

TE Connectivity Ltd. (TEL)

\$85.49 (As of 07/15/20)

Price Target (6-12 Months): **\$90.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 01/02/20)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:B

Value: A

Growth: B

Momentum: F

Summary

TE Connectivity is currently benefiting from strong momentum across interventional applications. This is driving the company's growth in medical field. Further, solid momentum in defense market remains a major positive. Additionally, the company's expanding content in engineered solutions is another positive. Also, its global manufacturing strategy and high levels of automation in factories are acting as tailwinds. We believe continued solid execution of the company's strategic plans especially cost reduction and footprint consolidation initiatives, are likely to aid its performance in the near term. However, slowdown in the global auto-production and inventory destocking remain concerns. Further, supply chain disruptions are likely to be headwinds. Notably, the stock has underperformed its industry on a year-to-date basis.

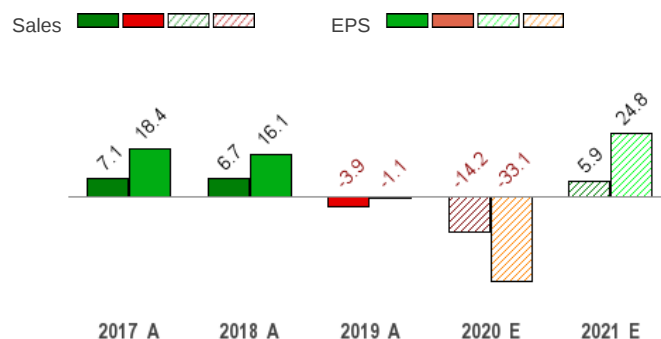
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$101.00 - \$48.62
20 Day Average Volume (sh)	1,601,616
Market Cap	\$28.2 B
YTD Price Change	-10.8%
Beta	1.32
Dividend / Div Yld	\$1.92 / 2.2%
Industry	Electronics - Miscellaneous Components
Zacks Industry Rank	Bottom 19% (204 out of 251)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	30.3%
Last Sales Surprise	9.7%
EPS F1 Est- 4 week change	-0.9%
Expected Report Date	07/29/2020
Earnings ESP	8.9%
P/E TTM	16.0
P/E F1	23.0
PEG F1	2.2
P/S TTM	2.2

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	2,850 E	3,025 E	3,029 E	3,065 E	12,215 E
2020	3,168 A	3,195 A	2,412 E	2,786 E	11,538 E
2019	3,347 A	3,412 A	3,389 A	3,300 A	13,448 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.93 E	\$1.06 E	\$1.16 E	\$1.20 E	\$4.63 E
2020	\$1.21 A	\$1.29 A	\$0.42 E	\$0.76 E	\$3.71 E
2019	\$1.29 A	\$1.42 A	\$1.50 A	\$1.33 A	\$5.55 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 07/15/2020. The reports text is as of 07/16/2020.

Overview

TE Connectivity based in Schaffhausen, Switzerland, manufactures and designs products that connect and protect the flow of power and data inside millions of products used by consumers and industries. The company partners with customers in a broad array of industries ranging from consumer electronics, energy, and healthcare to automotive, aerospace and communication networks.

TE Connectivity reports under the following three segments –

Transportation Solutions (58.2% of total fiscal 2019 revenues): The segment caters to the needs of automotive, commercial transportation and sensors end markets. It offers sensor solutions and automotive connectivity solutions and products. Its electronic components comprising, connectors, wire and cable, circuit protection devices, heat shrink tubing and molded parts. It also provides application tooling and custom-engineered solutions for the aerospace, defense and marine markets.

