

Meritor, Inc.(MTOR)

\$26.19 (As of 01/01/20)

Price Target (6-12 Months): **\$27.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 09/30/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:A

Value: B

Growth: A

Momentum: B

Summary

Shares of Meritor have outperformed the industry over the past year. The buyout of AxleTech has enhanced Meritor's growth platform. It also regularly introduces products that position it as a leader in electric drivetrains. Further, an expanding product portfolio will help meet customers' changing needs. The firm's soaring FCF and buyback programs are also positives. However, softening heavy-duty truck markets in the United States and declining demand for Class 8 trucks are likely to weigh on commercial truck and industrial parts makers like Meritor. In fact, the firm's initial guidance for fiscal 2020 sales is projected in the band of \$3.7-\$3.8 billion, indicating 14% decline from the midpoint of the forecast. Elevated leverage is also a concern. As such, investors are recommended to wait for a better entry point.

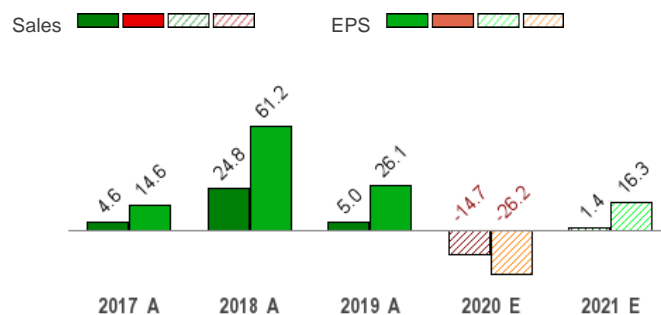
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$27.18 - \$15.96
20 Day Average Volume (sh)	1,308,528
Market Cap	\$2.0 B
YTD Price Change	54.9%
Beta	2.29
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Automotive - Original Equipment
Zacks Industry Rank	Bottom 25% (190 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	22.1%
Last Sales Surprise	-2.3%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	02/04/2020
Earnings ESP	0.0%
P/E TTM	6.8
P/E F1	9.3
PEG F1	NA
P/S TTM	0.5

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					3,799 E
2020	981 E	1,023 E	1,026 E	897 E	3,745 E
2019	1,038 A	1,156 A	1,166 A	1,028 A	4,388 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021					\$3.28 E
2020	\$0.58 E	\$0.80 E	\$0.89 E	\$0.70 E	\$2.82 E
2019	\$0.79 A	\$1.03 A	\$1.20 A	\$0.83 A	\$3.82 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 01/01/2020. The reports text is as of 01/02/2020.

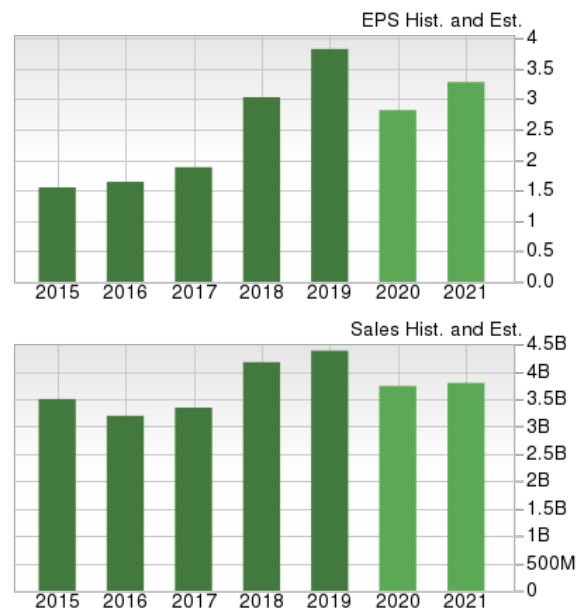
Overview

Meritor, Inc. headquartered in Troy, MI, is a global automotive parts manufacturer and supplier. The company supplies a broad range of integrated systems, modules and components for commercial and specialty vehicles worldwide, with leading positions in most of its markets. Meritor serves a broad range of original equipment manufacturers (OEMs) worldwide, including commercial truck, trailer, military, bus and coach, other industrial OEMs and certain aftermarkets.

