



Donaldson Company (DCI)

Updated September 3rd, 2023, by Josh Arnold

Key Metrics

Current Price:	\$65	5 Year CAGR Estimate:	9.8%	Market Cap:	\$7.8 B
Fair Value Price:	\$66	5 Year Growth Estimate:	8.0%	Ex-Dividend Date:	11/15/23 ¹
% Fair Value:	98%	5 Year Valuation Multiple Estimate:	0.4%	Dividend Payment Date:	11/30/23
Dividend Yield:	1.5%	5 Year Price Target	\$97	Years Of Dividend Growth:	27
Dividend Risk Score:	A	Retirement Suitability Score:	C	Rating:	Hold

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 \$3.6 billion in revenue this year and trades with a current market capitalization of \$7.8 billion.

Donaldson posted fourth quarter and full-year earnings on August 29th, 2023, and results were largely in line with expectations. Adjusted earnings-per-share came to 78 cents, which met expectations. Revenue was down 1.2% year-over-year to \$880 million, which missed estimates by \$16 million.

Gross margin was 34.1% of revenue, up 130 basis points from the year-ago period, driven by the company's pricing benefits and stabilization of input costs. Adjusted gross margin, which excludes restructuring charges, was 34.3% of revenue, up from 32.9% a year ago.

Operating expenses were 20.0% of sales, up from 18% a year ago. The company said the increase was due to additional hiring and acquisition-related expenses.

Operating income was 14.3% of revenue, off from 14.9% in last year's Q4. This was due to deleveraging of gross margin and a rise in operating costs.

We start fiscal 2024 with an estimate of \$3.15 per share.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	\$1.76	\$1.49	\$1.42	\$1.69	\$2.00	\$2.05	\$2.03	\$2.32	\$2.68	\$3.04	\$3.15	\$4.63
DPS	\$0.61	\$0.67	\$0.69	\$0.70	\$0.76	\$0.82	\$0.84	\$0.86	\$0.89	\$0.96	\$1.00	\$1.47
Shares²	140	135	133	131	130	130	128	126	123	121	120	116

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.

¹ Estimated date

² Share count 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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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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	23.1	25.5	21.9	24.9	23.9	24.7	24.2	24.6	18.0	20.7	20.6	21.0
Avg. Yld.	1.5%	1.8%	2.2%	1.7%	1.6%	1.5%	1.7%	1.5%	1.8%	1.5%	1.5%	1.5%

Donaldson's price-to-earnings multiple has been remarkably steady in the past decade. However, given where shares are today, we are forecasting a small tailwind to total returns as shares are fractionally under our estimate of fair value. We cut our estimate from 24 times earnings to 21 given recent years' multiples, as well as a challenging environment for costs.

We are forecasting the yield to stay flat in the years to come as the payout increases while the valuation rises. 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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	32%	44%	48%	41%	38%	38%	41%	37%	33%	32%	32%	32%

