

Meritor, Inc.(MTOR)

\$23.23 (As of 07/23/20)

Price Target (6-12 Months): **\$24.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 07/24/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

5-Strong Sell

Zacks Style Scores:

VGM:A

Value: A

Growth: A

Momentum: C

Summary

Meritor's regularly introduces products that position it as a market leader in electric drivetrains and has enabled it to clinch contracts from MAN, Mercedes Benz and Iveco. Its buyout of AxleTech has enhanced its exposure in adjacent end markets served, which will support its target of realizing more than \$15 million in annual cost synergies by fiscal 2020. It is likely to gain from higher margins tied to OEM adoption of advanced products. However, depressed demand of vehicles and weak consumer sentiment amid the COVID-19 will mar its near-term revenues and earnings. In fact, for third-quarter fiscal 2020, Meritor projects sales in the band of \$400-\$500 million, implying a year over year decline of 61.4% from the midpoint of the guided range. High debt of the firm also plays a spoilsport. As such, the stock warrants a cautious stance.

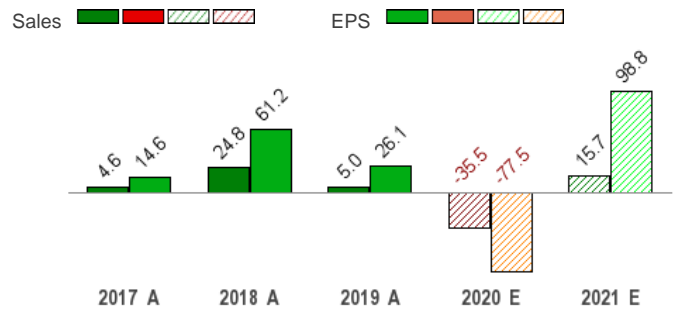
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$27.18 - \$10.91
20 Day Average Volume (sh)	573,925
Market Cap	\$1.7 B
YTD Price Change	-11.3%
Beta	2.45
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Automotive - Original Equipment
Zacks Industry Rank	Top 42% (107 out of 252)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	37.0%
Last Sales Surprise	-2.1%
EPS F1 Est- 4 week change	-3.7%
Expected Report Date	07/29/2020
Earnings ESP	-8.4%
P/E TTM	6.8
P/E F1	27.0
PEG F1	NA
P/S TTM	0.4

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	822 E	894 E	806 E	817 E	3,275 E
2020	901 A	871 A	456 E	627 E	2,830 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	\$0.48 E	\$0.61 E	\$0.54 E	\$0.50 E	\$1.71 E
2020	\$0.64 A	\$0.74 A	-\$0.52 E	-\$0.06 E	\$0.86 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 07/23/2020. The reports text is as of 07/24/2020.

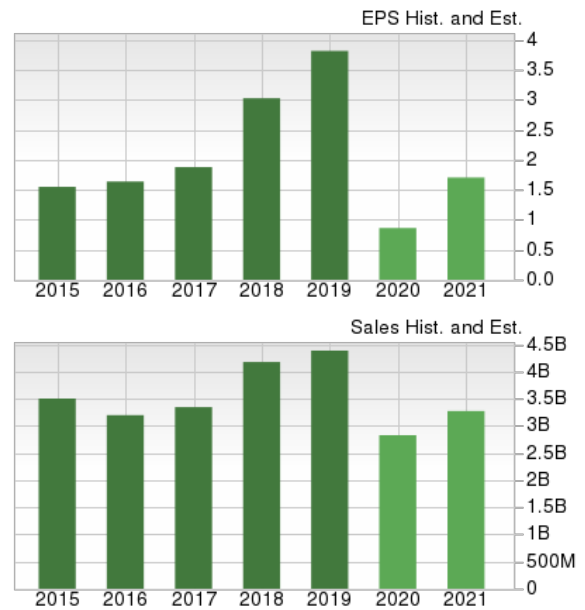
Overview

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 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. 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.
- ▲ In response to the uncertainty caused by the coronavirus pandemic, Meritor has initiated a series of cost savings across the company including substantial staffing adjustments, compensation cuts and marketing cost reduction. It seeks to re-scale the firm to comply with existing industry expectations for global truck to trailer production. These restructuring actions represent a reduction of 8% in global wage positions. Meritor anticipates that this turnaround program would incur about \$25 in employee severance costs related to this restructuring plan and expects to complete the vast majority of these actions by the end of 2020. The focus on cost discipline may provide the firm some respite amid the financial crisis.