From Mar 12, 2018, the company changed its reportable segments. The two new segments are:

Commercial Truck & Trailer (79.6% of revenues in fiscal 2018): The segment supplies drivetrain systems and components, including axles, drivelines, and braking and suspension systems, primarily for medium- and heavy-duty trucks in North America, South America and the Asia Pacific. It also offers a varied range of undercarriage products and systems for trailer applications in North America. This segment also includes the company's aftermarket businesses in the Asia Pacific and South America.

Aftermarket & Industrial (24.5%): This segment supplies axle, brakes, drivelines, suspension parts and other replacement parts to commercial vehicle and industrial aftermarket customers, primarily in North America and Europe. The segment also supplies a wide variety of drivetrain system and certain components, including axles, drivelines, brakes and suspension systems for in North America.



Note: The percentage share of segment revenues in total revenues includes inter-segment sales.



Reasons To Buy:

- ▲ While Meritor has successfully executed the three-year M2019 program, it is on track to achieve M2022 goals that focus on new business opportunities, margin expansion and cost-containment efforts. Per the M2022 goals, the firm is expected to attain 75% free cash flow conversion and remain committed to return money to its shareholders.
- ▲ Meritor's buyout of AxleTech has enhanced its growth. The buyout led to the introduction of a complementary product portfolio, providing the company with a full line of independent suspensions, material handling axles, new braking solutions and drivetrain components. It also diversified Meritor's exposure in adjacent end markets served, which will support its target of realizing more than \$15 million in annual cost synergies by fiscal 2020.
- ▲ The company regularly introduces products that position it as a market leader in electric drivetrains. These product introductions have enabled it to clinch contracts from MAN, Mercedes Benz and Iveco. The expanding product portfolio will enable the company to meet the changing needs of customers. In addition, it announced 22 electrification programs with global OEMs that are expected to put nearly 130 fully-electric medium and heavy-duty commercial trucks on road through 2020. The company is likely to gain from higher margins tied to OEM adoption of advanced products such as eAxle, air disc brakes and precision gearing.
- ▲ The firm's free cash flow, a key metric to gauge the financial health, has been increasing over the past two years. The metric came in at \$147 and \$163 million in fiscal 2018 and 2019, reflecting a year-over-year increase of 4% and 81.4%, respectively. The company's investor-friendly moves boost its shareholders' confidence. In fiscal 2019, Meritor repurchased 5.3 million shares of common stock for \$95 million. The company also approved an increase in the share repurchase authorization from \$250 million to \$325 million during the fiscal year.

Meritor's buyout of AxleTech has enhanced its growth prospects and is likely to result into various synergies.

Reasons To Sell:

- ▼ Trade tensions and slowdown in global economic growth are playing spoilsports for truck makers. Amid sluggish freight volumes, truck makers are logging lower orders. Amid macroeconomic headwinds, the truck manufactures are not expecting market conditions and sales to improve in the near term as well. Softening heavy-duty truck markets in the United States and declining demand for Class 8 trucks are likely to weigh on commercial truck and industrial parts makers like Meritor.
- ▼ In the North America Class 8 market, Meritor projects fiscal 2020 production within 240,000-250,000 units. Production levels in the markets of Europe and India are expected to decline 6% and 17%, respectively, in fiscal 2020. As such, Meritor's initial guidance for fiscal 2020 sales is projected in the band of \$3.7-\$3.8 billion, indicating 14% decline from the midpoint of the forecast.
- ▼ Rising tariffs in China remain a concern, in turn, escalating cost of raw materials, which may dent the company's margins. Also, significant economic slowdown in China is likely to lower the firm's revenues from the region.
- ▼ Meritor's high debt is a spoilsport. The long-term debt of the company was \$902 million in fiscal 2019 (ended on Sep 30), reflecting a year-over-year increase of 23.5%. The firm's elevated leverage of 68.4% restricts its financial freedom to tap onto growth opportunities.

Meritor's initial guidance for fiscal 2020 sales is projected in the band of \$3.7-\$3.8 billion, indicating 14% decline from the midpoint of the forecast.

