Gorman-Rupp (GRC)

Updated April 21st, 2018 by Josh Arnold

Key Metrics

Current Price:	$31	**5 Year CAGR Estimate:**	6.1%	**Quality Percentile:**	N/A
Fair Value Price:	$31	**5 Year Growth Estimate:**	4.3%	**Momentum Percentile:**	N/A
% Fair Value:	99%	**5 Year Valuation Multiple Estimate:**	0.2%	**Total Return Percentile:**	N/A
Dividend Yield:	1.6%	**5 Year Price Target**	$39	**Valuation Percentile:**	N/A

Overview & Current Events

Gorman-Rupp began manufacturing pumps and pumping systems back in 1933. Since that time it has grown into an industry leader with annual sales approaching $380M and a market cap of $800M. Today, GRC is a focused, niche manufacturing of critical systems many industrial clients rely upon for their own success.

The company's recent Q4 report was mixed as sales were up just 1%, but profits rose sharply thanks to higher margins. In addition, orders were up 6%, indicating 2018 will see better levels of revenue growth. Higher gross margins and lower SG&A costs allowed GRC to produce $0.31 EPS against $0.19 in the comparable quarter in 2016.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$1.04	$0.70	$0.93	$1.10	$1.07	$1.15	$1.38	$1.06	$0.95	$1.22	***$1.42***	***$1.75***
DPS	$0.26	$0.26	$0.27	$0.27	$0.31	$0.33	$0.37	$0.41	$0.43	$0.47	***$0.50***	***$0.67***

GRC's EPS volatility has been very high and that has translated into lots of volatility for the stock as well in the past decade. As GRC makes products for industrial and municipal clients, its revenue can swing wildly from one year to another. Margins have been fairly stable over the past decade but it does experience boom/bust cycles in revenue generation, leading to lots of EPS volatility. We are forecasting 4.3% EPS growth going forward for GRC as its recent performance and near-term outlook have both improved.

It will achieve this result through a combination of low single digit sales growth and higher margins. The company's strong order rate in Q4 portends a stronger 2018 than 2017 and indeed, its backlog has grown heading into this year. Sales were roughly flat in 2017 but this year should prove much better; management has said as much, providing extra confidence to the forecast. In addition, gross margins have risen of late on favorable revenue mix as well as lower manufacturing costs. Finally, SG&A costs have leveraged down as a result of higher volumes as well as prudent cost controls. Keep in mind this is all in addition to the company's lower tax rate afforded it by the Tax Cuts and Jobs Act.

We are forecasting mid-single digit growth in the dividend as GRC's increases have been lumpy in the past, but have picked up in terms of significance lately. GRC is not a stock one buys for dividend growth or current yield, however.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	20.7	21.3	19.1	21.4	21.5	23.5	23.1	25.8	28.4	24.7	***21.8***	***22.0***
Avg. Yld.	1.2%	1.7%	1.5%	1.1%	1.4%	1.2%	1.2%	1.5%	1.6%	1.6%	***1.6%***	***1.7%***

GRC's PE multiple stayed in a fairly narrow range from 2008 to 2014 but in more recent years, investors have been willing to pay more. However, as of now GRC's PE multiple has fallen back towards more normalized levels that appear to be right at fair value. Thus, we are forecasting essentially the same valuation moving forward from here, having virtually no impact on total returns at just a 0.2% tailwind annually.

The yield should also creep up just a bit from the current 1.6% to 1.7% as the company continues to raise the payout. But again, GRC isn't appropriate for income investors because of its low current yield and in the mid-single digits, growth in the payout isn't particularly enticing for dividend growth investors.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	23.3%	23.2%	25.7%	24.4%	24.0%	23.9%	24.7%	22.8%	24.1%	26.0%	***26.5%***	***27.0%***
Debt/A	32%	29%	30%	28%	30%	26%	26%	21%	21%	18%	***18%***	***18%***
Int. Cov.	-	161.3	-	-	-	-	-	-	-	-	-	-
Payout	25%	37%	29%	26%	29%	29%	27%	38%	45%	39%	***35%***	***38%***
Std. Dev.	76.3%	65.9%	41.5%	56.6%	32.6%	31.3%	35.0%	32.8%	37.7%	30.0%	***35.0%***	***38.0%***

GRC's quality metrics have improved somewhat over the past decade. Its gross margins continue to head higher due to lower manufacturing costs and product mix, and it has no debt to speak of other than trade payables. Thus, its balance sheet is very clean and it is clear this company is very conservatively-financed. That affords GRC the ability to continuously invest in innovation the way it always has, but more importantly, GRC's balance sheet is strong enough to weather any economic weakness. Its payout ratio is well under 40% and should remain there for the foreseeable future as dividend growth should be just slightly ahead of EPS growth. GRC's EPS performance has also led to a high level of volatility in the stock and we are forecasting that volatility to continue in the coming years.

Its competitive advantage is in its many decades of experience in providing innovative solutions for niche, but critical, engineering problems facing its customers. However, GRC is far from immune to recession as its revenue and earnings both fell very sharply during the Great Recession. The next time a recession strikes, GRC's performance will be at risk.

Final Thoughts & Recommendation

Overall, GRC looks fairly valued here. The company's moderate level of EPS growth should afford investors 6.1% total annual returns, consisting of the current 1.6% yield, a modest 0.2% tailwind from the valuation, and 4.3% EPS growth boost. The current yield likely isn't high enough to entice income investors and its dividend growth is fairly unattractive as well. Due to mediocre total return prospects, investors should wait to buy into Gorman-Rupp until it is significantly undervalued. There are currently more enticing total return investments elsewhere.

Total Return Breakdown by Year