

## TransDigm Group Inc.

## TDG embracing “good fortunes” in the year of the dragon – Reiterate Buy

Reiterate Rating: BUY | PO: 1,310.00 USD | Price: 1,146.39 USD

## Story is intact, reiterate Buy

TDG reported its eighth consecutive quarter of double digital Y/Y topline growth and third quarter of >20% Y/Y growth. Despite industry wide headwinds in supply chains, the original equipment manufacturer (OEM) production ramp and talent acquisition, TDG continues to stand out amongst peers as the exception. TDG's unique strategy focusing on aggressive M&A supporting a niche intellectual property (IP) driven product portfolio remains resilient and a gold standard. Demand remains healthy in Commercial OEM, Aftermarket and Defense. We expect another year of substantial topline growth (high-teens Y/Y) with >100bps EBITDA margin improvement, driven by strong demand and continued cost cutting execution.

## Aftermarket stronger for longer, PO to \$1,310

We outlined in our: [2024 Year Ahead: Butterflies and Bullets](#), we were wary of the notion that 2024 would be the year commercial OEM production would normalize. With that perspective, we noted a preference for Aftermarket over OEM and concerns of a massive aftermarket deceleration were overdone. Only a few weeks into the year, the thesis appears correct so far and we maintain our view the aftermarket hasn't run out of steam. We see upside to TDG's aftermarket business. We expect high-teens growth for the segment, which will support EBITDA margins holding above the >51% line set in FY2023. Given the upside we expect in the aftermarket, continued strong execution, and robust M&A pipeline we are raising our PO to \$1,310 from \$1,100. This reflects a 1.6x (prior 1.5x) rel. multiple to the S&P500, and a premium to the historical 1.4x.

## Defense growth acceleration, a pleasant surprise

TDG reporting strong topline growth, strong margins, and acquiring companies is almost always expected at this point. However, a stand-out and positive surprise this quarter, was defense revenue up 28% Y/Y. Defense aftermarket revenues did outpace OEM, however the OEM segment did meaningfully contribute. In the OEM business, deliveries from TDG's Armtec subsidiary were called out for being very strong, and not a one-off event. We do see upside opportunity for the TDG's defense segment, given Armtec's exposure to artillery and munition production. As we noted this past fall, the Department of Defense is hyper-focused on munitions replenishment. This munition emphasis resulted in TDG's Armtec business being awarded a: [\\$692mn contract which runs through 2026](#).

Estimates (Sep) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	17.14	25.84	31.45	39.20	42.35
GAAP EPS	13.39	22.05	26.80	36.19	39.25
EPS Change (YoY)	41.3%	50.8%	21.7%	24.6%	8.0%
Consensus EPS (Bloomberg)			31.51	36.87	41.66
DPS	18.50	0	0	0	0
Valuation (Sep)					
P/E	66.9x	44.4x	36.5x	29.2x	27.1x
GAAP P/E	85.6x	52.0x	42.8x	31.7x	29.2x
Dividend Yield	1.6%	0%	0%	0%	0%
EV / EBITDA*	30.5x	23.8x	19.8x	17.5x	16.9x
Free Cash Flow Yield*	1.3%	1.9%	2.5%	3.5%	3.8%

\* For full definitions of *IQmethod*<sup>SM</sup> measures, see page 6.

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Timestamp: 20 February 2024 03:00AM EST

20 February 2024

## Equity

## Key Changes

(US\$)	Previous	Current
Price Obj.	1,100.00	1,310.00
2024E Rev (m)	7,734.2	7,749.9
2025E Rev (m)	8,733.0	8,754.5
2026E Rev (m)	9,127.2	9,145.5
2024E EPS	32.35	31.45
2025E EPS	39.55	39.20
2026E EPS	44.30	42.35

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## Stock Data

Price	1,146.39 USD
Price Objective	1,310.00 USD
Date Established	20-Feb-2024
Investment Opinion	B-1-9
52-Week Range	662.12 USD - 1,165.00 USD
Mkt Val (mn) / Shares Out (mn)	63,746 USD / 55.6
Free Float	96.0%
Average Daily Value (mn)	257.85 USD
BoFA Ticker / Exchange	TDG / NYS
Bloomberg / Reuters	TDG US / TDG.N
ROE (2024E)	NA
Net Dbt to Eqty (Sep-2023A)	NA
ESGMeter™	Medium

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BoFA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "BoFA ESGMeter Methodology".