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

Reasons To Sell:

- ▼ The coronavirus pandemic has crippled the auto industry, and will lead to decline in sales and production, hurting the automotive parts manufacturer and supplier. Meritor withdrew the 2020 guidance and suspended its share buyback program in response to disruptions to the company's supply chain due to the pandemic-led crisis. Weak consumer sentiment amid the pandemic is likely to hurt its sales and earnings of Meritor in the near future.
- ▼ For the third-quarter fiscal 2020, Meritor projects sales in the band of \$400-\$500 million, implying a year over year decline of 61.4% from the midpoint of the guided range. Cash flow from operations is anticipated in the range of negative \$150 million to negative \$225 million.
- ▼ Meritor's high debt is a spoilsport. Long-term debt was \$1,203 million at the end of second-quarter fiscal 2020, depicting a rise from \$902 million as of Sep 30, 2019. Its total debt to capital stands at 0.76 versus the industry's 0.45, restricting its financial freedom to tap onto growth opportunities.
- ▼ 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.

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Last Earnings Report

Meritor Q2 Earnings Top, Down Y/Y

Meritor recorded adjusted earnings of 74 cents per share in second-quarter fiscal 2020 (ended Mar 31, 2020), surpassing the Zacks Consensus Estimate of 54 cents. The outperformance resulted from higher-than-anticipated EBITDA (earnings before interest, tax, depreciation and amortization) from the Aftermarket & Industrial segment. Precisely, EBITDA from the segment came in at \$49 million, topping the consensus mark of \$44.6 million.

The bottom line declined from the year-ago adjusted earnings of \$1.03 a share. Adjusted income from continuing operations was \$56 million compared with \$88 million in second-quarter fiscal 2019.

Sales declined 24.6% year over year to \$871 million and missed the Zacks Consensus Estimate of \$890 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 \$107 million from \$139 million in the year-ago quarter. Adjusted EBITDA margin was 12.3% compared with 12% a year ago.

Segment Results

Revenues at the Commercial Truck & Trailer segment amounted to \$588 million in second-quarter fiscal 2020, down 33% from the year-ago level due to lower production volumes across most markets served amid the coronavirus crisis. The segment's adjusted EBITDA fell to \$55 million from \$88 million in the year-ago quarter. EBITDA margin declined to 9.4% from 10% in the prior-year quarter.

Revenues at the Aftermarket & Industrial segment totaled \$319 million, down 3% from the year-ago level, primarily due to lower production volumes across most markets served partly offset by revenues generated from the AxleTech acquisition. The segment's adjusted EBITDA was \$49 million, compared with \$52 million in the year-ago quarter. EBITDA margin declined to 15.4% from 15.8% in the prior-year quarter.

Financial Position

In the reported quarter, Meritor's cash and cash equivalents totaled \$508 million as of Mar 31, 2020, compared with \$108 million as of Sep 30, 2019. Long-term debt was \$1,203 million at the end of second-quarter fiscal 2020, depicting a rise from \$902 million as of Sep 30, 2019.

Meritor suspended its existing share-repurchase program until further notice on the heightening coronavirus scare.

2020 Outlook

Meritor scrapped the fiscal 2020 guidance as it expects that the pandemic's impact to strain the company's operations in the days to come.

For third-quarter fiscal 2020, Meritor now projects sales in the band of \$400-\$500 million. Cash flow from operations is anticipated in the range of negative \$150 million to negative \$225 million.

Quarter Ending **03/2020**

Report Date	Apr 30, 2020
Sales Surprise	-2.11%
EPS Surprise	37.04%
Quarterly EPS	0.74
Annual EPS (TTM)	3.41

Valuation

Meritor's shares are down 11.3% in the year-to-date period and down 5.6% over the trailing 12-month period. Stocks in the Zacks Automotive - Original Equipment industry and the Zacks Automotive sector are down 6.4% and up 21%, respectively, in the year-to-date period. Over the past year, the Zacks sub-industry and sector are down 6.4% and up 29.1%, respectively.

The S&P 500 index is up 1.9% in the year to date period and up 9.2% in the past year.

