The Timken Co. (TKR)

Updated August 3rd, 2022, by Ian Bezek

Key Metrics

Current Price:	$64	**5 Year CAGR Estimate:**	6.2%	**Market Cap:**	$4.7 B
Fair Value Price:	$69	**5 Year Growth Estimate:**	3.0%	**Ex-Dividend Date:**	08/12/22
% Fair Value:	93%	**5 Year Valuation Multiple Estimate:**	1.5%	**Dividend Payment Date:**	09/02/22
Dividend Yield:	1.9%	**5 Year Price Target**	$80	**Years Of Dividend Growth:**	9
Dividend Risk Score:	C	**Retirement Suitability Score:**	D	**Rating:**	Hold

Overview & Current Events

Timken is an industrial company focused on making bearings, belts, gear drives, and other such assorted products. The company is heavily involved in vehicles but also sells to aerospace, energy, and agricultural end markets among others. Timken historically was also a significant player in the steel industry, but it spun off that business in 2014.

Timken has generally been viewed as a cyclical company prone to booms and busts. However, management has refocused operations around new verticals, such as renewable energy applications, which should have a more sustained demand growth profile. Timken also completed the acquisition of Spinea in May. Spinea is a European tech company that will give Timken inroads in the robotics and automation market.

Timken's strong operating performance continued with its Q2 earnings, released July 28th, 2022. Net sales equaled $1.15 billion, which represented 11% organic year-over-year growth. GAAP earnings of $1.42 per share topped expectations and rose from $1.36 per share in the same quarter of 2021. The company also offered upbeat guidance, raising its full-year outlook to a midpoint of $5.30 per share for GAAP earnings.

The guidance increase was a pleasant surprise, as it comes in stark contrast to Q1, when Timken offered more hedged guidance and warned of potential cost inflation and risks from geopolitical and economic headwinds. Now, however, the company sees a strong order backlog, rising product volumes, and continued favorable pricing.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	$4.66	$2.75	$2.55	$2.21	$1.97	$2.63	$4.18	$4.60	$4.10	$4.72	***$5.30***	***$6.14***
DPS	$0.92	$0.92	$1.00	$1.03	$1.04	$1.07	$1.11	$1.12	$1.13	$1.19	***$1.24***	***$1.44***
Shares	96	93	88	80	77	78	76	76	76	75	***74***	***72***

Timken has had an uneven earnings profile historically. Earnings fell every year sequentially from 2013 through 2016, though this was impacted by the spin-off of the company's former steel business. Earnings jumped dramatically between 2017 and 2019 and have held up during the pandemic as well. The company is forecasting record profits in 2022 and should be able to achieve further growth in future years as well.

The company has had a modest approach to capital returns to shareholders. In the early part of the 2010s, Timken repurchased a substantial amount of its stock. After a pause, it appears Timken is returning to more aggressive share repurchases. It bought back 750,000 shares in Q2 alone.

The company has given investors steady dividend hikes dating back to 2014. They have been conservative in size, though, with the company averaging just a 3% annualized dividend growth rate. On the other hand, Timken's dividend has been incredibly consistent; it has paid a dividend for 400 consecutive quarters.

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Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	9.7	20.5	20.5	16.1	16.8	17.5	10.9	10.1	12.6	16.4	***12.1***	***13.0***
Avg. Yld.	2.0%	1.6%	1.9%	2.9%	3.1%	2.3%	2.4%	2.4%	2.2%	1.5%	***1.9%***	***1.8%***

Timken stock has rarely received a high P/E multiple from the market; it's had a historical range of 10 to 20 times earnings over the past decade. Right now, shares are back in the lower part of that range.

On a yield basis, Timken offered a yield as high as 3% in the wake of the spin-off of the steel business in 2014. However, the yield has settled closer to 2% in recent years. That seems likely to persist, given Timken's increasing focus on growth and M&A of late. The company's current 1.9% dividend yield is right in-line with its more recent history.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	20%	33%	39%	47%	53%	41%	27%	24%	28%	25%	***23%***	***23%***

Timken priced a 10-year bond offering in March 2022 at an interest rate of just 4.125%. That's a strong vote of confidence for Timken from the credit market. The balance sheet backs that up. As of last quarter, Timken has just $1.7 billion of long-term debt against $2.5 billion of current assets and a market cap of more than $4 billion. Timken's profitability has improved in recent years, and it has financial capacity to withstand a significant recession.

