

## The Timken Company (TKR)

**\$50.05** (As of 08/05/20)

Price Target (6-12 Months): **\$56.00**

Long Term: 6-12 Months

**Zacks Recommendation:** **Outperform**

(Since: 08/05/20)

Prior Recommendation: Underperform

Short Term: 1-3 Months

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

**1-Strong Buy**

Zacks Style Scores:

VGM:C

Value: D

Growth: D

Momentum: A

### Summary

Timken's second-quarter 2020 adjusted earnings per share (EPS) and revenues both declined from the prior-year quarter due weak demand amid the coronavirus pandemic. However, both the metrics beat the Zacks Consensus Estimate. Timken anticipates revenues and margins to come in lower than the first half of 2020 in the second half due to the impact of the pandemic on its end markets. The company will nevertheless gain from its cost reduction actions and efforts to enhance liquidity. Strategic acquisitions to broaden portfolio and capabilities across diverse markets with a focus on bearings, adjacent power transmission products, and related services will drive growth. The company's diversity in terms of end market, customer and geography, product innovation, and engineering expertise provide it with a competitive edge.

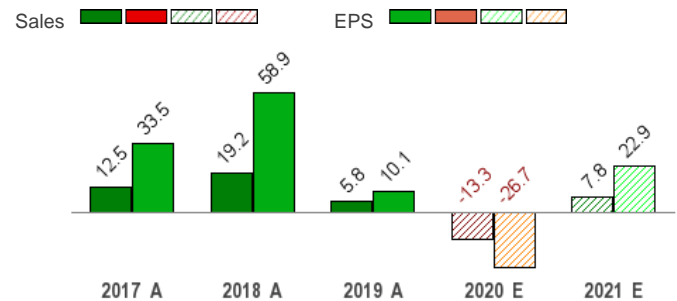
### Price, Consensus & Surprise



### Data Overview

52 Week High-Low	\$58.78 - \$22.26
20 Day Average Volume (sh)	516,655
Market Cap	\$3.8 B
YTD Price Change	-11.1%
Beta	1.78
Dividend / Div Yld	\$1.12 / 2.2%
Industry	<a href="#">Metal Products - Procurement and Fabrication</a>
Zacks Industry Rank	Top 28% (72 out of 253)

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



Last EPS Surprise	209.1%
Last Sales Surprise	13.9%
EPS F1 Est- 4 week change	24.7%
Expected Report Date	11/04/2020
Earnings ESP	0.0%
P/E TTM	12.2
P/E F1	14.9
PEG F1	1.8
P/S TTM	1.1

### Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	923 E	880 E	874 E	858 E	3,541 E
2020	923 A	804 A	799 E	819 E	3,285 E
2019	980 A	1,000 A	914 A	896 A	3,790 A

### EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.14 E	\$1.19 E	\$1.15 E	\$0.84 E	\$4.14 E
2020	\$1.11 A	\$1.02 A	\$0.90 E	\$0.68 E	\$3.37 E
2019	\$1.35 A	\$1.27 A	\$1.14 A	\$0.84 A	\$4.60 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 08/05/2020. The reports text is as of 08/06/2020.

## 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.

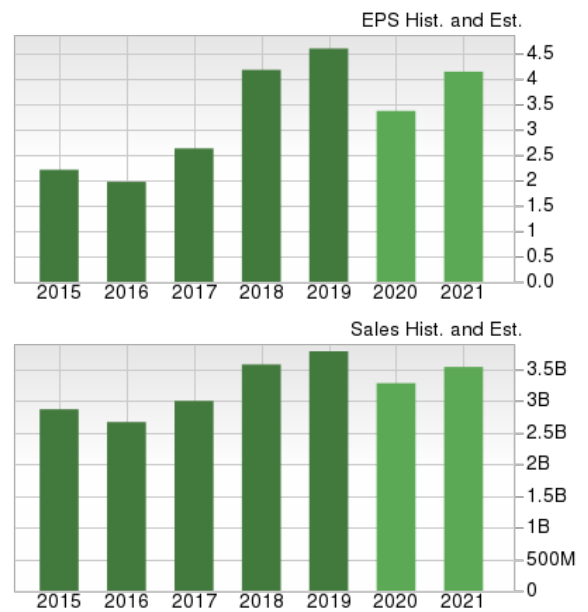
The company's portfolio features many strong brands, such as Timken, Philadelphia Gear, Drives, Cone Drive, Rollon, Lovejoy, Diamond, BEKA, and Groeneveld. Timken's global footprint consists of 125 manufacturing facilities, 21 technology and engineering centers, and 68 distribution centers and warehouses. The company employs more than 18,000 people across 42 countries.

