TransDigm Group Inc. (NYSE: TDG)

Sector: Industrials

Target Price	Current Price	52 Week High	52 Week Low	P/E	Market Cap.	Dividend Yield	Beta
$314.16	$252.02	$294.38	$180.76	28x	$13.75B	N/A	0.55

Business Description

TransDigm Group Inc. develops, distributes, and manufactures commercial and military aerospace components such as mechanical actuators and ignition systems. TransDigm products are highly engineered and unique, with 90% of fiscal 2016 net sales derived from proprietary products and 80% of 2016 net sales derived from products of which TransDigm was the sole source provider. Company revenue is segmented into three units. Revenue breakdown based on segment as a percent in 2016 was ($3.17B total):
Power & Control: 51.1% | Airframe: 45.7% | Non-Aviation: 3.2%

Industry Trends

Due to increases in global GDP, the commercial aerospace industry is estimated to grow with increases in number of passengers and miles traveled, especially in more populous regions of the world such as Asia and the Middle East. According to projections made by the Federal Aviation Administration, global revenue passenger miles are expected to grow around 2.5% until about 2030. With this demand, airplane manufacturers are operating at record level backlogs and are actually planning on increasing production rates through 2019.

Within the defense industry, many countries are projected to increase their military budgets, especially the largest purchaser, the U.S. Department of Defense. Although there is not any data to include for projections, President Trump as stated that he would use deficit spending to fund the military and is planning on ending sequestration. With an agenda of protecting the U.S. and U.S. interests and also unrest from other regions in the globe, TransDigm is expected to grow its defense segment moving forward.

Investment Thesis

TransDigm's proprietary product offerings, coupled with stringent regulatory certifications and approvals, allow the company to experience high barriers to entry in the aerospace parts industry. In addition, management's focus on creating value through acquiring synergetic businesses expands TransDigm's product portfolio and improves cost efficiencies among its three business segments.

Valuation Assumptions

WACC: 7.00%
Terminal FCF Growth Rate: 2.25%

Key Financials

Gross Profit Margin: 55%
Net Income 2016: $586 million

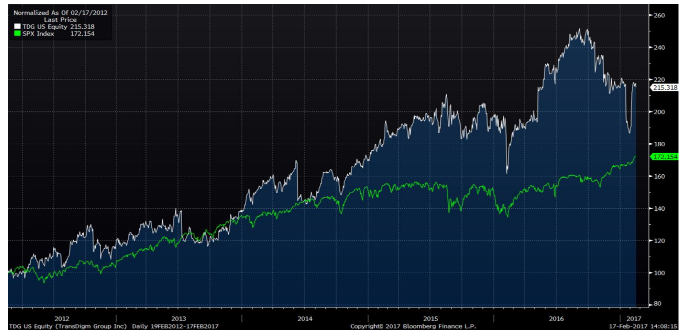
Corporate Social Responsibility

ESG Disclosure Score: 13.22 (Industry average: 18.18)
Percent Female Executives: 0% (Industry average: 14.8%)
Non-Executive Directors on Board: 7.00 (Industry median 8.00)
Average Exec. Salary + Bonus: $390.57K (Industry average: $538.94K)

Competitive Analysis

The aerospace parts and components industry is highly fragmented. Some of TransDigm's closest competitors based on product overlap and market capitalization include HEICO, AAR Corp., and Parker Hannifin. These three companies offer aerospace, industrial, and defense parts to OEM's and the aircraft aftermarket. TransDigm's competitive advantage lies in the portfolio of 58 subsidiary companies it has acquired since 1993 that produce specialized proprietary products that other companies are limited to competing with due to FAA certification and approval processes.

5-Year Stock Performance vs S&P 500



Growth Opportunities

Commercial Aircraft Market: With revenue passenger miles expected to increase at their highest rates through 2020 by about 5.9% each year and low energy prices, airline companies are projected to use older aircraft fleets for longer time periods than expected. These older aircrafts will require more demand in servicing, which is expected to boost TransDigm's highest margin business; the aftermarket segment.

2016 Acquisitions: TransDigm acquired three new businesses in 2016, namely Breeze Eastern, Young & Franklin Inc., and Data Device Corporation (DDC). All three companies receive approximately 70% of their revenues from the aftermarket (TransDigm received 54% of its revenues from the aftermarket), allowing the company to increase exposure to the higher margin aftermarket. Breeze Eastern helps TransDigm gain access to the helicopter industry with major customer accounts Sikorsky and AgustaWestland. Young & Franklin expands TransDigm's product portfolio of steering and landing control systems, as well as increases the company's exposure to the non-aviation market (i.e. industrial turbines). And DDC strengthens TransDigm's military market exposure with data bus control systems on the Apache, F-15, F-18, and other military aircraft.

Risks

Citron Research Report: Citron Research is accusing TransDigm of becoming the "Valeant of the Aerospace Industry" due to claims of price gouging and high profit margins. TransDigm's stock plunged 12% on 1/20/17 (the day the report was published), but rebounded 13 trading days later. Analysts covering TransDigm have deemed the report as non-factual and over-speculative. In addition, TransDigm's intellectual property on its products allow it to enjoy limited competition and barriers to entry in its product categories, resulting in higher prices and margins. The company, as of 2/16/17 has not released a formal statement regarding the report.

High Debt Levels: While the company has one of the highest debt levels in the industry from its acquisition strategy, management is focused on reducing exposure to interest rates. As of Q1 2017, 75% of the company's debt has been fixed or capped.

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Sources: Bloomberg, Mintel, IBISWorld, Morning Star, Value Line, Statista, Yahoo! Finance