

Hexcel Corporation (HXL)

\$76.30 (As of 02/20/20)

Price Target (6-12 Months): **\$65.00**

Long Term: 6-12 Months

Zacks Recommendation: Underperform
(Since: 02/11/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:D

Value: D

Growth: C

Momentum: F

Summary

The grounding of 737 Max jets last March and the consequent uncertainty surrounding this program has forced Hexcel Corp. to keep its financial guidance in a conservative range. The company projects sales to be flat to up low-single digit and EPS growth of low-to-mid single digit in 2020. In January 2020, the Trump administration announced plans to expand its existing tariffs on imports of steel and aluminum, thereby bringing steel and aluminum derivatives under the tariff mandate. This tariff expansion is expected to raise input costs thereby hurting the growth prospects of Hexcel Corp. Shares of the company have underperformed its industry in a year's time. Yet, its pending merger with Woodward may enhance investors' interest in this stock, with the combined company set to capture more share of the aircraft parts market.

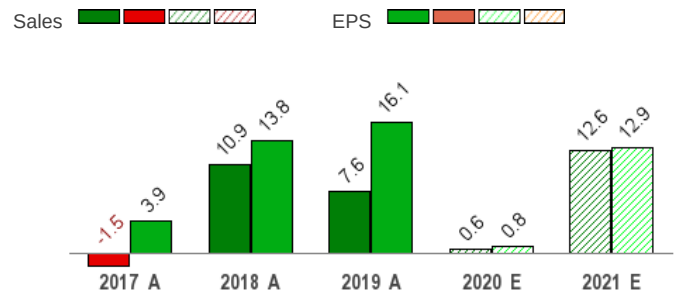
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$87.00 - \$65.61
20 Day Average Volume (sh)	670,973
Market Cap	\$6.4 B
YTD Price Change	4.1%
Beta	1.03
Dividend / Div Yld	\$0.68 / 0.9%
Industry	Aerospace - Defense Equipment
Zacks Industry Rank	Bottom 17% (211 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	1.2%
Last Sales Surprise	-4.5%
EPS F1 Est- 4 week change	-6.5%
Expected Report Date	04/28/2020
Earnings ESP	0.0%
P/E TTM	21.6
P/E F1	21.4
PEG F1	2.1
P/S TTM	2.7

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					2,669 E
2020	593 E	592 E	586 E	601 E	2,371 E
2019	610 A	609 A	573 A	564 A	2,356 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021					\$4.03 E
2020	\$0.83 E	\$0.87 E	\$0.91 E	\$0.94 E	\$3.57 E
2019	\$0.84 A	\$0.94 A	\$0.90 A	\$0.86 A	\$3.54 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 02/20/2020. The reports text is as of 02/21/2020.

Overview

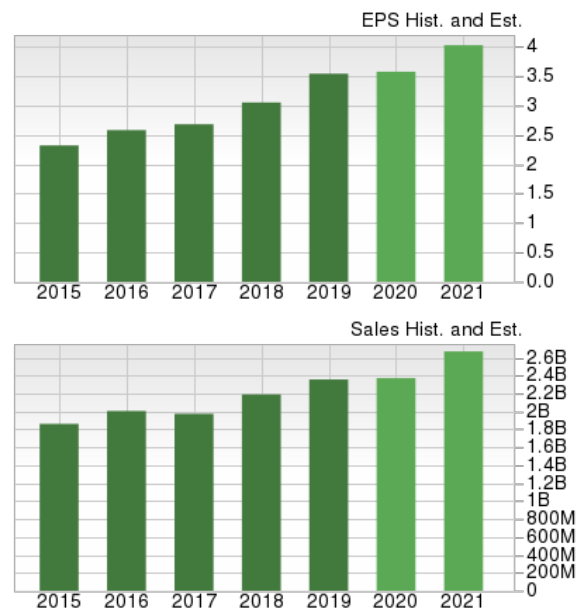
Delaware-based Hexcel Corporation develops, manufactures and distributes lightweight, high-performance structural materials for use in Commercial Aerospace, Space & Defense and Industrial markets. Hexcel Corporation, founded in 1946, was incorporated in California in 1948, and reincorporated in Delaware in 1983. The company's products are used in a wide variety of end applications, such as commercial and military aircraft, space launch vehicles and satellites, wind turbine blades, automotive and other complex industrial applications. The company serves international markets through manufacturing facilities located in the United States, Asia Pacific, Europe, Russia and Africa.

Hexcel Corporation operates in two segments namely the Composite Materials and Engineered Products.

