

## TransDigm Group Inc. (TDG)

**\$495.64** (As of 03/10/20)

Price Target (6-12 Months): **\$525.00**

Long Term: 6-12 Months

**Zacks Recommendation:**
**Neutral**

(Since: 10/07/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

**Zacks Rank:** (1-5)

**2-Buy**

Zacks Style Scores:

VGM:C

Value: D

Growth: C

Momentum: B

### Summary

TransDigm has been enjoying significant growth opportunities in the defense space on account of the expansionary budgetary policy adopted by the U.S. administration and other developing nations in past couple of years. Consistent improvement in revenue passenger miles has been boosting the commercial aerospace industry, thereby benefitting TransDigm. Its latest acquisition, Esterline, should improve its position in the aerospace aftermarket. In the past year, its shares have outperformed its industry. However, its business is sensitive to flight hours of customer planes, size and age of the worldwide aircraft fleet and customers' profitability. Its unfavorable leverage ratios and high debt levels may discourage safe-bet investors in choosing this stock going ahead. Its trailing 12-month P/E ratio is higher than that of its industry's.

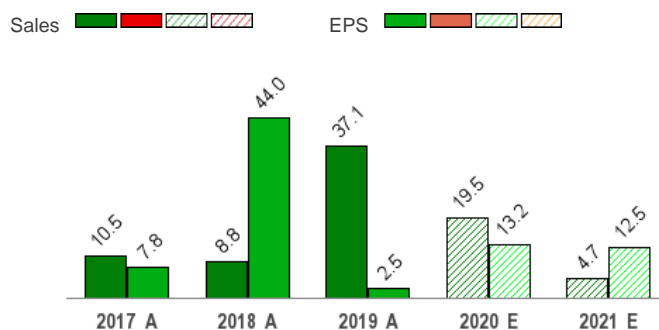
### Price, Consensus & Surprise



### Data Overview

52 Week High-Low	\$673.51 - \$423.00
20 Day Average Volume (sh)	567,557
Market Cap	\$26.6 B
YTD Price Change	-11.5%
Beta	1.07
Dividend / Div Yld	\$0.00 / 0.0%
Industry	<a href="#">Aerospace - Defense Equipment</a>
Zacks Industry Rank	Top 45% (115 out of 253)

### Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	8.1%
Last Sales Surprise	1.0%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	05/05/2020
Earnings ESP	8.6%
P/E TTM	25.2
P/E F1	24.0
PEG F1	2.0
P/S TTM	4.5

### Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					6,537 E
2020	1,465 A	1,509 E	1,652 E	1,656 E	6,242 E
2019	993 A	1,196 A	1,658 A	1,541 A	5,223 A

### EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$4.91 E	\$5.35 E	\$6.31 E	\$6.76 E	\$23.27 E
2020	\$4.93 A	\$4.81 E	\$5.73 E	\$5.58 E	\$20.69 E
2019	\$3.85 A	\$4.21 A	\$4.95 A	\$5.62 A	\$18.27 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 03/10/2020. The reports text is as of 03/11/2020.

## Overview

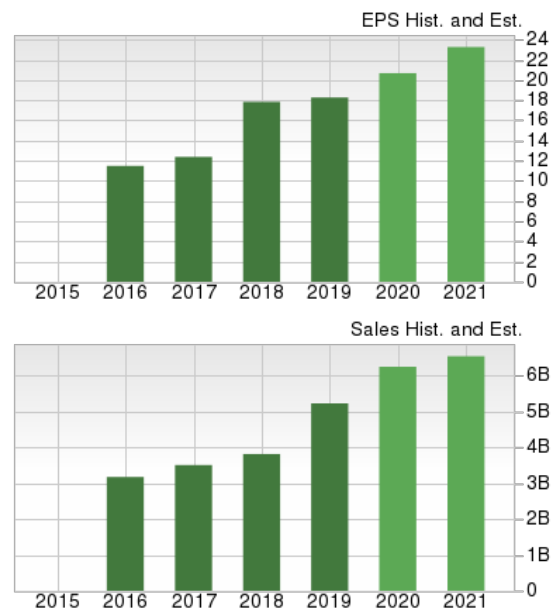
Incepted in 1993, TransDigm is a leading global designer, producer and supplier of highly engineered aerospace components that are used in commercial and military aircraft. The company, through its well-diversified business, offers a broad range of products to its customers. TransDigm currently has four reportable segments:

**Airframe:** This segment produces systems and components like engineered latching and locking devices, security components and systems, aircraft audio systems, specialized lavatory components, seat belts and safety restraints, engineered interior surfaces and related components, military personnel parachutes and cargo delivery systems. These are used in non-power airframe applications utilizing airframe and cabin structure technologies. It contributed 44.6% to the company's total sales in fiscal 2019.

