Donaldson Company (DCI)

Updated December 14th, 2022, by Josh Arnold

Key Metrics

Current Price:	$60	**5 Year CAGR Estimate:**	13.2%	**Market Cap:**	$7.3 B
Fair Value Price:	$72	**5 Year Growth Estimate:**	8.0%	**Ex-Dividend Date:**	03/02/23[1]
% Fair Value:	83%	**5 Year Valuation Multiple Estimate:**	3.7%	**Dividend Payment Date:**	03/15/23
Dividend Yield:	1.5%	**5 Year Price Target**	$106	**Years Of Dividend Growth:**	26
Dividend Risk Score:	A	**Retirement Suitability Score:**	C	**Rating:**	Buy

Overview & Current Events

Donaldson has been creating filtration solutions for a wide array of applications since 1915. Its sales consist of filters in various engine and industrial applications as core categories, but continuous innovation and acquisitions have expanded the portfolio. The company is expected to produce about $3.4 billion in revenue this year and trades with a current market capitalization of $7.3 billion.

Donaldson reported first quarter earnings on November 30th, 2022, and results were better than expected on both the top and bottom lines. Adjusted earnings-per-share came to 75 cents, which was a nickel better than expected. Revenue was up 11% to $847 million, which was $29 million higher than estimates. The gain in revenue was driven by pricing and volume growth, partially offset by a negative impact from currency translation.

Gross margin was 33.9% of revenue, up 10bps year-over-year as pricing benefits offset elevated input costs.

Operating expenses were 18.9% of revenue, an improvement of 80bps year-over-year as a result of leverage on higher revenue.

Operating income was 15% on an adjusted basis, up 90bps year-over-year.

The company reiterated guidance for adjusted earnings, and we're reiterating our estimate of $3.00 in earnings-per-share for this year following strong Q1 results.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	$1.64	$1.76	$1.49	$1.42	$1.69	$2.00	$2.05	$2.03	$2.32	$2.68	***$3.00***	***$4.41***
DPS	$0.45	$0.61	$0.67	$0.69	$0.70	$0.76	$0.82	$0.84	$0.86	$0.89	***$0.92***	***$1.35***
Shares[2]	146	140	135	133	131	130	130	128	126	123	***120***	***112***

Donaldson's earnings growth has been inconsistent in the past decade as it is very much beholden to economic conditions around the world. Its customer base is diverse and deep, but growth seems to come in bunches, not in a steady fashion. Looking forward, we are forecasting robust 8% earnings-per-share growth annually, and above-trend growth for 2023 once again. We remain somewhat cautious on the company's ability to grow revenue, as well as expand its margins despite recent pricing increases. However, management is bullish, seeing improvement on the horizon in the near-term, and recent results have been supportive of higher revenue and better margins, excluding COVID-19.

The company can grow through a variety of methods. First, sales increases ought to continue from organic growth, pricing increases, and acquisitions, which should amount to mid-single-digit or better growth. We see margin improvement activities as key to the company producing meaningfully higher earnings in the coming years, as well as a rebound in revenue producing leverage on SG&A costs.

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[1] Estimated date

[2] Share count in millions

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Lastly, Donaldson is buying back stock each year. We forecast moderate dividend growth, but Donaldson is not a high-income stock, choosing instead to use its excess cash for acquisitions and share repurchases. Share repurchases are relatively small in any particular year, but over time, add up to meaningful gains for shareholders.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	21.7	23.1	25.5	21.9	24.9	23.9	24.7	24.2	24.6	18.0	***20.0***	***24.0***
Avg. Yld.	1.3%	1.5%	1.8%	2.2%	1.7%	1.6%	1.5%	1.7%	1.5%	1.8%	***1.5%***	***1.3%***

Donaldson's price-to-earnings multiple has been remarkably steady in the past decade. However, given where shares are today, we are forecasting a large tailwind to total returns as shares are well under our estimate of fair value.

We are forecasting the yield to move down in the years to come as the payout increases while the valuation rises substantially. This is not a stock one buys for the current yield, as the company's stated strategy requires the use of excess cash for acquisitions and buybacks.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	24%	32%	44%	48%	41%	38%	38%	41%	37%	33%	***31%***	***31%***

