

BorgWarner Inc. (BWA)

\$20.50 (As of 03/20/20)

Price Target (6-12 Months): **\$22.00**

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:C

Value: A

Growth: C

Momentum: F

Summary

As the global auto industry evolves to meet increasingly stringent emissions, BorgWarner is likely to benefit from accelerating vehicle electrification. In the long term, BorgWarner expects that hybrid and electric technologies will be the major revenue drivers. BorgWarner's planned buyout of Delphi Technologies will strengthen its propulsion leadership. The company's restructuring efforts is likely to help the firm to sustain margin profile and competitiveness in the long term. However, decline in light-vehicle production across all its major markets served, is likely to mar BorgWarner's top line. Bleak outlook for 2020 sales and profits has dampened investors' sentiments. High R&D costs and unfavorable foreign exchange translations are other headwinds. As such, investors are advised to wait for a better entry point.

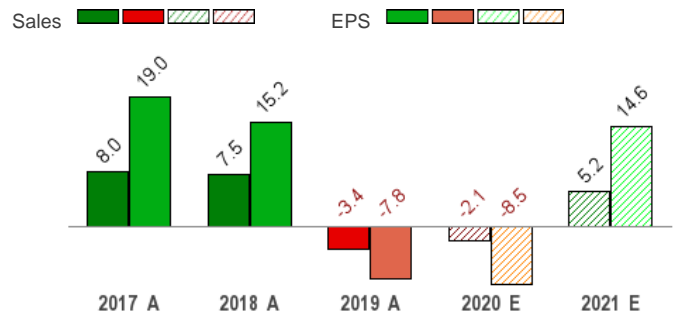
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$46.60 - \$17.00
20 Day Average Volume (sh)	4,936,115
Market Cap	\$4.2 B
YTD Price Change	-52.7%
Beta	1.75
Dividend / Div Yld	\$0.68 / 3.3%
Industry	Automotive - Original Equipment
Zacks Industry Rank	Bottom 13% (221 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	4.5%
Last Sales Surprise	-0.0%
EPS F1 Est- 4 week change	-3.2%
Expected Report Date	04/23/2020
Earnings ESP	-14.6%
P/E TTM	5.0
P/E F1	5.4
PEG F1	0.7
P/S TTM	0.4

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	2,597 E	2,651 E	2,602 E	2,748 E	10,476 E
2020	2,428 E	2,491 E	2,482 E	2,573 E	9,954 E
2019	2,566 A	2,551 A	2,492 A	2,559 A	10,168 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.02 E	\$1.11 E	\$1.07 E	\$1.18 E	\$4.33 E
2020	\$0.84 E	\$0.90 E	\$0.97 E	\$1.12 E	\$3.78 E
2019	\$1.00 A	\$1.00 A	\$0.96 A	\$1.17 A	\$4.13 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 03/20/2020. The reports text is as of 03/23/2020.

Overview

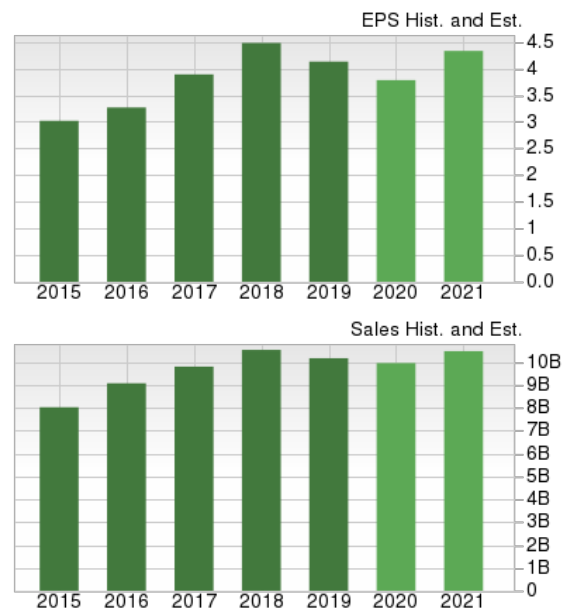
Michigan-based BorgWarner, Inc. is a global leader in clean and efficient technology solutions required for combustion, hybrid and electric vehicles. Its products include four-wheel-drive and all-wheel-drive transfer cases (primarily for light trucks and sport utility vehicles or SUVs), as well as automatic 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 (60.7% of sales in 2019): 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 (39.3%): 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.



