



Parker-Hannifin Corporation (PH)

Updated January 31st, 2020 by Aristofanis Papadatos

Key Metrics

Current Price:	\$205	5 Year CAGR Estimate:	3.9%	Market Cap:	\$25.6 B
Fair Value Price:	\$158	5 Year Growth Estimate:	7.5%	Ex-Dividend Date:	2/6/2020
% Fair Value:	130%	5 Year Valuation Multiple Estimate:	-5.0%	Dividend Payment Date:	3/6/2020
Dividend Yield:	1.7%	5 Year Price Target	\$227	Years Of Dividend Growth:	63
Dividend Risk Score:	A	Retirement Suitability Score:	B	Last Dividend Increase:	15.8%

Overview & Current Events

Parker-Hannifin is a diversified industrial manufacturer specializing in motion and control technologies. The company was founded in 1917 and has grown to a market capitalization of \$26 billion with annual revenues of \$14 billion. Parker-Hannifin has paid a dividend for 69 years and has increased that dividend for a remarkable 63 consecutive years.

On October 29th, Parker-Hannifin completed the acquisition of LORD, a leading manufacturer of advanced adhesives and coatings, for \$3.675 billion in cash. On September 16th, Parker-Hannifin completed the acquisition of Exotic Metals Forming Company LLC for \$1.725 billion in cash. These two acquisitions are expected to add \$1.5 billion in annual revenues. Notably Parker-Hannifin has exceeded analysts' earnings-per-share estimates for 18 consecutive quarters.

In late January, Parker-Hannifin reported (1/30/20) financial results for the second quarter of fiscal 2020. Sales edged up 0.9%, from \$3.47 billion in prior year's quarter to a second quarter record of \$3.50 billion, and adjusted earnings-per-share rose from \$2.51 to \$2.54. The company is experiencing softening demand for its products and is doing its best to assimilate its two recently acquired companies. Management narrowed its adjusted earnings-per-share guidance for this fiscal year, from \$10.10-\$10.90 to \$10.25-\$10.85. We have thus marginally raised our forecast for this year, from \$10.50 to \$10.55. Nevertheless, the new guidance is still much worse than previous guidance for at least 10% annual earnings-per-share growth until 2023. The current guidance includes a 5.1%-7.5% decrease in organic sales in this fiscal year.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	\$3.40	\$6.37	\$7.45	\$6.26	\$6.45	\$7.25	\$6.46	\$8.11	\$10.42	\$11.85	\$10.55	\$15.15
DPS	\$1.01	\$1.25	\$1.54	\$1.70	\$1.86	\$2.37	\$2.52	\$2.58	\$2.81	\$3.16	\$3.52	\$4.80
Shares¹	161.3	155.1	149.6	149.3	148.8	138.4	134.0	133.1	132.4	128.5	128.0	115.0

During the last decade, Parker-Hannifin has more than tripled its earnings-per-share. While the company cannot maintain this growth rate in the upcoming years, it still has promising growth prospects ahead. Nevertheless, due to deceleration in North America and international markets, we expect approximately 7.5% annual earnings-per-share growth over the next five years.

Parker-Hannifin's growth will come in part from acquisitions. The \$4.3 billion CLARCOR transaction and the aforementioned two acquisitions are examples of this. Parker Hannifin integrates the new products in its system while it achieves significant synergies.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2025
Avg. P/E	14.5	16.7	12.6	10.8	13.9	18.0	16.6	16.3	17.3	14.2	19.4	15.0
Avg. Yld.	2.2%	1.8%	1.6%	1.9%	2.0%	1.6%	2.0%	2.4%	1.8%	1.9%	1.7%	2.1%

¹ In millions.

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.



