

Woodward, Inc. (WWD)

\$56.66 (As of 03/19/20)

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

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: B

Growth: C

Momentum: D

Summary

Woodward continues to witness healthy momentum in Aerospace segment, backed by strong flight utilization trends, sustained global passenger growth and higher defense spending. Its merger with Hexcel is expected to upgrade the overall financial health of both companies with scalability in operational activities in 2020. Woodward continues to focus on diversifying its revenue stream. Its strategic plan to become a systems integrator has increased contract flow substantially. However, it witnesses demand-related challenges in the industrial gas and turbine market due to higher penetration and greater energy efficiency of renewables. Industrial segment faces headwinds due to reduced inventory management and aftermarket activity. Availability of new products and services, and changes in OEM might hamper its relationship with clients and affect sales.

Data Overview

52 Week High-Low	\$129.06 - \$51.40
20 Day Average Volume (sh)	1,114,733
Market Cap	\$3.5 B
YTD Price Change	-52.2%
Beta	1.29
Dividend / Div Yld	\$1.12 / 2.0%
Industry	Instruments - Control
Zacks Industry Rank	Bottom 5% (242 out of 254)

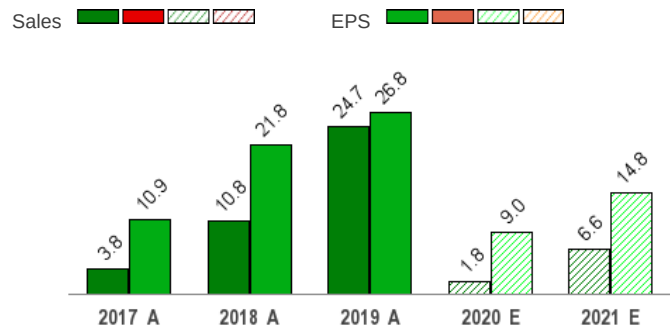
Last EPS Surprise	6.8%
Last Sales Surprise	8.0%
EPS F1 Est- 4 week change	-1.8%
Expected Report Date	05/04/2020
Earnings ESP	-22.2%

P/E TTM	11.3
P/E F1	10.7
PEG F1	0.8
P/S TTM	1.2

Price, Consensus & Surprise



Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					3,145 E
2020	720 A	745 E	742 E	753 E	2,951 E
2019	653 A	759 A	752 A	737 A	2,900 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021					\$6.11 E
2020	\$1.10 A	\$1.29 E	\$1.34 E	\$1.50 E	\$5.32 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 03/19/2020. The reports text is as of 03/20/2020.

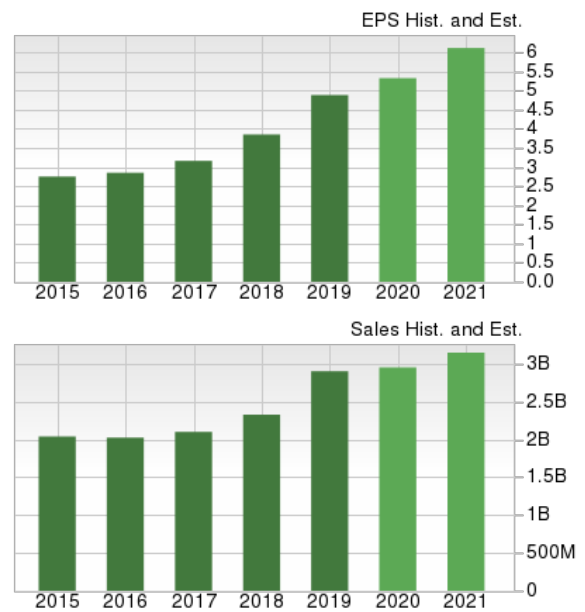
Overview

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 \$473.9 million in first-quarter fiscal 2020, representing 65.8% 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 \$246.4 million in first-quarter fiscal 2020, representing 34.2% of total revenues.



Reasons To Buy:

- ▲ Backed by solid performance of its Aerospace segment, Woodward has updated outlook for fiscal 2020 to better reflect the expected bearings of lower tax rate, renewables portfolio divestiture, halted production of 737 MAX, higher outstanding shares and weak sales performance of oil and gas sectors. The company expects total net sales to be in the range of \$2.9-\$3 billion. Aerospace sales are projected to be up low single digits compared with earlier guidance of 6% rise. Adjusted earnings per share are anticipated to be between \$5.22 and \$5.52, based on around 65 million outstanding shares. Despite Boeing's 737 MAX grounding, its Aerospace segment is expected to deliver strong performance, driven by strong flight utilization trends, sustained global passenger growth and higher defense spending. 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 from broad-based sales growth across commercial OEM and defense aftermarket. 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 20.6% 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's all-stock \$6.4 billion merger deal with Hexcel is anticipated to generate nearly \$1 billion of free cash flow in fiscal 2020. Expected to close in the third quarter of 2020, the tax-exempted merger will upgrade the overall financial health of both companies with a perfect combination of growth trajectories, complementary cultures and scalability in operational activities.

