Jan 02, 2020

The Timken Company (TKR)

$56.31 (As of 01/01/20)

Price Target (6-12 Months): **$60.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 12/31/19) Prior Recommendation: Underperform	**Neutral**
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	**3-Hold**
	Zacks Style Scores:	VGM:A
	Value: B | Growth: A | Momentum: F	

Summary

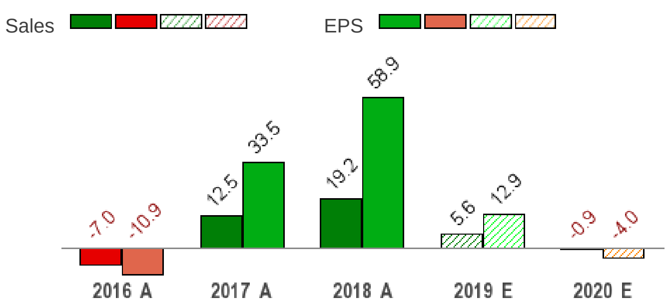
Timken expects adjusted earnings per share of between $4.70 and $4.75 for 2019. The mid-point of the guidance suggests year-over-year growth of 13%. Earnings will be benefited from acquisitions and favorable price and mix. Its top-line will gain from strong organic growth in wind and solar energy, aerospace, marine and rail sectors as well as positive pricing. Further, the company's measures to reduce costs and improving operating efficiency will boost margins. Timken is also benefiting from acquisitions and divestitures. However, ongoing weakness in industrial markets and automotive sector will impact Timken's top-line performance. Strength in the wind, solar, energy and aerospace markets will likely be offset by lower demand in off-highway and heavy truck. Also, higher inventory and weakness in order intake rate are other concerns.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	**$58.52 - $36.27**
20 Day Average Volume (sh)	**542,754**
Market Cap	**$4.2 B**
YTD Price Change	**50.9%**
Beta	**1.84**
Dividend / Div Yld	**$1.12 / 2.0%**
Industry	**Metal Products - Procurement and Fabrication**
Zacks Industry Rank	**Bottom 15% (214 out of 253)**
Last EPS Surprise	**-3.4%**
Last Sales Surprise	**-3.4%**
EPS F1 Est- 4 week change	**-0.2%**
Expected Report Date	**02/06/2020**
Earnings ESP	**0.0%**
P/E TTM	**11.8**
P/E F1	**11.9**
PEG F1	**1.4**
P/S TTM	**1.1**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates **(millions of $)**

	Q1	Q2	Q3	Q4	Annual*
2020	937 E	976 E	933 E	911 E	3,746 E
2019	980 A	1,000 A	914 A	884 E	3,780 E
2018	883 A	906 A	881 A	910 A	3,581 A

EPS Estimates

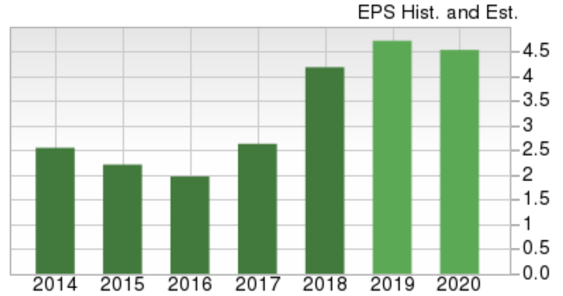
	Q1	Q2	Q3	Q4	Annual*
2020	$1.19 E	$1.20 E	$1.19 E	$1.05 E	$4.53 E
2019	$1.35 A	$1.27 A	$1.14 A	$0.95 E	$4.72 E
2018	$1.01 A	$1.11 A	$1.06 A	$1.00 A	$4.18 A

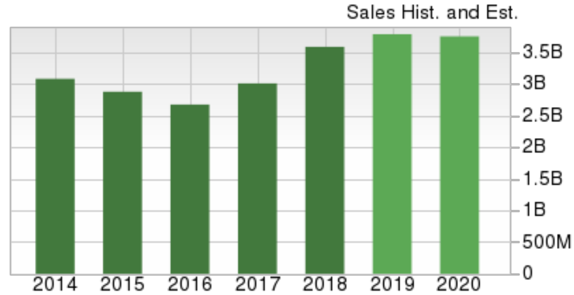
*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/01/2020. The reports text is as of 01/02/2020.

Overview

The Timken Company is a global manufacturer of bearings, friction management products, and mechanical power transmission components. The company serves a wide variety of end markets, including aerospace, automotive, construction, consumer, defense, energy, industrial equipment, health, heavy industry, machine tool, positioning control, power generation and rail markets.