# iQprofile<sup>SM</sup> TransDigm Group Inc.

## iQmethod<sup>SM</sup> – Bus Performance\*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	10.3%	12.9%	14.4%	14.6%	14.2%
Return on Equity	NM	NM	NM	NM	205.6%
Operating Margin	40.6%	43.7%	45.5%	45.8%	45.3%
Free Cash Flow	829	1,236	1,586	2,225	2,394

## iQmethod<sup>SM</sup> – Quality of Earnings\*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	1.0x	0.9x	1.0x	1.1x	1.0x
Asset Replacement Ratio	0.5x	0.5x	0.7x	0.6x	0.6x
Tax Rate	23.2%	24.3%	23.0%	24.0%	24.0%
Net Debt-to-Equity Ratio	NM	NM	NM	NM	NM
Interest Cover	2.0x	2.5x	2.6x	3.2x	3.7x

## Income Statement Data (Sep)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	5,429	6,585	7,750	8,755	9,145
% Change	13.2%	21.3%	17.7%	13.0%	4.5%
Gross Profit	3,099	3,842	4,572	5,149	5,348
% Change	23.3%	24.0%	19.0%	12.6%	3.9%
EBITDA	2,456	3,148	3,798	4,290	4,427
% Change	21.2%	28.2%	20.6%	13.0%	3.2%
Net Interest & Other Income	(1,076)	(1,164)	(1,380)	(1,241)	(1,122)
<b>Net Income (Adjusted)</b>	<b>998</b>	<b>1,478</b>	<b>1,820</b>	<b>2,280</b>	<b>2,476</b>
<b>% Change</b>	<b>40.8%</b>	<b>48.2%</b>	<b>23.1%</b>	<b>25.3%</b>	<b>8.6%</b>

## Free Cash Flow Data (Sep)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	866	1,299	1,652	2,105	2,294
Depreciation & Amortization	253	268	272	279	286
Change in Working Capital	(260)	(431)	(349)	(213)	(241)
Deferred Taxation Charge	(22)	3	0	0	0
Other Adjustments, Net	111	236	211	230	238
Capital Expenditure	(119)	(139)	(200)	(175)	(183)
<b>Free Cash Flow</b>	<b>829</b>	<b>1,236</b>	<b>1,586</b>	<b>2,225</b>	<b>2,394</b>
<b>% Change</b>	<b>2.6%</b>	<b>49.1%</b>	<b>28.3%</b>	<b>40.3%</b>	<b>7.6%</b>
Share / Issue Repurchase	(912)	0	0	(200)	(200)
Cost of Dividends Paid	(1,091)	(38)	(2,038)	0	0
Change in Debt	(275)	(173)	2,055	0	(2,000)