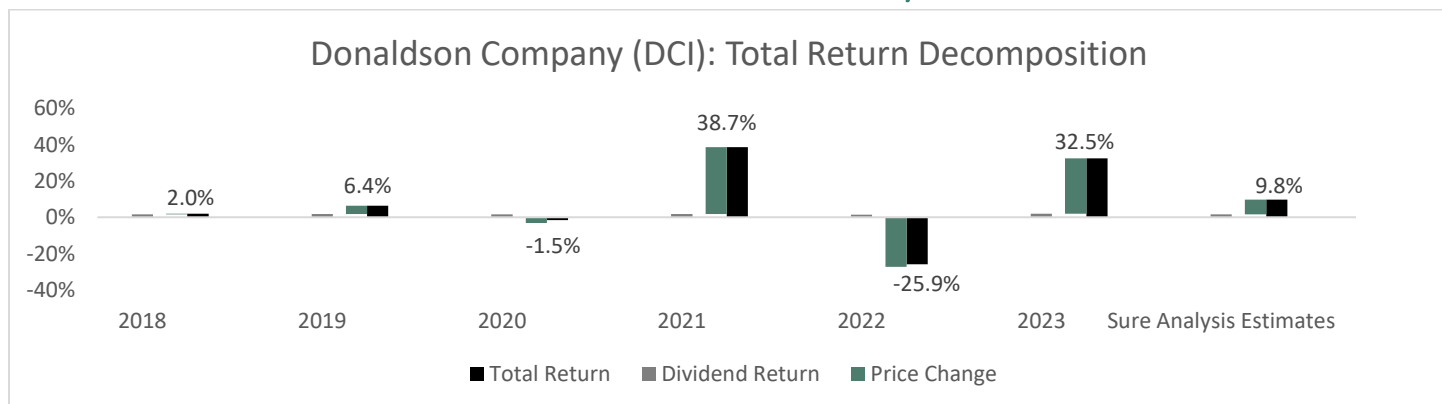
Donaldson's payout ratio remains well below 40% of earnings and we expect that is where it will stay for the foreseeable future. As mentioned, Donaldson prefers to use most of its excess cash for acquisitions and a small amount of share repurchases, but it does raise the dividend regularly, as we note a 27-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 slightly under our estimate of fair value, which is boosting prospective returns. We are forecasting total annual returns of 9.8%, consisting of the current 1.5% yield, a 0.4% tailwind from the valuation, and 8% earnings growth. The stock still offers investors growth potential, but the yield is somewhat low for income investors. With the move down in total returns, we're moving from buy to hold heading into fiscal 2024.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	2,474	2,371	2,220	2,372	2,734	2,845	2,582	2,854	3,307	3,431
Gross Profit	878	809	755	821	936	948	872	972	1,067	1,161
Gross Margin	35.5%	34.1%	34.0%	34.6%	34.2%	33.3%	33.8%	34.0%	32.3%	33.8%
SG&A Exp.	460	460	425	443	499	498	470	519	555	602
D&A Exp.	67	74	75	75	77	81	88	95	94	92
Operating Profit	356	288	274	324	377	388	340	385	444	480
Operating Margin	14.4%	12.2%	12.3%	13.6%	13.8%	13.6%	13.2%	13.5%	13.4%	14.0%
Net Profit	260	208	191	233	180	267	257	287	333	359
Net Margin	10.5%	8.8%	8.6%	9.8%	6.6%	9.4%	10.0%	10.1%	10.1%	10.5%
Free Cash Flow	221	119	218	252	165	195	263	344	168	426
Income Tax	101	81	67	89	183	108	78	94	106	110

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	1,942	1,810	1,787	1,980	1,977	2,143	2,245	2,400	2,600	2,771
Cash & Equivalents	296	190	243	308	205	178	237	223	193	187
Accounts Receivable	474	460	452	498	535	530	455	553	617	600
Inventories	253	265	234	294	334	333	323	385	502	418
Goodwill & Int. Ass.	202	262	268	279	274	374	384	384	446	669
Total Liabilities	940	1,031	1,016	1,125	1,119	1,250	1,252	1,263	1,467	1,450
Accounts Payable	217	179	143	194	201	238	188	294	339	305
Long-Term Debt	431	578	567	611	543	637	627	510	648	656
Shareholder's Equity	1,002	775	767	850	853	887	987	1,137	1,133	1,321
LTD/E Ratio	0.43	0.75	0.74	0.72	0.64	0.72	0.64	0.45	0.57	0.50

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	14.1%	11.1%	10.6%	12.4%	9.1%	13.0%	11.7%	12.4%	13.3%	13.4%
Return on Equity	24.9%	23.4%	24.7%	28.8%	21.2%	30.7%	27.4%	27.0%	29.3%	29.2%
ROIC	19.1%	14.9%	14.2%	16.6%	12.6%	18.2%	16.3%	17.6%	19.4%	19.1%
Shares Out.	140	135	133	131	130	130	128	126	125	124
Revenue/Share	16.76	17.01	16.47	17.69	20.68	21.83	20.12	22.26	26.41	27.76
FCF/Share	1.49	0.85	1.62	1.88	1.25	1.50	2.05	2.68	1.34	3.45

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

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