

TransDigm Group Inc. (TDG)

\$324.55 (As of 05/08/20)

Price Target (6-12 Months): **\$300.00**

Long Term: 6-12 Months

Zacks Recommendation: Underperform

(Since: 04/19/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

5-Strong Sell

Zacks Style Scores:

VGM:D

Value: F

Growth: C

Momentum: F

Summary

TransDigm ended second-quarter of fiscal 2020 with both earnings and revenues surpassing the Zacks Consensus Estimate. It expects demand for commercial OEM products to be significantly reduced during the second half of fiscal 2020 due to the impacts of the COVID-19 pandemic. The company's debt-to-capital ratio is 1.31, which being more than 1 suggests that it carries more debt than its assets, as of Mar 31, 2020. TransDigm's trailing 12-month P/E ratio is higher than that of the industry's. However, the company 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. Moreover, in a year's time, its shares have outperformed the industry.

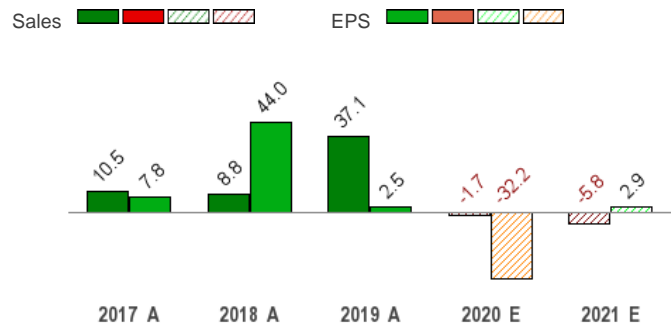
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$673.51 - \$200.06
20 Day Average Volume (sh)	720,001
Market Cap	\$19.1 B
YTD Price Change	-37.0%
Beta	1.43
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Aerospace - Defense Equipment
Zacks Industry Rank	Bottom 14% (218 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	33.2%
Last Sales Surprise	1.0%
EPS F1 Est- 4 week change	-18.9%
Expected Report Date	NA
Earnings ESP	-20.0%
P/E TTM	17.1
P/E F1	26.2
PEG F1	2.2
P/S TTM	3.1

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					4,837 E
2020	1,465 A	1,443 A	1,127 E	1,105 E	5,134 E
2019	993 A	1,196 A	1,658 A	1,541 A	5,223 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$2.26 E	\$3.22 E	\$2.45 E	\$2.48 E	\$12.74 E
2020	\$4.93 A	\$5.10 A	\$1.79 E	\$1.93 E	\$12.38 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 05/08/2020. The reports text is as of 05/11/2020.

Overview

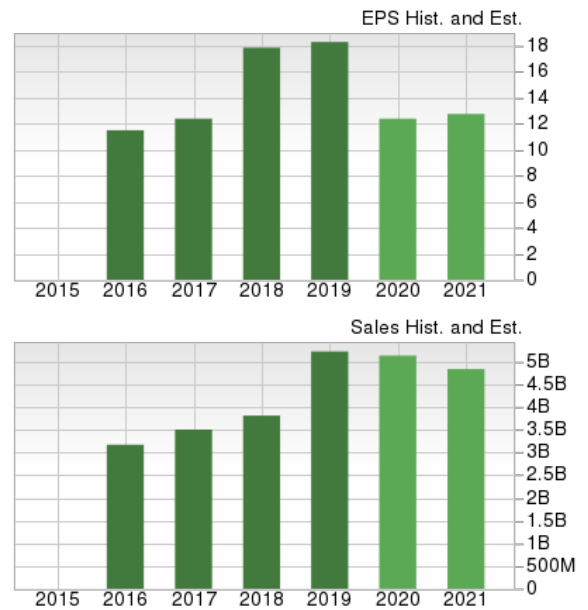
Incepted in 1993, TransDigm is a leading global designer, producer and supplier of highly engineered aerospace components that are used in commercial and military aircraft. The company, through its well-diversified business, offers a broad range of products to its customers. TransDigm currently has four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



Reasons To Sell:

- ▼ Transdigm has a long-term debt of \$17,933 million as of Mar 31, 2019, slightly lower than \$17,952 million as of Dec 31, 2019. The company's current debt stands at \$629 million as of Mar 31, 2020. As of Mar 31, 2020, its cash equivalents were \$2,668 million, which decreased sequentially from \$4,194 million. A comparative analysis of these figures reflect that the company's cash reserve, although higher than its current debt, lies much below its long-term debt value.

Moreover, the company's debt-to-capital ratio is 1.31, which being more than 1 suggests that the company carries more debt than its assets, as of Mar 31, 2020. Such unimpressive financial ratio makes us skeptical about the company's ability to pay off its debt obligations, at least in the near term.

