



The Gorman-Rupp Company (GRC)

Updated May 11th, 2019 by Josh Arnold

Key Metrics

Current Price:	\$33	5 Year CAGR Estimate:	3.4%	Volatility Percentile:	76.9%
Fair Value Price:	\$29	5 Year Growth Estimate:	4.5%	Momentum Percentile:	51.3%
% Fair Value:	115%	5 Year Valuation Multiple Estimate:	-2.7%	Growth Percentile:	32.9%
Dividend Yield:	1.6%	5 Year Price Target	\$36	Valuation Percentile:	30.1%
Dividend Risk Score:	A	Retirement Suitability Score:	B	Total Return Percentile:	14.7%

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 \$430 million and a market capitalization just under \$900 million. Today, Gorman-Rupp is a focused, niche manufacturer of critical systems that many industrial clients rely upon for their own success. Gorman-Rupp generates about one-third of its total revenue from outside the US.

Gorman-Rupp reported Q1 earnings on 4/25/19 and results were weak. Total revenue was up 0.3% in Q1 to \$96.9 million as domestic sales rose 5.1%, but that gain was offset by a 9.4% decline in international sales.

The company's water markets revenue rose 4.7% thanks to increased sales to municipal customers, but that was partially offset by a decline in fire protection revenue. Sales in non-water markets declined 8.8% as sales were weak across the board in that segment.

Gross margins came in at 24.1% in Q1, a decline of 300bps from 27.1% in last year's comparable quarter. The decline was due to material cost inflation, tariffs, and higher freight costs. This has been the case for Gorman-Rupp for three quarters now as the company continues to suffer due to factors largely outside of its control.

SG&A costs were 14.8% of revenue in Q1, essentially flat to last year's Q1 number of 14.9%. This meant that operating income was 9.2% of revenue in Q1 compared to 12.3% in last year's Q1. The decline of 310bps was due primarily to the loss in gross margins, as discussed above.

Net income came in at \$0.28 per share, a decline of nine cents, or 24% year-over-year thanks to lower operating margins.

After the weaker-than-expected Q1 report, we're lowering our earnings-per-share estimate for this year from \$1.65 to \$1.45. While that is a significant reduction, we believe it is warranted given the enormous margin weakness the company experienced in Q1.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	\$0.70	\$0.93	\$1.10	\$1.07	\$1.15	\$1.38	\$1.06	\$0.95	\$1.22	\$1.53	\$1.45	\$1.81
DPS	\$0.26	\$0.27	\$0.27	\$0.31	\$0.33	\$0.37	\$0.41	\$0.43	\$0.47	\$0.51	\$0.54	\$0.66
Shares	26	26	26	26	26	26	26	26	26	26	26	26

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, as was the case in Q1. We are forecasting 4.5% earnings-per-share growth going forward as its recent performance and near-term outlook have both improved, Q1 results notwithstanding.

It can achieve this result mostly through low single digit sales growth. Management correctly forecast higher sales in 2018 and given its robust backlog of uncompleted work, we see that continuing for the near term. Gorman-Rupp's primary earnings growth driver is certainly revenue as its margins fluctuate over time, even when sales rise.

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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	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	21.3	19.1	21.4	21.5	23.5	23.1	25.8	28.4	24.7	21.6	23.0	20.0
Avg. Yld.	1.7%	1.5%	1.1%	1.4%	1.2%	1.2%	1.5%	1.6%	1.6%	1.5%	1.6%	1.8%

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. Given the lateness of the cycle we're in, we've moved Gorman-Rupp's fair value down from 22 to 20 times earnings. Shares trade at 23 times earnings today, so we are forecasting a nearly 3% headwind to total returns from the valuation in the coming years.

The yield should also remain about where it is today; Gorman-Rupp did pay a \$2 special dividend in Q4 of 2018.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	37%	29%	26%	29%	29%	27%	38%	45%	39%	33%	37%	37%