## Balance Sheet Data (Sep)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	3,001	3,472	3,736	5,761	5,956
Trade Receivables	967	1,230	1,435	1,505	1,572
Other Current Assets	1,681	2,036	2,286	2,411	2,538
Property, Plant & Equipment	807	1,255	1,403	1,439	1,477
Other Non-Current Assets	11,651	11,977	13,234	13,094	12,954
<b>Total Assets</b>	<b>18,107</b>	<b>19,970</b>	<b>22,094</b>	<b>24,211</b>	<b>24,496</b>
Short-Term Debt	426	420	530	530	530
Other Current Liabilities	1,000	1,159	1,288	1,270	1,223
Long-Term Debt	19,369	19,330	21,346	21,346	19,346
Other Non-Current Liabilities	1,078	1,039	1,027	1,027	1,027
<b>Total Liabilities</b>	<b>21,873</b>	<b>21,948</b>	<b>24,191</b>	<b>24,173</b>	<b>22,126</b>
<b>Total Equity</b>	<b>(3,766)</b>	<b>(1,978)</b>	<b>(2,097)</b>	<b>38</b>	<b>2,370</b>
<b>Total Equity &amp; Liabilities</b>	<b>18,107</b>	<b>19,970</b>	<b>22,094</b>	<b>24,211</b>	<b>24,496</b>

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 6.

## Company Sector

Aerospace

## Company Description

TDG is a holding company for different businesses which provide a diverse array of products including ignition systems, pumps, valves, motors, actuators, controls, water faucets and systems, quick disconnects and couplings, batteries, chargers and power conditioning, cockpit security systems, composites and elastomers, audio systems, and lighting and displays.

## Investment Rationale

TDG's unique positioning distinguishes it from competition and warrants a premium multiple to the market. 90% of sales are proprietary, 75% are sole-sourced and 50%+ are aftermarket-related. This provides TDG with strong margins, cash flow, and high barriers to entry. Strong cash flow allows TDG to pursue opportunistic M&A. In our view, TDG's management team and operations will drive it to outperform peers, even in a demand-pressured aerospace market.

## Stock Data

Average Daily Volume 224,922

## Quarterly Earnings Estimates

	2023	2024
Q1	4.58A	7.16A
Q2	5.98A	7.00E
Q3	7.25A	7.88E
Q4	8.03A	9.24E

## Strong bookings support continued growth

During the quarter, TDG saw growth in its revenues and bookings for all of their three segments. EBITDA as defined margin was 51% (51.8% excl. Calspan), attributed to the continued recovery in its commercial aftermarket revenues, along with diligent focus on its operating strategy.

### Commercial OEM: TDG expects 20% Y/Y in FY25e, BofA sees downside risks

Revenue increased 25% in Q1 Y/Y, driven by a 22% growth in Commercial Transport and a 29% growth in BizJets/Helicopter revenues. Strong bookings continue to support the commercial OEM revenue outlook for 20% growth for FY25. Despite persistent supply chain issues across OEMs, the company is still encouraged by the steadily increasing commercial OEM production rates and strong airline demand for new aircraft. We remain more conservative on commercial OE ramp and expect 18% Y/Y growth in FY25.

### Commercial Aftermarket: TDG expect mid-teens, BofAe see upside risks

Revenue increased 22% in Q1 Y/Y primarily driven by the continued strength in its passenger, interior, and Biz Jets sub-markets. These were minimally offset by a slight decline in its freight submarket, mainly driven by the return of passenger belly capacity. Commercial aftermarket bookings for this quarter were strong Y/Y, which continue to support FY25e revenue growth in the mid-teens' percent range. We see upside to aftermarket growth, mainly driven by continued delays to OE production ramp and pressure to in-service fleet from limited Maintenance, Repair, & Overhaul (MRO) capacity.

### Defense: Strengthening US O&M spending supports higher growth

Revenue increased 28% in Q1 Y/Y, with growth across businesses (aftermarket outpaced OEM). Y/Y growth is expected to moderate throughout the year on tougher comps. Defense bookings were up significantly this quarter.

TDG now expects revenue growth in the high single digit to low double-digit percentage range, from mid to high single digit percentage range. We are increasing our FY25 growth to 9% from 7% to factor in strengthening US O&M spending.

## The master of capital deployment

TDG reported strong operating cash flow in 1Q of \$636mn and ended the quarter with over \$4.1bn of cash. This cash balance includes the \$2bn of cash from the new debt issued during the first quarter. Net debt-to-EBITDA ratio was 5.0x, down from 5.4x at the end of last quarter and in line with the targeted range of 5-7x. Adjusting for the pending CPI's electronic device business, and refinanced notes, net leverage is 6.4x.

