



Parker-Hannifin Corporation (PH)

Updated July 23rd, 2018 by Nick McCullum

Key Metrics

Current Price: \$160	5 Year CAGR Estimate: 9.7%	Volatility Percentile: 46.8%
Fair Value Price: \$151	5 Year Growth Estimate: 9.0%	Momentum Percentile: 33.2%
% Fair Value: 106%	5 Year Valuation Multiple Estimate: -1.2%	Valuation Percentile: 49.4%
Dividend Yield: 1.9%	5 Year Price Target \$232	Total Return Percentile: 63.3%

Overview & Current Events

Parker-Hannifin is a diversified industrial manufacturer specialized in motion and control technologies. The company was founded in 1917 and has grown to a market capitalization of \$21 billion and annual revenues of \$12 billion. Parker-Hannifin has paid a dividend for 68 years and has increased that dividend for a remarkable 61 consecutive years.

Parker-Hannifin reported (4/26/18) financial results for the third quarter of fiscal 2018 in late April. In the quarter, sales increased by 20% to \$3.75 billion, driven by an 8% increase in organic sales and an 11% increase in order rates. Better yet, Parker-Hannifin's strong sales growth was accompanied by meaningful margin expansion. The company's EBITDA margins increased by 280 basis points to 17.1% as reported, or 17.6% as adjusted. Bottom line results were even better. Parker-Hannifin generated GAAP earnings-per-share of \$2.70 and adjusted earnings-per-share of \$2.80 (a 33% year-on-year increase), both representing single-quarter records for this industrial manufacturing firm. More broadly, Parker-Hannifin set all-time records for both revenue and company-wide net income. Parker-Hannifin's robust financial performance was driven by the acquisition of CLARCOR (a filtration system and packing material manufacturer that was acquired by the company on February 28th, 2017) as well as general ongoing business growth. Parker-Hannifin passed this strong financial performance onto its shareholders through a 15% dividend increase.

Parker-Hannifin also updated its 2018 financial guidance with the release of its third-quarter financial results. The company now expects to generate adjusted earnings-per-share between \$9.95 and \$10.15 for the twelve-month reporting period. This is up meaningfully from the previous guidance range, which called for adjusted earnings-per-share between \$9.65 and \$10.05. More importantly, the company now expects to generate "a greater than 10% compound annual growth rate in adjusted earnings-per-share by fiscal year 2023." We have updated our 2018 earnings estimate to reflect the midpoint of Parker-Hannifin's new guidance band and have also slightly increased our 5-year growth rate estimate.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	\$5.53	\$3.13	\$3.40	\$6.37	\$7.45	\$6.26	\$6.45	\$7.25	\$6.46	\$8.11	\$10.05	\$15.45
DPS	\$0.84	\$1.00	\$1.01	\$1.25	\$1.54	\$1.70	\$1.86	\$2.37	\$2.52	\$2.58	\$2.81	\$4.35

Parker-Hannifin compounded its adjusted earnings-per-share at a rate of 4.3% per year over the last decade. We believe that the company's historical growth grossly understates its potential moving forward. Previously, we had been forecasting for 7% growth in adjusted earnings-per-share moving forward. After the company provided ambitious 10%+ 5-year earnings growth guidance in its most recent quarterly earnings release, we believe that it is prudent to raise our growth estimate to 9% moving forward. Applying a 9% growth rate to the midpoint of 2018's earnings guidance gives a 2023 earnings estimate of \$15.45.

Parker-Hannifin's growth will come in part from acquisitions. The \$4.3 billion CLARCOR transaction is an example of this. The purchase is expected to generate \$140 million in annual run rate cost synergies three years after closing. Importantly, the acquisition was immediately accretive to the pro-forma company's cash flow, earnings-per-share, and EBITDA margins after adjusting for one-time costs. We expect similarly acquisitions moving forward.

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.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	13.2	14.5	16.7	12.6	10.8	13.9	18.0	16.6	16.3	17.3	15.9	15.0
Avg. Yld.	1.2%	2.2%	1.8%	1.6%	1.9%	2.0%	1.6%	2.0%	2.4%	1.8%	1.9%	2.0%

The combination of a lower stock price and higher 2018 financial guidance has meaningfully improved Parker-Hannifin's valuation profile since the publication of our last quarterly research report. The company is currently trading at a price-to-earnings ratio of 15.9, slightly above our fair value estimate of 15.0. Due to the likelihood of valuation contraction, we are forecasting a 1.2% headwind to Parker-Hannifin's returns moving forward.