Last Earnings Report

Meritor Q4 Earnings Top, Revenues Decline Y/Y

Meritor's adjusted earnings of 83 cents per share in fourth-quarter fiscal 2019 (ended Sep 30, 2019), which surpassed the Zacks Consensus Estimate of 68 cents. In the year-ago quarter, the bottom line was 82 cents per share. The outperformance resulted from higher-than-anticipated sales at the Aftermarket & Industrial segment.

Adjusted income from continuing operations was \$70 million compared with \$73 million in fourth-quarter fiscal 2018.

Sales declined 4.81% year over year to \$1.03 billion and missed the Zacks Consensus Estimate of \$1.05 billion. The year-over-year decline was led by lower production in India, Europe and China.

Meritor's adjusted EBITDA (earnings before interest, tax, depreciation and amortization) dropped to \$116 million from \$118 million in the year-ago quarter. Adjusted EBITDA margin was 11.3% compared with 10.9% a year ago on lower net steel, premium and freight costs.

Segment Results

Revenues at the Commercial Truck & Trailer segment amounted to \$728 million in fourth-quarter 2019, down 11% from the year-ago quarter level due to lower production in India, Europe and China. The segment's adjusted EBITDA fell to \$69 million from \$74 million in the year-ago quarter. EBITDA margin rose to 9.5% from 9.1% in the prior-year quarter on lower net steel, premium and freight costs.

Revenues at the Aftermarket & Industrial segment totaled \$341 million, up 11% from the year-ago quarter level, primarily backed by revenues generated from the AxleTech acquisition. The segment's adjusted EBITDA was \$44 million compared with \$42 million in the year-ago quarter. EBITDA margin declined to 12.9% from 13.7% in the fourth quarter of fiscal 2018 owing to the AxleTech acquisition which dented margins as certain targeted synergies were not fully realized in the quarter.

Financial Position

In the reported quarter, Meritor's cash and cash equivalents totaled \$108 million as of Sep 30, 2019, compared with \$115 million as of Sep 30, 2018. Long-term debt was \$902 million at the end of the fiscal fourth quarter compared with \$730 million at the end of fourth-quarter fiscal 2018. The debt-to-capital ratio was 60.93%, as of Sep 30, 2019.

Meritor's cash inflow from operating activities was \$62 million compared with \$60 million in the year-ago quarter. During the quarter under review, capital expenditure was \$40 million compared with \$52 million in the year-ago quarter.

Share Repurchase

In fiscal 2019, Meritor repurchased 5.3 million shares of common stock for \$95 million. The company also approved an increase in the share repurchase authorization from \$250 million to \$325 million in the year.

Fiscal 2020 Outlook

In fiscal 2020, Meritor expects sales in the range of \$3.7-\$3.8 billion. Net income from continuing operations is anticipated in the band of \$145-\$155 million. Adjusted earnings per share from continuing operations are projected in the range of \$2.75-\$2.85.

Quarter Ending **09/2019**

Report Date	Nov 13, 2019
Sales Surprise	-2.31%
EPS Surprise	22.06%
Quarterly EPS	0.83
Annual EPS (TTM)	3.85

Valuation

Meritor's shares are up 59.7% over the trailing 12-month period. Stocks in the Zacks Automotive - Original Equipment industry and the Zacks Automotive sector are up 32.2% and 23.7%, over the past year, respectively.

The S&P 500 index is up 33.5% in the past year.

The stock is currently trading at 8.93X forward 12-month earnings, which compares to 14.36X for the Zacks sub-industry, 11.86X for the Zacks sector and 20.29X for the S&P 500 index.

Over the past five years, the stock has traded as high as 15.6X and as low as 3.66X, with a 5-year median of 7.19X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$27 price target reflects 9.22X forward 12-month earnings per share.

The table below shows summary valuation data for MTOR

Valuation Multiples - MTOR					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	8.93	14.36	11.86	20.29
	5-Year High	15.6	14.36	11.86	20.29
	5-Year Low	3.66	8.52	8.23	15.17
	5-Year Median	7.19	11.6	9.91	17.44
EV/EBITDA TTM	Current	5.71	6.46	8.85	12.01
	5-Year High	24.77	8.66	11.33	12.86
	5-Year Low	NA	4.63	7.05	8.49
	5-Year Median	5.64	6.63	9.26	10.65
P/S F12M	Current	0.53	0.66	0.67	3.51
	5-Year High	0.73	0.81	0.76	3.51
	5-Year Low	0.16	0.49	0.5	2.54
	5-Year Median	0.39	0.66	0.62	3

