

BorgWarner Inc. (BWA)

\$35.04 (As of 02/05/20)

Price Target (6-12 Months): **\$37.00**

Long Term: 6-12 Months

Zacks Recommendation:
Neutral

(Since: 09/25/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:A

Value: A

Growth: B

Momentum: F

Summary

Strong backlogs and increasing demand for hybrid and electric propulsion engines are likely to bolster BorgWarner's market presence. It is also expected to gain from a diverse product range that caters to hybrid and electric vehicles. The company follows the strategy of acquiring businesses that can expand its product portfolio while divesting non-core operations. However, BorgWarner is witnessing a decline in light-vehicle production across all its major markets served, which is in turn marring the top line. Management expects the challenging conditions to continue, which will further impact its sales in the remainder of 2019. Further, supply chain inefficiencies and higher research and development costs are likely to mar its margins. As such, investors are recommended to wait for a better entry point.

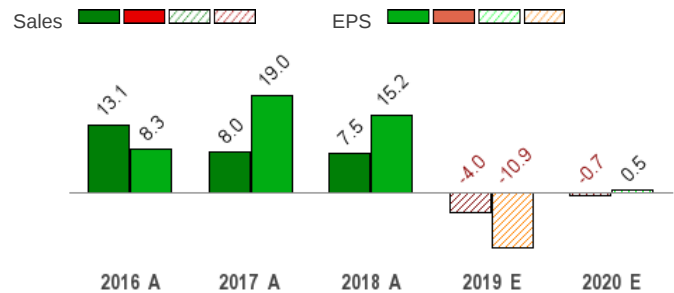
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$46.60 - \$30.71
20 Day Average Volume (sh)	2,864,836
Market Cap	\$7.2 B
YTD Price Change	-19.2%
Beta	1.91
Dividend / Div Yld	\$0.68 / 1.9%
Industry	Automotive - Original Equipment
Zacks Industry Rank	Bottom 36% (163 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	12.9%
Last Sales Surprise	4.8%
EPS F1 Est- 4 week change	-2.8%
Expected Report Date	02/13/2020
Earnings ESP	0.8%
P/E TTM	8.4
P/E F1	8.7
PEG F1	1.1
P/S TTM	0.7

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	2,547 E	2,577 E	2,528 E	2,501 E	10,045 E
2019	2,566 A	2,551 A	2,492 A	2,493 E	10,112 E
2018	2,784 A	2,694 A	2,479 A	2,573 A	10,530 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$0.97 E	\$1.02 E	\$0.98 E	\$1.07 E	\$4.01 E
2019	\$1.00 A	\$1.00 A	\$0.96 A	\$1.03 E	\$3.99 E
2018	\$1.10 A	\$1.18 A	\$1.00 A	\$1.21 A	\$4.48 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/05/2020. The reports text is as of 02/06/2020.

Overview

Michigan-based BorgWarner, Inc. is a global leader in clean and efficient technology solutions required for combustion, hybrid and electric vehicles. Its products include four-wheel-drive and all-wheel-drive transfer cases (primarily for light trucks and sport utility vehicles or SUVs), as well as automatic transmission and timing chain systems. These products are aimed at to improve vehicle performance, propulsion efficiency, stability and air quality. These products are produced and sold worldwide, primarily to OEMs of passenger cars, SUVs, trucks and commercial transportation products.