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

**Mobile Industries** (54% of 2019 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 2019, Timken completed the acquisition of BEKA Lubrication, and The Diamond Chain Company.



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## Reasons To Buy:

- ▲ Timken continues to pursue strategic acquisitions to broaden its portfolio and capabilities across diverse markets, with a focus on bearings, adjacent power transmission products, and related services. In 2018, the company acquired Rollon, Cone Drive and ABC Bearings and divested the ICT Business. In 2019, Timken completed the acquisition of BEKA Lubrication and the Diamond Chain Company. The acquisition of BEKA Lubrication strengthened the company's global leadership in the automatic lubrication systems market sector. It also expanded its geographic reach in Europe and Asia. It enhanced the company's position in lucrative markets such as wind and food and beverage. Diamond Chain augments Timken's leadership in high-performance roller chains for industrial markets. These acquisitions have strengthened the company's global presence in growing markets, particularly China and Europe. These buyouts are expected to deliver significant cost and revenue synergies, going ahead.
- ▲ Timken continues to measure a balanced approach to stoke growth, margins, returns and cash flow through industrial cycles. During the second quarter of 2020, Timken paid its 392nd consecutive quarterly dividend. Due to uncertainty caused by COVID-19, the company suspended its share buyback program for the time being. Timken's net debt to capital ratio was 0.41 as of Jun 30, 2020 compared with 0.44 as of Dec 31, 2019. The company proactively amended debt agreements in second-quarter 2020 to boost financial flexibility. The company has no significant long-term maturity before September 2023. Timken had \$416 million of cash on hand and over \$400 million of availability under committed credit facilities as of Jun 30, 2020. Timken expects to generate strong free cash flow over the balance of the year aided by favorable working capital and cost saving initiatives, and continue to reduce net debt.
- ▲ Timken is taking actions to enhance liquidity, reduce costs and generate strong cash flow. During second-quarter 2020, it implemented temporary salary reductions, work furloughs and other actions to reduce costs. Recently, the company began expanding and accelerating certain structural cost reduction initiatives to align its costs with near-term demand expectations and improve its long-term profitability. Timken expects these structural cost reduction actions and other cost reduction initiatives to generate approximately \$50-60 million of total year-on-year savings in the second half of 2020. These actions will help sustain margins amid lower volumes. Timken meanwhile continues to advance its ongoing strategy – footprint, acquisition integration, and driving operational excellence.
- ▲ Timken's products are essential for efficient and reliable operation of industrial equipment globally. Demand for the company's products will remain strong in the years to come. Its diversity in terms of end market, customer and geography, product innovation, and engineering expertise provide it with a competitive edge.
- ▲ The Wind and Solar sectors continue to perform well and experienced significant growth in second-quarter 2020. Timken's strong underlying market growth and share gains are driving sales. The outlook for the renewable energy sector remains strong for the balance of the year. The company has built its presence in the renewable space organically over the last decade, recently complemented through acquisitions. The company continues to make targeted investments to support growth beyond 2020. The renewable energy sector currently generates 7% of the company's revenues. It is anticipated to become bigger part of the company's portfolio in the future.