As of 12/31/2019

Industry Analysis Zacks Industry Rank: Bottom 25% (190 out of 253)



Top Peers

Dana Incorporated (DAN)	Neutral
Gentex Corporation (GNTX)	Neutral
Garrett Motion Inc. (GTX)	Neutral
Lear Corporation (LEA)	Neutral
Magna International Inc. (MGA)	Neutral
Oshkosh Corporation (OSK)	Neutral
Cooper-Standard Holdings Inc. (CPS)	Underperform
Wabco Holdings Inc. (WBC)	Underperform

Industry Comparison Industry: Automotive - Original Equipment				Industry Peers		
	MTOR Neutral	X Industry	S&P 500	DAN Neutral	OSK Neutral	WBC Underperform
VGM Score	A	-	-	A	A	B
Market Cap	2.05 B	837.74 M	23.93 B	2.62 B	6.44 B	6.95 B
# of Analysts	3	3	13	6	8	8
Dividend Yield	0.00%	0.00%	1.78%	2.20%	1.27%	0.00%
Value Score	B	-	-	A	A	C
Cash/Price	0.06	0.10	0.04	0.16	0.07	0.13
EV/EBITDA	5.45	5.42	13.95	5.42	7.40	11.66
PEG Ratio	NA	1.42	2.12	1.36	0.96	1.23
Price/Book (P/B)	5.21	1.50	3.33	1.39	2.49	4.78
Price/Cash Flow (P/CF)	5.19	5.19	13.67	3.71	9.23	13.03
P/E (F1)	9.25	11.29	19.66	5.95	12.15	18.48
Price/Sales (P/S)	0.47	0.49	2.69	0.30	0.77	1.95
Earnings Yield	10.77%	7.76%	5.08%	16.81%	8.23%	5.41%
Debt/Equity	2.17	0.41	0.72	1.32	0.32	0.61
Cash Flow (\$/share)	5.05	3.65	6.94	4.90	10.26	10.40
Growth Score	A	-	-	B	A	B
Hist. EPS Growth (3-5 yrs)	27.19%	9.38%	10.56%	13.57%	26.73%	7.57%
Proj. EPS Growth (F1/F0)	-26.26%	0.00%	0.00%	5.22%	-6.27%	-5.16%
Curr. Cash Flow Growth	15.83%	7.34%	14.83%	16.61%	17.40%	13.33%
Hist. Cash Flow Growth (3-5 yrs)	19.94%	10.36%	9.00%	2.65%	9.98%	6.15%
Current Ratio	1.30	1.56	1.23	1.64	1.96	3.01
Debt/Capital	68.49%	35.95%	42.92%	56.93%	23.96%	37.82%
Net Margin	6.63%	3.02%	11.08%	2.80%	6.91%	9.20%
Return on Equity	78.25%	14.34%	17.10%	26.97%	23.21%	23.60%
Sales/Assets	1.59	1.30	0.55	1.24	1.56	0.90
Proj. Sales Growth (F1/F0)	-10.49%	0.00%	0.00%	0.00%	-4.22%	0.00%
Momentum Score	B	-	-	B	D	A
Daily Price Chg	12.31%	0.00%	0.33%	0.22%	-0.06%	0.07%
1 Week Price Chg	0.04%	0.00%	0.13%	-0.38%	0.42%	-0.06%
4 Week Price Chg	10.74%	1.43%	3.67%	9.24%	6.61%	0.53%
12 Week Price Chg	56.64%	13.27%	10.64%	39.04%	35.74%	0.93%
52 Week Price Chg	54.88%	11.99%	27.46%	33.53%	54.38%	26.23%
20 Day Average Volume	1,308,528	168,677	1,693,267	1,068,188	506,006	433,718
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.00%	0.00%	0.00%	0.00%	-0.37%	0.32%
(F1) EPS Est 12 week change	-12.39%	-4.02%	0.14%	-4.49%	-2.43%	-1.20%
(Q1) EPS Est Mthly Chg	4.17%	0.00%	0.00%	0.00%	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	A
Momentum Score	B
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.