**Power & Control:** This segment develops products like mechanical/electro-mechanical actuators and controls, ignition systems and engine technology, specialized pumps and valves, power conditioning devices, specialized AC/DC electric motors and generators, and lifting devices and cargo loading and handling systems. These are used in controlling power of the aircraft utilizing electronic, fluid, power and mechanical motion control technologies. It contributed 52.4% to the company's total sales in fiscal 2019.

**Non-aviation:** This segment's products include seat belts and safety restraints for ground transportation applications, mechanical/electro-mechanical actuators and controls for space applications, and refueling systems for heavy equipment used in mining, construction and other industries. It contributed 3% to the company's total sales in fiscal 2019.

**Esterline:** Esterline Technologies became a reportable segment of TransDigm, post its acquisition in March 2019. Notably, Esterline includes a collection of approximately 20 reporting units that primarily develop, produce and market products for the aerospace and defense industry. However, the company is yet to include this segment in its core business.



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## Reasons To Buy:

- ▲ The commercial aerospace industry is witnessing increased revenue passenger miles (RPMs) since 2010, which resulted in steady growth in this industry throughout 2019. Also, growth in the large commercial OEM sector (aircraft with 100 or more seats) with order announcements by Boeing and Airbus leading to planned increases in aircraft production (except for 737 Max) has been boosting this industry. As a result of these traits, TransDigm has been experiencing solid top-line growth, which can be expected to continue in the near term as well. Notably, the industry consensus expects increase in production rate for commercial airframes as well as RPM growth to continue in 2020. Anticipating these growth trends to continue, the company's management projects its commercial aftermarket revenues to grow annually in the mid-single-digit to high single-digit percent range, while commercial OEM revenue growth is estimated in the low single-digit to mid-single-digit percent range for fiscal 2020.

Increased revenue passenger miles should boost TransDigm's revenue growth. Expansionary defense budget will aid its defense business.

- ▲ Apart from serving the commercial aerospace market, TransDigm's products also holds a significant position in the U.S. defense aerospace market. Impressively, the company's defense business witnessed solid 11% year over year revenue growth in the fiscal first quarter. Moreover, TransDigm has been enjoying significant growth opportunities in the defense space on account of the expansionary budgetary policy adopted by the U.S. administration as well as other developing nations in past couple of years.

For instance, the U.S. fiscal 2020 defense budget includes a massive spending plan of \$57.7 billion on aircraft. This should enable Boeing and other military aircraft producers to acquire significant defense contracts from the Pentagon, which in turn, should benefit equipment suppliers like Transdigm. Backed by the higher-than-expected defense sales growth in fiscal 2019, management projects its fiscal 2020 defense revenues to grow in the mid-single-digit figure compared with the previous year.

- ▲ While frequent contract wins boost TransDigm's organic growth, the company strives to strengthen its position in highly-engineered proprietary aerospace components' niche markets through strategic acquisitions. As of Sep 30, 2019, the company successfully acquired approximately 85 businesses or product lines since its formation in 1993. In March 2019, TransDigm completed its largest acquisition by buying Esterline Technologies Corporation for \$4 billion. This deal has significantly expanded TransDigm's platform of proprietary and sole-source products for the aerospace and defense industries, strengthening its position both in the Original Equipment Manufacturing (OEM) and aerospace aftermarket.

Notably, company's cash generated from operating activities grew 31% year over year in fiscal first quarter to \$433 million driven by the Esterline deal, which also drove 39% of TransDigm's sales growth in the last reported quarter. Given the company's track record, we may expect to witness more such accretive acquisitions by TransDigm in the coming days. Such solid acquisition strategy must have caused investors to retain their confidence in this stock. Evidently, in a year's time shares of the company have gained 13.5% against its industry's 5.1% decline.

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## Reasons To Sell:

- ▼ TransDigm had a notable long-term debt of \$18 billion as of Sep 30, 2019, compared with \$16.5 billion at the end of Sep 30, 2019. Interestingly, the company has been witnessing a trend in relation to its rising long-term debt over the past few years. The company's long-term debt rose 32% at the end of fiscal 2019, 9.5% at the end of fiscal 2018 and 15.4% at the end of fiscal 2017. Moreover, the company's debt leverage ratio, computed as total debt divided by EBITDA, stood at 7.25 to 1, as of Dec 28, 2019. Such unimpressive leverage ratios and debt levels may discourage safe-bet investors in choosing this stock going ahead.
- ▼ TransDigm's business is sensitive to the number of flight hours that its customers' planes spend in air, the size and age of the worldwide aircraft fleet and customers' profitability. Its business is also directly affected by changes in RPMs, the size and age of the worldwide aircraft fleet and changes in the profitability of the commercial airline industry (to a lesser extent). These items are, in turn, affected by the general economic conditions and any unfavorable fluctuations in them can hurt the company's growth trajectory.
- ▼ Although the company has outperformed its industry in the past year, a comparative analysis of its historical P/E ratio reflects a relatively gloomy picture that might be a cause for investors' concern. The stock currently has a trailing 12-month P/E ratio of 26.56. This level compares unfavorably with what the stock saw in the past 12 months. The ratio is also higher than the industry's average of 18.4.