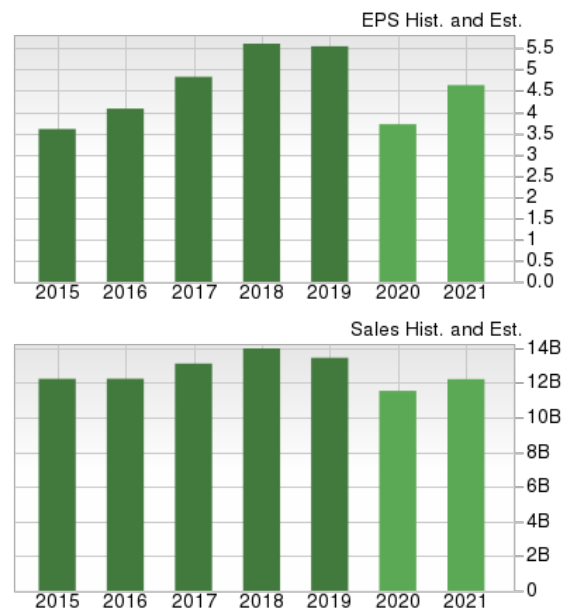
Industrial Solutions (29.4%): The segment caters to growing demand for the company's products in the end markets – industrial equipment, energy, and aerospace, defense, oil and gas. TE Connectivity supplies electronic components, including connectors, relays, circuit protection devices, antennas and heat shrink tubing for industrial machinery, consumer devices, data communications and household appliance markets. Further, it also offers intelligent building and rail products.

Communication Solutions (12.4%): The segment offers data and devices, appliances. Also, it is a leader in developing, manufacturing, installing, and maintaining some of the world's most advanced sub-sea fiber optic communications systems. This segment caters to demands of appliances, and data and devices end-markets.

Further, the company generates revenues by operating in three organized geographic regions – Europe/Middle East/Africa (EMEA), Asia-Pacific and Americas.

TE Connectivity had approximately 78,000 employees worldwide as of the end of fiscal year 2019. Out of this total employee strength, there were 25,000 employed in Americas, 22,000 in Asia-Pacific and 31,000 in EMEA region.

Notably, the company sells products via direct sales channels and third-party distributors in 150 countries.



Reasons To Buy:

- ▲ TE Connectivity's long-term growth strategy rests on market expansion through focus on harsh environment applications, efforts to reduce fixed cost for margin expansion, and execute a balanced capital allocation strategy to conduct bolt-on acquisitions and return capital back shareholders— to stoke growth. Moreover, continued progress on strategic priorities and solid execution along with an overarching business model are expected to continue benefiting TE Connectivity.
- ▲ TE Connectivity is the market leader in the connectivity and sensor business, armed with a comprehensive portfolio. About 80% of TE Connectivity's revenues are driven by harsh environment applications. Over the past five years, the company's harsh business applications have had experienced mid-single digit growth, driving top-line growth. This apart, the sensor business is anticipated to see strong design win momentum, fuelled by the growth of automotive space and contribute significantly to the top-line growth of the company. Going forward, the company believes that this business will provide ample opportunities of margin expansion. In a nutshell, TE Connectivity expects its harsh-environment application business to perform well, mainly supported by secular trends like increased safety features, autonomous driving systems, higher emission standards and infotainment.
- ▲ TE Connectivity's Industrial business has ample room for growth. The company expects industrial solutions to grow on an organic basis, driven by the continued strength of industrial equipment and aerospace segments. In a bid to further focus more on gaining industrial leadership, the company has been continuously making efforts. Moreover, the sale of its subsea communications business (SubCom), which used to be sluggish, is allowing the company to focus more on its industrial pertaining solutions.
- ▲ In order to strengthen its core business, TE Connectivity constantly looks for strategic acquisitions, particularly in sensor and harsh weather management segments. Over the past year, strategic acquisitions have given TE a leading position in solutions for the minimally-invasive medical market, fortified its portfolio of industrial connectors and bolstered our offering of sensors for the auto market. Hence, the company is taking measures to broaden offerings through acquisitions to maximize its growth potential.

TE Connectivity's harsh-environment application business and industrial solutions are positives. Secular trends in autonomous driving systems and infotainment areas are tailwinds.