Timken will benefit from its actions to enhance liquidity, reduce costs and generate strong cash flow. Acquisitions and efforts to boost market share and market offerings will also contribute to growth.

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## Risks

- During the first quarter, Timken's operations in China were shut down for two weeks amid the coronavirus crisis. For major part of the second quarter, the company's operations were adversely impacted by lower global demand stemming from the COVID-19 pandemic, which included various customer shut-downs and government imposed operating restrictions in places like India and Italy. Timken's operations in China and across the rest of the world are now running at near-normal levels as government restrictions have been lifted. Notably, there is considerable uncertainty at this point regarding the overall impact of the pandemic on its business as a whole.
  - COVID-19 has impacted most of Timken's end markets including — Heavy Truck, Automotive, Off-Highway and Industrial sectors. Considering persistent uncertainty surrounding the same, the company suspended sales and earnings guidance for 2020. Timken anticipates revenues to come in lower than the first half of 2020 in the second half due to decline in its end markets. Operating margins are anticipated to be lower in the second half of 2020 compared with the first half of 2020, due to the timing of realization with respect to cost reduction initiatives, normal seasonality, higher restructuring charges and other items.
  - Among its diverse end market mix, the Industrial sector generates the highest proportion of revenues for Timken. The sector, which had been reeling under the protracted U.S.-China trade tensions and waning global demand, has now been hit hard by the coronavirus pandemic and energy market volatility. Per the Institute for Supply Management's report, the U.S Purchasing Managers' Index (PMI) came in at 41.5% for April — the lowest since April 2009 when it registered 39.9%. In May, the PMI came in at 43.1%. A reading below 50 denotes contraction. Even though the index climbed to 52.6% in June, the manufacturing index averaged 45.7% for the second quarter. The July PMI reading came in at 54.2%. It remains to be seen whether the recovery in the past two months will sustain considering the surge in coronavirus cases. A sluggish industrial sector will continue to weigh on Timken's results, particularly on the Process Industries segment. The Mobile Industries segment is expected to be hurt by significant declines in off highway and heavy truck as well as weakness in the automotive market in the current year.
  - Timken expects to incur higher costs related to manufacturing footprint initiatives. In the Mobile Industries segment, Timken announced reorganization of its bearing plant in Gaffney, SC. The company will transfer its high-volume bearing production and roller production to other facilities, which is expected to occur by the end of the third quarter of 2020. Timken expects to incur \$8-\$10 million of pretax costs related to this reorganization. In the Process Industries segment, Timken announced the closure of its chain plant in Indianapolis, IN in February. This plant was part of the Diamond Chain acquisition completed on Apr 1, 2019. The company will transfer the manufacturing of its Diamond Chain product line to its chain facility in Fulton, IL. The chain plant is expected to close by the end of the fourth quarter of 2021. Timken expects to incur approximately \$10 million to \$12 million related to this closure. The imposition of tariffs on certain foreign goods, including steel and other raw materials 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.
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## Last Earnings Report

### Timken Q2 Earnings and Revenues Surpass Estimates

Timken reported second-quarter 2020 adjusted earnings per share of \$1.02, which beat the Zacks Consensus Estimate of 33 cents by a wide margin. However, the bottom line declined 20% from the prior-year quarter due to lower volumes and related manufacturing utilization, and impact of unfavorable currency. However, lower selling, general and administrative expenses, favorable price/mix, and lower material and logistics costs somewhat mitigated the impact. Timken had implemented cost reduction actions in the quarter under review, which led to lower operating expenses.

Quarter Ending **06/2020**

Report Date	Aug 03, 2020
Sales Surprise	13.93%
EPS Surprise	209.09%
Quarterly EPS	1.02
Annual EPS (TTM)	4.11

On a reported basis, Timken delivered earnings per share of 82 cents in the reported quarter compared with \$1.20 in the prior-year quarter.