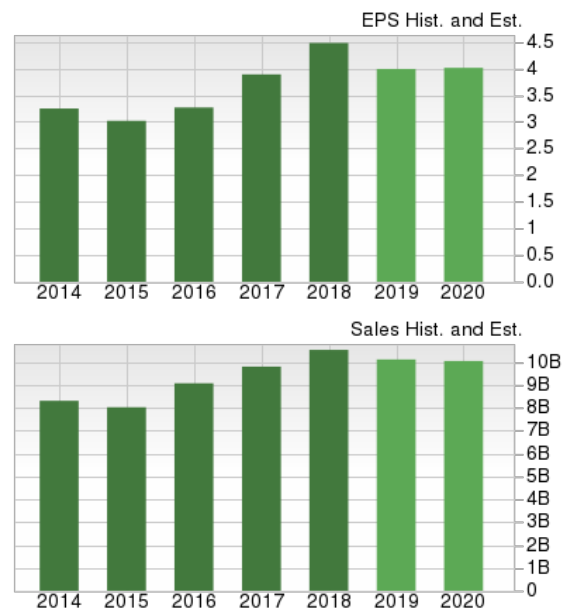
BorgWarner's largest customers include Volkswagen and Ford. The company operates manufacturing facilities catering to the customers in Europe, the Americas and Asia and is an original equipment supplier to every major automotive OEM in the world. The company's production and technical facilities are spread over 64 locations in 17 countries.

BorgWarner operates under two segments:

Engine segment (61% of sales in 2018): This segment develops and manufactures products to manage engines. Products include turbochargers, chains as well as emission and thermal systems. The segment also produces fluid pumps, including engine hydraulic pumps for variable cam timing and engine lubrication.

Drivetrain segment (39%): This segment engineers and manufactures components for automatic transmission and systems that combine such components. Products include friction plates, one-way clutches, transmission bands, torque converters and lock-up clutches for automatic transmission. The segment also offers polymer fans for engine cooling systems and sells products to OEMs of commercial trucks, buses as well as agricultural and off-highway vehicles, primarily in North America, South America, Europe and Asia.

In November 2015, BorgWarner acquired rotating electrical components producer, Remy International, Inc. for \$1.2 billion. In October 2016, the company sold the light vehicle aftermarket business related to this acquisition for a loss of \$127.1 million.



Reasons To Buy:

- ▲ For 2023, BorgWarner expects revenues of \$14 billion and free cash flow of \$1 billion, majorly depending on strong backlogs, and business wins across combustion, hybrid and electric vehicles. Between 2019 and 2021, the backlog is expected to be \$2-\$2.4 billion. With a diverse product range, it projects that the new business gains will be more for its products that cater to hybrid and electric vehicles by 2023.
- ▲ In the long term, BorgWarner expects that hybrid and electric technologies will be the major revenue drivers. Through 2021, 80% of its backlog will consist of hybrid and electric propulsion systems, and rest 20% will comprise combustion propulsion. Region wise, it expects 25% backlog in the Americas, 15% in Europe and 60% in Asia. Strong product demand impelled BorgWarner to invest in innovative product launches and undergo collaborations. In January 2019 and October 2018, it opened two plants each in India and China to meet the demand for EVs, and hybrid electric vehicles. In the same month, the company partnered with WM Motor to set up a transportation model for smart city in China.
- ▲ BorgWarner follows the strategy of acquiring businesses that can expand its product portfolio while divesting non-core operations. In January 2019, it agreed to sell the thermostat business to Arlington Industries Group Ltd. The divestment will help BorgWarner to part ways with a non-core business and focus on developing technically-enhanced propulsion systems. Very recently, the company divested BorgWarner Morse TEC LLC ("Morse TEC"), a wholly-owned subsidiary of the company that holds asbestos and certain other liabilities, to Enstar Holdings (US) LLC.

BorgWarner is poised to benefit from global expansion and capital deployment. Strong backlogs with rising demand also drive the company.

Reasons To Sell:

- ▼ Bleak outlook for the remainder of 2019 has dampened investors' sentiments. The company has downwardly revised its revenue expectations in the range of \$9.95-\$10.1 billion versus the prior guidance of \$9.94-\$10.18 billion. Foreign currencies are expected to result in a year-over-year decrease in sales of \$375 million, mainly due to the depreciation of the Euro, Chinese Renminbi and Korean Won against the U.S. dollar. The divestiture of the thermostat product line will decrease year-over-year sales by approximately \$90 million.
- ▼ BorgWarner is witnessing a decline in light-vehicle production across all its major markets served, which is in turn marring the top line. Management expects the challenging conditions to continue, which will further impact its sales in the remainder of 2019. BorgWarner anticipates global light vehicles volumes to decline 4-4.5% in 2019. Due to softening demand in China amid trade tensions, the company is increasingly pessimistic about the Chinese market.
- ▼ As the company has to deal with a struggling Tier 2 supplier base, margins are expected to erode. As we know, annual price reductions for OEM customers have become a common practice. While BorgWarner faces pressure from OEMs to reduce prices, it is unable to pass on any increase in raw material costs to OEM customers. While it's normal for auto OEMs to demand price reductions from tier-1 suppliers like BorgWarner, these firms try to recover the costs from Tier-2 suppliers. However, weakness witnessed in Tier 2 suppliers is limiting BWA's ability to pass on pricing concessions to OEMs. Further, supply chain inefficiencies and higher research and development costs are likely to mar its margins. In fact, the company expects R&D costs to be higher in the second half of the year as it continues to invest heavily in electrification-related programs.

Pricing pressure from OEMs and bleak outlook for 2019 might negatively impact BorgWarner's financials.

Last Earnings Report

BorgWarner Beats Q3 Earnings & Revenue Estimates

BorgWarner Inc. delivered adjusted earnings of 96 cents per share in third-quarter 2019, beating the Zacks Consensus Estimate of 85 cents. This was mainly driven by revenue growth in the Drivetrain segment which amounted to \$993 million, outpacing the Zacks Consensus Estimate of \$964 million. However, the earnings per share came in lower than the \$1 recorded in the year-ago quarter. Net income amounted to \$194 million compared with the \$204 million reported in the prior-year quarter.

Quarter Ending **09/2019**

Report Date	Oct 31, 2019
Sales Surprise	4.83%
EPS Surprise	12.94%
Quarterly EPS	0.96
Annual EPS (TTM)	4.17

BorgWarner's net sales inched up 0.6% year over year to \$2.49 billion, which beat the Zacks Consensus Estimate of \$2.38 billion. The reported figure, however, fell nearly \$66 million year over year, due to foreign currency fluctuations.

In the third quarter, operating income amounted to \$276 million compared with the prior-year quarter's figure of \$278 million.

Segmental Performance

Net sales in the Engine segment fell to \$1,514million fromthe prior-year quarter's \$1,516 million. Excluding impact of foreign-currency translation and divestiture of the thermostat product line, net sales went up4.6% year over year and adjusted EBIT (earnings before interest, income taxes and non-controlling interest) inched up 1.26% to \$241 million. This was primarily aided by higher revenuesand the net impactof acquisitions and divestitures.

In the Drivetrain segment, net sales increased to \$993 million from the \$976 million reported in the prior-year quarter. Excluding impacts of foreign currencies, net sales were up 4.2% on a year-over-year basis and adjusted EBIT fell 7.4% to \$100 million due to higher amount spent on research and development andstart-up costs for launches.

Financial Position

As of Sep 30, 2019, BorgWarner had \$916 million in cash compared with \$739 million as of Dec 31, 2018. Long-term debt was \$1.66 billion, down from the \$1.94 billion recorded at the end of 2018. The debt-to-capital ratio stands at 31.2%.

Net cash provided by operating activities was \$824 million as of Sep 30, 2019 compared with \$556 million as of Sep 30, 2018. Investment in capital expenditure, including tooling outlays, declined to \$346 million from \$394 million recorded as of Sep 30, 2018.

Outlook

For full-year 2019, the company's net organic sales are likely to be down 1% to flat, with an estimated range of \$9.95-\$10.1 billion. Further, it envisions adjusted net earnings between \$3.85 and \$4 per diluted share. Further, adjusted operating margin is expected in the range of 11.7-12% and full-year free cash flow is estimated between \$550 million and \$600million.