- ▼ The coronavirus pandemic hit the commercial aerospace market the most along with the aftermarket industry. To this end, it is imperative to mention that TransDigm's results for the second quarter of fiscal 2020 were modestly affected due to decreases in sales from its commercial aftermarket and commercial OEM channels during the last three weeks of the second quarter of fiscal 2020. This was primarily led by the impact of the COVID-19 pandemic on the company's nondefense customers and their demand for its products and services. The company expects demand for commercial OEM products to significantly reduce during the second half of fiscal 2020, due to reductions in OEM production rates and airlines deferring or canceling new aircraft orders. Looking ahead, although the duration and severity of the pandemic remains uncertain, TransDigm fears that a prolonged demand crunch in its commercial aftermarket might have a significant adverse impact on its sales, net income and EBITDA for the remainder of fiscal 2020.
 - ▼ 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 18.12. 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 11.34.
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Unfavorable debt-to-capital ratio and coronavirus impact may keep TransDigm's operating results under pressure.

Risks

- TransDigm's products hold a significant position in the U.S. defense aerospace market. Impressively, the company's defense business witnessed solid 23.5% year over year revenue surge in the fiscal second 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 2021 defense budget proposal includes a massive spending plan of \$56.9 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.

- 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 Mar 28, 2020, 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. For the quarter ended Mar 28, 2020, the businesses acquired through the Esterline acquisition generated total sales of \$372 million. 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 declined 24% compared to its industry's 39.1% decline.
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Last Earnings Report

TransDigm Q2 Earnings Beat Estimates, Sales Up Y/Y

TransDigm Group Incorporated reported second-quarter fiscal 2020 adjusted earnings of \$5.10 per share, which surpassed the Zacks Consensus Estimate of \$3.83 by 33.1%. Moreover, the bottom line increased 22.6% from \$4.16 registered a year ago.

Barring one-time items, the company reported GAAP earnings of \$5.63 per share compared with \$3.56 in the year-ago quarter.

Quarter Ending 03/2020

Report Date	May 05, 2020
Sales Surprise	1.00%
EPS Surprise	33.16%
Quarterly EPS	5.10
Annual EPS (TTM)	20.60

Sales

Net sales amounted to \$1,443 million, reflecting growth of 23.5% from \$1,168 million in the prior-year quarter. The reported figure also outpaced the Zacks Consensus Estimate of \$1,429 million by 1%. Meanwhile, organic sales grew 4.8%.

Operating Results

Net income from continuing operations for the quarter increased 61.5% to \$323 million compared with \$200 million in the comparable quarter a year ago.

The effective tax rate was 4.2% compared with 24.2% for the comparable period in fiscal 2019.

Financial Position

TransDigm ended the second quarter of fiscal 2020 with cash and cash equivalents of \$2,668 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 \$17.93 billion, up from \$16.47 billion as of Sep 30, 2019.

Cash from operating activities amounted to \$594 million, as of Mar 28, 2020, compared with \$453 million, as of Mar 30, 2019.

Fiscal 2020 Outlook

On Apr 2, 2020, the company withdrew its previously-provided financial guidance for the fiscal year ending Sep 30, 2020, due to the uncertainties concerning the ultimate impact of COVID-19 on the global market and economy.

Recent News

On **April 2, 2020**, TransDigm Group announced cost mitigation efforts as a result of disruption in the aerospace and travel industries as a result of the COVID-19 virus. As an additional action to reduce costs, TransDigm's senior management team will substantially reduce their cash compensation for the balance of 2020.

Valuation

TransDigm Group's shares are down 37% in the year to date period and 24% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Aerospace sector are down 46.2% and 34.2% in the year to date period, respectively. Over the past year, the Zacks sub-industry and sector are down 39.1% and 29.9%, respectively.

The S&P 500 index is down 9% in the year to date period and up 4% in the past year.

The stock is currently trading at 28X forward 12-month earnings, which compares to 20.3X for the Zacks sub-industry, 19.6X for the Zacks sector and 21.2X for the S&P 500 index.

