

Meritor, Inc.(MTOR)

\$21.45 (As of 03/03/20)

Price Target (6-12 Months): **\$18.00**

Long Term: 6-12 Months

Zacks Recommendation: Underperform

(Since: 01/31/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:D

Value: B

Growth: F

Momentum: B

Summary

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. Amid the weakening global market, the company has trimmed its 2020 guidance, dampening the sentiments of the shareholders. For fiscal 2020, Meritor expects net income from continuing operations to be \$150 million vis a vis the prior forecast of \$145-\$155 million. The firm's elevated leverage of 70.1% restricts its financial freedom to tap onto growth opportunities. The company has been bearing the brunt of rising SG&A expenses over the past several quarters. The trend is likely to continue, thereby denting the company's operating margins. As such, the stock is viewed as a risky bet.

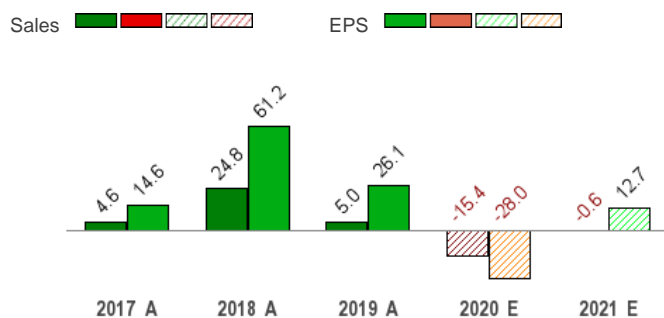
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$27.18 - \$15.96
20 Day Average Volume (sh)	1,302,395
Market Cap	\$1.6 B
YTD Price Change	-18.1%
Beta	2.00
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Automotive - Original Equipment
Zacks Industry Rank	Bottom 28% (184 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	14.3%
Last Sales Surprise	-1.8%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	05/06/2020
Earnings ESP	0.0%
P/E TTM	5.8
P/E F1	7.8
PEG F1	NA
P/S TTM	0.4

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	867 E	963 E	1,027 E	980 E	3,690 E
2020	901 A	959 E	980 E	866 E	3,713 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	\$0.67 E	\$0.80 E	\$0.92 E	\$0.77 E	\$3.10 E
2020	\$0.64 A	\$0.72 E	\$0.77 E	\$0.59 E	\$2.75 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 03/03/2020. The reports text is as of 03/04/2020.

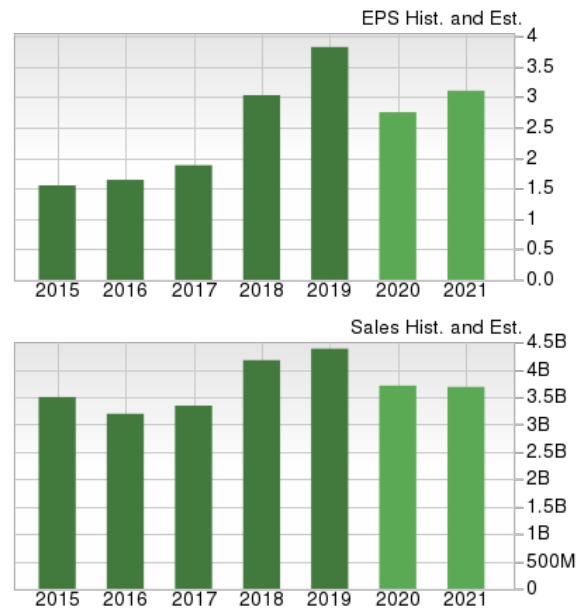
Overview

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 2019): 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 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. Due to 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.
 - ▼ Bleak guidance amid weakening global markets is a dampener. For fiscal 2020, Meritor expects sales to total \$3.7 billion, down from the previous guided range of \$3.7-\$3.8 billion. Net income from continuing operations is anticipated to be \$150 million vis a vis the prior forecast of \$145-\$155 million. Free cash flow is anticipated to be \$165 million compared with the prior guided range of \$165-\$175 million.
 - ▼ Meritor's high debt is a spoilsport. The long-term debt of the company was \$901 million at the end of December 2019. The firm's elevated leverage of 70.1% restricts its financial freedom to tap onto growth opportunities.
 - ▼ The company has been bearing the brunt of rising SG&A expenses over the past several quarters. The trend is likely to continue, thereby denting the company's operating margins.
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Bleak fiscal 2020 guidance amid weakening global markets is a dampener

Risks

- 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. The company's improving free cash flow and investor friendly moves bode well.
 - 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.
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Last Earnings Report

Meritor Q1 Earnings Top, Down Y/Y

Meritor recorded adjusted earnings of 64 cents per share in first-quarter fiscal 2020 (ended Dec 31, 2019), surpassing the Zacks Consensus Estimate of 56 cents. The outperformance resulted from higher-than-anticipated EBITDA (earnings before interest, tax, depreciation and amortization) from the Commercial Truck & Trailer segment. Precisely, EBITDA from the segment came in at \$56 million, topping the consensus mark of \$52 million.