Woodward has updated 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 5.2%, as softness in oil and gas resulted in reduced inventory management and aftermarket activity. Furthermore, Woodward's plan to divest its renewable power systems to Aurelia Group for \$23.4 million is expected to reduce sales by \$45 million to \$50 million for fiscal 2020.

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 Q1 Earnings Beat Estimates, Revenues Up Y/Y

Woodward reported strong first-quarter fiscal 2020 results, wherein earnings and revenues jumped year over year. The company's performance was primarily driven by healthy market fundamentals in the Aerospace segment and strong product portfolios.

Net Earnings

On a GAAP basis, net earnings in the fiscal first quarter were \$53.4 million or 83 cents per share compared with \$49.1 million or 77 cents per share in the year-ago quarter. The year-over-year increase was mainly driven by top-line growth and reduced income tax expenses.

Adjusted net earnings in the fiscal first quarter were \$71.2 million or \$1.10 per share compared with \$61.6 million or 96 cents per share in the year-ago quarter. The bottom line surpassed the Zacks Consensus Estimate by 7 cents.

Revenues

In the December quarter, net sales increased 10.3% year over year to \$720.4 million, which reflect healthy market momentum in Aerospace segment, partly offset by headwinds from the halted production schedule of The Boeing Company's (BA) 737 MAX aircraft. The top line outperformed the consensus estimate of \$667 million.

Segment Results

Aerospace: Net sales were up 20.6% year over year to \$473.9 million, benefiting from broad-based sales growth across commercial OEM and defense aftermarket. Despite 737 MAX grounding, the segment continues to benefit from strong flight utilization trends, sustained global passenger growth, higher defense spending coupled with increased demand for aircraft content as narrowbody production ramps. The segment's earnings were \$92.9 million, up 27.5% from \$72.9 million in the year-ago quarter, primarily due to higher sales volume.

Industrial: Net sales totaled \$246.4 million, down 5.2% as softness in oil and gas resulted in reduced inventory management and aftermarket activity. However, it was partially offset by higher sales in renewable business. The segment's earnings were \$28.2 million, down 3.2% from \$29.2 million in the year-ago quarter mainly due to lower sales volume.

Notably, from the perspective of resource allocation and capital investment, renewables portfolio was not a primary focus area for Woodward in this quarter. Instead, the company is streamlining its power generation business with the proposed sale of renewable power systems to Aurelia Group for \$23.4 million. The transaction, announced in February 2020, is anticipated to close in the third quarter of the current fiscal.

Cash Flow & Liquidity

In the first three months of fiscal 2020, Woodward generated \$27.4 million of net cash from operating activities compared with \$84.7 million in the year-ago quarter. In the same period, free cash flow was \$10.2 million, down from \$53.4 million, primarily attributable to higher working capital. As of Dec 31, 2019, the company had \$148 million in cash and equivalents with \$729.2 million of long-term debt (less current portion).

Significant Development

Subsequent to the quarter end, Woodward inked an all-stock 6.4 billion merger deal with Hexcel Corporation. Per the deal, Hexcel shareholders will own 45% of the combined entity, and that of Woodward will have an ownership stake of 55%. Projected to generate nearly \$1 billion of free cash flow in fiscal 2020, the tax-exempted merger is expected to upgrade the overall financial health of both companies with a perfect combination of growth trajectories, complementary cultures and scalability in operational activities. The transaction is expected to close in the third quarter of 2020.

Updated Fiscal 2020 Guidance

Woodward has updated outlook for fiscal 2020 to better reflect the expected bearings of lower tax rate, renewables portfolio divestiture, halted production of 737 MAX, higher outstanding shares and weak sales performance of oil and gas sectors. The company expects total net sales to be in the range of \$2.9-\$3 billion compared with the previous guidance of \$3-\$3.1 billion. Aerospace sales are projected to be up low single digits compared with earlier guidance of 6% rise. In line with the previous guidance, Industrial sales are anticipated to be flat year over year.

Adjusted earnings per share are anticipated to be between \$5.22 and \$5.52, based on around 65 million outstanding shares compared with the prior guidance of \$5.30-\$5.60, based on 64 million outstanding shares. Adjusted free cash flow is expected to be approximately \$420 million. The effective tax rate is likely to be 20% compared with the preceding guidance of 22%.

Quarter Ending **12/2019**

Report Date	Feb 03, 2020
Sales Surprise	7.97%
EPS Surprise	6.80%
Quarterly EPS	1.10
Annual EPS (TTM)	5.02

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 down 40.9% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Computer and Technology sector are down 34.1% and 10.1% over the past year, respectively.

The S&P 500 index is down 15.8% in the past year.