Reasons To Sell:

- ▼ The sluggishness in oil and gas markets and its derivative impact on industrial market will likely act as strong headwinds for TE Connectivity. Also, low prices in oil & gas are reducing sales in industrial equipment business as well as areas like factory equipments and rail. Helicopter demand has also been impacted negatively, which can prove to be a drag on the company's aerospace business. Also, a major portion of the company's net sales is invoiced in currencies other than the U.S. dollar and management expects non-U.S. dollar revenue to represent a significant and likely increased portion of future net revenue. Therefore, when the U.S. Dollar strengthens in relation to the currencies of the countries where TE Connectivity sells its products, the dollar reported revenue and income will decrease.
- ▼ TE Connectivity also has a leveraged balance sheet. As of Mar 31, 2020, the company's net debt was \$3.6 billion compared with \$3.2 billion as of Dec 31, 2019. Accumulating high debt levels might restrict sufficient cash flow generation which is needed to meet future debt obligations. Moreover, this may keep the company away from accessing the debt market and refinancing at suitable rates. Further, the company's debt-to-total capital was 29% as of Mar 31, 2020 which increased from 24.3% as of Dec 31, 2019.
- ▼ TE Connectivity operates in a highly competitive market for electronic components and expects that both direct and indirect competition will increase in the future. Notably, the company faces stiff competition from Amphenol and Molex in all its reporting segments. The competition is across product lines from other companies ranging in size from large, diversified manufacturers to small, highly specialized manufacturers. In the recent times, the electronic components industry has become increasingly concentrated and globalized and the major competitors have significant financial resources and technological capabilities. A number of these competitors compete on the basis of price and in some cases enjoy lower production costs for certain products. Therefore, increased competition results in price reductions, reduced margins, or loss of market share, any of which has an adverse affect on the results of operations, financial position, and cash flows.

Sluggishness in oil and gas markets and its derivative impact on other industrial markets are acting as strong headwinds for TE Connectivity.

Last Earnings Report

TE Connectivity's Q2 Earnings & Revenues Beat Estimates

TE Connectivity reported second-quarter fiscal 2020 adjusted earnings of \$1.29 per share, beating the Zacks Consensus Estimate by 30.3%. Further, the figure was higher than management's guided range of \$1.22-\$1.28.

However, the bottom line declined 9.1% on a year-over-year basis but improved 6.6% sequentially.

Net sales in the reported quarter were \$3.2 billion, which surpassed the Zacks Consensus Estimate by 9.7%. Further, the figure came within the company's guided range of \$3.1 billion to \$3.3 billion. It also surged 0.9% from the prior quarter. However, the top line declined 6% from the year-ago quarter.

The year-over-year decline in the top line can be attributed to weakness in all the key end-markets, which affected the performance of Transportation, Industrial and Communication segments during the reported quarter. Moreover, coronavirus-induced disruptions remained concerns.

Nevertheless, the company's global manufacturing strategy and high levels of automation in factories acted as tailwinds during the reported quarter.

Notably, the company's total orders came in at \$3.4 billion during the reported quarter.

Although the company witnessed sequential improvement of 3.9% in its fiscal second quarter orders, it has been declining since March.

The company has withdrawn full fiscal 2020 guidance owing to uncertainty in the overall demand environment induced by the coronavirus pandemic.

Moreover, supply chain disruptions are expected to result in a headwind of \$100 million in fiscal third-quarter 2020.

Nevertheless, continued solid execution of the company's strategic plans especially cost reduction and footprint consolidation initiatives, are likely to remain positives. Further, investments in content growth, and recovery in China and auto market are expected to aid the company's performance in the days ahead.

Top-Line in Detail

TE Connectivity operates in three organized segments.

Transportation Solutions: The company generated sales worth \$1.86 billion (58.1% of net sales) in the reported quarter, down 5.8% on a year-over-year basis. This can be attributed to weakness in auto production globally, which resulted in a year-over-year decline of 4% in automotive sales. Further, sluggishness in commercial transportation and industrial markets led to year-over-year decline of 11% in the company's sensor business.

Additionally, weakness in all regions led to decline of 9% in sales of its commercial transportation business on a year-over-year basis.

Industrial Solutions: This segment generated sales of \$962 million (30.1% of net sales), which fell 4.5% year over year. This was primarily driven by inventory destocking, which led to year-over-year decline of 14% in the industrial equipment business.

Although the company witnessed growth in defense market, sluggish commercial aerospace market led to 4% decline in the aerospace, defense and marine business from the year-ago quarter.

