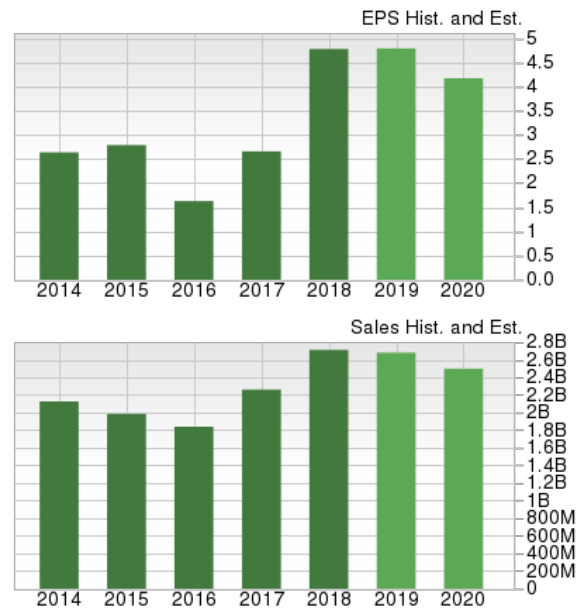
Headquartered in Indianapolis, IN, Allison Transmission Holdings, Inc. is a designer and manufacturer of fully-automatic transmissions for medium and heavy-duty commercial, and heavy-tactical U.S. defense vehicles. The company's transmissions are used for a wide variety of applications that include on-highway trucks, buses, motorhomes, off-highway vehicles and equipment, and defense vehicles. The company also offers electric hybrid propulsion systems. In 2018, Allison globally sold roughly 60% of all fully-automatic transmissions for medium and heavy-duty on-highway commercial vehicle applications.

Although North America contributed roughly 77% to total revenues for Allison in 2018, it also has presence in Europe, Asia, South America and Africa. The company has roughly 1,400 distributor and dealer locations worldwide.

The company has segregated revenues by end markets. In North America, it serves On-Highway (contributed 49% in 2018), Off-Highway (3%) end markets. Likewise, Outside North America, it serves On-Highway (contributed 14% in 2018) and Off-Highway (5%) end markets. Beside on and off-highway, it also serves Defense (6%), and Service Parts, Support Equipment and Other (23%) end markets.

Allison is one of the largest transmission manufacturers for on-highway, medium and heavy-duty commercial vehicle market. Within the on-highway market, it serves fully-automatic transmissions in North America, majorly catering to Class 8, followed by Class 6-7 trucks, school buses, transits/shuttle, motorhomes and others. Outside North America, Africa (collectively, "EMEA") is the company's largest market.

In the off-highway market, the company offers products used in vehicles and equipment that serve energy, mining and construction applications in North America and Outside the region. Further, Outside North America, EMEA's mining and construction are the largest markets.



Reasons To Buy:

- ▲ Allison is the largest manufacturer of fully-automatic transmissions for medium and heavy-duty commercial vehicles. Notably, the company holds approximately 60% of the total market share on a global basis. It has a strong and diversified presence in North America. In addition, the company is focusing on increasing its footprint in emerging and under-served markets.
- ▲ Improving adjusted free cash flow is strengthening the company's balance sheet, enabling it to invest in acquisitions, and product and technology development strategies, in addition to rewarding its shareholders. Earlier this year, the board of directors approved a \$1-billion increase in the existing stock repurchase authorization.
- ▲ The firm's recent acquisitions including the buyout of Walker Die and C&R Tool bode well for future growth. Of late, Allison has increased the pace of development of products that cater to electrification and fuel cell markets for commercial vehicles. In this regard, early this year, the firm announced acquisitions of Vantage Power and AxleTech's electric vehicle systems division.

Favorable pricing and North America On-Highway drive Allison. Further, strong cash flow supports its acquisitions and investment in technologies.

Reasons To Sell:

- ▼ Weakness in Off-Highway end market due to contracting demand for hydraulic fracturing applications is likely to adversely impact the company's bottom line in 2019. The firm expects year-over year decline in net income and adjusted EBITA in 2019.
 - ▼ Allison has been bearing the brunt of increasing research and development costs. It expects the costs to soar in the upcoming quarters, in turn denting margins. The company expects engineering R&D expenses to be up about \$20 million year over year in 2019, with the majority of the increase to be witnessed in the second half.
 - ▼ All automakers are drifting toward the global shift to electric vehicles. Allison is also developing hybrid and electrification products for commercial customers. However, weak product line, increased product initiatives spending, uncertainties about timing and scope of product development are a few concerns for the company, which makes it vulnerable to compete with other transmission producers.
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Last Earnings Report

Allison's Q3 Earnings Top, Decline Y/Y

Allison Transmission's third-quarter 2019 earnings came in at \$1.23 per share, beating the Zacks Consensus Estimate of \$1.13. It delivered better-than-expected results on the back of higher-than-anticipated revenues of \$369 million from the North America On Highway end market, outpacing the Zacks Consensus Estimate of \$349 million. The reported figure, however, comes in lower than the year-ago quarter's \$1.27.

