

## Hexcel Corporation

# Tightrope walk continues due to OEM production hiccups – reiterate Neutral

Reiterate Rating: NEUTRAL | PO: 75.00 USD | Price: 72.89 USD

## Long-term narrative intact, near-term pressures increased

Hexcel's arch in the broader aerospace recovery saga remains on course. We continue to expect Hexcel (HXL) to benefit from the strong demand and growing backlogs in commercial aerospace. HXL's portfolio is heavily skewed toward widebodies, which are still in their early innings of ramping production. That said, due to the production ramp cap currently place on the 737MAX, we do expect near-term topline and margin pressure. We reiterate our Neutral rating as the delayed narrowbody ramp limits near-term stock appreciation.

## Overhead from lagging narrowbodies pressures margins

Due to HXL's position in the supply chain, they need to deliver their content ~6 months ahead of the OEMs intended production rate. HXL's workforce grew 5% Y/Y to gear towards the messaged 2025-2026 monthly production rates of 50 MAXs, 75 A320s, 10 787s and 10 A350s. However, Boeing's MAX production being frozen indefinitely at 38/mo will drag on margins due to lower overhead absorption and excess capacity. While HXL does have more content on Airbus platforms, the MAX cap will delay HXL's margin recovery timeline. Due to stickiness in wage growth, longer recovery timeline, and inflated materials pricing, we do not expect HXL's margins to return to >16% until after 2028.

## Widebody production hums along to HXL's benefit

Despite the choppiness in narrowbodies, the widebody production ramp has remained robust. HXL's 4Q Commercial Aerospace sales grew 5% Y/Y, with widebody sales offsetting a decline in narrowbody shipset content. For 2024, we expect Boeing to produce 60 787s (>60% increase Y/Y), and Airbus to produce 73 A350s (>14% increase Y/Y). As widebodies continue to ramp, HXL will continue to benefit from the stronger revenue and margin profile, compared to narrowbodies.

## Lowering EPS, but raising PO to \$75 on market re-rating

We are lowering our near-term EPS estimates to factor in for the drag on margins related to increased overhead on lower throughput. See details inside. However, we raise our PO to \$75 from \$65 mainly to reflect the market rerating. We maintain our 1.3x P/FCF multiple relative to the S&P500 on 2025e (in line with historical average).

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	1.28	1.81	2.25	2.70	3.20
GAAP EPS	1.49	1.24	2.25	2.70	3.20
EPS Change (YoY)	374.1%	41.4%	24.3%	20.0%	18.5%
Consensus EPS (Bloomberg)			2.31	3.02	3.57
DPS	0.43	0.53	0.62	0.62	0.62
Valuation (Dec)					
P/E	56.9x	40.3x	32.4x	27.0x	22.8x
GAAP P/E	48.9x	58.8x	32.4x	27.0x	22.8x
Dividend Yield	0.6%	0.7%	0.9%	0.9%	0.9%
EV / EBITDA*	26.3x	23.3x	20.4x	17.7x	15.9x
Free Cash Flow Yield*	1.3%	2.1%	2.8%	3.1%	3.5%

\* For full definitions of *IQmethod*<sup>SM</sup> measures, see page 5.

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Timestamp: 12 February 2024 08:55AM EST

12 February 2024

### Equity

#### Key Changes

(US\$)	Previous	Current
Price Obj.	65.00	75.00
2024E Rev (m)	2,006.4	1,998.2
2025E Rev (m)	2,198.3	2,221.1
2026E Rev (m)	2,356.4	2,393.6
2024E EPS	2.35	2.25
2025E EPS	2.90	2.70
2026E EPS	3.40	3.20
2024E DPS	0.53	0.62

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### Stock Data

Price	72.89 USD
Price Objective	75.00 USD
Date Established	12-Feb-2024
Investment Opinion	B-2-7
52-Week Range	58.81 USD - 79.08 USD
Mrkt Val (mn) / Shares Out (mn)	7,234 USD / 99.2
Free Float	99.2%
Average Daily Value (mn)	56.86 USD
BofA Ticker / Exchange	HXL / NYS
Bloomberg / Reuters	HXL US / HXLN
ROE (2024E)	11.1%
Net Dbt to Eqty (Dec-2023A)	27.5%
ESGMeter <sup>TM</sup>	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".

