

Timken Company

Winded: 2024 outlook falls below expectations

Reiterate Rating: UNDERPERFORM | PO: 78.00 USD | Price: 82.10 USD

2024 guidance disappoints, falls well short of consensus

Timken (TKR) shares fell 4.5% (vs SPX -0.3%) on the back of a weaker than expected 2024 guide: adj EPS of \$5.80-6.20, down 12-18% YoY, fell below cons (\$6.76). The weaker 2024 set up is partly attributed to i) organic sales downturn (-5.5% to -7.5%): reflects a cautious view that current demand weakness likely persists through 2024 (i.e. no volume recovery anticipated in 2H24) ii) organic decremental margin of 40%: tough comparatives, fixed cost absorption, and underproduction resulting in EBITDA margin in the low-to-mid 18% range (vs 19.7% '23). Do we believe this is likely TKR's last cut? Yes, based on some OEM commentary yesterday and TKR likely captured the further pressure of distributor destocking. That said, catalysts to drive higher near-term earnings limited for now.

Renewables in the penalty box

Timken's Renewable segment (~9 of sales) is facing headwinds, driven primarily by weaker demand for Wind in China. Renewables likely finished FY23 flattish at near record levels yet was a tale of two halves: robust 1H (customers in China building inventory in anticipation of more wind installations), with a big downturn in 2H given weak economic conditions (Q4 -30% YoY). The 1H of 2024 is likely to see a steep downturn (40% YoY) with leveling off in the 2H. While TKR remains positive long-term (renewables a positive story for TKR's 'out-growth'), there appears limited demand catalysts in 2024.

Solid Q4 results: solid execution despite volume declines

TKR reported EBITDA of \$195mn, beat BofAe by 10%. EBITDA margin of 17.9% (+70bps YoY), beat BofAe by 110bps. The margin beat was driven by Engineered Bearings: 18.3% (+20bps YoY) & Industrial Motion: 22.2% (+310bps YoY). TKR's positive price vs cost spread (pricing +3%, tailwinds on logistics, manuf) offset the volume decline.

Underperform: waiting for a catalyst

We reduced our estimates post results. We raise our PO to \$78 (\$71) based on 8.5x EV/EBITDA '24 (vs 7x prior), as a higher multiple is warranted given lead indicators (ISM New Orders in expansion for first time in 1.5 years) are starting to improve. While we believe EPS downside is limited post the weak 2024 guidance, TKR's slightly elevated inventories and renewables overhang (China wind) keeps us Underperform.

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	6.46	7.05	6.00	6.70	7.60
GAAP EPS	5.92	5.47	5.10	6.70	7.60
EPS Change (YoY)	24.7%	9.1%	-14.9%	11.7%	13.4%
Consensus EPS (Bloomberg)			6.66	7.21	7.97
DPS	1.23	1.31	1.33	1.44	1.56
Valuation (Dec)					
P/E	12.7x	11.6x	13.7x	12.3x	10.8x
GAAP P/E	13.9x	15.0x	16.1x	12.3x	10.8x
Dividend Yield	1.5%	1.6%	1.6%	1.8%	1.9%
EV / EBITDA*	8.8x	8.0x	8.9x	8.5x	7.9x
Free Cash Flow Yield*	4.9%	6.1%	7.3%	7.9%	9.0%

* For full definitions of *IQmethod*SM measures, see page 4.

06 February 2024

Equity

Key Changes

(US\$)	Previous	Current
Price Obj.	71.00	78.00
2024E Rev (m)	4,619.4	4,589.5
2025E Rev (m)	4,761.1	4,730.3
2026E Rev (m)	NA	4,875.4
2024E EPS	6.75	6.00
2025E EPS	7.35	6.70
2026E EPS	NA	7.60
2024E DPS	1.39	1.33

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Stock Data

Price	82.10 USD
Price Objective	78.00 USD
Date Established	6-Feb-2024
Investment Opinion	B-3-7
52-Week Range	65.71 USD - 95.08 USD
Mkt Val (mn) / Shares Out (mn)	5,824 USD / 70.9
Free Float	90.0%
Average Daily Value (mn)	38.38 USD
BofA Ticker / Exchange	TKR / NYS
Bloomberg / Reuters	TKR US / TKR.N
ROE (2024E)	14.8%
Net Dbt to Eqty (Dec-2023A)	73.1%
ESGMeter™	High

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Manuf = manufacturing

ISM = institute supply management

OEM = original equipment manufacturer

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Timestamp: 06 February 2024 05:30AM EST

iQprofileSM Timken Company

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	11.2%	10.2%	8.0%	8.3%	8.8%
Return on Equity	20.3%	20.1%	14.8%	15.0%	15.7%
Operating Margin	15.3%	17.0%	15.0%	15.7%	16.5%
Free Cash Flow	285	357	425	460	525

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	1.0x	1.1x	1.4x	1.4x	1.4x
Asset Replacement Ratio	1.1x	0.9x	0.9x	0.9x	0.9x
Tax Rate	25.5%	28.1%	26.0%	26.0%	26.0%
Net Debt-to-Equity Ratio	69.0%	73.1%	54.3%	46.7%	38.4%
Interest Cover	9.7x	7.3x	6.1x	6.7x	7.4x

Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	4,497	4,769	4,590	4,730	4,875
% Change	8.8%	6.1%	-3.8%	3.1%	3.1%
Gross Profit	1,338	1,550	1,412	1,489	1,571
% Change	19.4%	15.9%	-8.9%	5.4%	5.6%
EBITDA	856	944	843	890	952
% Change	19.2%	10.3%	-10.7%	5.5%	7.0%
Net Interest & Other Income	(65)	(103)	(104)	(102)	(100)
Net Income (Adjusted)	480	508	426	468	516
% Change	20.4%	5.8%	-16.3%	10.1%	10.1%

Free Cash Flow Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	463	459	392	428	476
Depreciation & Amortization	164	201	209	209	209
Change in Working Capital	(171)	(125)	(31)	(38)	(15)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	8	9	33	40	40
Capital Expenditure	(178)	(188)	(179)	(180)	(185)
Free Cash Flow	285	357	425	460	525
% Change	19.4%	25.2%	18.9%	8.2%	14.2%
Share / Issue Repurchase	(214)	(246)	0	(205)	(225)
Cost of Dividends Paid	(92)	(94)	(95)	(101)	(106)
Change in Debt	512	687	0	0	0

Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	341	419	750	904	1,098
Trade Receivables	804	816	818	855	868
Other Current Assets	1,360	1,399	1,467	1,580	1,607
Property, Plant & Equipment	1,207	1,312	1,282	1,253	1,229
Other Non-Current Assets	2,061	2,595	2,595	2,595	2,595
Total Assets	5,772	6,542	6,912	7,186	7,396
Short-Term Debt	49	606	606	606	606
Other Current Liabilities	963	866	905	1,017	1,042
Long-Term Debt	1,914	1,790	1,790	1,790	1,790
Other Non-Current Liabilities	493	578	578	578	578
Total Liabilities	3,420	3,839	3,878	3,990	4,016
Total Equity	2,353	2,702	3,033	3,196	3,381
Total Equity & Liabilities	5,772	6,542	6,912	7,186	7,396

* For full definitions of iQmethodSM measures, see page 4.

Company Sector

Industrial Machinery

Company Description

Founded in 1898 and headquartered in Canton, Ohio, the Timken Company (TKR) is the largest manufacturer of tapered roller bearings in the US and a leading global manufacturer of highly-engineered bearings and power transmission products. The company generates 50% of sales from its Mobile Products division, which primarily sells bearings to new heavy equipment products and the remaining 50% from Process Industries which is more aftermarket driven. 55% of sales are from North America.

Investment Rationale

Timken has a robust competitive position in high end industrial bearings and power transmission products with stronger than appreciated barriers to entry. That said, we see some headwinds emerging that can weigh on the growth profile (inventory destocking, Renewables, auto strike). In our view, these headwinds are a potential overhang on growth and valuation in the near-term.

Stock Data

Average Daily Volume 467,443

Quarterly Earnings Estimates

	2023	2024
Q1	2.09A	1.45E
Q2	2.01A	1.49E
Q3	1.55A	1.65E
Q4	1.37A	1.41E

Price objective basis & risk

Timken Company (TKR)

Our \$78/share PO is based on 8.5x 2024E EV/EBITDA, which is near the middle of the historical range (5-12x). We do not view the very low end of the range as appropriate given Timken is demonstrating cycle to cycle margin improvement with an improved business mix over the last decade and growing exposure to higher multiple end markets. That said, we do not view the high end of the range as appropriate given higher rates, slowing growth across the industrial backdrop, and a weaker backdrop for the China wind market

Upside risks to our PO: 1) a faster and stronger than expected recovery in the global economy, 2) China stimulus tailwind stronger than expected, 3) better than expected price vs cost performance 4) shaper drive towards renewables driven by government policy.

Downside risks to our PO: 1) integration issues on recent acquisitions, 2) deterioration in the pricing environment, 3) weaker than expected growth in renewables, 4) prolonged auto strikes weigh on production.

Analyst Certification

I, Michael Feniger, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Machinery Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	AECOM	ACM	ACM US	Michael Feniger
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	Caterpillar Inc	CAT	CAT US	Michael Feniger
	CNH Industrial NV	CNHI	CNHI US	Michael Feniger
	Construction Partners Inc.	ROAD	ROAD US	Michael Feniger
	ESAB Corp	ESAB	ESAB US	Sherif El-Sabbahy
	Finning International Inc.	YFTT	FTT CN	Sherif El-Sabbahy
	H&E Equipment Services Inc	HEES	HEES US	Sherif El-Sabbahy
	Knife River Corp	KNF	KNF US	Sherif El-Sabbahy
	Republic Services	RSG	RSG US	Michael Feniger
	Techtronic Industries Co Ltd	TTNDF	669 HK	Michael Feniger
	Techtronic Industries Co Ltd	TTNDY	TTNDY US	Michael Feniger
	United Rentals Inc	URI	URI US	Michael Feniger
	Vulcan Materials	VMC	VMC US	Michael Feniger
	Waste Connections Inc	WCN	WCN US	Michael Feniger
	WillScot Mobile Mini	WSC	WSC US	Sherif El-Sabbahy
NEUTRAL				
	AGCO Corp	AGCO	AGCO US	Michael Feniger
	Deere & Co	DE	DE US	Michael Feniger
	Fluor	FLR	FLR US	Michael Feniger
	GFL Environmental Inc	GFL	GFL US	Michael Feniger
	GFL Environmental Inc	YGFL	GFL CN	Michael Feniger
	Jacobs Eng.	J	J US	Michael Feniger
	Kennametal Inc.	KMT	KMT US	Michael Feniger