Net income in the third quarter declined to \$149 million compared with the \$167 million recorded in the year-ago quarter. This downside primarily resulted from lower gross profit, increased product-initiatives spending and elevated interest expense.

In the reported quarter, net sales declined 3% year over year to \$669 million due to lower demand in the Service Parts, Support Equipment & Other and Global Off-Highway end markets. However, the figure outpaced the Zacks Consensus Estimate of \$664 million. Gross profit decreased 5% year over year to \$348 million. Gross margin was 52% compared with 53.2% recorded in the prior-year quarter. This downside primarily stemmed from lower net sales and higher manufacturing expenses.

Quarter in Detail

Allison segregates its revenues by the end markets served, which are as follows:

Net sales in the North America On-Highway end market increased 11% year over year to \$369 million, driven by stellar demand for rugged duty series and highway series models. This was led by the continued execution of growth initiatives and market-share gains in the company's Class 4/5 truck.

Net sales in the North America Off-Highway end market tanked 50% year over year to \$6 million. This downside was caused by lower demand from hydraulic fracturing applications.

Net sales in the Defense end market went down 5% to \$40 million, due to lower demand for Wheeled vehicle.

The Outside North America On-Highway end market's net sales increased 3% to \$99 million, owing to higher demand in Europe and South America, partially offset by lower demand in Asia.

Net sales in the Outside North America Off-Highway end market plummeted 48% to \$24 million in third-quarter 2019 on lower demand in the mining and energy sectors.

Net sales in the Service Parts, Support Equipment & Other end market fell 20% to \$131 million, due to lower demand for North America service parts.

Financial Position

Allison had cash and cash equivalents of \$152 million as of Sep 30, 2019 compared with \$231 million as of Dec 31, 2018. Long-term debt was \$2,513 million as of Sep 30, 2019, compared with the \$2,523 million recorded on Dec 31, 2018. The debt-to-capital ratio stands at 77.2%.

In third-quarter 2019, the company's net cash provided by operating activities was \$212 million compared with the year-ago quarter's \$239 million. Adjusted free cash flow (FCF) in the reported quarter was \$165 million compared with the prior-year quarter's \$216 million.

2019 Outlook

Allison reiterated its guidance for 2019. For the year, it anticipates net sales in the range of \$2.65-\$2.7 billion. Further, net income is estimated to be \$555-\$575 million and adjusted EBITDA is projected at \$1.03-\$1.07 billion.

For full-year 2019, net cash provided by operating activities is projected at \$745-\$775 million, while adjusted FCF is expected in the range of \$570-\$610 million.

Quarter Ending **09/2019**

| Report Date | Oct 30, 2019 |
|------------------|--------------|
| Sales Surprise | 0.77% |
| EPS Surprise | 8.85% |
| Quarterly EPS | 1.23 |
| Annual EPS (TTM) | 5.15 |

Valuation

Allison's shares are up 11.9% over the trailing 12-month period. Over the past year, the Zacks sub-industry and the Zacks sector are up 26.9% and 18.4%, respectively.

The S&P 500 index is up 29% in the past year.

The stock is currently trading at 10.66X forward 12-month earnings, which compares to 12.82X for the Zacks sub-industry, 10.92X for the Zacks sector and 18.94X for the S&P 500 index.

Over the past five years, the stock has traded as high as 29.37X and as low as 8.35X, with a 5-year median of 11.08X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$48 price target reflects 11.37X forward 12-month earnings per share.

The table below shows summary valuation data for ALSN:

| Valuation Multiples - ALSN | | | | | |
|----------------------------|---------------|-------|--------------|--------|---------|
| | | Stock | Sub-Industry | Sector | S&P 500 |
| P/E F12M | Current | 10.66 | 12.82 | 10.92 | 18.94 |
| | 5-Year High | 29.37 | 13.46 | 11.75 | 19.34 |
| | 5-Year Low | 8.35 | 8.52 | 8.23 | 15.18 |
| | 5-Year Median | 11.08 | 11.61 | 9.93 | 17.45 |
| EV/EBITDA TTM | Current | 7.18 | 6.17 | 8.74 | 12.25 |
| | 5-Year High | 12.25 | 8.66 | 11.33 | 12.86 |
| | 5-Year Low | 6.34 | 4.63 | 7.05 | 8.48 |
| | 5-Year Median | 8.65 | 6.63 | 9.27 | 10.68 |
| P/S F12M | Current | 2.15 | 0.64 | 0.67 | 3.52 |
| | 5-Year High | 3.36 | 0.81 | 0.76 | 3.52 |
| | 5-Year Low | 1.9 | 0.49 | 0.5 | 2.54 |
| | 5-Year Median | 2.47 | 0.65 | 0.62 | 3 |

As of 01/27/2020

Industry Analysis Zacks Industry Rank: Bottom 29% (180 out of 255)