Reasons To Buy:

- ▲ BorgWarner's planned buyout of Delphi Technologies will further strengthen its propulsion leadership. The combined company would offer flexibilities across the combustion, hybrid and electric propulsion lines, which is consistent with BorgWarner's evolution toward the future propulsion industry and transition toward electric vehicles. BorgWarner will also achieve cost synergies of approximately \$125 million by 2023 primarily by SG&A and procurement savings.
- ▲ As the global auto industry evolves to meet increasingly stringent emissions, BorgWarner is likely to benefit from accelerating vehicle electrification. In the long term, BorgWarner expects that hybrid and electric technologies will be the major revenue drivers. Electrification programs are likely to drive the company's backlog. Between 2020 and 2023, the backlog is expected to be \$2.5-\$2.63 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. Region wise, it expects 20% backlog in the Americas, 10% in Europe and 70% in Asia.
- ▲ The company's restructuring efforts, including footprint reduction in manufacturing technical centers and consolidation of Turbo/ETS business, bode well and is likely to help the firm to sustain margin profile and competitiveness in the long term. BorgWarner's turbocharger and timing products are its primary growth drivers. Since turbochargers help auto engines to remain in compliance with the tough emission standards, the demand for turbocharged engines is increasing. The timing system, which comes with one of the key technologies namely VCT, results in improved fuel economy and reduced emissions. High sales of turbocharger and timing products are likely to drive the top-line of the firm.
- ▲ The company fares well in the cash flow parameter. BorgWarner's FCF totaled \$700 million in 2019 and the company expects to generate \$675-\$725 million of FCFs in 2020. Full-year operating cash flow is expected to be approximately \$1,250 million, suggesting an uptick from \$1,008 million in 2019. BorgWarner's investor friendly moves also boost investors' confidence. In January 2020, the firm approved the implementation of a share-repurchase program of up to \$1 billion over the next three years.

BorgWarner's planned buyout of Delphi Technologies is likely to strengthen its propulsion unit.

Reasons To Sell:

- ▼ Bleak outlook for 2020 has dampened investors' sentiments. For full-year 2020, net sales are expected in the range of \$9,750 million to \$10,075 million, suggesting a year-over-year fall of 2.5% at the mid-point of the guidance. Adjusted operating margin is expected to be in the range of 11.6% to 12%, suggesting a decline from 2019. Adjusted net earnings are expected to lie between \$3.85 and \$4.15 per share, suggesting a 3.1% y/y decline at the mid-point of the guidance.
 - ▼ BorgWarner expects a decline in light-vehicle production across all its major markets served, which is likely to mar its top line. The company expects the light-vehicle markets to decline in the range of 2%-4% in 2020. Due to softening demand in China amid trade tensions, the company is increasingly pessimistic about the Chinese market. The firm expects production in China, Europe and North America to decline around 1%-5%, 2%-5% and 1%-2%, respectively, on a year-over-year basis.
 - ▼ Higher research and development costs are likely to mar its margins in 2020. The company expects R&D costs to be higher in 2020 as it continues to invest heavily in electrification-related programs. Unfavorable foreign currency translations are also likely to dent the results of the firm. The company expects foreign currencies to result in a year-over-year decrease in sales of \$130 million, primarily due to the depreciation of the Euro, Chinese Renminbi and Korean Won against the U.S. dollar.
 - ▼ As the company has to deal with a struggling Tier 2 supplier base, margins are expected to erode. 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.
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BorgWarner expects a decline in light-vehicle production across all its major markets served, which is likely to mar its top line.