### Refinancing of 2026 Notes results in \$95mn interest expense headwind

On February 12, TDG priced \$4.4bn in two new series of senior secured notes (\$2.2bn of 6.375% Notes due 2029 + \$2.2bn of 6.625% Notes due 2032). The net proceeds are intended to repurchase all of the outstanding 6.250% Notes due 2026. We estimate the refinancing will increase annual interest expense by \$95mn in FY2024.

### M&A environment – new opportunities abound

On M&A, TDG's strategy and disciplined approach is unchanged. TDG remains focused on targeting Aerospace & Defense business with unique IP, significant aftermarket exposure, and opportunities for margin expansion. While the current rate environment does make M&A more challenging, TDG noted an abundance of opportunities are coming through the pipeline, with many names they were surprised to see.



## Cut EPS: Strong aftermarket & defense, offset by interest expense

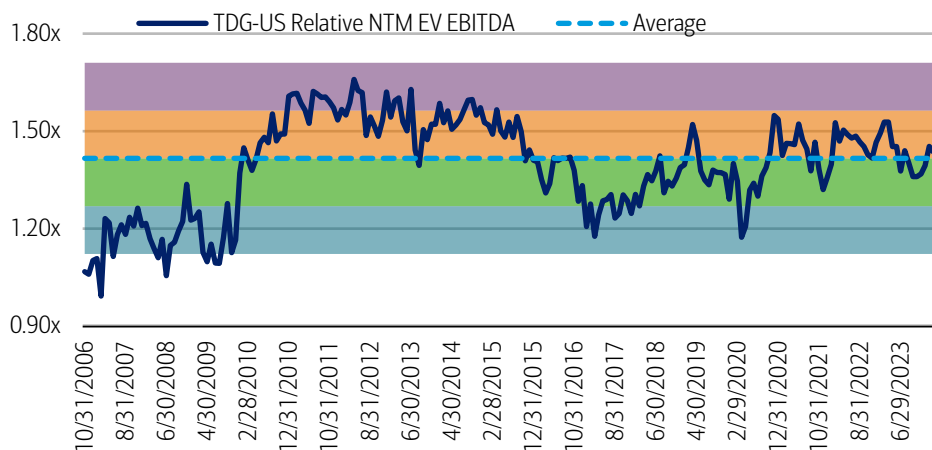
We are lowering our EPS estimates mainly to reflect higher interest expense. We are also pushing the close of CPI acquisition from 3QFY25 to 4QFY25. However, our EBITDA estimates raise to \$4.52bn from \$4.50bn in FY25 and to \$4.67 from \$4.65 in FY26, mainly to reflect strong aftermarket and defense end-markets.

## Raising PO to \$1,310 on aftermarket momentum

We are raising our PO to \$1,310 from \$1,100 mainly to reflect stronger operations and better than previously expected aftermarket demand. We are rolling our valuation to reflect CY25 estimates. Our \$1,310 PO is based on a 1.6x EV/EBITDA relative multiple to the S&P 500 on CY25e (vs. prior 1.5x). The 1.6x multiple reflects a premium to average relative multiple of 1.4x. In our view, a multiple above historic average fairly reflects TDG's strong aftermarket positioning, robust margin performance and solid cash generation.

### Exhibit 1: TDG NTM EV/EBITDA Rel. to the S&P500

Since 2006, TDG has traded on average ~1.4x rel. to the S&P500



Source: BofA Global Research, FactSet

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## Price objective basis & risk

### TransDigm Group Inc. (TDG)

Our \$1310 PO is based on a 1.6x EV/EBITDA relative multiple to the S&P 500 on CY25e. The 1.6x multiple reflects a premium to average relative multiple of 1.4x. In our view, a multiple above historic average fairly reflects TDG's strong aftermarket positioning, robust margin performance and solid cash generation.

