

The Timken Company (TKR)

\$33.03 (As of 04/06/20)

Price Target (6-12 Months): **\$35.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 12/31/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:B

Value: B

Growth: B

Momentum: D

Summary

Timken expects adjusted earnings per share of between \$4.25 and \$4.65 for 2020. Its top-line will gain from acquisition benefits while cost-reduction initiatives, positive pricing, lower material costs and improving operating efficiency will boost margins in the current year. Timken is also benefiting from acquisitions and divestitures. The company's acquisition of BEKA Lubrication will create opportunities for it to better serve wind and other industrial end markets. The company continues to drive margin improvement and cost synergies through integrating the Diamond Chain and BEKA business. However, ongoing weakness in industrial and automotive markets owing to the unfavorable impact of coronavirus will affect Timken's top-line performance. Timken has business operations worldwide hence, the outbreak might strain demand for its products.

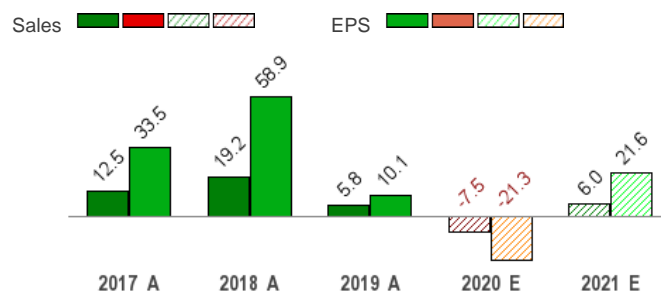
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$58.78 - \$22.26
20 Day Average Volume (sh)	901,899
Market Cap	\$2.5 B
YTD Price Change	-41.3%
Beta	1.86
Dividend / Div Yld	\$1.12 / 3.4%
Industry	Metal Products - Procurement and Fabrication
Zacks Industry Rank	Bottom 24% (192 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-11.6%
Last Sales Surprise	1.4%
EPS F1 Est- 4 week change	-18.6%
Expected Report Date	05/06/2020
Earnings ESP	-2.3%
P/E TTM	7.2
P/E F1	9.1
PEG F1	1.1
P/S TTM	0.7

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	973 E	1,012 E	958 E	948 E	3,714 E
2020	931 E	821 E	801 E	869 E	3,505 E
2019	980 A	1,000 A	914 A	896 A	3,790 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.24 E	\$1.23 E	\$1.28 E	\$1.00 E	\$4.40 E
2020	\$1.08 E	\$0.70 E	\$0.88 E	\$0.81 E	\$3.62 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 04/06/2020. The reports text is as of 04/07/2020.

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.