The company's portfolio features many strong brands, such as Timken, Fafnir, Philadelphia Gear, Drives, Cone Drive, Rollon, Lovejoy and Groeneveld. Timken's global footprint consists of 118 manufacturing facilities, 19 technology and engineering centers, and 53 distribution centers and warehouses. The company employs more than 18,000 people across 35 countries.

Timken reports its operations through two segments: Mobile Industries and Process Industries.

Mobile Industries (54% of 2018 revenues) serves OEM customers that manufacture off-highway equipment for the agricultural, mining and construction markets; on-highway vehicles, including passenger cars, light trucks, and medium- and heavy-duty trucks; rail cars and locomotives; outdoor power equipment; rotorcraft and fixed-wing aircraft; and other mobile equipment. The segment also provides aftermarket sales and services.

Process Industries (55%) serves OEM and end-user customers in industries that place heavy demand on the fixed operating equipment they make or use in heavy and other general industrial sectors. This includes metals, cement and aggregate production; coal power generation and renewable energy sources; oil and gas extraction and refining; pulp and paper and food processing; automation and robotics; and health and critical motion control equipment. Other applications include marine equipment, gear drives, cranes, hoists and conveyors. This segment also supports after-market sales and service needs of customers.

During 2018, the company completed three acquisitions — ABC Bearings Limited, Apiary Investments Holdings Limited and Rollon S.p.A. In April 2019, Timken completed the acquisition of Diamond Chain, a leading supplier of high-performance roller chains which serves a diverse range of market sectors.

Reasons To Buy:

Timken will likely benefit from favorable price and mix, cost-reduction initiatives and strong cash flow. Acquisitions and efforts to boost market share and market offerings will also drive growth.

- Timken now expects 2019 adjusted earnings per share between $4.70 and $4.75. The mid-point of the guidance suggests year-over-year growth of 13%. Earnings for the current year will benefit from acquisitions and favorable price and mix. For 2019, Timken now expects total revenues to be up 5-6% year on year, driven by acquisition benefits, strong organic growth in wind and solar energy, aerospace, marine and rail sectors as well as positive pricing. The company also expects continued demand growth in its products and services for the second half of the current year. Further, the company's measures to reduce costs and improving operating efficiency will boost margins. Also, Timken aims to reduce inventory.

- Timken is benefiting from acquisitions and divestitures. Last year, the company acquired Rollon, Cone Drive and ABC Bearings and divested the ICT Business. In the June-end quarter, Timken acquired Diamond chain for $84.9 million.. Timken recently completed the acquisition of BEKA Lubrication for $165 million. The buyout will strengthen the company's global leadership in the automatic lubrication systems market sector and expand its geographic reach in Europe and Asia. The deal will also create opportunities for Timken to better serve wind and other industrial end markets. Notably, these acquisitions, including the recently-concluded BEKA buyout, will likely boost 2019 top-line growth by 7.5%. The company is also poised to benefit from cost synergies for acquisitions.

- The company is focused on providing the highest returns for shareholders through its capital-allocation framework. Timken continues to measure a balanced approach to stoke growth, margins, returns and cash flow through industrial cycles. Timken expects to generate strong free cash flow of around $375 million in 2019, backed by improved working capital performance. The company continues to mitigate tariff impact through pricing initiatives.

Reasons To Sell:

Timken's near-term results will be hurt by input cost inflation due to the implementation of tariffs. Also, higher inventory, weakness in order intake rate and currency fluctuations are concerns.

- In off-highway and heavy trucks, the company coninues to witness decline in all regions and across also subsectors, including agriculture, mining and construction. This reflects lower end-user demand as well as customer de-stocking. Also, the ongoing slowdown in industrial markets remain a concern. Consequently, strength in the wind, solar, energy and aerospace markets will likely be offset by lower demand in off-highway, heavy truck and industrial services in the current year. Furtherm, weakness in the automotive sector will also dent Timken's top-line.
- Timken is exposed to the risks of currency-exchange rate fluctuations, which will likely hurt its top-line growth for the ongoing year. Also, higher inventory and weakness in order intake rate are other concerns.
- The U.S. government has initiated the imposition of tariffs on certain foreign goods, including steel and other raw materials. These measures have led to higher input costs for Timken. This, in turn, will dent margins if the company is not able to pass the price increases to customers.
- Timken's debt has gone up following the Rollon, Cone Drive and BEKA acquisitions. The consequent increase in interest expense will hurt earnings. A higher debt level also limits further investment.

