



The Gorman-Rupp Company (GRC)

Updated November 6th, 2020 by Josh Arnold

Key Metrics

| | | | | | |
|-----------------------------|------|--|-------|----------------------------------|----------|
| Current Price: | \$33 | 5 Year CAGR Estimate: | 4.3% | Market Cap: | \$867 M |
| Fair Value Price: | \$31 | 5 Year Growth Estimate: | 4.0% | Ex-Dividend Date: | 11/12/20 |
| % Fair Value: | 108% | 5 Year Valuation Multiple Estimate: | -1.5% | Dividend Payment Date: | 12/10/20 |
| Dividend Yield: | 1.9% | 5 Year Price Target | \$37 | Years Of Dividend Growth: | 48 |
| Dividend Risk Score: | A | Retirement Suitability Score: | B | Last Dividend Increase: | 6.9% |

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 \$350 million and a market capitalization of \$867 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 48 years.

Gorman-Rupp reported third quarter earnings on October 23rd, with results coming in better than expected on the top and bottom lines. Net sales were \$89 million, down from \$99.3 million in the year-ago period, a decrease of -10.4%. Domestic sales were down -8.9% and international sales fell -13.8%. The company saw sales declines in all markets as a result of COVID-19, as well as the resulting slowdown in the oil & gas industry. Sales did improve 3.7% against this year's second quarter.

Gross profit was \$23 million, or 25.8% of revenue, down from \$25.8 million and 26%, respectively, in the same period last year. SG&A costs were 14.9% of sales, up from 14.3% a year ago, due to revenue deleveraging. Operating income came to \$9.7 million, or 10.9% of revenue, down from \$11.6 million and 11.7%, respectively, in the same period in 2019.

Net income was \$7.3 million in Q3, down from \$9.8 million a year ago, and down from \$0.37 to \$0.28 on a per-share basis. We estimate earnings-per-share at \$1.10 for this year, but we use an earnings power estimate of \$1.40 per share for our fair value and valuation calculations to adjust for the temporary impacts of COVID-19.

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 | \$1.10 | \$1.70 |
| DPS | \$0.27 | \$0.27 | \$0.31 | \$0.33 | \$0.37 | \$0.41 | \$0.43 | \$0.47 | \$0.51 | \$0.55 | \$0.62 | \$0.79 |
| Shares¹ | 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 2018. We are forecasting 4% earnings-per-share growth going forward from our earnings power estimate but note that recent weakness continues to suggest further volatility moving forward.

The company can achieve this result mostly through low single-digit sales growth. Management correctly forecast higher sales in 2018 and 2019 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. Q3 profits were down on revenue deleveraging, but Gorman-Rupp is focusing on cost containment efforts to help combat this while it waits for revenue to rise.

¹ Share count in millions

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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 solely for the 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 | 23.7 | 22.0 |
| Avg. Yld. | 1.5% | 1.1% | 1.4% | 1.2% | 1.2% | 1.5% | 1.6% | 1.6% | 1.5% | 1.6% | 1.9% | 2.1% |

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 23.7 times our earnings power estimate, which is in excess of our fair value estimate of 22 times earnings, so we are forecasting a small headwind to total returns from the valuation in the coming years. The yield should also remain near 2%; 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% | 44% | 47% |

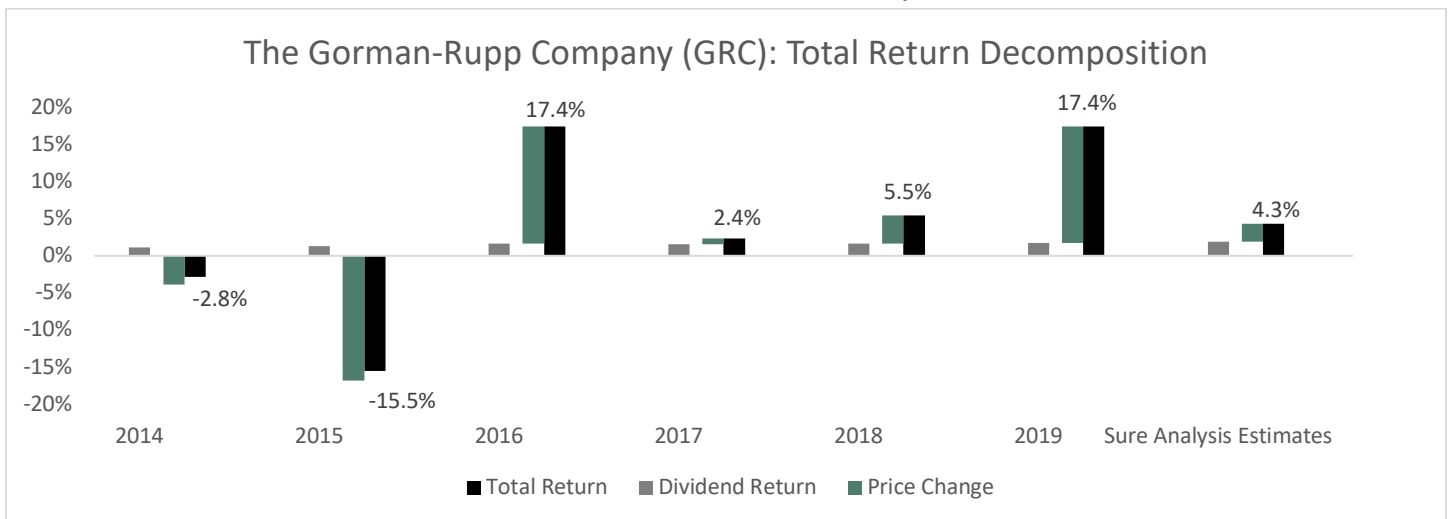
Gorman-Rupp's payout ratio is around half of earnings and should remain there for the foreseeable future as we anticipate moderate dividend growth over the intermediate term.

The company's 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. We see earnings as at-risk for this recession, as noted above, and indeed, depressed earnings for 2020 have come to fruition.

Final Thoughts & Recommendation

Gorman-Rupp is trading at 108% of our estimate of fair value following the Q3 report. The company's moderate level of earnings growth could afford investors 4.3% annual returns as the valuation has improved somewhat since our last report. As a result, we're reiterating Gorman-Rupp at a hold rating, but note that investors are likely to experience significant volatility in earnings in the coming years. Indeed, much is dependent upon a recovery in the oil & gas industry, as well as general economic recovery for the company's customers.

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 | 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 | 51 |
| 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 | 1.96 |

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

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