Last Earnings Report

BorgWarner Beats Q4 Earnings & Revenue Estimates

BorgWarner delivered adjusted earnings of \$1.17 per share in fourth-quarter 2019, beating the Zacks Consensus Estimate of \$1.05. This was mainly driven by the better-than-anticipated performance of the Drivetrain and Engine segments. However, the reported figure came in lower than the year-ago quarter's \$1.21 per share. Net income amounted to \$220 million compared with the \$230 million reported in the prior-year quarter.

BorgWarner's net sales edged down 0.6% year over year to \$2,559 million, due to the unfavorable impact of the thermostat product line divestiture and foreign-currency fluctuations. The reported figure, however, beat the Zacks Consensus Estimate of \$2,533 million.

In the fourth quarter, operating income amounted to \$478 million compared with the prior-year quarter's figure of \$266 million.

Segmental Performance

Net sales in the Engine segment fell to \$1,533 million from the year-ago quarter's \$1,541 million. The figure, however, surpassed the Zacks Consensus Estimate of \$1,480 million. Excluding impact of foreign-currency translation and divestiture of the thermostat product line, net sales went up 3.5% year over year and adjusted EBIT (earnings before interest, income taxes and non-controlling interest) climbed 8.6% to \$264 million. This was primarily aided by higher revenues, excluding the impact of weaker currencies, and lower SG&A and R&D expense.

In the Drivetrain segment, net sales decreased to \$1,042 million from the \$1,047 million reported in the prior-year quarter. The figure, however, outpaced the Zacks Consensus Estimate of \$1,041 million. Excluding impacts of foreign currencies, net sales inched up 1.5% on a year-over-year basis and adjusted EBIT rose 4.6% to \$136 million owing to supplier cost savings and lower R&D costs.

Financial Position

As of Dec 31, 2019, BorgWarner had \$832 million in cash compared with \$739 million as of Dec 31, 2018. Long-term debt was \$1.67 billion, down from the \$1.94 billion recorded at the end of 2018. The debt-to-capital ratio stands at 25.68%.

Net cash provided by operating activities was \$1,008 million as of Dec 31, 2019, compared with \$1,126 million as of Dec 31, 2018. Investment in capital expenditure, including tooling outlays, declined to \$481 million from the \$546 million recorded as of Dec 31, 2018.

Outlook

For full-year 2020, net sales are expected in the range of \$9,750 million to \$10,075 million, suggesting a year-over-year fall of 2.5% at the mid-point of the guidance. Further, it envisions adjusted net earnings between \$3.85 and \$4.15 per diluted share. In addition, adjusted operating margin is expected in the range of 10-11% and full-year free cash flow is estimated between \$675 million and \$725 million.

Quarter Ending **12/2019**

Report Date	Feb 13, 2020
Sales Surprise	-0.04%
EPS Surprise	4.46%
Quarterly EPS	1.17
Annual EPS (TTM)	4.13

Valuation

BorgWarner's shares are down 52.7% and 43.7% 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 38.5% and 31%, respectively, on a year to date basis. Over the past year, the Zacks sub-industry and sector are down 31.3% and 22.3%, respectively.

The S&P 500 index is down 28.2% and 18.2% in the year-to-date period and over the past year, respectively.

The stock is currently trading at 5.25X forward 12-month earnings, which compares to 9.13X for the Zacks sub-industry, 8.11X for the Zacks sector and 13.75X for the S&P 500 index.

Over the past five years, the stock has traded as high as 17.67X and as low as 4.86X, with a 5-year median of 10.71X.

Our Neutral recommendation indicates that the stock will in line with the market. Our \$22 price target reflects 5.64X 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	5.25	9.13	8.11	13.75
	5-Year High	17.67	13.46	11.75	19.34
	5-Year Low	4.86	8.52	8.11	13.75
	5-Year Median	10.71	11.59	9.88	17.42
EV/EBITDA TTM	Current	2.82	4.47	8.34	8.52
	5-Year High	11.02	8.62	11.34	12.88
	5-Year Low	2.73	4.42	6.97	8.31
	5-Year Median	6.73	6.57	9.31	10.78
P/S F12M	Current	0.42	0.41	0.47	2.5
	5-Year High	1.6	0.81	0.76	3.43
	5-Year Low	0.4	0.41	0.47	2.5
	5-Year Median	0.88	0.64	0.62	3

