

Woodward, Inc. (WWD)

\$127.84 (As of 01/13/20)

Price Target (6-12 Months): **\$134.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 11/19/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:C

Value: C

Growth: B

Momentum: F

Summary

Woodward has been investing significantly in technologies to secure new businesses. The company is witnessing healthy momentum in Aerospace and Industrial segment, backed by solid global passenger and cargo growth coupled with distributed power for data center applications. Global uncertainty continues to augment defense activity, which in turn is likely to boost Woodward's top line. However, the company faces intense competition from major players in the United States and abroad. It witnesses demand-related challenges in the industrial gas and turbine market due to higher penetration and greater energy efficiency of renewables. Availability of new products and services, introduction of new channels of distribution and changes in OEM and aftermarket pricing might hamper its relationship with clients and affect sales.

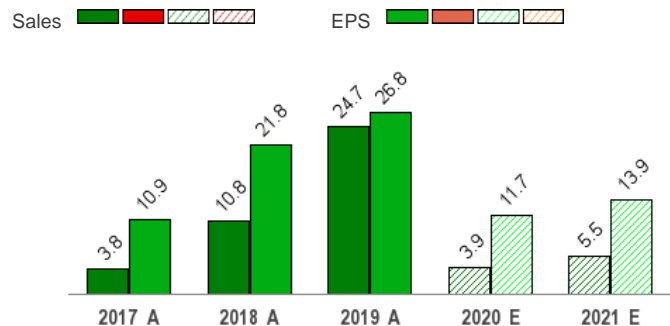
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$129.06 - \$75.10
20 Day Average Volume (sh)	391,755
Market Cap	\$7.9 B
YTD Price Change	7.9%
Beta	1.31
Dividend / Div Yld	\$0.65 / 0.5%
Industry	Instruments - Control
Zacks Industry Rank	Bottom 15% (215 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-5.4%
Last Sales Surprise	-0.5%
EPS F1 Est- 4 week change	-1.3%
Expected Report Date	01/27/2020
Earnings ESP	0.0%
P/E TTM	26.2
P/E F1	23.5
PEG F1	1.8
P/S TTM	2.7

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					3,177 E
2020	667 E	771 E	783 E	791 E	3,012 E
2019	653 A	759 A	752 A	737 A	2,900 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021					\$6.21 E
2020	\$1.03 E	\$1.37 E	\$1.47 E	\$1.56 E	\$5.45 E
2019	\$0.96 A	\$1.40 A	\$1.30 A	\$1.22 A	\$4.88 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 01/13/2020. The reports text is as of 01/14/2020.

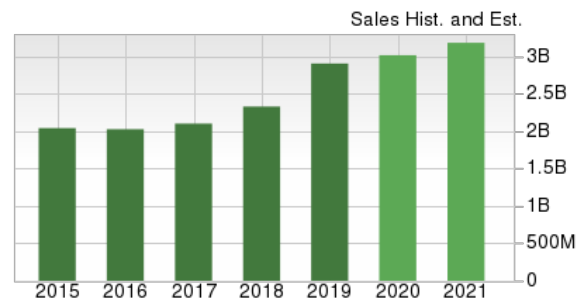
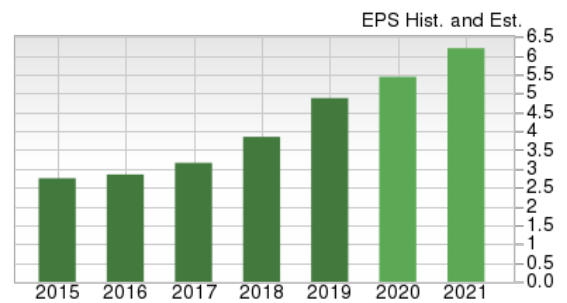
Overview

Headquartered in Fort Collins, CO, Woodward, Inc. is an independent designer, manufacturer and service provider of energy control and optimization solutions. The company provides a wide array of products for fuel, combustion, fluid, actuation and electronic applications, which serve the commercial aerospace, business jet, military and energy markets. Apart from serving Original Equipment Manufacturers (OEMs), it also engages in aftermarket repairs, replacements and other service support operations.

Woodward serves the aerospace and energy markets through two reportable segments: Aerospace and Industrial. Both segments have multiple business groups under them.

The Aerospace segment consists of the Aircraft Turbine Systems and the Airframe Systems business groups. This segment is mainly involved in the production, designing and servicing of products for the management of fuel, air, combustion and motion. The products developed at this segment, including pumps, cockpit controls, motors and sensors, are used by commercial aircraft manufacturers like The Boeing Company and General Dynamics Corp. They are also used in military aircraft and defense systems. This segment generated revenues of \$505.9 million in fourth-quarter fiscal 2019, representing 68.7% of total revenues.

