Gorman-Rupp (GRC)

Updated August 3rd, 2018 by Josh Arnold

Key Metrics

Current Price:	$37	**5 Year CAGR Estimate:**	3.9%	**Volatility Percentile:**	86.4%
Fair Value Price:	$34	**5 Year Growth Estimate:**	4.3%	**Momentum Percentile:**	75.7%
% Fair Value:	109%	**5 Year Valuation Multiple Estimate:**	-1.7%	**Valuation Percentile:**	48.0%
Dividend Yield:	1.3%	**5 Year Price Target**	$42	**Total Return Percentile:**	21.7%

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 of about $400 million and a market capitalization just under $1 billion. Today, Gorman-Rupp is a focused, niche manufacturing of critical systems many industrial clients rely upon for their own success.

Gorman-Rupp reported Q2 earnings on 7/27/18 and the company beat expectations on the top and bottom lines. Total revenue was up 14% while incoming orders were up 9.9%, portending further strong revenue growth in the quarters to come. Strength came from all over as the company's water markets were up 17%, non-water markets rose 7% and international markets increased 17%. Earnings-per-share was 39 cents against 30 cents in last year's comparable quarter. We have raised our 2018 earnings-per-share estimates slightly as a result of the strong Q2 report.

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	***$1.55***	***$1.90***
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***

Gorman-Rupp's earnings volatility has been very high and that has translated into lots of volatility for the stock in the past decade. As the company 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 earnings volatility. We are forecasting 4.3% earnings-per-share growth going forward as its recent performance and near-term outlook have both improved, including the strong Q2 report.

It will achieve this result through a combination of low single digit sales growth and higher margins. Sales were roughly flat in 2017 but this year should prove much better; management has said as much, providing extra confidence to the forecast and confirmed by Q2 results. 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 Gorman-Rupp's increases have been lumpy in the past but have picked up in terms of significance lately. This 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	***24.0***	***22.0***
Avg. Yld.	1.2%	1.7%	1.5%	1.1%	1.4%	1.2%	1.2%	1.5%	1.6%	1.6%	***1.3%***	***1.6%***

Gorman-Rupp's price-to-earnings multiple stayed in a fairly narrow range from 2008 to 2014 but in more recent years, investors have been willing to pay more. The stock's recent rally has the price-to-earnings ratio back to 24, putting the stock slightly in excess of fair value once again. We are therefore forecasting a 1.7% headwind to total returns.

The yield should also creep up from the current 1.3% to 1.6% as the company continues to raise the payout. But again, Gorman-Rupp 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%	***32%***	***35%***
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%***

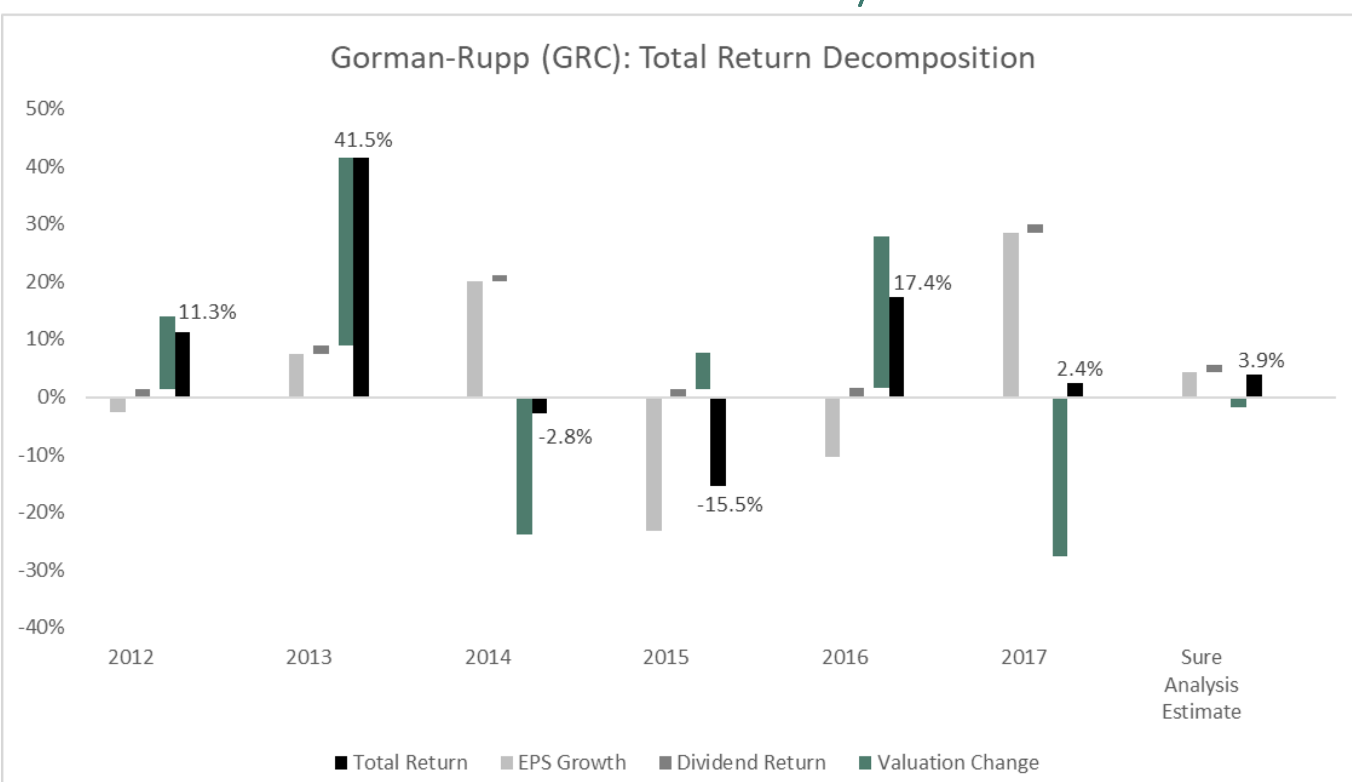
Gorman-Rupp's quality metrics have improved somewhat over the past decade. Its gross margins continue to head higher due to lower manufacturing costs and product mix, and it has no debt to speak of other than trade payables. Thus, its balance sheet is very clean and it is clear this company is very conservatively-financed. That affords Gorman-Rupp the ability to continuously invest in innovation the way it always has, but more importantly, its 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 earnings-per-share growth. Its earnings performance has also led to a high level of volatility in the stock and we are forecasting that volatility to continue.

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

Final Thoughts & Recommendation

Overall, Gorman-Rupp looks slightly overvalued after the recent rally. The company's moderate level of earnings growth should afford investors 3.9% total annual returns, consisting of the current 1.3% yield, a 1.7% headwind from the valuation, and 4.3% earnings-per-share growth. The current yield likely is not 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. Accordingly, Gorman-Rupp earns a sell recommendation from Sure Dividend at current prices.

Total Return Breakdown by Year



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.