Downside risks to our PO are: Higher oil prices would likely derail air traffic growth and, therefore, aircraft demand, resulting in a downturn in commercial aviation. A downturn in commercial aviation, due to exogenous factors, such as a terrorist attack or natural business cyclicity, could adversely impact TDG's financial results. If the defense budget for RDT&E and investment accounts do not increase as we expect, this could affect TDG's defense business.

However, if the commercial aerospace and business aviation jet recoveries are better than we are forecasting, earnings could fare better than our projections and the stock could perform better. If margins fare better than we are forecasting, there could also be upside potential to our valuation.

## Analyst Certification

I, Ronald J. Epstein, 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 - Aerospace and Defense Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	AerCap Holdings N.V.	AER	AER US	Ronald J. Epstein
	Air Lease Corporation	AL	AL US	Ronald J. Epstein
	Booz Allen Hamilton	BAH	BAH US	Mariana Perez Mora
	BWX Technologies, Inc.	BWXT	BWXT US	Ronald J. Epstein
	CACI International	CACI	CACI US	Mariana Perez Mora
	Cadre Holdings Inc	CDRE	CDRE US	Ronald J. Epstein
	Crane Co.	CR	CR US	Ronald J. Epstein
	Embraer	ERJ	ERJ US	Ronald J. Epstein
	General Dynamics	GD	GD US	Ronald J. Epstein
	HEICO Corporation	HEI	HEI US	Ronald J. Epstein
	Howmet Aerospace Inc.	HWM	HWM US	Ronald J. Epstein
	KBR	KBR	KBR US	Mariana Perez Mora
	Leidos Holdings	LDOS	LDOS US	Mariana Perez Mora
	Leonardo DRS, Inc.	DRS	DRS US	Ronald J. Epstein
	Northrop Grumman	NOC	NOC US	Ronald J. Epstein
	Palantir Technologies	PLTR	PLTR US	Mariana Perez Mora
	Parsons Corporation	PSN	PSN US	Mariana Perez Mora
	RBC Bearings Inc	RBC	RBC US	Ronald J. Epstein
	Rocket Lab	RKLB	RKLB US	Ronald J. Epstein
	Teledyne Technologies Inc	TDY	TDY US	Ronald J. Epstein
	TransDigm Group Inc.	TDG	TDG US	Ronald J. Epstein
	Triumph Group	TGI	TGI US	Ronald J. Epstein
<b>NEUTRAL</b>				
	Albany International	AIN	AIN US	Ronald J. Epstein
	Boeing	BA	BA US	Ronald J. Epstein
	Garmin	GRMN	GRMN US	Ronald J. Epstein
	Hexcel Corporation	HXL	HXL US	Ronald J. Epstein
	L3Harris	LHX	LHX US	Ronald J. Epstein
	Lockheed Martin	LMT	LMT US	Ronald J. Epstein
	RTX Corp	RTX	RTX US	Ronald J. Epstein
	Textron	TXT	TXT US	Ronald J. Epstein



**US - Aerospace and Defense Coverage Cluster**

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
<b>UNDERPERFORM</b>	Bombardier	BDRBF	BDRBF US	Ronald J. Epstein
	Bombardier Inc.	YBBD B	BBD/B CN	Ronald J. Epstein
	CAE Inc.	YCAE	CAE CN	Ronald J. Epstein
	CAE Inc.	CAE	CAE US	Ronald J. Epstein
	Huntington Ingalls Industries	HII	HII US	Ronald J. Epstein
	Mercury Systems	MRCY	MRCY US	Ronald J. Epstein
	Spirit AeroSys-A	SPR	SPR US	Ronald J. Epstein

**iQmethod<sup>SM</sup> 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

iQmethod<sup>SM</sup> is the set of BofA Global Research standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and valuations. The key features of iQmethod are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