Over the past five years, the stock has traded as high as 32X and as low as 11.7X, with a 5-year median of 22.2X. Our Underperform recommendation indicates that the stock will perform worse than the market. Our \$300 price target reflects 23.8X 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	27.98	20.31	19.61	21.15
	5-Year High	31.97	20.89	20.94	21.15
	5-Year Low	11.69	12.99	14.17	15.19
	5-Year Median	22.24	17.11	17.16	17.44
P/S F12M	Current	3.85	0.76	1.05	3.3
	5-Year High	5.58	1.29	1.49	3.44
	5-Year Low	2.07	0.76	0.92	2.54
	5-Year Median	4.1	1.01	1.17	3.02
EV/EBITDA TTM	Current	12.76	6.81	11.03	10.64
	5-Year High	20.26	12.02	15	12.86
	5-Year Low	10.22	6.21	7.38	8.28
	5-Year Median	16.67	8.77	10.48	10.77

As of 05/08/2020

Industry Analysis Zacks Industry Rank: Bottom 14% (218 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
Air Industries Group (AIRI)	Neutral	2
Aerojet Rocketdyne Holdings Inc (AJRD)	Neutral	4
Astronics Corporation (ATRO)	Neutral	3
Heico Corporation (HEI)	Neutral	4
Kratos DefenseSecurity Solutions Inc (KTOS)	Neutral	3
Leidos Holdings Inc (LDOS)	Neutral	3
Teledyne Technologies Incorporated (TDY)	Neutral	3
Hexcel Corporation (HXL)	Underperform	5

Industry Comparison Industry: Aerospace - Defense Equipment				Industry Peers		
	TDG	X Industry	S&P 500	HEI	HXL	TDY
Zacks Recommendation (Long Term)	Underperform	-	-	Neutral	Underperform	Neutral
Zacks Rank (Short Term)	5	-	-	4	5	3
VGM Score	D	-	-	C	F	C
Market Cap	19.07 B	1.05 B	20.19 B	12.18 B	2.49 B	12.20 B
# of Analysts	5	3	14	5	3	1
Dividend Yield	0.00%	0.00%	2.12%	0.18%	2.28%	0.00%
Value Score	F	-	-	F	F	F
Cash/Price	0.22	0.11	0.06	0.01	0.12	0.02
EV/EBITDA	14.81	7.16	11.95	23.35	6.26	21.15
PEG Ratio	2.41	3.55	2.60	6.85	4.19	NA
Price/Book (P/B)	NA	1.86	2.75	6.73	1.75	4.43
Price/Cash Flow (P/CF)	13.86	6.57	10.78	30.44	5.64	23.98
P/E (F1)	28.49	18.55	19.85	43.43	23.63	35.78
Price/Sales (P/S)	3.12	0.66	2.03	5.81	1.09	3.81
Earnings Yield	3.51%	4.24%	4.83%	2.30%	4.22%	2.80%
Debt/Equity	-4.26	0.35	0.75	0.31	0.98	0.31
Cash Flow (\$/share)	25.44	2.02	7.01	2.97	5.29	13.88
Growth Score	C	-	-	A	F	B
Hist. EPS Growth (3-5 yrs)	18.97%	13.43%	10.87%	22.72%	10.08%	18.64%
Proj. EPS Growth (F1/F0)	-32.24%	-16.99%	-9.87%	-9.48%	-64.31%	-11.51%
Curr. Cash Flow Growth	24.18%	9.60%	5.88%	23.18%	12.73%	14.47%
Hist. Cash Flow Growth (3-5 yrs)	15.48%	4.37%	8.55%	20.26%	9.27%	11.00%
Current Ratio	3.14	2.39	1.24	3.39	3.36	1.80
Debt/Capital	NA%	31.14%	44.23%	29.68%	49.44%	23.89%
Net Margin	15.22%	5.34%	10.68%	17.68%	12.10%	12.78%
Return on Equity	-37.53%	8.64%	16.36%	21.76%	19.92%	15.49%
Sales/Assets	0.36	0.74	0.55	0.71	0.71	0.72
Proj. Sales Growth (F1/F0)	-4.73%	0.00%	-2.26%	-12.80%	-50.86%	0.13%
Momentum Score	F	-	-	C	A	C
Daily Price Chg	8.65%	2.99%	2.40%	6.30%	4.77%	3.90%
1 Week Price Chg	14.60%	4.42%	0.53%	9.84%	12.45%	1.20%
4 Week Price Chg	2.34%	-0.77%	2.68%	10.28%	-15.73%	1.46%
12 Week Price Chg	-46.22%	-30.00%	-19.20%	-29.48%	-60.26%	-15.13%
52 Week Price Chg	-25.46%	-30.34%	-8.44%	-13.35%	-57.71%	34.23%
20 Day Average Volume	720,001	184,180	2,398,409	742,449	1,857,233	217,083
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-18.94%	-6.52%	-6.95%	-3.07%	-54.17%	-4.50%
(F1) EPS Est 12 week change	-36.96%	-26.87%	-15.68%	-23.12%	-66.22%	-16.50%
(Q1) EPS Est Mthly Chg	-41.11%	-12.30%	-13.12%	-12.30%	-12.50%	25.16%

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	F
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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