The Industrial segment consists of the Industrial Turbo Machinery Systems, and the Engine Systems and Electrical Power Systems business groups. This segment produces power converters, ignition systems and injectors among others and generates revenues mainly from OEMs through aftermarket sales. This segment generated revenues of \$230.6 million in fourth-quarter fiscal 2019, representing 31.3% of total revenues.



Reasons To Buy:

- ▲ Backed by solid performance at the Aerospace segment and steady improvements at the Industrial segment, Woodward has issued a bullish outlook for fiscal 2020. The company expects total net sales to be in the range of \$3-\$3.1 billion, with about a 6% rise in Aerospace sales. Adjusted earnings per share are anticipated between \$5.30 and \$5.60, based on around 64 million outstanding shares. Its Aerospace segment is expected to deliver strong performance, driven by healthy global passenger and cargo growth. In the Industrial markets, while the industrial turbine market remains uncertain, the company is witnessing robust growth in distributed power for data center applications. Woodward L'Orange is likely to continue to enhance its Industrial segment with respect to both sales and earnings. It is well positioned to capitalize on the near-term production ramp-up along with opportunities that lies ahead.
- ▲ Woodward has been investing significantly in technologies in order to secure fresh businesses. It is spending on new manufacturing units and automation equipment to perk up efficiency as the company intends to accelerate production. Woodward continues to focus on diversifying its revenue stream. Its strategic plan to become a systems integrator has increased contract flow substantially enabling it to capture a larger market share in the wide-body commercial aircraft field. Notably, the commercial aerospace market is expanding substantially, driven by record passenger and cargo traffic and ongoing elevated load factors. Increased production in this space has been observed as aircraft operators continue to take delivery of new aircraft models that are more fuel efficient and retire older. Driven by the strong demand for smart weapons, it is witnessing continued increase in defense sales that's coming from both domestic as well as foreign military sales.
- ▲ Woodward's Aerospace business continues to perform well with production increases in the Airbus A320neo driving significant growth in commercial OEM sales. Momentum within its defense OEM business also remained strong, supported by guided weapon sales as well as fixed-wing, rotorcraft and ground programs. The acquisition of L'Orange — a supplier of fuel injection systems for industrial diesel, heavy fuel oil and dual-fuel — in June 2018 has expanded its footprint in the OEM market. The buyout enhanced Woodward's product portfolio as well as extended its presence in key end markets. In the last reported quarter, Woodward's Aerospace sales improved 9.7% buoyed by strength across commercial OEM and military markets. The company has been shifting resources from its industrial market to support new activity in aerospace. Overall, the aerospace industry is reflecting solid growth prospects driven by continued improvement in the business jet and rotorcraft markets. Also, global uncertainty continues to drive increased defense activity, which in turn will likely boost Woodward's top line.

Woodward has issued its outlook for fiscal 2020 and remains well positioned to capitalize on the near-term production ramp-up along with other potential growth opportunities that lies ahead.

Reasons To Sell:

- ▼ Within the power generation market, Woodward is witnessing demand-related challenges in the industrial gas and turbine market as well as a drop in volume tied to renewables penetration and greater energy efficiency. The weakness in the company's renewables business is due to the short-term unfavorable impact of platform transitions by some of its customers. With no notable improvement expected in these aspects before 2020, Woodward is projected to perform poorly in power generation market.
- ▼ Woodward has a significant presence in the commercial aerospace market, which is cyclical in nature. It also faces intense competition from a number of major players in the United States and abroad. Changes in competitive conditions, including factors like the availability of new products and services, introduction of new channels of distribution and changes in OEM and aftermarket pricing will likely hamper its association with clients and affect sales. For the near term, it expects softness in the regional aircraft.
- ▼ Woodward caters to fewer customers compared to companies with similar sales volume. Approximately 45% of the company's annual consolidated net sales come from its five largest customers. Therefore, loss of any one of its significant customers will have a material impact on its operational results. Woodward also faces the risk of third-party payments, which may hamper credit availability for further product offerings. Moreover, as the company caters to international customers, it is subject to risks arising from fluctuations in foreign exchange rates.
- ▼ In the last reported quarter, Woodward's Industrial sales declined 10.7% due to the weak demand for natural gas trucks in China, compliance of China V trucks for the implementation of China VI emission regulations and the impact of Servion bankruptcy on renewables business. This is likely to be a nagging concern with soft economic growth in the communist nation.

Woodward is likely to face challenges in the power generation market due to short-term headwinds. Softness in the regional aircraft business remains another concern.

Last Earnings Report

Woodward Q4 Earnings Miss Estimates, Revenues Up Y/Y

Woodward reported mixed fourth-quarter fiscal 2019 financial results, wherein earnings declined year over year but revenues jumped. The company's performance was primarily driven by strong product portfolios and healthy market fundamentals in Aerospace and Industrial segments. However, customer bankruptcy in the renewables business was on the downside.