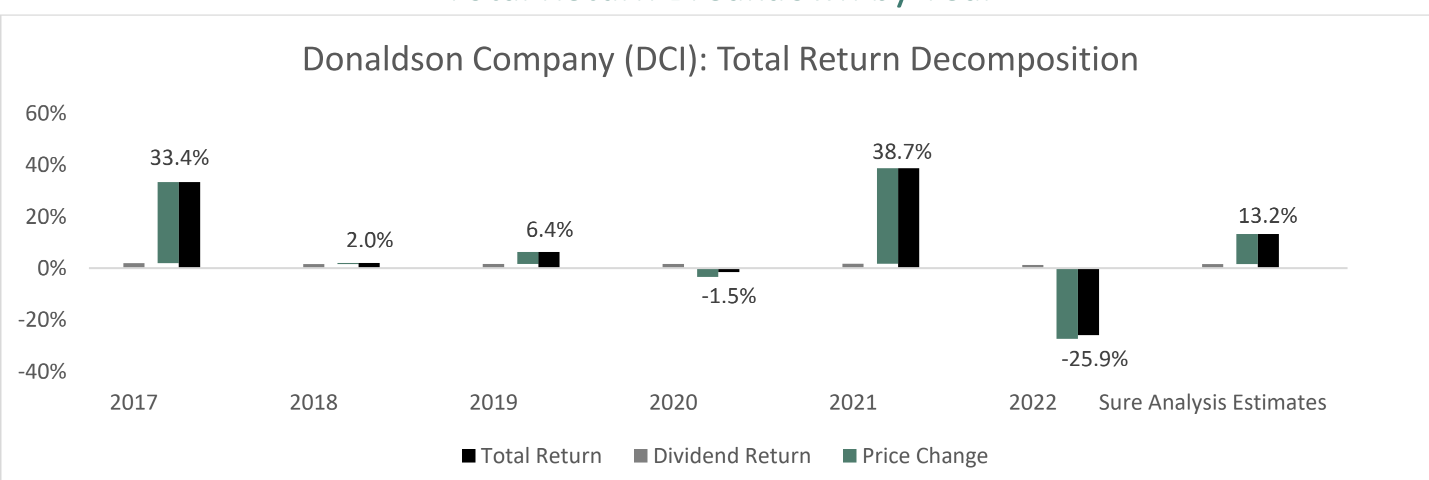
Donaldson's payout ratio remains well below 40% of earnings and we expect that is where it will stay for the foreseeable future. As mentioned, Donaldson prefers to use most of its excess cash for acquisitions and a small amount of share repurchases, but it does raise the dividend regularly, as we note a 26-year streak of dividend increases.

Donaldson's recession performance is somewhat of an issue, as you'd expect for an industrial stock, and earnings will likely fall significantly during the next downturn. It does enjoy the competitive advantage of more than 100 years of experience in its field, as well as a strong history of innovation and a sizable installed customer base.

Final Thoughts & Recommendation

Donaldson's stock price is well under our estimate of fair value, which is boosting prospective returns. We are forecasting total annual returns of 13.2%, consisting of the current 1.5% yield, a 3.7% tailwind from the valuation, and 8% earnings growth. The stock still offers investors growth potential, but the yield is low for income investors. However, given the low valuation, we're reiterating the stock at a buy rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	2,437	2,474	2,371	2,220	2,372	2,734	2,845	2,582	2,854	3,307
Gross Profit	847	878	809	755	821	936	948	872	972	1,067
Gross Margin	34.8%	35.5%	34.1%	34.0%	34.6%	34.2%	33.3%	33.8%	34.0%	32.3%
SG&A Exp.	441	460	460	425	443	499	498	470	519	555
D&A Exp.	64	67	74	75	75	77	81	88	95	94
Operating Profit	343	356	288	274	324	377	388	340	385	444
Operating Margin	14.1%	14.4%	12.2%	12.3%	13.6%	13.8%	13.6%	13.2%	13.5%	13.4%
Net Profit	247	260	208	191	233	180	267	257	287	333
Net Margin	10.2%	10.5%	8.8%	8.6%	9.8%	6.6%	9.4%	10.0%	10.1%	10.1%
Free Cash Flow	221	221	119	218	252	165	195	263	344	168
Income Tax	101	101	81	67	89	183	108	78	94	106

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	1,744	1,942	1,810	1,787	1,980	1,977	2,143	2,245	2,400	2,600
Cash & Equivalents	224	296	190	243	308	205	178	237	223	193
Accounts Receivable	431	474	460	452	498	535	530	455	553	617
Inventories	235	253	265	234	294	334	333	323	385	502
Goodwill & Int. Ass.	207	202	262	268	279	274	374	384	384	446
Total Liabilities	658	940	1,031	1,016	1,125	1,119	1,250	1,252	1,263	1,467
Accounts Payable	186	217	179	143	194	201	238	188	294	339
Long-Term Debt	211	431	578	567	611	543	637	627	510	648
Shareholder's Equity	1,085	1,002	775	767	850	853	887	987	1,137	1,133
LTD/E Ratio	0.19	0.43	0.75	0.74	0.72	0.64	0.72	0.64	0.45	0.57

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	14.2%	14.1%	11.1%	10.6%	12.4%	9.1%	13.0%	11.7%	12.4%	13.3%
Return on Equity	24.8%	24.9%	23.4%	24.7%	28.8%	21.2%	30.7%	27.4%	27.0%	29.3%
ROIC	19.7%	19.1%	14.9%	14.2%	16.6%	12.6%	18.2%	16.3%	17.6%	19.4%
Shares Out.	146	140	135	133	131	130	130	128	126	125
Revenue/Share	16.20	16.76	17.01	16.47	17.69	20.68	21.83	20.12	22.26	26.41
FCF/Share	1.47	1.49	0.85	1.62	1.88	1.25	1.50	2.05	2.68	1.34

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