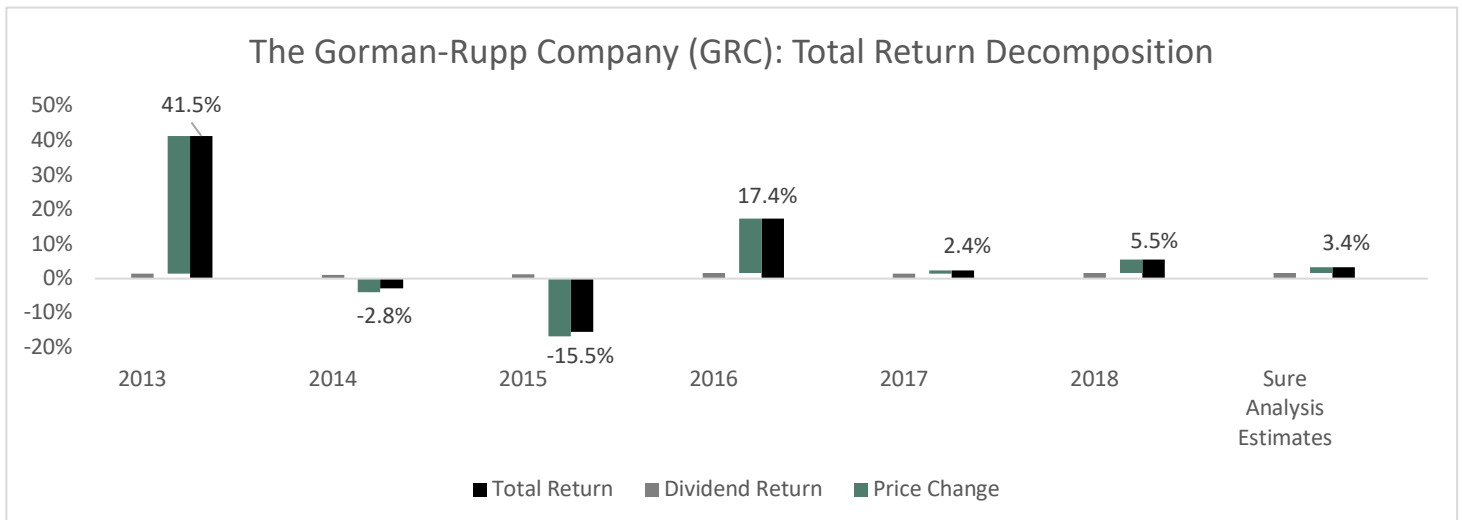
Gorman-Rupp's payout ratio is around one-third of earnings and should remain there for the foreseeable future as dividend growth should be just slightly ahead of earnings-per-share growth.

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 recessions as revenue and earnings both fell very sharply during the Great Recession. The next time a recession strikes, earnings will be at risk.

Final Thoughts & Recommendation

Gorman-Rupp is trading at 115% of our estimate of fair value following the weak Q1 report. The company's moderate level of earnings growth could afford investors just 3.4% total annual returns, consisting of the current 1.6% yield, -2.7% impact from the valuation, and 4.5% 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. As a result of mediocre total return prospects, Gorman-Rupp earns a sell recommendation from Sure Dividend at current prices.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	266	297	359	376	392	435	406	382	379	414
Gross Profit	62	76	88	90	94	108	93	92	99	110
Gross Margin	23.2%	25.7%	24.4%	24.0%	23.9%	24.7%	22.8%	24.1%	26.0%	26.5%
SG&A Exp.	35	37	45	48	52	54	56	55	57	59
D&A Exp.	9	11	11	12	14	15	15	16	15	N/A
Operating Profit	26	39	43	42	42	53	36	37	42	51
Operating Margin	9.9%	13.1%	12.0%	11.2%	10.7%	12.3%	9.0%	9.8%	11.1%	12.2%
Net Profit	18	26	29	28	30	36	25	25	27	40
Net Margin	6.9%	8.7%	8.0%	7.5%	7.7%	8.3%	6.2%	6.5%	7.0%	9.6%
Free Cash Flow	50	20	10	16	29	16	32	47	36	N/A
Income Tax	9	12	14	14	14	18	12	12	13	10

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	249	287	299	335	356	381	364	383	395	368
Cash & Equivalents	44	32	20	20	31	24	24	58	80	46
Accounts Receivable	37	52	56	59	59	71	77	71	67	68
Inventories	41	51	73	91	90	95	83	69	75	87
Goodwill & Int. Ass.	7	26	25	32	32	40	41	43	38	36
Total Liabilities	72	87	84	100	91	99	77	80	70	75
Accounts Payable	9	12	16	15	18	18	15	16	16	17
Long-Term Debt	15	25	10	22	9	12	0	0	0	0
Shareholder's Equity	177	200	215	235	264	282	287	303	325	293
D/E Ratio	0.08	0.13	0.05	0.09	0.03	0.04	0.00	0.00	0.00	0.00

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	7.6%	9.7%	9.8%	8.9%	8.7%	9.8%	6.7%	6.7%	6.8%	10.5%
Return on Equity	10.9%	13.8%	13.9%	12.5%	12.1%	13.2%	8.8%	8.4%	8.5%	12.9%
ROIC	10.4%	12.4%	12.8%	11.7%	11.4%	12.7%	8.6%	8.4%	8.5%	12.9%
Shares Out.	26	26	26	26	26	26	26	26	26	26
Revenue/Share	10.20	11.36	13.70	14.32	14.92	16.56	15.51	14.65	14.54	15.86
FCF/Share	1.90	0.78	0.38	0.62	1.12	0.60	1.24	1.78	1.36	N/A

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

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