The **Composite Materials** segment manufactures and markets carbon fibers, fabrics and specialty reinforcements, prepregs and other fiber-reinforced matrix materials, structural adhesives, honeycomb, molding compounds, tooling materials, polyurethane systems and laminates that are incorporated into military and commercial aircrafts, wind turbine blades, recreational products, automobiles and other industrial applications. Net sales for this segment were \$1,946.5 million in 2019, representing 82.6% of the company's total sales.

The **Engineered Products** segment manufactures and markets composite structures and precision machined honeycomb parts primarily for use in the aerospace industry. Composite structures are manufactured from a variety of composite and other materials, including prepregs, honeycomb, and structural adhesives, using manufacturing processes like autoclave processing, multi-axis numerically controlled machining, heat forming, and other composite manufacturing techniques. Net sales for this segment were \$493.4 million in 2019, representing 20.9% of the company's total sales.

However, total sales included corporate expenses of \$84.2 million.



Reasons To Sell:

- ▼ Lower deliveries for Boeing's 737 jets continued during the fourth quarter of 2019, following the grounding of these jets since last March. Boeing announced a temporary production rate decrease to 42 planes per month in April from 52 produced before. In December, Boeing announced its decision to temporarily suspend the production of its once fastest-selling jet. Such consecutive setbacks in the 737 Max program affect its parts suppliers like Hexcel.

737 Max issue and extended tariff on import of aluminum poses concern for Hexcel Corp.'s growth

In fact, Hexcel provided conservative expectation for its operations in 2020, considering the uncertainty surrounding 737 Max program. Notably, based on the 737 issue, the company projects sales to be flat to up low-single digit and EPS growth of low-to-mid single digit in 2020.

- ▼ In January 2020, the Trump administration announced plans to expand its existing tariffs on imports of steel and aluminum, stating from Feb 8. Steel and aluminum derivatives will also come under the tariff mandate. This tariff expansion is expected to deal a heavy blow to the U.S. aerospace and defense industry, which relies heavily on imported aluminum. In 2018, when the initial tariff was imposed, the AIA had expressed concern by saying that such a tariff will raise cost and disrupt the supply chain. Now that tariffs are being imposed on derivatives as well, input costs are expected to rise even more, thereby hurting the growth prospects of aerospace and defense equipment stocks like Hexcel Corp.
 - ▼ The company's shares have only increased 6.5% compared with the industry's rally of 21.4% in the past year. Moreover, a comparative analysis of its historical P/S ratio reflects a relatively gloomy picture that might be a cause for investors' concern. The stock currently has a trailing 12-month P/S ratio of 2.76. This level compares unfavorably with what the stock saw in the past 12 months. The ratio is higher than the industry's average of 2.37. Therefore, the company's valuation from a P/S perspective along with its underperformance compared to its industry might hurt investors' confidence in this stock.
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Risks

- During the second quarter, Hexcel Corp announced its financial outlook through 2021 long with its other long-term targets. For the three-year period 2019 to 2021, the company expects total sales to witness a compounded annual growth rate (CAGR) of 6-9%. Strong commercial aerospace programs, continued growth in the F35 Joint Strike Fighter build rate and consistent growth in other fixed wing programs are expected to drive Hexcel Corp.'s growth. Also, double-digit demand growth for its wind energy products are expected to contribute to the top line.
- In January 2020, Hexcel entered into an all-stock merger of equals agreement with aircraft control system providers, Woodward, for providing premier, technology-rich integrated systems and services to the aerospace and industrial sectors. Post the merger, the new company will be named Woodward Hexcel, with more than \$5 billion in revenues. Post the completion of merger formalities, existing Hexcel shareholders will own approximately 45% of the combined company on a fully diluted basis. The merger is also expected to be tax free for U.S. federal income tax purposes.

The combined company is expected to be capitalized with a strong balance sheet, with significant free cash flow generation. The merger will provide opportunities to enhance the scale of operations and offer significant content for all key aerospace programs, with approximately \$1 billion of free cash flow in the first full fiscal year. Since, both companies are two of the biggest suppliers of aircraft giants, Boeing and Airbus Group, the merger should enable the combined company to capture a large share of the aircraft parts market by catering to increasing requirements of technologically advanced aircraft parts and systems.

Last Earnings Report

Hexcel's Q4 Earnings Surpass Estimates, Revenues Miss

Hexcel Corporation reported fourth-quarter 2019 adjusted earnings of 86 cents per share, surpassing the Zacks Consensus Estimate of 85 cents by 1.2%. Further, the bottom line improved 4.9% from the prior-year quarter's 82 cents.

In the reported quarter, the company's GAAP earnings came in at 86 cents compared with the prior-year quarter's 76 cents.