The stock is currently trading at 14.6X forward 12-month earnings, which compares to 24.03X for the Zacks sub-industry, 28.66X for the Zacks sector and 23.05X 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 7.13X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$24 price target reflects 15.09X 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	14.6	24.03	28.66	23.05
	5-Year High	15.6	25.87	28.66	23.05
	5-Year Low	3.66	8.36	8.2	15.25
	5-Year Median	7.13	11.41	9.9	17.52
EV/EBITDA TTM	Current	5.22	5.74	11.77	12.19
	5-Year High	24.77	8.44	11.8	12.86
	5-Year Low	NA	3.94	6.94	8.25
	5-Year Median	5.46	6.31	9.31	10.88
P/S F12M	Current	0.52	0.68	0.9	3.62
	5-Year High	0.73	0.78	0.9	3.62
	5-Year Low	0.16	0.44	0.49	2.53
	5-Year Median	0.42	0.61	0.61	3.02

As of 07/23/2020

Industry Analysis Zacks Industry Rank: Top 42% (107 out of 252)



Top Peers

Company (Ticker)	Rec	Rank
Garrett Motion Inc. (GTX)	Outperform	1
Dana Incorporated (DAN)	Neutral	3
Gentex Corporation (GNTX)	Neutral	3
Lear Corporation (LEA)	Neutral	2
Magna International Inc. (MGA)	Neutral	2
Oshkosh Corporation (OSK)	Neutral	3
Strattec Security Corporation (STRT)	Neutral	1
Veoneer, Inc. (VNE)	Neutral	3

Industry Comparison Industry: Automotive - Original Equipment				Industry Peers		
	MTOR	X Industry	S&P 500	DAN	OSK	VNE
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	5	-	-	3	3	3
VGM Score	A	-	-	D	A	B
Market Cap	1.68 B	877.55 M	22.58 B	1.83 B	5.41 B	1.53 B
# of Analysts	3	3	14	5	9	1
Dividend Yield	0.00%	0.00%	1.81%	3.15%	1.51%	0.00%
Value Score	A	-	-	C	A	D
Cash/Price	0.33	0.18	0.06	0.36	0.08	0.72
EV/EBITDA	4.56	5.43	13.13	5.67	6.32	-1.93
PEG Ratio	NA	2.25	3.04	7.29	2.25	NA
Price/Book (P/B)	3.96	1.33	3.15	0.98	2.01	1.03
Price/Cash Flow (P/CF)	4.60	4.76	12.33	2.30	7.74	NA
P/E (F1)	27.01	28.47	22.09	39.63	19.90	NA
Price/Sales (P/S)	0.42	0.42	2.41	0.22	0.67	0.87
Earnings Yield	3.70%	2.07%	4.30%	2.52%	5.02%	-36.29%
Debt/Equity	2.84	0.49	0.76	1.33	0.30	0.13
Cash Flow (\$/share)	5.05	2.94	7.01	5.52	10.26	-3.46
Growth Score	A	-	-	D	A	A
Hist. EPS Growth (3-5 yrs)	26.99%	8.02%	10.82%	15.09%	30.52%	NA
Proj. EPS Growth (F1/F0)	-77.40%	-59.65%	-9.01%	-89.54%	-51.97%	-1.42%
Curr. Cash Flow Growth	15.83%	-4.87%	5.47%	9.05%	17.40%	133.33%
Hist. Cash Flow Growth (3-5 yrs)	19.94%	6.06%	8.55%	7.11%	9.98%	NA
Current Ratio	1.64	1.65	1.31	1.60	1.96	2.78
Debt/Capital	73.94%	40.06%	44.41%	57.03%	23.31%	11.73%
Net Margin	10.29%	1.92%	10.46%	1.98%	6.02%	-33.64%
Return on Equity	64.86%	11.26%	15.13%	21.22%	19.08%	-29.08%
Sales/Assets	1.36	1.25	0.54	1.15	1.44	0.65
Proj. Sales Growth (F1/F0)	-35.50%	-16.45%	-2.06%	-23.96%	-17.71%	-30.09%
Momentum Score	C	-	-	F	D	A
Daily Price Chg	2.70%	0.00%	-0.20%	-0.70%	0.28%	8.61%
1 Week Price Chg	13.87%	3.59%	3.82%	4.85%	7.12%	6.55%
4 Week Price Chg	19.99%	7.29%	6.02%	11.03%	13.31%	27.91%
12 Week Price Chg	13.32%	19.92%	10.03%	10.26%	17.59%	40.59%
52 Week Price Chg	-3.17%	-10.82%	-2.89%	-34.61%	-5.90%	-22.75%
20 Day Average Volume	573,925	185,488	2,026,477	1,360,213	406,123	326,278
(F1) EPS Est 1 week change	-3.72%	0.00%	0.00%	-6.98%	0.00%	2.15%
(F1) EPS Est 4 week change	-3.72%	0.00%	0.15%	-27.60%	0.22%	8.41%
(F1) EPS Est 12 week change	-34.43%	-22.14%	-3.24%	-36.26%	-4.38%	8.94%
(Q1) EPS Est Mthly Chg	14.29%	0.25%	0.00%	-9.09%	1.85%	-1.47%

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	A
Growth Score	A
Momentum Score	C
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.

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