Valuation

BorgWarner's shares are down 19.3% and 10.7% in the year-to-date period and over the trailing 12-month period, respectively. Stocks in the Zacks Automotive - Original Equipment industry and the Zacks Auto-Tires-Trucks sector are down 1% and up 5.4%, respectively, over the past year. Over the past year, the Zacks sub-industry and sector are down 7.4% and 20.9%, respectively.

The S&P 500 index is up 3.3% and 20.8% in the year-to-date period and over the past year, respectively.

The stock is currently trading at 8.65X forward 12-month earnings, which compares to 13.15X for the Zacks sub-industry, 24.73X for the Zacks sector and 18.89X for the S&P 500 index.

Over the past five years, the stock has traded as high as 17.67X and as low as 7.19X, with a 5-year median of 10.94X.

Our Neutral recommendation indicates that the stock will in line with the market. Our \$37 price target reflects 9.13X forward 12-month earnings per share.

The table below shows summary valuation data for BWA:

Valuation Multiples - BWA					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	8.65	13.15	24.73	18.89
	5-Year High	17.67	13.46	26.2	19.34
	5-Year Low	7.19	8.52	19.07	15.18
	5-Year Median	10.94	11.6	22.96	17.46
EV/EBITDA TTM	Current	4.96	6.05	15.29	11.95
	5-Year High	10.97	8.66	15.37	12.85
	5-Year Low	4.51	4.63	10.63	8.49
	5-Year Median	6.81	6.62	12.38	10.66
P/S F12M	Current	0.71	0.64	1.07	3.5
	5-Year High	1.62	0.81	1.1	3.5
	5-Year Low	0.62	0.49	0.8	2.54
	5-Year Median	0.9	0.65	0.91	3

As of 02/05/2020

Industry Analysis Zacks Industry Rank: Bottom 36% (163 out of 255)



Top Peers

Autoliv, Inc. (ALV)	Neutral
American Axle & Manufacturing Holdings, Inc. (AXL)	Neutral
Caterpillar Inc. (CAT)	Neutral
Dana Incorporated (DAN)	Neutral
Navistar International Corporation (NAV)	Neutral
PACCAR Inc. (PCAR)	Neutral
Tenneco Inc. (TEN)	Neutral
Deere & Company (DE)	Underperform