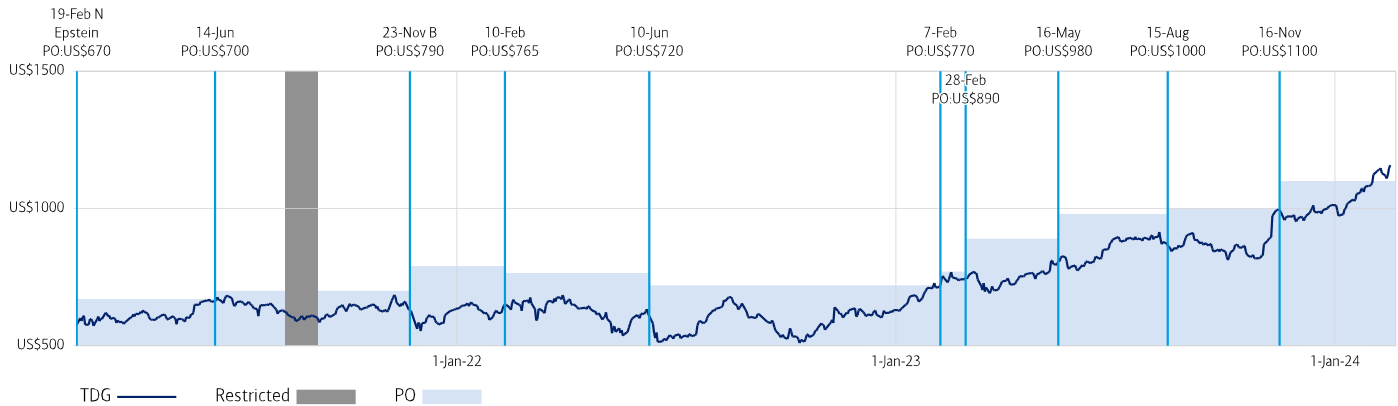
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# Disclosures

## Important Disclosures

### TransDigm Group (TDG) 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: Aerospace/Defense Electronics Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	31	62.00%	Buy	23	74.19%
Hold	11	22.00%	Hold	9	81.82%
Sell	8	16.00%	Sell	6	75.00%

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

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	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%

<sup>R1</sup> 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.

**FUNDAMENTAL EQUITY OPINION KEY:** Opinions include a Volatility Risk Rating, an Investment Rating and an Income Rating. **VOLATILITY RISK RATINGS**, indicators of potential price fluctuation, are: A - Low, B - Medium and C - High. **INVESTMENT RATINGS** reflect the analyst's assessment of both a stock's absolute total return potential as well as its attractiveness for investment relative to other stocks within its Coverage Cluster (defined below). Our investment ratings are: 1 - Buy stocks are expected to have a total return of at least 10% and are the most attractive stocks in the coverage cluster; 2 - Neutral stocks are expected to remain flat or increase in value and are less attractive than Buy rated stocks and 3 - Underperform stocks are the least attractive stocks in a coverage cluster. An investment rating of 6 (No Rating) indicates that a stock is no longer trading on the basis of fundamentals. Analysts assign investment ratings considering, among other things, the 0-12 month total return expectation for a stock and the firm's guidelines for ratings dispersions (shown in the table below). The current price objective for a stock should be referenced to better understand the total return expectation at any given time. The price objective reflects the analyst's view of the potential price appreciation (depreciation).

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

<sup>R2</sup> Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

**INCOME RATINGS**, indicators of potential cash dividends, are: 7 - same/higher (dividend considered to be secure), 8 - same/lower (dividend not considered to be secure) and 9 - pays no cash dividend. **Coverage Cluster** is comprised of stocks covered by a single analyst or two or more analysts sharing a common industry, sector, region or other classification(s). A stock's coverage cluster is included in the most recent BofA Global Research report referencing the stock.

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