Net Earnings

On a GAAP basis, net earnings for the fiscal fourth quarter were \$66.8 million or \$1.03 per share compared with \$74.5 million or \$1.16 per share in the year-ago quarter. The year-over-year decline despite top-line growth was attributable to higher operating costs and income tax expense.

Adjusted net earnings for the fiscal fourth quarter came in at \$78.7 million or \$1.22 per share compared with \$89.1 million or \$1.39 per share in the year-ago quarter. The bottom line missed the Zacks Consensus Estimate by 7 cents.

Net earnings for fiscal 2019 were \$259.6 million or \$4.02 per share compared with \$180.4 million or \$2.82 per share a year ago. The improvement was primarily due to top-line growth.

Revenues

For the September quarter, net sales increased 2.4% year over year to \$736.5 million, which reflect healthy market fundamentals in Aerospace and Industrial segments, partly offset by headwinds from the 737 MAX grounding and impact of a significant customer bankruptcy in the renewables business. The top line lagged the consensus estimate of \$740 million.

Net sales for fiscal 2019 came in at \$2,900.2 million, an increase of 24.7% from fiscal 2018. Organic net sales, which exclude sales attributable to Woodward L'Orange, were \$2.6 billion in fiscal 2019, up 16% from \$2.2 billion in fiscal 2018.

Segment Results

Aerospace: Net sales were up 9.7% year over year to \$505.9 million, benefiting from strength across commercial OEM and military market, partly offset by 737 MAX grounding. The segment continues to benefit from higher defense spending and increased aircraft content as narrowbody production rises. The segment's earnings were \$111.3 million, up from \$104.8 million in the year-ago quarter primarily due to higher sales volume, partially offset by increased capacity expansion costs.

Industrial: Net sales totaled \$230.6 million, down 10.7% due to the reduced demand for natural gas trucks in China, compliance of China V trucks for the implementation of China VI emission regulations and the impact of Servion bankruptcy on renewables business. The segment's earnings increased to \$11 million from \$8.5 million.

Cash Flow & Liquidity

For fiscal 2019, Woodward generated \$390.6 million of net cash from operating activities compared with \$299.3 million a year ago. For the same period, free cash flow was \$291.5 million, up from \$172.2 million, primarily driven by higher earnings and lower capital expenditures.

As of Sep 30, 2019, the company had \$99.1 million in cash and equivalents with \$864.9 million of long-term debt (less current portion) compared with the respective tallies of \$83.6 million and \$1,092.4 million a year ago.

Fiscal 2020 Outlook

Woodward has provided outlook for fiscal 2020. The company expects total net sales to be in the range of \$3-\$3.1 billion, with about 6% rise in Aerospace sales. Industrial sales are anticipated to be flat year over year.

Adjusted earnings per share are anticipated between \$5.30 and \$5.60, based on around 64 million outstanding shares. While free cash flow is expected to be approximately \$400 million, effective tax rate is likely to be 22%.

Quarter Ending **09/2019**

Report Date	Nov 18, 2019
Sales Surprise	-0.49%
EPS Surprise	-5.43%
Quarterly EPS	1.22
Annual EPS (TTM)	4.88

Recent News

On Jan 12, 2020, Woodward announced that it has inked a deal to merge with Hexcel Corporation for a whopping \$6.4 billion. This all-stock merger of equals comes as a relief to aircraft component suppliers that suffered setbacks due to the halt in production of The Boeing Company's BA 737 MAX. Per the deal, Hexcel shareholders will be entitled to receive 0.625 share of Woodward stock for every share they own whereas Woodward investors will possess the same number of shares as they owned before the transaction. While Hexcel shareholders will own 45% of the combined entity dubbed Woodward Hexcel, that of Woodward will have an ownership stake of 55%.

Valuation

Woodward shares are up 68.6% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Computer and Technology sector are up 30.8% and 32% over the past year, respectively.

The S&P 500 index is up 24.2% in the past year.

The stock is currently trading at 16.01X trailing 12-month EV/EBITDA, which compares to 12.73X for the Zacks sub-industry, 12.41X for the Zacks sector and 12.12X for the S&P 500 index.

Over the past five years, the stock has traded as high as 18.7X and as low as 9.8X, with a 5-year median of 14.3X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$134 price target reflects 5.94X forward 12-month earnings.