For 2019, Hexcel's earnings were \$3.54 per share, up 16.1% from \$3.05 in the year-ago period. The full-year earnings figure surpassed the Zacks Consensus Estimate of \$3.53 by 0.3%.

Quarter Ending **12/2019**

Report Date	Feb 03, 2020
Sales Surprise	-4.53%
EPS Surprise	1.18%
Quarterly EPS	0.86
Annual EPS (TTM)	3.54

Total Revenues

Net sales totaled \$564.3 million, which missed the Zacks Consensus Estimate of \$591.1 million by 4.5%. However, the top line witnessed an increase of 0.6% from the year-ago quarter's \$561 million.

In 2019, total revenues grew 7.6% year over year to \$2,355.7 million. However, the full-year revenues figure missed the Zacks Consensus Estimate of \$2,380 million by 1%.

Operational Update

Hexcel's gross margin was 26% in the fourth quarter, reflecting a year-over-year contraction of 80 basis points.

The company's operating expenses amounted to \$49.1 million in the quarter compared with the previous year's \$54.6 million. Selling, general and administrative expenses were up 13.3%, while research and technology expenses were down 13.2%.

Quarterly Performance

Commercial Aerospace: Net sales were down 1.5% year over year to \$379.8 million. The decline can be attributed to lower sales for legacy narrow-body programs.

Space and Defense: Net sales rose 18% year over year to \$115.3 million, primarily owing to growth across several defense and space programs, and the F-35 Joint Strike Fighter (JSF) program alongside the contribution from ARC Technologies.

Industrial: Net sales declined 11.2% year over year to \$69.2 million, primarily due to soft wind energy sales.

Financial Details

As of Dec 31, 2019, cash and cash equivalents were \$64.4 million compared with \$32.7 million as of Dec 31, 2018.

Long-term debt totaled \$1,050.6 million as of Dec 31, up from \$947.4 million as of 2018-end.

At the end of 2019, cash generated from operating activities summed \$491.1 million compared with \$421.4 million in the prior year.

Other Financial Updates

The effective tax rate for the fourth quarter of 2019 was 16.6% compared with 24.2% in the year-ago period. The fourth quarter of 2019 was favorably impacted by a rate adjustment.

The company used \$76 million to repurchase shares of its common stock during the fourth quarter of 2019, bringing the total share repurchase value to \$143 million in 2019. The remaining authorization under the share repurchase program as of Dec 31 was \$242 million.

2020 Guidance

Hexcel forecasts its free cash flow to exceed \$300 million and accrual basis capital expenditures to remain between \$100 million and \$120 million in 2020. The underlying effective tax rate is estimated at 23%.

Recent News

On **Feb 7, 2020**, Hexcel Corporation collaborated with NaCa Systems, a Tier 1 supplier of natural fiber composite automotive interior parts, on the development of a lightweight carbon fiber prepreg and wood fiber composite sports car seat back using a rapid press molding process. This innovation validates a short-cycle time production process for CFRP and wood fiber composite parts and offers a host of benefits to automotive manufacturers.

Hexcel supplies NaCa Systems with an optimized version of its HexPly M77CS epoxy prepreg material. HexPly® M77CS is a fast curing hot melt, thermosetting epoxy matrix, specifically designed for prepreg applications for which short-cure cycles and clear surfaces with perfect aesthetics are required.

Valuation

Hexcel Corp.'s shares are down 6.9% in the past six months and are up 6.5% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Aerospace sector are up 9.1% and 4.8% in the past six-month period, respectively. Over the past year, the Zacks sub-industry and sector are up 21.4% and 8.8%, respectively.

The S&P 500 index is up 16% in the past six-month period and up 20% in the past year.

The stock is currently trading at 20.98X of forward 12-month earnings, which compares to 20.98X for the Zacks sub-industry, 21.69X for the Zacks sector and 19.31X for the S&P 500 index.

Over the past five years, the stock has traded as high as 23.52X and as low as 14.58X, with a 5-year median of 19.23X. Our Underperformance recommendation indicates that the stock will perform worse than the market. Our \$65 price target reflects 17.87X forward 12-month earnings.

