



The Gorman-Rupp Company (GRC)

Updated February 17th, 2020 by Josh Arnold

Key Metrics

Current Price:	\$36	5 Year CAGR Estimate:	3.8%	Market Cap:	\$928M
Fair Value Price:	\$32	5 Year Growth Estimate:	4.5%	Ex-Dividend Date:	05/13/20 ¹
% Fair Value:	112%	5 Year Valuation Multiple Estimate:	-2.2%	Dividend Payment Date:	06/10/20 ²
Dividend Yield:	1.6%	5 Year Price Target	\$40	Years Of Dividend Growth:	47
Dividend Risk Score:	A	Retirement Suitability Score:	B	Last Dividend Increase:	7.4%

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 \$410 million and a market capitalization of \$928 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 of the US. The company also has one of the most impressive dividend increase streaks in the market, which currently stands at 47 years.

Gorman-Rupp reported Q4 and full-year earnings on February 7th and results missed expectations on the top and bottom lines. Total sales for 2019 were \$398 million, down from \$414 million in 2018, and missing our expectations. Domestic sales were up 1.3%, but international sales declined -13.8%. Unfavorable currency translation was a small part of the decline, but the company continues to experience significant weakness in its international markets, particularly with respect to oil and gas markets.

Gross profit came to \$102.7 million, or 25.8% of revenue, compared to \$109.9 million, or 26.5% of revenue, in 2018. The decline of 70bps was due to a loss of leverage on fixed labor and overhead costs resulting from lower revenue, as well as higher healthcare costs. The company did see a favorable inventory adjustment that offset some of those declines, but margins were certainly weak in 2019.

SG&A costs also rose as a percentage of sales, although they fell on a dollar basis. The increase of 50bps to 14.8% of revenue was due once again to a loss of leverage from lower revenue. Resulting operating margin was 150bps lower than 2018, with operating income declining from \$50.6 million to \$43.8 million year-over-year.

Net income came to \$35.8 million in 2019, down from \$40 million in 2018, with per-share earnings declining from \$1.53 to \$1.37. The company's backlog stands at just over \$100 million, and incoming orders were strong in Q4, so we see a slight rebound in earnings to \$1.45 for 2020.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	\$0.93	\$1.10	\$1.07	\$1.15	\$1.38	\$1.06	\$0.95	\$1.22	\$1.53	\$1.37	\$1.45	\$1.81
DPS	\$0.27	\$0.27	\$0.31	\$0.33	\$0.37	\$0.41	\$0.43	\$0.47	\$0.51	\$0.55	\$0.58	\$0.66
Shares³	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 2019 following a strong performance in

¹ Estimated date

² Estimated date

³ Share count in millions

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2018. We are forecasting 4.5% earnings-per-share growth going forward, but note that recent weakness continues to suggest further volatility in earnings moving forward.

The company 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.

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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2024
Avg. P/E	19.1	21.4	21.5	23.5	23.1	25.8	28.4	24.7	21.6	24.5	24.6	22.0
Avg. Yld.	1.5%	1.1%	1.4%	1.2%	1.2%	1.5%	1.6%	1.6%	1.5%	1.6%	1.6%	1.7%

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. Shares trade at 24.6 times earnings today, which is in excess of our fair value estimate of 22 times earnings, so we are forecasting a ~2% 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	29%	26%	29%	29%	27%	38%	45%	39%	33%	40%	40%	36%