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Parker-Hannifin has rallied 35% in eight months and is currently trading at a price-to-earnings ratio of 19.4, which is much higher than our fair value estimate of 15.0 and the richest valuation level in more than a decade. If the stock reverts to our fair value estimate over the next five years, it will incur a -5.0% annualized drag in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	29.7%	19.6%	20.7%	27.2%	28.8%	32.7%	39.0%	31.8%	27.0%	26.7%	33.4%	31.7%

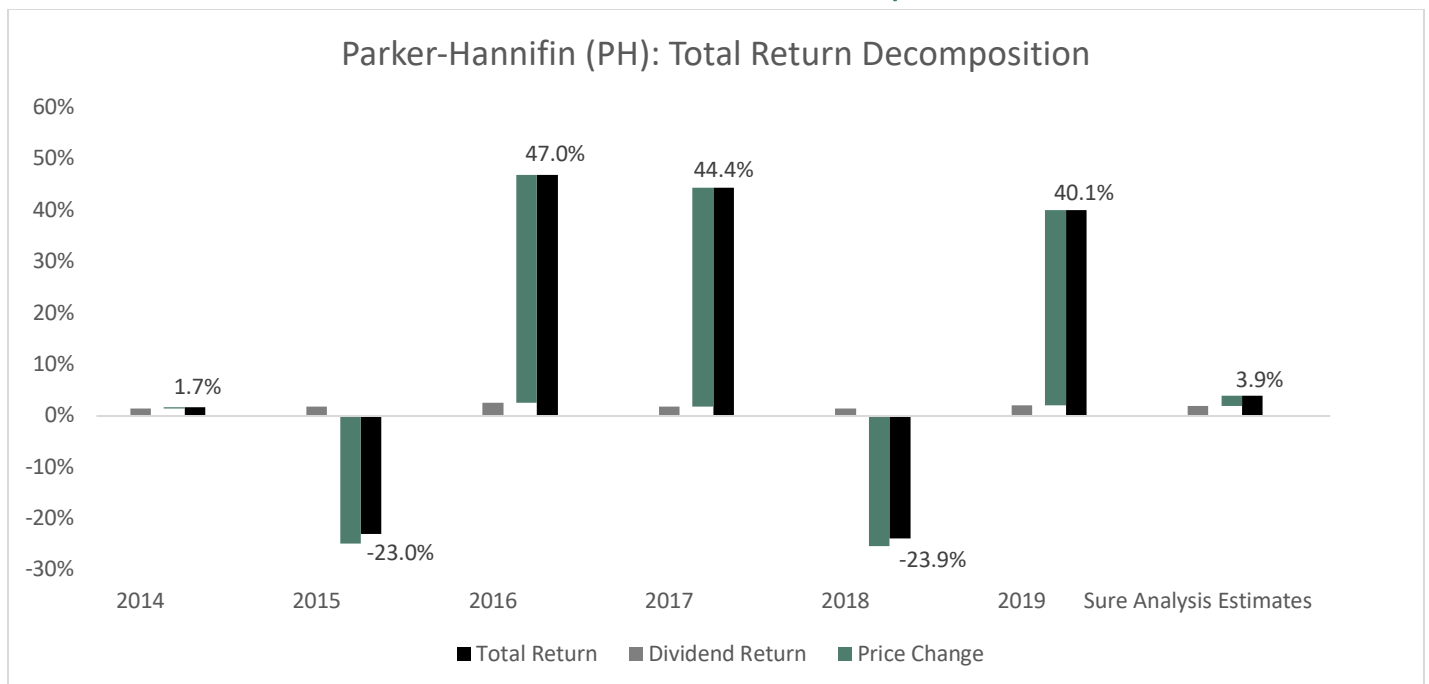
Parker-Hannifin has a number of competitive advantages, including its scale, global distribution network, and technical experience. Parker-Hannifin manufactures components that are relatively obscure yet absolutely critical to the operations of heavy machinery, factory equipment, aircrafts, and other large industrial devices. This is appealing because the company operates in a profitable niche that helps discourage large would-be competitors. The competitive advantage of Parker-Hannifin is clearly reflected in its dividend growth record, which is exceptional, particularly given the high cyclicality of the industrial sector. The company raised its dividend by 16% last year and it has now raised its dividend for 63 consecutive years.