Nevertheless, TE Connectivity experienced improvement of 6% in medical year over year courtesy of solid traction across interventional medical applications. Additionally, the company witnessed year-over-year growth of 2% in energy, owing to investments for upgraded infrastructure.

Communications Solutions: This segment generated sales of \$376 million (11.8% of net sales), declining 13.4% year over year. This can be attributed to inventory destocking, which resulted in a decline of 13% in data & devices and 14% in appliances solutions on a year-over-year basis.

Operating Details

Per the company, gross margin came in 32.2%, contracting 60 basis points (bps) from the year-ago quarter.

We note that R&D expenses were \$158 million, which decreased 4.8% year over year. Further, selling, general, and administrative expenses came in at \$352 million, down 5.6% year over year. Further, restructuring costs decreased 47.6% from the year-ago quarter to \$22 million in the reported quarter.

However, acquisition and integration expenses totaled \$12 million, up 71.4% from the year-ago quarter.

Consequently, adjusted operating margin came in at 16.2%, contracting 80 bps from the prior-year quarter.

Balance Sheet & Cash Flow

As of Mar 27, 2020, TE Connectivity's cash and cash equivalents were \$796 million, higher than \$742 million as of Dec 27, 2019.

Quarter Ending **03/2020**

Report Date	Apr 28, 2020
Sales Surprise	9.70%
EPS Surprise	30.30%
Quarterly EPS	1.29
Annual EPS (TTM)	5.33

Long-term debt was \$3.75 billion, up from \$3.41 billion in the previous quarter.

The company generated \$481 million of cash from operation in the reported quarter, up from with \$411 million in the prior quarter.

Further, free cash flow of \$311 million was generated in the reported quarter. Additionally, TE Connectivity paid out \$433 million to shareholders through share repurchases and dividend payments.

Guidance

Due to expected sluggish end-market demand conditions as a result of coronavirus pandemic, the company anticipates net sales to be down 25% sequentially in third-quarter fiscal 2020.

TE Connectivity anticipates transportation and commercial aerospace markets to be significantly impacted by coronavirus-induced disruptions.

Further, auto production is expected to decline in the ongoing quarter.

Recent News

On **May 5, 2020**, TE Connectivity's Board of Directors approved a quarterly dividend of 48 cents per share for the shareholders of the record as of May 22 payable on Jun 5.

On **Mar 12, 2020**, TE Connectivity acquired 71.87% stake in First Sensor which a sensor technology company. The acquisition is expected to add strength to the company's sensor business.

Valuation

TE Connectivity shares are down 10.8% in the year-to-date period and 3.1% over the trailing 12-month period. While stocks in the Zacks sub-industry are down 7.7%, the same in the Zacks Computer & Technology sector are up 15% in the year-to-date period. Over the past year, the Zacks sub-industry and the sector is up 0.5% and 26.5%, respectively.

The S&P 500 index is up 0.4% in the year-to-date period and 8.8% in the past year.

The stock is currently trading at 19.38X forward 12-month earnings, which compares to 21.78X for the Zacks sub-industry, 26.2X for the Zacks sector and 22.72X for the S&P 500 index.

Over the past five years, the stock has traded as high as 20.8X and as low as 9.73X, with a 5-year median of 15.59X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$90 price target reflects 20.4X forward 12-month earnings.

The table below shows summary valuation data for TEL

Valuation Multiples - TEL					
		Stock	Sub-Industry	Sector	S&P 500
P/E F 12M	Current	19.38	21.78	26.2	22.72
	5-Year High	20.8	21.78	26.2	22.72
	5-Year Low	9.73	13.9	16.72	15.25
	5-Year Median	15.59	17.08	19.33	17.52
P/S F12M	Current	2.35	1.68	3.94	3.55
	5-Year High	2.56	1.87	3.94	3.55
	5-Year Low	1.33	0.94	2.32	2.53
	5-Year Median	2.08	1.45	3.14	3.02
EV/EBITDA TTM	Current	8.38	7.92	13.06	11.88
	5-Year High	24.75	16.52	13.2	12.86
	5-Year Low	6	5.45	7.59	8.25
	5-Year Median	11.86	8.69	10.85	10.87