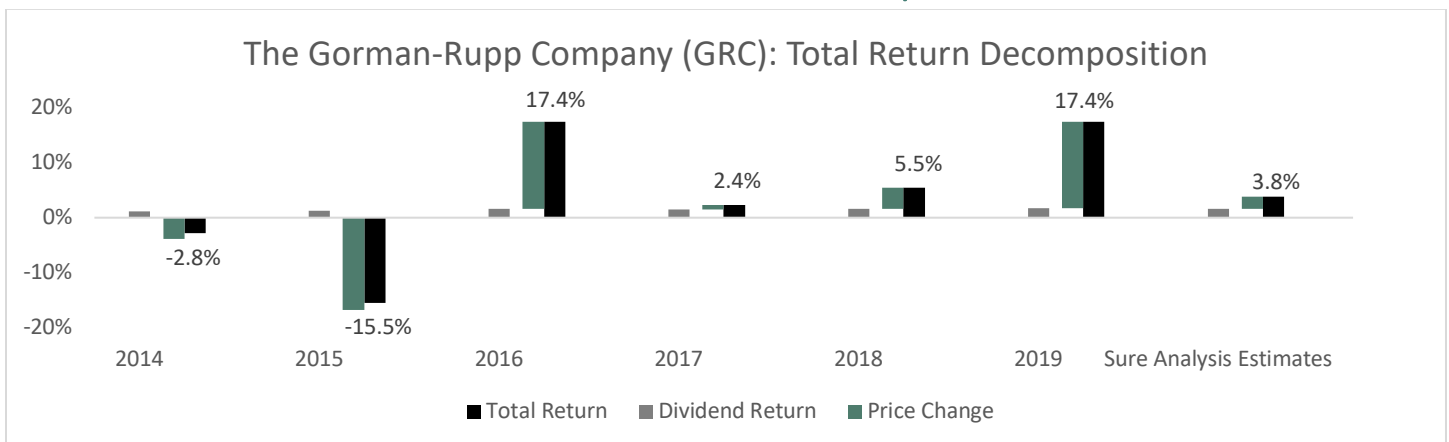
Gorman-Rupp's payout ratio is less than half of earnings and should remain there for the foreseeable future as we anticipate dividend growth to be just slightly ahead of earnings-per-share growth.

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 112% of our estimate of fair value following the Q4 report. The company's moderate level of earnings growth could afford investors ~4% annual returns as the valuation has improved since our last report. However, given low expected total returns, we continue to rate Gorman-Rupp a sell.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	297	359	376	392	435	406	382	379	414	398
Gross Profit	76	88	90	94	108	93	93	101	110	103
Gross Margin	25.7%	24.4%	24.0%	23.9%	24.7%	22.8%	24.2%	26.7%	26.5%	25.8%
SG&A Exp.	37	45	48	52	54	56	54	55	59	59
D&A Exp.	11	11	12	14	15	15	16	15	14	
Operating Profit	39	43	42	42	53	36	38	46	51	44
Operating Margin	13.1%	12.0%	11.2%	10.7%	12.3%	9.0%	10.0%	12.1%	12.2%	11.0%
Net Profit	26	29	28	30	36	25	25	27	40	36
Net Margin	8.7%	8.0%	7.5%	7.7%	8.3%	6.2%	6.5%	7.0%	9.6%	9.0%
Free Cash Flow	20	10	16	29	16	32	47	36	30	
Income Tax	12	14	14	14	18	12	12	13	10	9

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	287	299	335	356	381	364	383	395	368	383
Cash & Equivalents	32	20	20	31	24	24	58	80	46	81
Accounts Receivable	52	56	59	59	71	77	71	67	68	65
Inventories	51	73	91	90	95	83	69	75	87	76
Goodwill & Int. Ass.	26	25	32	32	40	41	43	38	36	35
Total Liabilities	87	84	100	91	99	77	80	70	75	75
Accounts Payable	12	16	15	18	18	15	16	16	17	16
Long-Term Debt	25	10	22	9	12	-	-	-	-	-
Shareholder's Equity	200	215	235	264	282	287	303	325	293	308
D/E Ratio	0.13	0.05	0.09	0.03	0.04	-	-	-	-	-

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	9.7%	9.8%	8.9%	8.7%	9.8%	6.7%	6.7%	6.8%	10.5%	9.5%
Return on Equity	13.8%	13.9%	12.5%	12.1%	13.2%	8.8%	8.4%	8.5%	12.9%	11.9%
ROIC	12.4%	12.8%	11.7%	11.4%	12.7%	8.6%	8.4%	8.5%	12.9%	11.9%
Shares Out.	26	26	26	26	26	26	26	26	26	26
Revenue/Share	11.36	13.70	14.32	14.92	16.56	15.51	14.65	14.54	15.87	15.23
FCF/Share	0.78	0.38	0.62	1.12	0.60	1.24	1.78	1.36	1.16	

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

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