US - Machinery Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	Martin Marietta Materials	MLM	MLM US	Michael Feniger
	NV5 Global Inc.	NVEE	NVEE US	Michael Feniger
	PACCAR Inc	PCAR	PCAR US	Michael Feniger
	RB Global, Inc	RBA	RBA US	Michael Feniger
	Waste Management	WM	WM US	Michael Feniger
UNDERPERFORM				
	Allison Transmission Holdings Inc.	ALSN	ALSN US	Sherif El-Sabbahy
	Casella	CWST	CWST US	Michael Feniger
	Cummins Inc	CMI	CMI US	Michael Feniger
	Herc Holdings Inc	HRI	HRI US	Sherif El-Sabbahy
	IPG Photonics	IPGP	IPGP US	Michael Feniger
	Oshkosh Corp.	OSK	OSK US	Michael Feniger
	Terex Corp.	TEX	TEX US	Michael Feniger
	Timken Company	TKR	TKR US	Michael Feniger

iQmethodSM Measures Definitions**Business Performance**

Return On Capital Employed

Return On Equity
Operating Margin
Earnings Growth
Free Cash Flow

Quality of Earnings

Cash Realization Ratio
Asset Replacement Ratio
Tax Rate
Net Debt-To-Equity Ratio
Interest Cover

Valuation Toolkit

Price / Earnings Ratio
Price / Book Value
Dividend Yield
Free Cash Flow Yield
Enterprise Value / Sales

EV / EBITDA

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income
Operating Profit
Expected 5 Year CAGR From Latest Actual
Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations
Capex
Tax Charge
Net Debt = Total Debt – Cash & Equivalents
EBIT

Numerator

Current Share Price
Current Share Price
Annualised Declared Cash Dividend
Cash Flow From Operations – Total Capex
EV = Current Share Price × Current Shares + Minority Equity + Net Debt + Other LT Liabilities
Enterprise Value

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Amortization
Shareholders' Equity
Sales
N/A
N/A

Denominator

Net Income
Depreciation
Pre-Tax Income
Total Equity
Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)
Shareholders' Equity / Current Basic Shares
Current Share Price
Market Cap = Current Share Price × Current Basic Shares
Sales

Basic EBIT + Depreciation + Amortization

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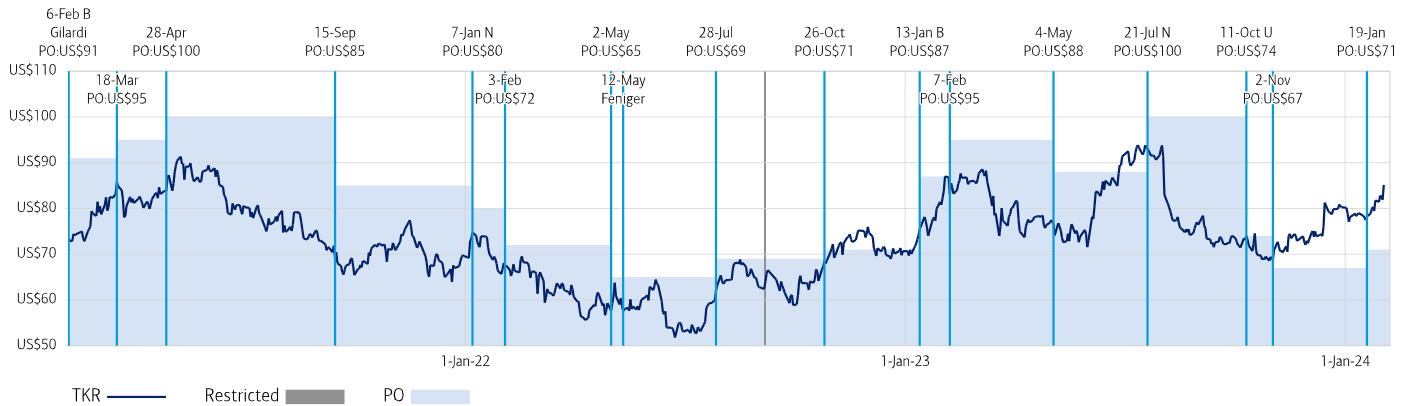
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Timken Company (TKR) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Machinery/Diversified Manufacturing Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	27	42.19%	Buy	8	29.63%
Hold	17	26.56%	Hold	8	47.06%
Sell	20	31.25%	Sell	8	40.00%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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