Increased debt may keep TransDigm's operating results under pressure. A comparative analysis of the company's historical P/E ratio reflects a relatively gloomy picture

## Last Earnings Report

### TransDigm Q1 Earnings Beat Estimates, Sales Up Y/Y

TransDigm Group reported first-quarter fiscal 2020 adjusted earnings of \$4.93 per share, which surpassed the Zacks Consensus Estimate of \$4.56 by 8.1%. Moreover, the bottom line improved 28.1% from the prior-year quarter figure of \$3.85.

Including one-time items, the company reported GAAP earnings of 83 cents per share compared with \$3.05 in the year-ago quarter. The year-over-year bottom-line decline can be attributed to payments made in the quarter under review.

#### Sales

Net sales amounted to \$1,465 million, reflecting year-over-year growth of 47.5% from the prior-year quarter. The top line also outpaced the Zacks Consensus Estimate of \$1,458 million by 0.5%. Meanwhile, organic sales improved 8.7%.

Acquisition sales from the Esterline takeover contributed \$385 million to total sales.

#### Financial Position

TransDigm ended first-quarter fiscal 2020 with cash and cash equivalents of \$4,194 million, up from \$1,467 million as of Sep 30, 2019.

At the end of the reported quarter, the company's long-term debt summed \$17.95 billion, up from \$16.47 billion as of Sep 30, 2019.

Cash from operating activities amounted to \$433 million as of Dec 28, 2019, compared with \$330 million as of Dec 29, 2018.

#### Fiscal 2020 Outlook

TransDigm trimmed part of its fiscal 2020 financial guidance. Net sales are still anticipated in the range of \$6,175-\$6,325 million. The Zacks Consensus Estimate for the same is pegged at \$6,280 million, which lies above the mid-point of the company's guided range.

EBITDA is also reiterated in the range of \$2,775-\$2,875 million. Adjusted earnings per share are still expected in the range of \$19.8-\$21.2. The Zacks Consensus Estimate for the same is pegged at \$20.83, which lies above the mid-point of the company's guided range.

However, the company has slashed GAAP earnings from the prior range of \$16.30-\$17.79 to \$14.20-\$15.60.

Net income from continuing operations is still anticipated between \$1,000 million and \$1,080 million.

Quarter Ending **12/2019**

Report Date	Feb 04, 2020
Sales Surprise	0.95%
EPS Surprise	8.11%
Quarterly EPS	4.93
Annual EPS (TTM)	19.71

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## Recent News

On **Dec 20, 2019**, TransDigm Group announced that it has completed the divestiture of Souriau-Sunbank Connection Technologies (Souriau-Sunbank) to Eaton Corporation in a transaction valued at approximately \$920 million.

Souriau-Sunbank was acquired by TransDigm in March 2019 as part of the Esterline Technologies acquisition and is a leading global supplier of highly-engineered interconnect solutions for harsh environments serving customers primarily in aerospace, defense and space end markets. The business is headquartered in Versailles, France and generated revenues of \$363 million for the trailing 12-month period ended June 30, 2019.

Following successful completion of the divestiture, TransDigm Group also announced that its board of directors has authorized and declared a special cash dividend of \$32.50 on each outstanding share of common stock and cash dividend equivalent payments on options granted under its stock option plans.

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## Valuation

TransDigm Group's shares are down 11.5% in the year to date period but up 13.5% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Aerospace sector are down 19.9% and 18.5% in the year to date period, respectively. Over the past year, the Zacks sub-industry and sector are down 5.1% and 13.6%, respectively.

The S&P 500 index is down 14.8% in the year to date period and down 2.6% in the past year.

The stock is currently trading at 22.7X forward 12-month earnings, which compares to 16.3X for the Zacks sub-industry, 16.9X for the Zacks sector and 15.8X for the S&P 500 index.