As of 03/20/2020

Industry Analysis Zacks Industry Rank: Bottom 13% (221 out of 254)



Top Peers

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

Industry Comparison Industry: Automotive - Original Equipment				Industry Peers		
	BWA Neutral	X Industry	S&P 500	CAT Neutral	DE Neutral	NAV Neutral
VGM Score	C	-	-	C	D	C
Market Cap	4.23 B	513.63 M	15.82 B	52.53 B	35.01 B	1.70 B
# of Analysts	9	2	13	10	10	4
Dividend Yield	3.32%	0.00%	2.79%	4.31%	2.72%	0.00%
Value Score	A	-	-	B	D	B
Cash/Price	0.16	0.15	0.06	0.15	0.10	0.40
EV/EBITDA	2.88	3.48	9.77	6.10	8.09	6.28
PEG Ratio	0.69	0.77	1.42	1.13	2.36	0.48
Price/Book (P/B)	0.87	0.80	2.07	3.59	2.93	NA
Price/Cash Flow (P/CF)	3.28	3.18	8.39	5.93	6.75	2.68
P/E (F1)	5.33	7.39	12.42	10.92	11.79	7.45
Price/Sales (P/S)	0.42	0.23	1.68	0.98	0.90	0.16
Earnings Yield	18.44%	13.38%	7.97%	9.16%	8.48%	13.42%
Debt/Equity	0.35	0.51	0.70	1.80	2.55	-1.14
Cash Flow (\$/share)	6.26	3.19	7.01	16.10	16.53	6.40
Growth Score	C	-	-	C	F	D
Hist. EPS Growth (3-5 yrs)	9.76%	7.17%	10.85%	27.28%	16.20%	NA
Proj. EPS Growth (F1/F0)	-8.39%	1.62%	4.90%	-20.90%	-4.73%	-45.88%
Curr. Cash Flow Growth	-5.66%	-3.78%	6.03%	-6.65%	4.09%	9.70%
Hist. Cash Flow Growth (3-5 yrs)	3.79%	6.21%	8.55%	4.31%	3.09%	81.17%
Current Ratio	1.65	1.60	1.23	1.47	2.12	1.41
Debt/Capital	25.68%	38.59%	42.57%	64.24%	71.88%	NA
Net Margin	7.34%	2.50%	11.57%	11.32%	8.41%	1.63%
Return on Equity	18.68%	14.04%	16.74%	41.85%	26.92%	-8.89%
Sales/Assets	1.01	1.30	0.54	0.68	0.53	1.54
Proj. Sales Growth (F1/F0)	-2.10%	-1.48%	3.13%	-9.04%	-7.32%	-16.38%
Momentum Score	F	-	-	F	B	C
Daily Price Chg	-2.43%	-0.36%	-4.39%	-7.29%	-6.71%	-4.94%
1 Week Price Chg	-11.12%	-12.70%	-11.01%	-17.93%	-15.29%	-20.87%
4 Week Price Chg	-41.68%	-40.13%	-36.57%	-30.26%	-32.68%	-54.48%
12 Week Price Chg	-53.21%	-45.87%	-34.28%	-35.57%	-36.14%	-42.19%
52 Week Price Chg	-45.74%	-42.55%	-27.95%	-28.76%	-30.11%	-48.47%
20 Day Average Volume	4,936,115	236,308	3,981,936	6,750,164	2,798,746	1,325,209
(F1) EPS Est 1 week change	-2.23%	0.00%	-0.01%	-1.30%	-1.66%	-1.39%
(F1) EPS Est 4 week change	-3.18%	-4.84%	-0.85%	-4.76%	0.29%	-1.81%
(F1) EPS Est 12 week change	-5.91%	-7.96%	-1.70%	-16.93%	-0.15%	-8.29%
(Q1) EPS Est Mthly Chg	-3.16%	-5.84%	-0.88%	-3.65%	-10.25%	-31.21%

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	C
Momentum Score	F
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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