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# iQprofile<sup>SM</sup> Hexcel Corporation

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

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	5.4%	7.5%	7.8%	9.7%	11.4%
Return on Equity	7.2%	9.5%	11.1%	13.5%	16.3%
Operating Margin	11.1%	12.0%	12.9%	14.1%	15.0%
Free Cash Flow	97	149	201	223	251

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

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	1.6x	1.7x	1.7x	1.6x	1.5x
Asset Replacement Ratio	0.6x	0.9x	0.8x	0.9x	0.9x
Tax Rate	21.1%	11.0%	22.1%	22.1%	22.1%
Net Debt-to-Equity Ratio	39.3%	27.5%	31.7%	38.2%	42.5%
Interest Cover	4.8x	6.3x	7.6x	9.5x	10.0x

## Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	1,578	1,789	1,998	2,221	2,394
% Change	19.1%	13.4%	11.7%	11.2%	7.8%
Gross Profit	357	433	486	558	622
% Change	42.8%	21.3%	12.2%	14.7%	11.5%
EBITDA	302	341	389	448	499
% Change	56.6%	12.8%	14.2%	15.2%	11.3%
Net Interest & Other Income	(25)	(106)	(34)	(33)	(36)
<b>Net Income (Adjusted)</b>	<b>109</b>	<b>155</b>	<b>187</b>	<b>218</b>	<b>252</b>
<b>% Change</b>	<b>369.0%</b>	<b>42.1%</b>	<b>20.7%</b>	<b>17.0%</b>	<b>15.5%</b>

## Free Cash Flow Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	126	106	187	218	252
Depreciation & Amortization	127	125	131	135	139
Change in Working Capital	(70)	(26)	(6)	(8)	(8)
Deferred Taxation Charge	(3)	(33)	0	0	0
Other Adjustments, Net	(7)	84	0	0	0
Capital Expenditure	(76)	(108)	(110)	(122)	(132)
<b>Free Cash Flow</b>	<b>97</b>	<b>149</b>	<b>201</b>	<b>223</b>	<b>251</b>
<b>% Change</b>	<b>-21.8%</b>	<b>53.8%</b>	<b>35.1%</b>	<b>10.8%</b>	<b>12.7%</b>
Share / Issue Repurchase	4	7	0	0	0
Cost of Dividends Paid	(34)	(42)	(51)	(50)	(49)
Change in Debt	(101)	(25)	30	0	0

## Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	112	227	207	130	82
Trade Receivables	223	235	247	256	263
Other Current Assets	400	403	416	432	446
Property, Plant & Equipment	1,658	1,679	1,658	1,645	1,638
Other Non-Current Assets	445	376	376	376	376
<b>Total Assets</b>	<b>2,837</b>	<b>2,919</b>	<b>2,903</b>	<b>2,839</b>	<b>2,805</b>
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	330	316	335	353	365
Long-Term Debt	723	699	729	729	729
Other Non-Current Liabilities	230	187	187	187	187
<b>Total Liabilities</b>	<b>1,283</b>	<b>1,202</b>	<b>1,251</b>	<b>1,269</b>	<b>1,282</b>
<b>Total Equity</b>	<b>1,554</b>	<b>1,717</b>	<b>1,652</b>	<b>1,570</b>	<b>1,523</b>
<b>Total Equity &amp; Liabilities</b>	<b>2,837</b>	<b>2,919</b>	<b>2,903</b>	<b>2,839</b>	<b>2,805</b>

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 5.

## Company Sector

Aerospace

## Company Description

HXL is the leading advanced structural materials company in the world. It develops, manufactures and markets lightweight, high-performance composites and composite weaves (prepreg) used as the primary building materials in endmarkets such as commercial and military aircraft and space launch vehicles and satellites. HXL manufactures low-cost industrial grade carbon fiber used in autos, bikes, skis and other industrial applications and manufactures fiber glass prepregs used in wind turbine blades.

## Investment Rationale

Hexcel is a pureplay on commercial aerospace carbon fiber. Increased penetration of carbon fiber in the airframe of new aircraft derivatives like the A320neo and 737 MAX and clean sheet programs like the A350 and 787 provides long-term growth. However, at Hexcel's current valuation we believe the aero recovery is mostly priced in, and there are cheaper options available for investors to buy for the Commercial Aerospace recovery.

## Stock Data

Average Daily Volume 780,012

## Quarterly Earnings Estimates

	2023	2024
Q1	0.50A	0.54E
Q2	0.50A	0.55E
Q3	0.38A	0.56E
Q4	0.43A	0.60E

## A promising outlook on commercial

While the recent Boeing quality escapes will hamper HXL's more immediate growth, we continue to see HXL having a strong position in the years ahead. Both Airbus & Boeing's current backlog represent >\$9bn in future revenue for HXL. Additionally, HXL will have opportunities to increase content onboard with composite rich aircraft like the 777X and A350F entering service in the near future.

The current situation at Boeing is not a positive for the industry overall. However, the changes Boeing makes today can only help ensure the next phases of the production ramp are smoother and more predictable, which could mitigate further margin impacts for HXL.

## Space & Defense: Well positioned for future programs

HXL's Space and Defense business is benefiting from the strong demand for F-35s, CH-53Ks, satellites, and rocket motors. We see future programs like NGAD/FA-XX, the next generation tanker, and replicator (unmanned aerial vehicles) all providing significant opportunities for HXL. During the quarter, HXL noted significant tailwinds from classified programs, which suggests they're well positioned on one of the previously mentioned programs.