Over the past five years, the stock has traded as high as 32X and as low as 17X, with a 5-year median of 22.4X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$525 price target reflects 24X forward 12-month earnings

The table below shows summary valuation data for TDG

Valuation Multiples - TDG					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	22.7	16.25	16.86	15.75
	5-Year High	31.97	20.63	21.54	19.34
	5-Year Low	16.97	14.51	14.26	15.18
	5-Year Median	22.42	18.01	16.9	17.42
P/S F12M	Current	4.18	1.49	1.08	2.91
	5-Year High	5.58	1.89	1.39	3.44
	5-Year Low	3.04	1.09	0.8	2.54
	5-Year Median	4.14	1.48	1.09	3
EV/EBITDA TTM	Current	15.45	10.74	14.26	11.04
	5-Year High	20.25	13.17	16.81	12.87
	5-Year Low	13.75	8.85	7.28	8.49
	5-Year Median	16.69	10.29	9.96	10.79

As of 03/10/2020

## Industry Analysis Zacks Industry Rank: Top 45% (115 out of 253)



## Top Peers

Leidos Holdings, Inc. (LDOS)	Outperform
Air Industries Group (AIRI)	Neutral
Aerojet Rocketdyne Holdings, Inc. (AJRD)	Neutral
Astronics Corporation (ATRO)	Neutral
Heico Corporation (HEI)	Neutral
Kratos Defense & Security Solutions, Inc. (KTOS)	Neutral
Teledyne Technologies Incorporated (TDY)	Neutral
Hexcel Corporation (HXL)	Underperform

Industry Comparison Industry: Aerospace - Defense Equipment				Industry Peers		
	TDG Neutral	X Industry	S&P 500	HEI Neutral	HXL Underperform	TDY Neutral
<b>VGM Score</b>	<b>C</b>	-	-	<b>C</b>	<b>B</b>	<b>B</b>
Market Cap	26.61 B	1.07 B	20.21 B	13.38 B	4.92 B	11.57 B
# of Analysts	5	3	13	5	3	2
Dividend Yield	0.00%	0.00%	2.18%	0.16%	1.15%	0.00%
<b>Value Score</b>	<b>D</b>	-	-	<b>F</b>	<b>C</b>	<b>D</b>
Cash/Price	0.16	0.08	0.05	0.00	0.01	0.02
EV/EBITDA	18.23	10.04	12.36	25.56	10.40	20.18
PEG Ratio	2.02	2.41	1.78	3.20	2.94	NA
Price/Book (P/B)	NA	2.69	2.77	7.39	3.44	4.24
Price/Cash Flow (P/CF)	19.48	11.16	11.04	33.44	11.16	22.76
P/E (F1)	23.96	22.03	16.09	36.25	16.52	27.85
Price/Sales (P/S)	4.54	1.65	2.17	6.38	2.09	3.66
Earnings Yield	4.17%	4.54%	6.20%	2.76%	6.05%	3.59%
Debt/Equity	-4.18	0.32	0.70	0.31	0.73	0.32
Cash Flow (\$/share)	25.44	2.02	7.01	2.97	5.29	13.88
<b>Growth Score</b>	<b>C</b>	-	-	<b>A</b>	<b>B</b>	<b>A</b>
Hist. EPS Growth (3-5 yrs)	18.97%	13.63%	10.85%	22.72%	10.06%	17.08%
Proj. EPS Growth (F1/F0)	13.22%	8.83%	6.14%	19.13%	0.94%	7.90%
Curr. Cash Flow Growth	24.18%	4.47%	6.09%	23.18%	12.73%	14.47%
Hist. Cash Flow Growth (3-5 yrs)	15.48%	3.45%	8.52%	20.26%	9.27%	11.00%
Current Ratio	1.99	2.34	1.24	3.39	2.19	1.72
Debt/Capital	NA%	29.68%	42.57%	29.68%	42.08%	24.25%
Net Margin	13.87%	6.73%	11.69%	17.68%	13.02%	12.72%
Return on Equity	-45.77%	8.88%	16.74%	21.76%	21.39%	15.67%
Sales/Assets	0.34	0.77	0.54	0.71	0.75	0.73
Proj. Sales Growth (F1/F0)	15.84%	0.00%	3.71%	5.43%	0.67%	6.26%
<b>Momentum Score</b>	<b>B</b>	-	-	<b>B</b>	<b>B</b>	<b>B</b>
Daily Price Chg	9.65%	1.08%	4.87%	2.75%	4.89%	3.92%
1 Week Price Chg	-9.81%	-2.99%	-0.67%	-2.57%	-3.57%	0.09%
4 Week Price Chg	-23.75%	-18.28%	-15.65%	-22.50%	-19.38%	-18.38%
12 Week Price Chg	-13.09%	-16.51%	-13.60%	-17.69%	-20.75%	-8.27%
52 Week Price Chg	13.47%	-8.88%	-2.27%	8.37%	-15.64%	38.47%
20 Day Average Volume	567,557	196,321	2,778,843	984,282	907,552	236,084
(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%	-0.16%	1.18%	0.00%	0.35%
(F1) EPS Est 12 week change	0.25%	-0.64%	-0.57%	7.28%	-8.22%	-0.31%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	-0.49%	-8.88%	0.00%	-0.85%

## 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>D</b>
Growth Score	<b>C</b>
Momentum Score	<b>B</b>
VGM Score	<b>C</b>

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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