The table below shows summary valuation data for HXL

Valuation Multiples - HXL					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	20.98	20.98	21.69	19.31
	5-Year High	23.52	20.98	21.69	19.34
	5-Year Low	14.58	14.51	14.26	15.18
	5-Year Median	19.23	18.01	16.87	17.47
P/S F12M	Current	2.67	1.93	1.39	3.56
	5-Year High	2.91	1.93	1.39	3.56
	5-Year Low	1.7	1.09	0.8	2.54
	5-Year Median	2.35	1.47	1.09	3
EV/EBITDA TTM	Current	12.82	13.67	13.23	12.31
	5-Year High	16.66	13.67	13.24	12.85
	5-Year Low	10.21	9.02	7.28	8.47
	5-Year Median	13.22	10.28	9.99	10.72

As of 02/20/2020

Industry Analysis Zacks Industry Rank: Bottom 17% (211 out of 255)



Top Peers

Heico Corporation (HEI)	Outperform
Leidos Holdings, Inc. (LDOS)	Outperform
AAR Corp. (AIR)	Neutral
Aerojet Rocketdyne Holdings, Inc. (AJRD)	Neutral
Curtiss-Wright Corporation (CW)	Neutral
Teledyne Technologies Incorporated (TDY)	Neutral
Astronics Corporation (ATRO)	Underperform
Spirit Aerosystems Holdings, Inc. (SPR)	Underperform

Industry Comparison Industry: Aerospace - Defense Equipment				Industry Peers		
	HXL Underperform	X Industry	S&P 500	AJRD Neutral	ATRO Underperform	TDY Neutral
VGM Score	D	-	-	B	D	D
Market Cap	6.36 B	1.51 B	24.34 B	4.28 B	748.96 M	14.30 B
# of Analysts	3	3	13	2	1	2
Dividend Yield	0.89%	0.00%	1.78%	0.00%	0.00%	0.00%
Value Score	D	-	-	D	C	D
Cash/Price	0.01	0.04	0.04	0.18	0.03	0.01
EV/EBITDA	14.85	14.85	14.18	12.72	9.34	27.90
PEG Ratio	2.14	2.91	2.09	4.96	2.48	NA
Price/Book (P/B)	4.45	3.35	3.30	7.42	1.86	5.27
Price/Cash Flow (P/CF)	14.43	14.43	13.49	19.99	9.66	32.01
P/E (F1)	21.37	24.75	19.28	27.25	24.75	34.58
Price/Sales (P/S)	2.70	1.85	2.68	2.16	0.96	4.52
Earnings Yield	4.68%	4.04%	5.17%	3.68%	4.04%	2.89%
Debt/Equity	0.73	0.33	0.70	0.68	0.42	0.28
Cash Flow (\$/share)	5.29	2.53	7.03	2.72	2.51	12.25
Growth Score	C	-	-	B	D	B
Hist. EPS Growth (3-5 yrs)	10.06%	14.73%	10.84%	41.45%	-19.77%	17.08%
Proj. EPS Growth (F1/F0)	0.94%	9.40%	7.09%	18.05%	3.16%	7.90%
Curr. Cash Flow Growth	12.73%	9.30%	6.72%	-8.04%	28.11%	21.28%
Hist. Cash Flow Growth (3-5 yrs)	9.63%	4.09%	8.25%	4.56%	14.18%	11.35%
Current Ratio	2.19	2.34	1.22	1.63	2.96	1.72
Debt/Capital	42.08%	29.72%	42.37%	40.43%	29.72%	21.65%
Net Margin	13.02%	7.70%	11.56%	7.12%	12.68%	12.72%
Return on Equity	21.39%	9.39%	16.80%	24.42%	7.98%	15.67%
Sales/Assets	0.75	0.75	0.55	0.76	1.00	0.73
Proj. Sales Growth (F1/F0)	0.67%	0.64%	3.90%	3.70%	-3.43%	6.26%
Momentum Score	F	-	-	A	C	F
Daily Price Chg	2.10%	0.00%	0.01%	2.33%	0.17%	-0.48%
1 Week Price Chg	-0.16%	0.00%	1.65%	3.69%	-1.27%	1.36%
4 Week Price Chg	2.48%	-0.31%	0.36%	5.16%	-13.42%	6.52%
12 Week Price Chg	-4.90%	1.34%	4.39%	22.62%	-19.04%	13.18%
52 Week Price Chg	7.86%	13.54%	15.29%	38.81%	-31.60%	68.10%
20 Day Average Volume	670,973	144,230	1,992,841	456,344	185,655	175,537
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	-11.31%	0.00%
(F1) EPS Est 4 week change	-6.54%	0.00%	-0.02%	0.00%	-27.68%	-0.31%
(F1) EPS Est 12 week change	-8.22%	-0.40%	-0.17%	0.00%	-36.23%	-0.31%
(Q1) EPS Est Mthly Chg	NA%	0.00%	-0.48%	0.00%	NA	NA

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	D
Growth Score	C
Momentum Score	F
VGM Score	D

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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