## Lowering near term expectations on margin pressures

As mentioned, HXL's increase overhead on lower throughput will drag on margins, despite what we expect will be another robust year for aerospace OEM growth. Due to the constraints, we are lowering our near-term EPS estimates. We estimate 2024E EPS: \$2.25 (vs. prior \$2.55), 2025E: \$2.70 (vs. prior \$3.05), 2026E: \$3.20 (vs. \$3.45), and 2027E: \$3.55 (vs. prior \$3.80).

## Raising PO to \$75 on market re-rating

We raise our PO to \$75 from \$65, to reflect the market re-rating. The S&P 500 is currently trading at 20.49x P/FCF on 2025e, vs. 18.03x in 2026e. Our PO is based on a 1.3x P/FCF relative to the S&P500 on 2025e. The 1.3x is in line with HXL's avg historical NTM P/FCF relative to the S&P multiple.



## Price objective basis & risk

### Hexcel Corporation (HXL)

We derive our PO of \$75 on a 1.3x P/FCF relative to the S&P500 on 2025e. The 1.3x multiple is in line with HXL's historical P/FCF relative S&P multiple. We maintain our Neutral rating on valuation. We see other names in our coverage universe that can provide a relative higher upside from commercial aero recovery.

Upside risks to our PO are: if Airbus A350, A32neo, and 737MAX production rates continue to ramp up better expected and 787 deliveries recommence, HXL will continue to benefit as a carbon fiber OE pure play and may trade at a higher premium to the market compared to our estimates. An increase in oil prices could also boost demand for newer, more fuel-efficient commercial jetliners and provide upside to estimates in the medium term.

Downside risks to our price objective are: the majority of sales are OEM and there is little aftermarket, which could prove problematic if the civil aircraft cycle turns dramatically due to the uncertain economic environment. HXL could be materially impacted if serious complications should arise from new platforms like the 787 and A350. Unexpected cancellations to programs in both commercial and military could materially impact HXL as a result. Should HXL run into any problems with execution, particularly as capacity is expanding, that would impact results.

## 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

**US - Aerospace and Defense Coverage Cluster**

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	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
<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

**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

**Denominator**

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization

Shareholders' Equity

Sales

N/A

N/A

**Quality of Earnings**

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

**Numerator**

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash &amp; Equivalents

EBIT

**Denominator**

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

**Valuation Toolkit**

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

**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**

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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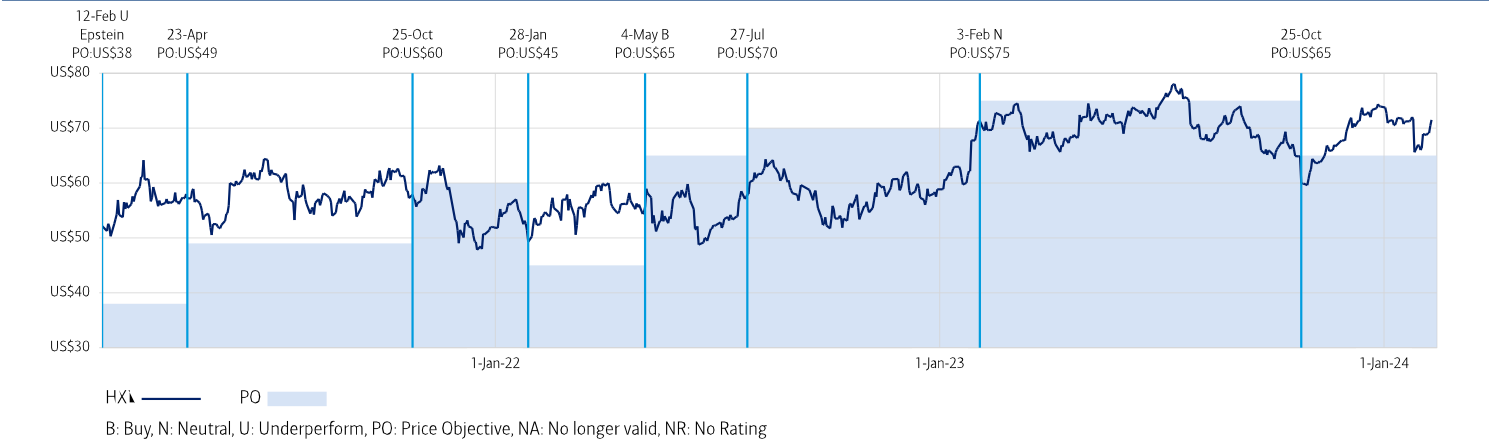
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Hexcel Corp (HXL) Price Chart



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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.

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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.

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