The table below shows summary valuation data for WWD

Valuation Multiples - WWD					
		Stock	Sub-Industry	Sector	S&P 500
EV/EBITDA TTM	Current	16.01	12.73	12.41	12.12
	5-Year High	18.67	14.12	12.6	12.86
	5-Year Low	9.84	9.77	7.68	8.48
	5-Year Median	14.26	11.65	10.52	10.67
P/E F12M	Current	22.57	17.97	22.65	18.87
	5-Year High	25.73	18.35	22.65	19.34
	5-Year Low	12.93	13.12	16.87	15.17
	5-Year Median	18.98	15.74	19.24	17.44
P/S F12M	Current	2.59	2.42	3.65	3.5
	5-Year High	2.59	2.42	3.65	3.5
	5-Year Low	1.19	1.53	2.3	2.54
	5-Year Median	1.9	2.03	3.01	3

As of 01/13/2020

Industry Analysis Zacks Industry Rank: Bottom 15% (215 out of 254)



Top Peers

Allied Motion Technologies, Inc. (AMOT)	Neutral
Badger Meter, Inc. (BMI)	Neutral
Roper Technologies, Inc. (ROP)	Neutral
Thermon Group Holdings, Inc. (THR)	Neutral
Transcat, Inc. (TRNS)	Neutral
Watts Water Technologies, Inc. (WTS)	Neutral
Xylem Inc. (XYL)	Neutral
Sensata Technologies Holding N.V. (ST)	Underperform

Industry Comparison Industry: Instruments - Control				Industry Peers		
	WWD Neutral	X Industry	S&P 500	BMI Neutral	ST Underperform	WTS Neutral
VGM Score	C	-	-	B	B	B
Market Cap	7.93 B	464.16 M	24.31 B	1.85 B	8.27 B	3.39 B
# of Analysts	5	2	13	2	7	7
Dividend Yield	0.51%	0.00%	1.76%	1.07%	0.00%	0.92%
Value Score	C	-	-	D	B	C
Cash/Price	0.01	0.05	0.04	0.02	0.09	0.05
EV/EBITDA	17.16	15.03	14.12	29.54	11.57	14.42
PEG Ratio	1.77	2.10	2.05	NA	1.22	2.90
Price/Book (P/B)	4.58	3.39	3.34	5.71	3.18	3.60
Price/Cash Flow (P/CF)	17.32	17.07	13.66	26.71	10.23	19.22
P/E (F1)	22.80	23.24	18.82	36.10	14.31	23.24
Price/Sales (P/S)	2.73	1.96	2.64	4.39	2.39	2.13
Earnings Yield	4.26%	4.30%	5.29%	2.77%	7.00%	4.30%
Debt/Equity	0.50	0.36	0.72	0.00	1.25	0.25
Cash Flow (\$/share)	7.38	2.28	6.94	2.38	5.09	5.20
Growth Score	B	-	-	B	C	B
Hist. EPS Growth (3-5 yrs)	14.30%	10.56%	10.56%	11.40%	9.72%	12.50%
Proj. EPS Growth (F1/F0)	11.60%	10.44%	7.49%	8.64%	2.83%	6.27%
Curr. Cash Flow Growth	26.08%	18.54%	14.83%	17.43%	5.54%	13.26%
Hist. Cash Flow Growth (3-5 yrs)	13.42%	7.68%	9.00%	12.69%	8.71%	6.66%
Current Ratio	1.80	3.20	1.23	3.26	3.14	1.80
Debt/Capital	33.37%	25.79%	42.99%	0.00%	55.52%	20.20%
Net Margin	8.95%	6.96%	11.08%	10.95%	14.00%	8.11%
Return on Equity	18.62%	14.78%	17.16%	14.85%	22.78%	14.70%
Sales/Assets	0.73	0.84	0.55	1.04	0.51	0.95
Proj. Sales Growth (F1/F0)	3.84%	2.91%	4.23%	4.61%	0.18%	2.62%
Momentum Score	F	-	-	A	B	C
Daily Price Chg	4.82%	1.21%	0.73%	0.83%	1.09%	1.61%
1 Week Price Chg	1.96%	-1.04%	0.39%	-1.35%	-4.10%	-1.89%
4 Week Price Chg	4.36%	0.73%	1.84%	-0.08%	-1.29%	1.45%
12 Week Price Chg	20.37%	7.97%	6.48%	9.12%	2.06%	8.83%
52 Week Price Chg	68.76%	16.50%	23.15%	25.06%	15.01%	42.65%
20 Day Average Volume	391,755	50,481	1,578,594	156,500	569,692	113,255
(F1) EPS Est 1 week change	-1.27%	0.00%	0.00%	0.00%	-0.73%	0.00%
(F1) EPS Est 4 week change	-1.27%	0.00%	0.00%	0.00%	-1.14%	-0.41%
(F1) EPS Est 12 week change	-1.24%	0.32%	-0.48%	7.10%	-8.91%	0.32%
(Q1) EPS Est Mthly Chg	-3.26%	-0.50%	0.00%	NA	-0.96%	-0.50%

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	C
Growth Score	B
Momentum Score	F
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.

Disclosures

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