Industry Comparison Industry: Automotive - Original Equipment				Industry Peers		
	BWA Neutral	X Industry	S&P 500	CAT Neutral	DE Underperform	NAV Neutral
VGM Score	A	-	-	B	B	A
Market Cap	7.24 B	784.25 M	24.26 B	75.96 B	53.00 B	3.72 B
# of Analysts	9	3	13	11	10	4
Dividend Yield	1.94%	0.00%	1.75%	3.00%	1.81%	0.00%
Value Score	A	-	-	B	C	B
Cash/Price	0.13	0.12	0.04	0.11	0.09	0.41
EV/EBITDA	4.73	4.81	14.19	8.12	10.40	8.32
PEG Ratio	1.10	1.15	2.04	1.67	3.98	1.03
Price/Book (P/B)	1.58	1.31	3.31	5.19	4.64	NA
Price/Cash Flow (P/CF)	5.33	5.02	13.70	8.58	10.19	5.86
P/E (F1)	8.55	11.59	19.17	14.60	17.83	16.00
Price/Sales (P/S)	0.71	0.45	2.67	1.41	1.35	0.33
Earnings Yield	11.44%	8.17%	5.22%	6.85%	5.61%	6.24%
Debt/Equity	0.36	0.41	0.71	1.80	2.65	-1.16
Cash Flow (\$/share)	6.58	3.65	6.92	16.03	16.53	6.40
Growth Score	B	-	-	B	B	A
Hist. EPS Growth (3-5 yrs)	9.55%	8.47%	10.80%	27.28%	12.82%	NA
Proj. EPS Growth (F1/F0)	0.53%	5.91%	7.35%	-14.89%	-5.00%	-44.88%
Curr. Cash Flow Growth	11.56%	5.67%	10.12%	-6.65%	4.09%	9.70%
Hist. Cash Flow Growth (3-5 yrs)	7.21%	9.98%	8.55%	4.31%	3.09%	81.17%
Current Ratio	1.58	1.56	1.20	1.47	2.04	1.39
Debt/Capital	26.56%	35.95%	42.91%	64.24%	72.60%	NA
Net Margin	7.43%	3.38%	11.79%	11.32%	8.29%	1.96%
Return on Equity	19.43%	14.34%	17.21%	41.85%	27.11%	-10.02%
Sales/Assets	1.00	1.30	0.54	0.68	0.54	1.59
Proj. Sales Growth (F1/F0)	-0.08%	0.00%	4.15%	-8.15%	-7.50%	-15.23%
Momentum Score	F	-	-	F	C	A
Daily Price Chg	1.77%	1.24%	1.40%	2.94%	2.38%	3.65%
1 Week Price Chg	-12.61%	-3.65%	-2.60%	-6.43%	-6.78%	43.21%
4 Week Price Chg	-17.94%	-1.98%	1.96%	-6.93%	-4.29%	33.81%
12 Week Price Chg	-21.61%	-0.76%	6.04%	-4.88%	-4.17%	14.27%
52 Week Price Chg	-14.93%	-1.93%	16.68%	5.29%	2.85%	12.32%
20 Day Average Volume	2,864,836	152,572	1,966,046	3,144,115	1,502,154	1,276,750
(F1) EPS Est 1 week change	-1.20%	0.00%	0.00%	-11.49%	0.00%	0.00%
(F1) EPS Est 4 week change	-2.78%	0.00%	0.00%	-12.78%	-0.11%	0.86%
(F1) EPS Est 12 week change	-2.22%	-3.88%	-0.08%	-13.52%	-15.48%	-29.14%
(Q1) EPS Est Mthly Chg	-4.29%	0.00%	0.00%	-21.30%	0.05%	5.22%

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	A
Growth Score	B
Momentum Score	F
VGM Score	A

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.

Disclosures

This report contains independent commentary to be used for informational purposes only. The analysts contributing to this report do not hold any shares of this stock. The analysts contributing to this report do not serve on the board of the company that issued this stock. The EPS and revenue forecasts are the Zacks Consensus estimates, unless indicated otherwise on the reports first page. Additionally, the analysts contributing to this report certify that the views expressed herein accurately reflect the analysts personal views as to the subject securities and issuers. ZIR certifies that no part of the analysts compensation was, is, or will be, directly or indirectly, related to the specific recommendation or views expressed by the analyst in the report.

Additional information on the securities mentioned in this report is available upon request. This report is based on data obtained from sources we believe to be reliable, but is not guaranteed as to accuracy and does not purport to be complete. Any opinions expressed herein are subject to change.

ZIR is not an investment advisor and the report should not be construed as advice designed to meet the particular investment needs of any investor. Prior to making any investment decision, you are advised to consult with your broker, investment advisor, or other appropriate tax or financial professional to determine the suitability of any investment. This report and others like it are published regularly and not in response to episodic market activity or events affecting the securities industry.

This report is not to be construed as an offer or the solicitation of an offer to buy or sell the securities herein mentioned. ZIR or its officers, employees or customers may have a position long or short in the securities mentioned and buy or sell the securities from time to time. ZIR is not a broker-dealer. ZIR may enter into arms-length agreements with broker-dealers to provide this research to their clients. Zacks and its staff are not involved in investment banking activities for the stock issuer covered in this report.

ZIR uses the following rating system for the securities it covers. **Outperform-** ZIR expects that the subject company will outperform the broader U.S. equities markets over the next six to twelve months. **Neutral-** ZIR expects that the company will perform in line with the broader U.S. equities markets over the next six to twelve months. **Underperform-** ZIR expects the company will underperform the broader U.S. equities markets over the next six to twelve months.

No part of this report can be reprinted, republished or transmitted electronically without the prior written authorization of ZIR.