Due to the recent acquisitions of Parker Hannifin, its interest expense has increased more than 50%. However, its interest expense still consumes only 11% of its operating income. In addition, thanks to its strong free cash flows, Parker-Hannifin will reduce its interest expense at a fast clip, just like it has done after past acquisitions. The decrease in interest expense will provide an additional (though modest) boost to the bottom line.

Final Thoughts & Recommendation

Parker-Hannifin has rallied 35% in eight months and has promising growth potential in the years ahead. However, growth has decelerated while the stock is trading at a decade-high valuation level. As a result, the stock has become much less attractive than it was a few months ago. We now expect the stock to offer just a 3.9% average annual return over the next five years and thus we maintain our hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	9,993	12,346	13,146	13,016	13,216	12,712	11,361	12,029	14,302	14,320
Gross Profit	2,146	2,958	3,188	2,929	3,028	3,056	2,537	2,910	3,565	3,617
Gross Margin	21.5%	24.0%	24.2%	22.5%	22.9%	24.0%	22.3%	24.2%	24.9%	25.3%
SG&A Exp.	1,277	1,468	1,519	1,555	1,634	1,545	1,359	1,413	1,640	1,544
D&A Exp.	363	340	322	336	337	317	307	355	466	436
Operating Profit	869	1,491	1,668	1,374	1,394	1,512	1,178	1,497	1,925	2,073
Op. Margin	8.7%	12.1%	12.7%	10.6%	10.5%	11.9%	10.4%	12.4%	13.5%	14.5%
Net Profit	554	1,049	1,152	948	1,041	1,012	807	983	1,061	1,512
Net Margin	5.5%	8.5%	8.8%	7.3%	7.9%	8.0%	7.1%	8.2%	7.4%	10.6%
Free Cash Flow	1,090	960	1,312	925	1,172	1,148	1,061	1,097	1,349	1,535
Income Tax	198	357	421	362	515	420	308	345	641	420

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	9,910	10,887	11,170	12,541	13,274	12,279	12,034	15,490	15,320	17,577
Cash & Equivalents	576	657	838	1,781	1,614	1,181	1,222	885	822	3,220
Accounts Receivable	1,443	1,770	1,782	1,841	1,858	1,620	1,594	1,931	2,146	2,131
Inventories	1,172	1,412	1,401	1,377	1,372	1,300	1,173	1,549	1,621	1,678
Goodwill & Int. Ass.	3,936	4,187	4,021	4,514	4,360	3,956	3,826	7,894	7,520	7,237
Total Liabilities	5,451	5,398	6,265	6,799	6,612	7,172	7,455	10,223	9,455	11,609
Accounts Payable	889	1,174	1,195	1,156	1,252	1,092	1,035	1,300	1,430	1,413
Long-Term Debt	1,777	1,766	1,730	2,830	2,325	2,947	3,014	5,870	4,957	7,108
Shareholder's Equity	4,368	5,384	4,897	5,738	6,659	5,104	4,575	5,262	5,860	5,962
D/E Ratio	0.41	0.33	0.35	0.49	0.35	0.58	0.66	1.12	0.85	1.19

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	5.6%	10.1%	10.4%	8.0%	8.1%	7.9%	6.6%	7.1%	6.9%	9.2%
Return on Equity	12.8%	21.5%	22.4%	17.8%	16.8%	17.2%	16.7%	20.0%	19.1%	25.6%
ROIC	8.6%	15.6%	16.6%	12.5%	11.9%	11.9%	10.3%	10.5%	9.7%	12.7%
Shares Out.	161.3	155.1	149.6	149.3	148.8	138.4	134.0	133.1	132.4	128.5
Revenue/Share	61.34	74.92	85.00	85.86	87.27	87.60	82.98	88.74	105.61	108.67
FCF/Share	6.69	5.82	8.48	6.10	7.74	7.91	7.75	8.11	9.99	11.65

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

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