As of 07/15/2020

Industry Analysis Zacks Industry Rank: Bottom 19% (204 out of 251)



Top Peers

Company (Ticker)	Rec	Rank
Applied Materials, Inc. (AMAT)	Neutral	3
Amphenol Corporation (APH)	Neutral	3
Broadcom Inc. (AVGO)	Neutral	3
Belden Inc (BDC)	Neutral	3
Eastman Chemical Company (EMN)	Neutral	3
Honeywell International Inc. (HON)	Neutral	3
MACOM Technology Solutions Holdings, Inc. (MTSI)	Neutral	3
STMicroelectronics N.V. (STM)	Neutral	3

Industry Comparison Industry: Electronics - Miscellaneous Components				Industry Peers		
	TEL	X Industry	S&P 500	AMAT	APH	MTSI
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	2	-	-	3	3	3
VGM Score	B	-	-	A	B	C
Market Cap	28.20 B	120.21 M	22.66 B	56.91 B	29.72 B	2.45 B
# of Analysts	8	2	14	10	8	7
Dividend Yield	2.25%	0.00%	1.83%	1.42%	1.00%	0.00%
Value Score	A	-	-	B	C	F
Cash/Price	0.03	0.14	0.07	0.10	0.08	0.09
EV/EBITDA	11.59	8.49	12.99	14.84	16.58	-10.42
PEG Ratio	2.22	2.89	2.97	1.20	4.52	NA
Price/Book (P/B)	3.07	1.80	3.12	6.31	6.68	8.58
Price/Cash Flow (P/CF)	11.14	11.80	12.14	17.72	20.36	35.59
P/E (F1)	22.86	29.04	22.04	16.28	33.56	54.27
Price/Sales (P/S)	2.16	1.29	2.38	3.69	3.66	5.26
Earnings Yield	4.34%	2.89%	4.32%	6.14%	2.98%	1.85%
Debt/Equity	0.41	0.17	0.76	0.69	1.03	2.39
Cash Flow (\$/share)	7.67	0.72	6.94	3.51	4.93	1.03
Growth Score	B	-	-	B	B	A
Hist. EPS Growth (3-5 yrs)	11.21%	12.30%	10.85%	31.78%	12.53%	-44.85%
Proj. EPS Growth (F1/F0)	-33.08%	-27.11%	-9.64%	25.46%	-19.99%	333.50%
Curr. Cash Flow Growth	-2.61%	-15.98%	5.51%	-35.58%	-1.02%	-30.98%
Hist. Cash Flow Growth (3-5 yrs)	3.85%	8.80%	8.55%	13.90%	10.51%	-8.89%
Current Ratio	1.44	2.25	1.30	2.67	2.54	4.50
Debt/Capital	29.03%	22.55%	44.46%	40.78%	50.81%	70.52%
Net Margin	5.36%	3.83%	10.59%	18.89%	13.90%	-76.21%
Return on Equity	17.58%	9.02%	15.75%	37.13%	25.06%	-12.55%
Sales/Assets	0.67	0.81	0.54	0.78	0.74	0.42
Proj. Sales Growth (F1/F0)	-14.20%	0.00%	-2.52%	14.10%	-8.35%	3.56%
Momentum Score	F	-	-	A	A	D
Daily Price Chg	4.93%	0.15%	1.91%	-0.70%	3.12%	0.16%
1 Week Price Chg	-2.61%	0.00%	-0.41%	2.61%	-0.98%	5.44%
4 Week Price Chg	5.01%	1.61%	1.88%	3.50%	2.00%	9.87%
12 Week Price Chg	27.07%	17.48%	16.37%	19.17%	22.98%	48.42%
52 Week Price Chg	-3.09%	-2.64%	-4.22%	34.36%	3.56%	109.16%
20 Day Average Volume	1,601,616	38,867	2,266,132	6,204,452	1,479,053	673,282
(F1) EPS Est 1 week change	-0.94%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.94%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 12 week change	-16.12%	-19.36%	-5.76%	2.17%	-9.32%	496.55%
(Q1) EPS Est Mthly Chg	-5.88%	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	A
Growth Score	B
Momentum Score	F
VGM Score	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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