Top Peers

| | |
|--------------------------------|--------------|
| BorgWarner Inc. (BWA) | Neutral |
| Caterpillar Inc. (CAT) | Neutral |
| Cummins Inc. (CMI) | Neutral |
| Dana Incorporated (DAN) | Neutral |
| Eaton Corporation, PLC (ETN) | Neutral |
| Magna International Inc. (MGA) | Neutral |
| Twin Disc, Incorporated (TWIN) | Neutral |
| AB Volvo (VLVLY) | Underperform |

| Industry Comparison Industry: Automotive - Original Equipment | | | | Industry Peers | | |
|---|--------------|------------|-----------|----------------|--------------|--------------------|
| | ALSN Neutral | X Industry | S&P 500 | CAT Neutral | TWIN Neutral | VLVLY Underperform |
| VGM Score | C | - | - | C | D | C |
| Market Cap | 5.37 B | 674.93 M | 23.86 B | 75.01 B | 132.92 M | 31.54 B |
| # of Analysts | 8 | 3 | 13 | 9 | 2 | 4 |
| Dividend Yield | 1.33% | 0.00% | 1.81% | 3.04% | 0.00% | 5.54% |
| Value Score | B | - | - | B | C | C |
| Cash/Price | 0.03 | 0.11 | 0.04 | 0.10 | 0.12 | 0.15 |
| EV/EBITDA | 7.05 | 4.92 | 13.94 | 7.91 | 5.93 | 6.31 |
| PEG Ratio | 1.09 | 1.17 | 2.00 | 1.47 | NA | NA |
| Price/Book (P/B) | 7.22 | 1.25 | 3.25 | 5.00 | 0.77 | 2.19 |
| Price/Cash Flow (P/CF) | 7.21 | 4.49 | 13.46 | 8.23 | 5.37 | 5.68 |
| P/E (F1) | 10.85 | 10.74 | 18.67 | 12.86 | NA | 12.12 |
| Price/Sales (P/S) | 1.97 | 0.41 | 2.62 | 1.36 | 0.46 | 0.68 |
| Earnings Yield | 9.29% | 8.84% | 5.35% | 7.78% | -3.42% | 8.25% |
| Debt/Equity | 3.38 | 0.41 | 0.72 | 1.71 | 0.36 | 0.78 |
| Cash Flow (\$/share) | 6.24 | 3.65 | 6.92 | 16.49 | 1.85 | 2.73 |
| Growth Score | C | - | - | D | D | D |
| Hist. EPS Growth (3-5 yrs) | 20.84% | 8.47% | 10.68% | 23.01% | 2.59% | 41.47% |
| Proj. EPS Growth (F1/F0) | -12.86% | 7.55% | 7.51% | -2.50% | -140.96% | -27.27% |
| Curr. Cash Flow Growth | 39.24% | 6.02% | 13.40% | 35.57% | 8.81% | 23.94% |
| Hist. Cash Flow Growth (3-5 yrs) | 6.55% | 10.36% | 8.78% | 6.65% | 11.18% | NA |
| Current Ratio | 1.57 | 1.56 | 1.22 | 1.44 | 2.75 | 1.30 |
| Debt/Capital | 77.18% | 35.95% | 42.92% | 63.05% | 26.22% | 43.90% |
| Net Margin | 23.61% | 3.02% | 11.39% | 10.99% | 1.09% | 7.31% |
| Return on Equity | 91.48% | 14.34% | 17.19% | 42.51% | 1.74% | 27.74% |
| Sales/Assets | 0.63 | 1.30 | 0.54 | 0.70 | 0.83 | 0.84 |
| Proj. Sales Growth (F1/F0) | -6.79% | 1.37% | 4.09% | -4.45% | -8.79% | -5.12% |
| Momentum Score | D | - | - | D | D | A |
| Daily Price Chg | -3.10% | -2.42% | -1.40% | -3.31% | 0.10% | -4.64% |
| 1 Week Price Chg | -4.07% | -2.95% | -1.09% | -5.01% | -5.87% | -2.66% |
| 4 Week Price Chg | -7.02% | -4.59% | -0.25% | -7.99% | -7.53% | -6.98% |
| 12 Week Price Chg | 1.15% | -8.30% | 3.64% | -7.62% | -7.36% | -1.30% |
| 52 Week Price Chg | -6.62% | -6.93% | 18.08% | 9.13% | -42.85% | 12.75% |
| 20 Day Average Volume | 768,650 | 155,167 | 1,615,215 | 2,521,839 | 32,618 | 20,740 |
| (F1) EPS Est 1 week change | -0.60% | 0.00% | 0.00% | -0.57% | 0.00% | 0.00% |
| (F1) EPS Est 4 week change | -0.71% | 0.00% | 0.00% | -1.45% | 0.00% | -0.26% |
| (F1) EPS Est 12 week change | -5.27% | -5.26% | -0.17% | -4.29% | -283.78% | -9.22% |
| (Q1) EPS Est Mthly Chg | -1.57% | 0.00% | 0.00% | -0.23% | 0.00% | 0.00% |

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

| | |
|----------------|----------|
| Value Score | B |
| Growth Score | C |
| Momentum Score | D |
| VGM Score | C |

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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