The stock is currently trading at 7.61X trailing 12-month EV/EBITDA, which compares to 6.94X for the Zacks sub-industry, 9.32X for the Zacks sector and 8.87X for the S&P 500 index.

Over the past five years, the stock has traded as high as 19.1X and as low as 7.5X, with a 5-year median of 14.3X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$60 price target reflects 6.07X 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	7.61	6.94	9.32	8.87
	5-Year High	19.12	14.15	12.84	12.88
	5-Year Low	7.49	6.94	7.6	8.31
	5-Year Median	14.26	11.55	10.6	10.79
P/E F12M	Current	9.88	10.44	16.37	14.12
	5-Year High	25.73	18.35	22.01	19.34
	5-Year Low	9.7	10.44	16.37	14.12
	5-Year Median	19.13	15.72	19.3	17.42
P/S F12M	Current	1.16	1.39	2.72	2.58
	5-Year High	2.59	2.42	3.58	3.43
	5-Year Low	1.14	1.39	2.3	2.54
	5-Year Median	1.92	2.03	3.02	3

As of 03/19/2020

Industry Analysis Zacks Industry Rank: Bottom 5% (242 out of 254)



Top Peers

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

Industry Comparison Industry: Instruments - Control				Industry Peers		
	WWD Neutral	X Industry	S&P 500	BMI Neutral	ST Neutral	WTS Neutral
VGM Score	C	-	-	C	B	B
Market Cap	3.53 B	192.20 M	16.45 B	1.47 B	4.08 B	2.56 B
# of Analysts	5	2	13	3	7	7
Dividend Yield	1.98%	0.00%	2.67%	1.35%	0.00%	1.22%
Value Score	B	-	-	D	B	C
Cash/Price	0.03	0.07	0.06	0.03	0.14	0.07
EV/EBITDA	8.11	8.07	10.36	16.52	8.04	10.40
PEG Ratio	0.82	1.09	1.49	NA	0.71	2.20
Price/Book (P/B)	1.95	1.62	2.16	4.44	1.60	2.62
Price/Cash Flow (P/CF)	7.68	10.51	8.92	20.60	4.88	13.79
P/E (F1)	10.55	15.38	13.12	28.73	7.80	17.62
Price/Sales (P/S)	1.19	1.19	1.72	3.46	1.18	1.60
Earnings Yield	9.39%	6.50%	7.54%	3.49%	12.84%	5.67%
Debt/Equity	0.41	0.30	0.70	0.00	1.26	0.21
Cash Flow (\$/share)	7.38	2.31	7.01	2.45	5.30	5.48
Growth Score	C	-	-	A	C	A
Hist. EPS Growth (3-5 yrs)	15.72%	10.84%	10.85%	12.63%	9.05%	13.50%
Proj. EPS Growth (F1/F0)	9.06%	6.38%	4.90%	9.11%	-6.86%	5.44%
Curr. Cash Flow Growth	26.08%	12.11%	6.03%	3.00%	-3.40%	5.03%
Hist. Cash Flow Growth (3-5 yrs)	13.42%	6.08%	8.55%	8.54%	5.87%	6.29%
Current Ratio	1.68	3.30	1.23	3.50	3.10	1.75
Debt/Capital	28.85%	22.59%	42.57%	0.00%	55.80%	17.27%
Net Margin	8.89%	6.74%	11.57%	11.11%	8.19%	8.22%
Return on Equity	18.72%	14.77%	16.74%	14.74%	22.24%	14.80%
Sales/Assets	0.74	0.84	0.54	1.03	0.51	0.94
Proj. Sales Growth (F1/F0)	1.73%	1.91%	3.13%	4.64%	-1.92%	2.09%
Momentum Score	D	-	-	C	C	D
Daily Price Chg	2.00%	-0.02%	1.03%	-1.00%	11.90%	-0.53%
1 Week Price Chg	-20.59%	-12.36%	-11.01%	-13.12%	-9.81%	-8.13%
4 Week Price Chg	-53.20%	-27.70%	-33.45%	-28.55%	-46.52%	-29.17%
12 Week Price Chg	-52.25%	-28.12%	-30.67%	-23.55%	-52.00%	-24.19%
52 Week Price Chg	-41.69%	-21.68%	-23.69%	-12.44%	-45.00%	-6.72%
20 Day Average Volume	1,114,733	141,303	3,981,936	282,489	1,731,401	227,342
(F1) EPS Est 1 week change	-1.44%	-0.46%	-0.01%	0.00%	-4.41%	-0.46%
(F1) EPS Est 4 week change	-1.81%	-0.46%	-0.85%	0.00%	-5.19%	-0.46%
(F1) EPS Est 12 week change	-3.53%	-6.42%	-1.70%	-0.19%	-9.47%	-0.29%
(Q1) EPS Est Mthly Chg	-2.58%	-0.55%	-0.88%	0.00%	-2.44%	-0.55%

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	C
Momentum Score	D
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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