Last Earnings Report

Timken Earnings & Revenues Trail Estimates in Q3, Up Y/Y

Quarter Ending	09/2019
Report Date	Oct 30, 2019
Sales Surprise	-3.42%
EPS Surprise	-3.39%
Quarterly EPS	1.14
Annual EPS (TTM)	4.76

Timken reported third-quarter 2019 adjusted earnings per share of $1.14. The figure improved 7.5% from the prior-year quarter's $1.11 per share. This upside was driven by favorable price and mix, benefit of acquisitions and lower material and logistics costs, partly offset by the impact of lower volume and related manufacturing utilization as well as higher interest expenses. Earnings, however, missed the Zacks Consensus Estimate of $1.18.

On a reported basis, Timken delivered earnings per share of 84 cents in the September-end quarter compared with the prior-year quarter's 91 cents.

Total revenues in the quarter came in at $914 million, up 3.7% from the year-ago quarter, backed by acquisition benefits, partly offset by lower organic revenue in Mobile Industries, and unfavorable foreign-currency translation impact. The top-line figure, however, missed the Zacks Consensus Estimate of $946 million.

Timken registered record earnings per share, strong operating margins and excellent cash flow despite weakness in several industrial markets in the reported quarter. The company continues to grow in renewable energy and rail sectors, and takes measures to reduce costs and improve operating efficiency.

Costs and Margins

Cost of sales was up 1.3% to $636.5 million for the July-September quarter. Gross profit grew 9.5% year over year to $277.5 million. Gross margin came in at 30.3% compared with the 28.7% reported in the year-ago quarter.

Selling, general and administrative expenses flared up 4.2% to $148 million from the $142 million reported in the prior-year quarter. Operating profit increased 17.7% year over year to $128 million. Operating margin came in at 14% compared with the 12% witnessed in the comparable period last year. Adjusted EBITDA grew 11.6% year over year to $181.3 million.

Segmental Performance

The **Mobile Industries** segment revenues went down to $455.1 million from the $464.2 million recorded in the year-ago quarter. This downside mainly resulted from lower shipments in off-highway and heavy truck, and unfavorable currency, partly offset by the benefit of acquisitions and growth in the rail sector. The segment's adjusted EBIT was up 2.5% year over year to $53.8 million.

The **Process Industries** segment revenues increased 10% year over year to $458.9 million in the quarter, aided by acquisitions and organic growth in the renewable energy and marine sectors. This was partly muted by lower revenues recorded in industrial services as well as unfavorable currency-translation impact. The segment adjusted EBIT jumped 17% year over year to $98.3 million.

Financial Position

Timken generated free cash flow of $101.2 million during the July-September quarter compared with the $114 million recorded in the prior-year quarter. Cash flow from operations came in at $144.9 million in the third quarter compared with the $137.2 million witnessed in the year-ago period.

During the quarter, the company returned $53.7 million of capital to shareholders. It also announced quarterly dividend of 28 cents per share, marking the 389th consecutive quarterly dividend payment. Also, Timken repurchased approximately 750 thousand shares.

Recent Development

Recently, Timken completed the acquisition of BEKA Lubrication for $165 million. This buyout will help Timken boost its global leadership in the automatic lubrication systems market sector as well as expand the company's geographic reach in Europe and Asia. Additionally, the deal will create opportunities for Timken to better serve wind and other industrial end markets.

Outlook

For 2019, Timken now expects total revenues to be up approximately 5-6% from 2018, on the back of acquisition benefits, partly offset by unfavorable currency-translation impact. For the full year, the company now anticipates adjusted earnings per share in the range of $4.70 to $4.75.

Valuation

Timken's shares are up 54.7% over the trailing 12-month period. Stocks in the Zacks Metal Products – Procurement and Fabrication industry and Industrial Products sector are up 27.1% and 26.9% over the past year, respectively.

The S&P 500 index has gained 30.7% in the past year.

The stock is currently trading at 11.94X forward 12-month earnings, which compares to 10.18X for the Zacks sub-industry, 19.44X for the Zacks sector and 20.29X for the S&P 500 index.

Over the past five years, the stock has traded as high as 22.22X and as low as 7.09X, with a 5-year median of 14.19X.

Our Neutral recommendation indicates that the stock will perform in-line with the market. Our $60 price target reflects 12.72X forward 12-month earnings per share.