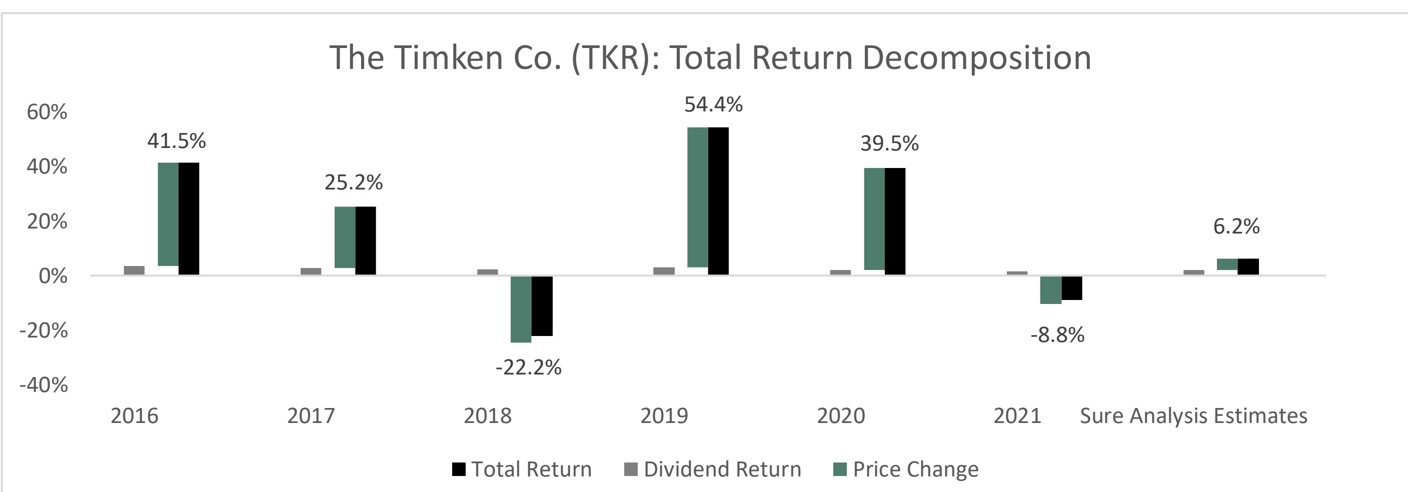
The company's dividend is also well-covered out of earnings. The payout ratio has fallen from a high of 53% in 2016 to just 23% now. This seemingly gives the company room for faster dividend increases or share repurchases in the future.

Final Thoughts & Recommendation

Historically, investors tended to view Timken as a lower-quality cyclical business. However, management's moves to reduce reliance on cyclical industries such as autos has served the company well. And now, Timken is enjoying a strong pricing environment in the current inflationary landscape.

Timken is still not the sort of business that is likely to sustain a high P/E multiple. Even so, the current 12.1 P/E ratio is attractive. We see the P/E ticking back up to a 13 multiple going forward. That, plus modest earnings growth could lead to shareholder returns of 6.2% annually through 2027. Timken stock earns a hold rating.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	3,360	3,035	3,076	2,872	2,670	3,004	3,581	3,790	3,513	4,133
Gross Profit	1,028	868	898	820	706	812	1,040	1,142	1,010	1,103
Gross Margin	30.6%	28.6%	29.2%	28.5%	26.5%	27.0%	29.0%	30.1%	28.7%	26.7%
SG&A Exp.	555	554	576	578	440	508	581	619	534	581
D&A Exp.	150	142	137	131	132	138	146	161	167	168
Operating Profit	474	315	322	242	266	304	459	523	476	522
Op. Margin	14.1%	10.4%	10.5%	8.4%	10.0%	10.1%	12.8%	13.8%	13.6%	12.6%
Net Profit	496	263	171	189	141	203	303	362	285	369
Net Margin	14.7%	8.7%	5.6%	6.6%	5.3%	6.8%	8.5%	9.6%	8.1%	8.9%
Free Cash Flow	506	296	180	275	266	132	220	410	456	239
Income Tax	186	115	55	26	61	58	103	98	104	95

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	4,244	4,478	3,001	2,784	2,763	3,402	4,445	4,860	5,042	5,171
Cash & Equivalents	586	385	279	130	149	122	133	210	320	257
Acc. Receivable	547	444	476	455	438	525	547	545	581	626
Inventories	862	583	586	543	554	739	836	842	841	1,043
Goodwill & Int.	564	554	499	599	629	932	1,694	1,752	1,789	1,692
Total Liabilities	1,998	1,829	1,412	1,440	1,452	1,928	2,803	2,905	2,816	2,793
Accounts Payable	216	140	144	160	176	265	273	302	351	430
Long-Term Debt	479	446	530	657	659	962	1,682	1,730	1,565	1,465
Total Equity	2,232	2,637	1,576	1,325	1,280	1,443	1,580	1,868	2,153	2,295
LTD/E Ratio	0.21	0.17	0.34	0.50	0.52	0.67	1.06	0.93	0.73	0.64

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	11.6%	6.0%	4.6%	6.5%	5.1%	6.6%	7.7%	7.8%	5.7%	7.2%
Return on Equity	23.3%	10.8%	8.1%	13.0%	10.8%	14.9%	20.0%	21.0%	14.2%	16.6%
ROIC	18.8%	9.0%	6.6%	9.2%	7.1%	9.2%	10.5%	10.3%	7.6%	9.7%
Shares Out.	96	93	88	80	77	78	76	76	76	75
Revenue/Share	34.42	31.68	33.72	33.65	33.70	38.07	45.71	49.29	45.98	53.67
FCF/Share	5.18	3.09	1.98	3.22	3.36	1.67	2.81	5.33	5.97	3.10

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.