Total revenues in the quarter were \$804 million, down 20% from the year-ago quarter on account of lower demand due to the COVID-19 situation and unfavorable currency impact, partially offset by the favorable impact of acquisitions. The top line, however, surpassed the Zacks Consensus Estimate of \$705 million.

### Costs and Margins

Cost of sales was down 17% to \$573 million from the prior-year quarter. Gross profit slumped 25% year over year to \$230 million. Gross margin was 28.7% compared with 30.6% in the year-ago quarter.

Selling, general and administrative expenses went down 30% to \$112 million from the prior-year quarter. Adjusted EBITDA declined 17% year over year to \$164.2 million. Adjusted EBITDA margin in the quarter was 20.4% compared with 19.7% in the prior-year quarter.

### Segmental Performance

The Mobile Industries segment revenues declined to \$343 million from \$494 million in the year-ago quarter. This downside was primarily due to lower shipments across the board, partly offset by the benefit of acquisitions. The segment's adjusted EBITDA plunged 47% year over year to \$42 million.

The Process Industries segment revenues decreased 9% year over year to \$461 million in the quarter, due to lower revenues across all sectors and unfavorable currency-translation impact. The segment's adjusted EBITDA dipped 1% year over year to \$129 million.

### Financial Position

Timken generated free cash flow of \$223 million in second-quarter 2020 compared with \$135 million in the prior-year quarter. Cash flow from operations was around \$247 million in the reported quarter compared with \$158 million in the previous-year quarter.

As of the second quarter end, the company had \$416 million of cash on hand and over \$400 million of availability under committed credit facilities. The company's net debt to capital ratio stood at 0.41 as of Jun 30, 2020.

Considering the ongoing uncertainty surrounding COVID-19, the company has not provided sales and earnings guidance for 2020.

Timken has accelerated and expanded structural cost reduction initiatives to align both its costs with near-term demand expectations and improve margins of the company longer-term. Cost reduction actions are expected to generate year-over-year savings of approximately \$50 to \$60 million in the second half of 2020.

## Valuation

Timken's shares are down 11.1% in the year-to-date period and 17.8% over the trailing 12-month period. Stocks in the Zacks Metal Products – Procurement and Fabrication industry and Industrial Products sector are down 21.5% and 6.5% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry are down 7.7% while the sector are up 7.5%.

The S&P 500 index is up 2.6% in the year-to-date period and up 14.9% in the past year.

The stock is currently trading at 15.57X forward 12-month earnings, which compares to 12.85X for the Zacks sub-industry, 21.38X for the Zacks sector and 22.58X for the S&P 500 index.

Over the past five years, the stock has traded as high as 22.22X and as low as 5.37X, with a 5-year median of 13.35X.

Our Outperform recommendation indicates that the stock will perform better than the market. Our \$56 price target reflects 17.77X 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	15.57	12.85	21.38	22.58
	5-Year High	22.22	20.35	21.53	22.58
	5-Year Low	5.37	6.67	12.55	15.25
	5-Year Median	13.35	13.56	17.15	17.55
P/S F12M	Current	1.12	1.65	2.88	3.63
	5-Year High	1.44	2.44	2.88	3.63
	5-Year Low	0.48	0.66	1.52	2.53
	5-Year Median	0.97	1.16	2.03	3.04
EV/EBITDA TTM	Current	8.29	7.24	16.94	12.8
	5-Year High	29.54	19.17	17.46	12.85
	5-Year Low	5.22	5.26	10.82	8.24
	5-Year Median	7.98	10.52	14.94	10.89

As of 08/05/2020

## Industry Analysis Zacks Industry Rank: Top 28% (72 out of 253)



## Top Peers

Company (Ticker)	Rec	Rank
TriMas Corporation (TRS)	Outperform	2
Century Aluminum Company (CENX)	Neutral	3
CIRCOR International, Inc. (CIR)	Neutral	3
GrafTech International Ltd. (EAF)	Neutral	4
Kaiser Aluminum Corporation (KALU)	Neutral	NA
Mueller Industries, Inc. (MLI)	Neutral	3
NN, Inc. (NNBR)	Neutral	3
Worthington Industries, Inc. (WOR)	Neutral	3