The table below shows summary valuation data for TKR:

Valuation Multiples - TKR

		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	11.94	10.18	19.44	20.29
	5-Year High	22.22	20.35	19.88	20.29
	5-Year Low	7.09	6.67	12.58	15.17
	5-Year Median	14.19	13.32	16.48	17.44
P/S F12M	Current	1.12	1.96	2.74	3.51
	5-Year High	1.44	2.44	2.74	3.51
	5-Year Low	0.67	0.66	1.51	2.54
	5-Year Median	0.98	1.07	1.96	3
EV/EBITDA TTM	Current	7.86	8	17.04	12.01
	5-Year High	29.43	18.63	17.4	12.86
	5-Year Low	6.27	6.74	10.89	8.49
	5-Year Median	8.9	10.8	14.67	10.65

As of 12/31/2019

Industry Analysis **Zacks Industry Rank:** Bottom 15% (214 out of 253)

Top Peers

Colfax Corporation **(CFX)**	Neutral
Donaldson Company, Inc. **(DCI)**	Neutral
IDEX Corporation **(IEX)**	Neutral
Regal Beloit Corporation **(RBC)**	Neutral
RBC Bearings Incorporated **(ROLL)**	Neutral
Rexnord Corporation **(RXN)**	Neutral
Altra Industrial Motion Corp. **(AIMC)**	Underperform
Kennametal Inc. **(KMT)**	Underperform

Industry Comparison Industry: Metal Products - Procurement And Fabrication

Industry Peers

	TKR Neutral	X Industry	S&P 500	KMT Underperform	RBC Neutral	ROLL Neutral
VGM Score	A	-	-	D	A	D
Market Cap	4.24 B	794.34 M	23.93 B	3.06 B	3.51 B	3.96 B
# of Analysts	5	2	13	5	3	5
Dividend Yield	1.99%	0.00%	1.78%	2.17%	1.40%	0.00%
Value Score	B	-	-	D	B	D
Cash/Price	0.04	0.08	0.04	0.04	0.08	0.01
EV/EBITDA	9.38	6.42	13.95	7.82	9.12	24.55
PEG Ratio	1.40	2.69	2.12	2.49	1.55	5.19
Price/Book (P/B)	2.33	2.14	3.33	2.28	1.54	3.80
Price/Cash Flow (P/CF)	9.14	8.36	13.67	8.35	9.10	26.15
P/E (F1)	11.92	14.72	19.66	20.77	15.49	30.44
Price/Sales (P/S)	1.12	0.83	2.69	1.33	1.04	5.52
Earnings Yield	8.38%	6.78%	5.08%	4.83%	6.46%	3.28%
Debt/Equity	0.89	0.49	0.72	0.47	0.54	0.05
Cash Flow ($/share)	6.16	1.69	6.94	4.42	9.41	6.05
Growth Score	A	-	-	D	C	C
Hist. EPS Growth (3-5 yrs)	16.55%	4.72%	10.56%	14.99%	6.08%	14.48%
Proj. EPS Growth (F1/F0)	12.09%	0.00%	0.00%	-41.19%	-6.54%	7.48%
Curr. Cash Flow Growth	37.17%	21.11%	14.83%	10.92%	14.06%	21.08%
Hist. Cash Flow Growth (3-5 yrs)	1.58%	7.13%	9.00%	2.02%	4.47%	14.85%
Current Ratio	2.57	2.57	1.23	2.54	2.83	5.14
Debt/Capital	47.22%	33.07%	42.92%	31.78%	35.03%	4.38%
Net Margin	8.11%	1.05%	11.08%	8.31%	7.62%	15.23%
Return on Equity	21.12%	7.33%	17.10%	15.40%	10.14%	12.61%
Sales/Assets	0.83	0.92	0.55	0.89	0.73	0.60
Proj. Sales Growth (F1/F0)	0.00%	0.00%	0.00%	-7.71%	0.00%	5.62%
Momentum Score	F	-	-	A	A	C
Daily Price Chg	-0.21%	0.09%	0.33%	-0.40%	0.04%	0.43%
1 Week Price Chg	0.89%	0.19%	0.13%	-0.19%	-1.19%	1.04%
4 Week Price Chg	8.85%	2.02%	3.67%	6.43%	5.33%	-2.27%
12 Week Price Chg	37.24%	10.71%	10.64%	29.53%	25.00%	3.48%
52 Week Price Chg	50.88%	10.41%	27.46%	10.85%	22.21%	20.78%
20 Day Average Volume	542,754	60,226	1,693,267	664,677	205,387	75,145
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.17%	0.00%	0.00%	0.00%	0.62%	-0.34%
(F1) EPS Est 12 week change	-3.91%	-2.01%	0.14%	-37.91%	-1.63%	-1.51%
(Q1) EPS Est Mthly Chg	-0.42%	0.00%	0.00%	0.00%	-0.40%	-1.43%

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	B
Growth Score	A
Momentum Score	F
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.

Disclosures

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