Safety, Quality, Competitive Advantage, & Recession Resiliency

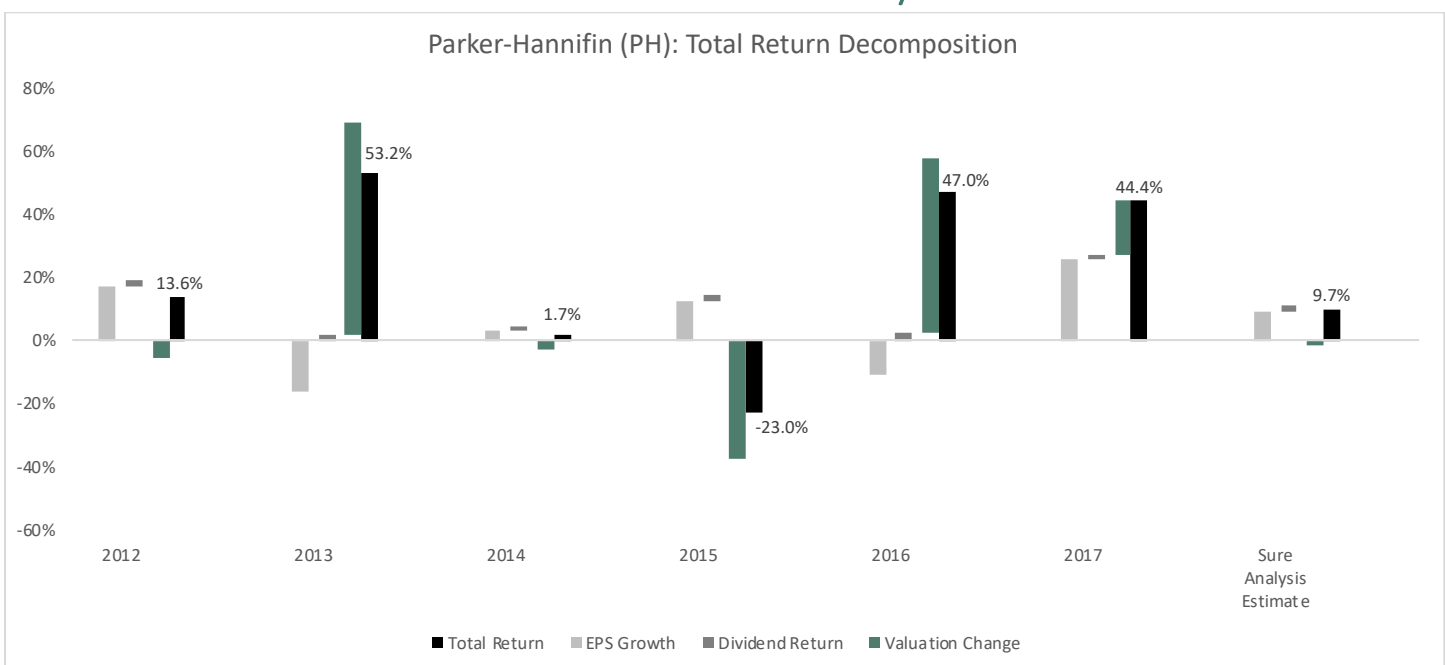
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	27.0%	21.6%	21.7%	27.2%	28.5%	23.4%	22.8%	24.9%	21.1%	18.3%	20.0%	20.0%
Debt/A	49.4%	56.7%	55.9%	50.5%	56.2%	54.2%	49.8%	58.4%	62.0%	66.0%	65.0%	60.0%
Int. Cov.	14.4	7.1	8.3	15.2	18.0	15.3	19.9	13.1	9.2	9.2	10.0	12.0
Payout	15.2%	31.9%	29.7%	19.6%	20.7%	27.2%	28.8%	32.7%	39.0%	31.8%	28.5%	32.7%
Std. Dev.	52.1%	42.3%	31.0%	38.1%	27.6%	20.5%	22.7%	22.9%	23.1%	17.1%	22.0%	22.0%

Parker-Hannifin's gross profits as a proportion of its total assets have declined over time. At the same time, its debt as a percent of total assets has increased. Still, the company's interest expense is still well-covered by its operating earnings. Qualitatively, Parker-Hannifin has a number of competitive advantages, including its scale, global distribution network, and technical experience. Parker-Hannifin manufactures components that are relatively obscure yet absolutely critical to the operations of heavy machinery, factory equipment, aircrafts, and other large industrial devices. This is appealing because the company operates in a profitable niche which helps to discourage large would-be competitors.

Final Thoughts & Recommendation

Parker-Hannifin's total return profile has improved significantly since last quarter's research report thanks to an improved valuation and a higher growth estimate resulting from management's optimistic view on future earnings. Because of this, Parker-Hannifin's high single-digit expected total returns earn it a potential buy recommendation for dividend growth investors looking to bolster their exposure to the industrial manufacturing sector.

Total Return Breakdown by Year



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