The bottom line declined from the year-ago adjusted earnings of 79 cents a share. Adjusted income from continuing operations was \$52 million compared with \$107 million in first-quarter fiscal 2019.

Sales declined 13.2% year over year to \$901 million and missed the Zacks Consensus Estimate of \$918 million. The year-over-year decline was due to lower production volumes, partly offset by sales from Axle Tech, which was acquired by Meritor in fourth-quarter fiscal 2019.

Its adjusted EBITDA dropped to \$98 million from \$119 million in the year-ago quarter. Adjusted EBITDA margin was 10.9% compared with 11.5% a year ago.

Segment Results

Revenues at the Commercial Truck & Trailer segment amounted to \$622 million in first-quarter fiscal 2020, down 20% from the year-ago level due to lower production volumes across most markets served. The segment's adjusted EBITDA fell to \$56 million from \$77 million in the year-ago quarter. EBITDA margin fell to 9% from 9.9% in the prior-year quarter.

Revenues at the Aftermarket & Industrial segment totaled \$317 million, up 5% from the year-ago level, primarily backed by revenues generated from the AxleTech acquisition. The segment's adjusted EBITDA was \$40 million, unchanged from the year-ago quarter. EBITDA margin declined to 12.6% from 13.2% in the prior-year period as targeted synergies from the AxleTech buyout were not fully realized in the quarter.

Financial Position

In the reported quarter, Meritor's cash and cash equivalents totaled \$108 million as of Dec 31, 2019. Long-term debt was \$901 million at the end of fiscal first-quarter 2020, representing a debt-to-capital ratio of 70.1%.

Meritor's cash outflow from operating activities was \$19 million versus inflow of \$11 million in the year-ago quarter. During the quarter under review, capital expenditure was \$16 million compared with \$23 million in the year-ago quarter.

Share Repurchase

In the quarter under review, Meritor repurchased 4.9 million shares of common stock for \$100 million. Additionally, the company bought back 3.9 million shares for \$100 million through Jan 29, bringing the total to 8.8-million shares repurchased for \$200 million. Investors should note that Meritor has completed two-thirds of the \$300-million share buyback target for fiscal 2020.

Downwardly Revised Fiscal 2020 Outlook

Meritor has revised down its fiscal 2020 guidance amid weakening global markets. For fiscal 2020, Meritor expects sales to total \$3.7 billion, down from the previous guided range of \$3.7-\$3.8 billion. Net income from continuing operations is anticipated to be \$150 million vis a vis the prior forecast of \$145-\$155 million. Adjusted earnings per share from continuing operations are now projected at \$2.75 versus the earlier forecast of \$2.75-\$2.85. Free cash flow is anticipated to be \$165 million compared with the prior guided range of \$165-\$175 million.

Quarter Ending **12/2019**

Report Date	Jan 30, 2020
Sales Surprise	-1.81%
EPS Surprise	14.29%
Quarterly EPS	0.64
Annual EPS (TTM)	3.70

Valuation

Meritor's shares are down 18.1% in the year-to-date period and down 3.8% over the trailing 12-month period. Stocks in the Zacks Automotive - Original Equipment industry and the Zacks Automotive sector are down 10.7% and 1.8%, respectively, in the year-to-date period. Over the past year, the Zacks sub-industry and sector are down 7.5% and up 8.5%, respectively.

The S&P 500 index is down 3.9% in the year to date period and up 11.9% in the past year.