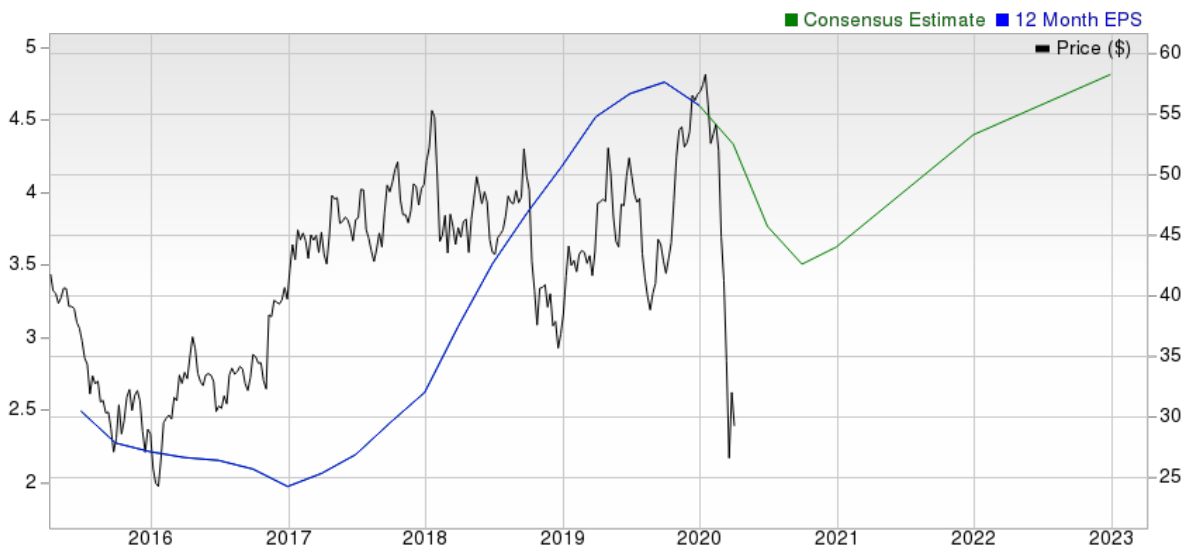
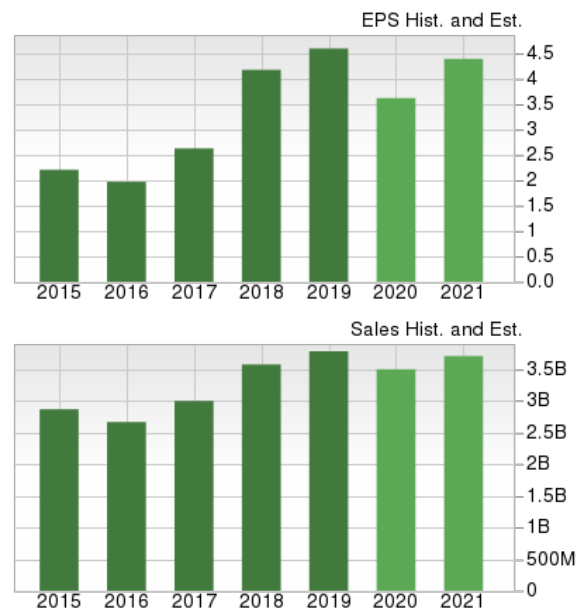
The company's portfolio features many strong brands, such as Timken, Fafnir, Philadelphia Gear, Drives, Cone Drive, Rollon, Lovejoy and Groeneveld. Timken's global footprint consists of 118 manufacturing facilities, 19 technology and engineering centers, and 53 distribution centers and warehouses. The 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 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 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:

- ▲ For 2020, Timken now expects total revenues in the range of down 2% to up 2% year on year, aided by acquisition benefits. Cost-reduction initiatives, positive pricing, lower material costs and improving operating efficiency will boost margins in this year. Also, Timken aims to reduce inventory. The Process Industries segment is expected to benefit from solid growth in renewable energy and industrial services. Moreover, easing of persisting expenses is likely to improve Timken's profitability in the near term.
- ▲ 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's acquisition of BEKA Lubrication strengthened 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.
- ▲ The company continues to drive margin improvement and cost synergies through integrating the Diamond Chain and BEKA business. In 2019, the company has implemented annualized cost synergies of more than \$3 million through the Diamond Chain buyout. In sync with Timken's cost-reduction and productivity initiatives, it recently announced the relocation and consolidation of Diamond Chain operation into existing operations.
- ▲ 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 \$400 million in 2020, backed by improved working capital performance. The company continues to mitigate tariff impact through pricing initiatives.

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

Reasons To Sell:

- ▼ Timken now expects 2020 adjusted earnings per share between \$4.25 and \$4.65. The mid-point of the guidance suggests year-over-year decline of 3%, due to lower organic revenue and unfavorable mix, along with a slightly higher tax rate. 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. Moreover, the coronavirus outbreak is likely to dent the company's results.
- ▼ Mobile Industries 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 also expects to incur higher costs related to manufacturing footprint initiatives. 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.
- ▼ 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. Further, Diamond and BEKA businesses have been affected by the industrial market slowdown due to the heavier North American concentration of the sales.

Timken's near-term results will be hurt by sluggish off-highway and heavy truck markets. Also, higher inventory, weakness in order intake rate and currency fluctuations are concerns.

Last Earnings Report

Timken's Q4 Earnings Miss Estimates, Revenues Beat

Timken reported fourth-quarter 2019 adjusted earnings per share of 84 cents, which fell short of the Zacks Consensus Estimate of 95 cents. The reported figure declined 16% from \$1.00 per share in the prior-year quarter. Lower volumes, and higher manufacturing and SG&A costs, partially offset by positive pricing and lower material and logistics costs, led to the overall decline in the company's earnings.