Industry Comparison Industry: Metal Products - Procurement And Fabrication				Industry Peers		
	TKR	X Industry	S&P 500	CENX	MLI	WOR
Zacks Recommendation (Long Term)	Outperform	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	1	-	-	3	3	3
VGM Score	C	-	-	A	A	B
Market Cap	3.76 B	764.74 M	22.93 B	923.24 M	1.65 B	2.19 B
# of Analysts	6	1	14	1	1	1
Dividend Yield	2.24%	0.00%	1.76%	0.00%	1.38%	2.42%
Value Score	D	-	-	C	A	B
Cash/Price	0.11	0.17	0.07	0.19	0.08	0.07
EV/EBITDA	7.33	7.03	13.16	47.51	7.92	8.70
PEG Ratio	1.75	3.51	2.99	NA	NA	NA
Price/Book (P/B)	1.91	1.64	3.20	1.37	2.39	2.30
Price/Cash Flow (P/CF)	7.33	6.53	12.45	NA	9.91	7.25
P/E (F1)	14.85	15.54	21.78	NA	NA	20.34
Price/Sales (P/S)	1.06	0.81	2.47	0.58	0.73	0.71
Earnings Yield	6.73%	5.07%	4.33%	-3.68%	-0.41%	4.92%
Debt/Equity	0.91	0.45	0.77	0.46	0.49	0.75
Cash Flow (\$/share)	6.83	2.51	6.94	-0.52	2.92	5.47
Growth Score	D	-	-	A	A	B
Hist. EPS Growth (3-5 yrs)	22.34%	7.12%	10.46%	NA	10.01%	3.24%
Proj. EPS Growth (F1/F0)	-26.74%	-28.48%	-7.14%	71.85%	-105.48%	-17.02%
Curr. Cash Flow Growth	8.64%	-11.05%	5.47%	-159.66%	13.44%	15.25%
Hist. Cash Flow Growth (3-5 yrs)	6.82%	4.92%	8.55%	NA	3.93%	5.91%
Current Ratio	3.02	2.73	1.32	2.05	2.93	2.53
Debt/Capital	47.78%	31.46%	44.59%	31.46%	32.75%	42.87%
Net Margin	9.06%	-0.46%	10.15%	-3.49%	5.22%	2.58%
Return on Equity	16.41%	7.01%	14.46%	-9.39%	15.69%	14.13%
Sales/Assets	0.73	0.86	0.51	1.03	1.63	1.28
Proj. Sales Growth (F1/F0)	-13.32%	-8.00%	-1.68%	-13.94%	-27.18%	-15.79%
Momentum Score	A	-	-	B	C	F
Daily Price Chg	2.02%	1.54%	0.59%	7.78%	2.33%	1.54%
1 Week Price Chg	-3.20%	-0.92%	0.14%	16.60%	-0.04%	-0.24%
4 Week Price Chg	11.84%	2.34%	5.31%	43.33%	12.41%	14.89%
12 Week Price Chg	38.95%	28.83%	19.84%	140.56%	30.00%	67.17%
52 Week Price Chg	17.79%	-8.69%	2.73%	51.54%	8.09%	5.90%
20 Day Average Volume	516,655	146,094	2,098,555	1,291,549	226,003	480,248
(F1) EPS Est 1 week change	24.89%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	24.74%	3.85%	1.10%	43.28%	0.00%	-16.13%
(F1) EPS Est 12 week change	24.74%	0.08%	1.04%	32.74%	0.00%	-17.02%
(Q1) EPS Est Mthly Chg	30.25%	2.50%	0.39%	30.43%	NA	0.00%

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## 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.

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### 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	D
Growth Score	D
Momentum Score	A
VGM Score	C

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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