The stock is currently trading at 7.4X forward 12-month earnings, which compares to 12.03X for the Zacks sub-industry, 10.67X for the Zacks sector and 17.66X 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 7.2X. Our Underperform recommendation indicates that the stock will perform worse than the market. Our \$18 price target reflects 6.21X 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	7.4	12.03	10.67	17.66
	5-Year High	15.6	13.46	11.75	19.34
	5-Year Low	3.66	8.52	8.23	15.18
	5-Year Median	7.2	11.6	9.91	17.46
EV/EBITDA TTM	Current	5.68	5.57	10.12	10.93
	5-Year High	24.77	8.63	11.33	12.88
	5-Year Low	NA	4.64	7.05	8.49
	5-Year Median	5.62	6.61	9.35	10.79
P/S F12M	Current	0.43	0.58	0.65	3.26
	5-Year High	0.73	0.81	0.76	3.43
	5-Year Low	0.16	0.49	0.5	2.54
	5-Year Median	0.4	0.64	0.62	3.01

As of 03/03/2020

Industry Analysis Zacks Industry Rank: Bottom 28% (184 out of 255)



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
Wabco Holdings Inc. (WBC)	Neutral
Cooper-Standard Holdings Inc. (CPS)	Underperform

Industry Comparison Industry: Automotive - Original Equipment				Industry Peers		
	MTOR Underperform	X Industry	S&P 500	DAN Neutral	OSK Neutral	WBC Neutral
VGM Score	D	-	-	A	D	D
Market Cap	1.59 B	638.40 M	21.37 B	1.94 B	5.08 B	6.94 B
# of Analysts	3	3	13	5	8	5
Dividend Yield	0.00%	0.00%	2.04%	2.97%	1.61%	0.00%
Value Score	B	-	-	A	B	D
Cash/Price	0.06	0.13	0.05	0.25	0.05	0.14
EV/EBITDA	4.57	4.63	12.65	6.04	6.13	15.78
PEG Ratio	NA	1.01	1.87	1.01	0.98	1.27
Price/Book (P/B)	4.13	1.18	2.96	0.99	1.90	4.83
Price/Cash Flow (P/CF)	4.25	4.35	11.68	2.44	7.28	18.79
P/E (F1)	7.77	10.10	16.98	4.60	9.63	19.09
Price/Sales (P/S)	0.37	0.40	2.44	0.23	0.61	2.03
Earnings Yield	12.82%	9.60%	5.87%	21.74%	10.39%	5.23%
Debt/Equity	2.35	0.51	0.70	1.26	0.31	0.63
Cash Flow (\$/share)	5.05	3.69	7.01	5.52	10.26	7.21
Growth Score	F	-	-	A	F	C
Hist. EPS Growth (3-5 yrs)	27.23%	8.01%	10.85%	14.51%	29.20%	7.57%
Proj. EPS Growth (F1/F0)	-28.01%	5.83%	6.36%	-4.31%	-6.68%	48.41%
Curr. Cash Flow Growth	15.83%	-2.66%	6.07%	9.05%	17.40%	-31.91%
Hist. Cash Flow Growth (3-5 yrs)	19.94%	6.21%	8.52%	7.11%	9.98%	-2.54%
Current Ratio	1.20	1.56	1.23	1.71	2.14	3.35
Debt/Capital	70.12%	38.59%	42.57%	55.72%	23.40%	38.59%
Net Margin	5.65%	3.15%	11.57%	2.62%	6.60%	7.19%
Return on Equity	71.38%	13.35%	16.66%	24.67%	21.05%	17.41%
Sales/Assets	1.51	1.30	0.54	1.19	1.50	0.85
Proj. Sales Growth (F1/F0)	-15.39%	0.32%	4.01%	-1.41%	-3.62%	-3.71%
Momentum Score	B	-	-	D	B	B
Daily Price Chg	-5.05%	-1.40%	-2.60%	-6.39%	-2.31%	-0.21%
1 Week Price Chg	-11.64%	-11.07%	-12.06%	-16.97%	-14.81%	-0.63%
4 Week Price Chg	-8.88%	-11.35%	-10.01%	-17.40%	-17.26%	-0.27%
12 Week Price Chg	-9.19%	-14.44%	-7.46%	-22.80%	-18.51%	0.20%
52 Week Price Chg	-3.77%	-22.50%	2.54%	-29.90%	-5.99%	-3.30%
20 Day Average Volume	1,302,395	182,559	2,406,738	1,689,626	764,741	863,863
(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%	-0.06%	-2.72%	0.05%	3.30%
(F1) EPS Est 12 week change	-2.37%	-2.28%	-0.39%	-3.37%	-0.80%	-6.15%
(Q1) EPS Est Mthly Chg	0.00%	-1.33%	-0.45%	NA	-0.46%	0.00%

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	F
Momentum Score	B
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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