On a reported basis, Timken delivered earnings per share of \$1.48 in the fourth quarter compared with the prior-year quarter's 77 cents.

Total revenues in the quarter came in at \$896 million, down 1.5% from the year-ago quarter due to lower demand, mainly in the Mobile Industries segment, and unfavorable currency, partially offset by the favorable impact of acquisitions and pricing. The top-line figure, however, beat the Zacks Consensus Estimate of \$884 million.

Costs and Margins

Cost of sales was down 2% to \$640 million from the prior-year quarter. Gross profit inched up 1% year over year to \$256 million. Gross margin came in at 28.6% compared with 28.0% in the year-ago quarter.

Selling, general and administrative expenses flared up 7% to \$159 million from \$148 million in the prior-year quarter. Operating profit decreased 9% year over year to \$97 million. Operating margin came in at 10.8% compared with 11.7% in the comparable period last year. Adjusted EBITDA declined 10.5% year over year to \$145.8 million.

Segmental Performance

The Mobile Industries segment revenues decreased to \$445 million from \$462 million in the year-ago quarter. This downside mainly resulted from lower shipments in off-highway and heavy trucks, partly offset by the benefit of acquisitions and growth in rail and aerospace sectors. The segment's adjusted EBITDA declined 7% year over year to \$60.3 million.

The Process Industries segment revenues increased 1% year over year to \$451 million in the quarter, aided by acquisitions and growth in the renewable energy sector. This was partly muted by lower revenues recorded in industrial and marine sectors as well as unfavorable currency-translation impact. The segment's adjusted EBITDA dipped 10% year over year to \$98.3 million.

Financial Position

Timken generated free cash flow of \$410 million in 2019 compared with \$220 million in the prior year. Cash flow from operations came in at \$550 million in 2019 compared with \$333 million witnessed in the previous year.

During the year, the company returned \$148 million of capital to shareholders through \$85 million of dividend payouts and \$63 million in share repurchases.

2019 Results

Timken reported adjusted earnings per share of \$4.60 in 2019, up 10% from the previous year's \$4.18. Earnings missed the Zacks Consensus Estimate of \$4.72. Including one-time items, the bottom line came in at \$4.71, up 22% from \$3.86 in 2018.

Sales rose 6% year over year to around \$3.8 billion from the prior-year figure of \$3.6 billion. The top line came in line with the Zacks Consensus Estimate.

Significant Acquisitions

In 2019, Timken completed the acquisition of BEKA Lubrication for \$165 million. This buyout makes Timken the world's second-largest producer of industrial automatic lubrication systems. It has also enhanced the company's position in lucrative markets such as wind, and food and beverage.

Timken also acquired Diamond Chain during 2019. Diamond Chain is a leading supplier of high-performance roller chains and serves a diverse range of market sectors. 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.

Guidance

For 2020, Timken now expects total revenues in the range of down 2% to up 2% from 2019. The guidance factors in acquisition benefits along with unfavorable currency translation and expected organic declines in Mobile Industries. For the full year, the company anticipates adjusted earnings per share of \$4.25 to \$4.65. The midpoint of the guidance reflects a year-over-year drop of 3%.

Quarter Ending **12/2019**

Report Date	Feb 05, 2020
Sales Surprise	1.43%
EPS Surprise	-11.58%
Quarterly EPS	0.84
Annual EPS (TTM)	4.60

Valuation

Timken's shares are down 29.7% over the trailing 12-month period. Stocks in the Zacks Metal Products – Procurement and Fabrication industry and Industrial Products sector are down 37.7% and 29.3% over the past year, respectively.

The S&P 500 index has lost 14.1% in the past year.

The stock is currently trading at 7.27X forward 12-month earnings, which compares to 7.16X for the Zacks sub-industry, 15.21X for the Zacks sector and 15.73X 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 13.64X.

Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$35 price target reflects 7.70X 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	7.27	7.16	15.21	15.73
	5-Year High	22.22	20.35	19.93	19.34
	5-Year Low	5.37	6.67	12.55	15.19
	5-Year Median	13.64	13.1	16.47	17.44
P/S F12M	Current	0.66	1.13	2.11	2.72
	5-Year High	1.44	2.44	2.72	3.44
	5-Year Low	0.48	0.66	1.52	2.54
	5-Year Median	0.97	1.1	1.99	3
EV/EBITDA TTM	Current	6.25	5.71	13.19	9.1
	5-Year High	29.54	19.17	17.37	12.87
	5-Year Low	5.22	5.26	10.71	8.27
	5-Year Median	8.77	10.79	14.75	10.78

As of 04/06/2020

Industry Analysis Zacks Industry Rank: Bottom 24% (192 out of 253)



Top Peers

Altra Industrial Motion Corp. (AIMC)	Neutral
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
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	B	-	-	D	B	F
Market Cap	2.50 B	277.73 M	18.06 B	1.82 B	2.66 B	2.95 B
# of Analysts	6	2	13	6	5	3
Dividend Yield	3.39%	0.00%	2.34%	3.64%	1.83%	0.00%
Value Score	B	-	-	C	A	F
Cash/Price	0.10	0.18	0.06	0.07	0.14	0.02
EV/EBITDA	5.68	4.80	11.15	5.14	7.16	18.07
PEG Ratio	1.12	2.04	1.87	4.15	1.22	NA
Price/Book (P/B)	1.27	0.97	2.46	1.35	1.13	2.73
Price/Cash Flow (P/CF)	4.84	5.01	9.59	4.97	7.32	19.43
P/E (F1)	9.49	9.19	15.66	20.75	12.22	22.94
Price/Sales (P/S)	0.66	0.60	1.92	0.82	0.82	4.07
Earnings Yield	10.96%	10.80%	6.30%	4.83%	8.19%	4.36%
Debt/Equity	0.88	0.41	0.70	0.47	0.50	0.04
Cash Flow (\$/share)	6.83	2.56	7.01	4.42	8.94	6.05
Growth Score	B	-	-	D	B	C
Hist. EPS Growth (3-5 yrs)	20.28%	5.64%	10.92%	17.42%	5.54%	15.01%
Proj. EPS Growth (F1/F0)	-21.27%	-11.33%	0.33%	-64.96%	-2.44%	0.79%
Curr. Cash Flow Growth	8.64%	-2.67%	5.93%	10.92%	-9.82%	21.08%
Hist. Cash Flow Growth (3-5 yrs)	6.82%	3.93%	8.55%	2.02%	1.95%	14.85%
Current Ratio	2.54	2.52	1.24	2.53	2.87	5.60
Debt/Capital	46.80%	29.19%	42.36%	31.85%	33.29%	3.50%
Net Margin	9.55%	0.23%	11.64%	5.89%	7.38%	17.09%
Return on Equity	19.49%	4.75%	16.74%	11.97%	9.69%	12.35%
Sales/Assets	0.81	0.90	0.54	0.85	0.71	0.60
Proj. Sales Growth (F1/F0)	-7.53%	-4.02%	1.00%	-13.97%	-6.10%	0.71%
Momentum Score	D	-	-	F	F	F
Daily Price Chg	12.92%	4.31%	7.93%	17.18%	13.17%	4.65%
1 Week Price Chg	-8.65%	-2.93%	-4.40%	4.28%	-2.33%	2.18%
4 Week Price Chg	-9.43%	-9.29%	-6.89%	3.68%	-3.49%	-19.27%
12 Week Price Chg	-42.74%	-30.78%	-24.81%	-38.63%	-24.76%	-30.24%
52 Week Price Chg	-29.71%	-40.19%	-17.63%	-45.75%	-23.14%	-9.52%
20 Day Average Volume	901,899	140,815	4,147,873	1,536,534	340,707	216,483
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	-4.63%	0.00%
(F1) EPS Est 4 week change	-18.61%	-13.13%	-4.97%	-19.42%	-7.91%	-7.90%
(F1) EPS Est 12 week change	-21.35%	-13.02%	-6.79%	-40.54%	-6.33%	-9.22%
(Q1) EPS Est Mthly Chg	-41.34%	-12.50%	-7.32%	-47.57%	-24.48%	-31.01%

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	B
Momentum Score	D
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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