



Donaldson Company (DCI)

Updated June 5th, 2024, by Josh Arnold

Key Metrics

Current Price:	\$73	5 Year CAGR Estimate:	8.6%	Market Cap:	\$8.1 B
Fair Value Price:	\$70	5 Year Growth Estimate:	8.0%	Ex-Dividend Date:	08/09/24 ¹
% Fair Value:	104%	5 Year Valuation Multiple Estimate:	-0.7%	Dividend Payment Date:	08/28/24
Dividend Yield:	1.5%	5 Year Price Target	\$103	Years Of Dividend Growth:	29
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 \$8.1 billion.

Donaldson posted third quarter earnings on June 4th, 2024, and results were better than expectations on both the top and bottom lines. Earnings-per-share came to 92 cents, which was eight cents better than estimates. Revenue was up 6% year-over-year to \$928 million, which was the result of strong volume growth and pricing benefits.

Gross margin was up 260 basis points year-over-year to 35.6% of revenue. The higher sales leverage, pricing benefits, and input cost deflation all contributed to the gain in margins.

Operating expenses were 20.1% of revenue, up from 18.8% a year ago. This was due to increased hiring and investments from the scaling of the Life Sciences business.

Operating income as a percentage of revenue was 15.5%, up 130 basis points year-over-year. The gain was from gross margin improvement, partially offset by higher operating expenses.

The company has paid \$90 million in dividends year-to-date, and repurchased \$114 million in common stock. Donaldson also boosted its payout once again, this time adding two cents per share per quarter, and the 29th consecutive year of increases.

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	\$3.35	\$4.92
DPS	\$0.61	\$0.67	\$0.69	\$0.70	\$0.76	\$0.82	\$0.84	\$0.86	\$0.89	\$0.96	\$1.08	\$1.59
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. 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.

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

¹ Estimated date

² Share count in millions

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rebound in revenue producing leverage on SG&A costs. The company saw higher operating margins in Q3 despite heavy investments for future growth, which we see as a bullish sign.

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. With the new authorization, we expect share repurchases to increase.

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	21.8	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 headwind to total returns as shares are ahead of our estimate of fair value. Shares go for 21.8 times earnings today, modestly up on our fair value estimate of 21 times.

We are forecasting the yield to stay flat in the years to come as the payout increases while the valuation declines slightly. 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%

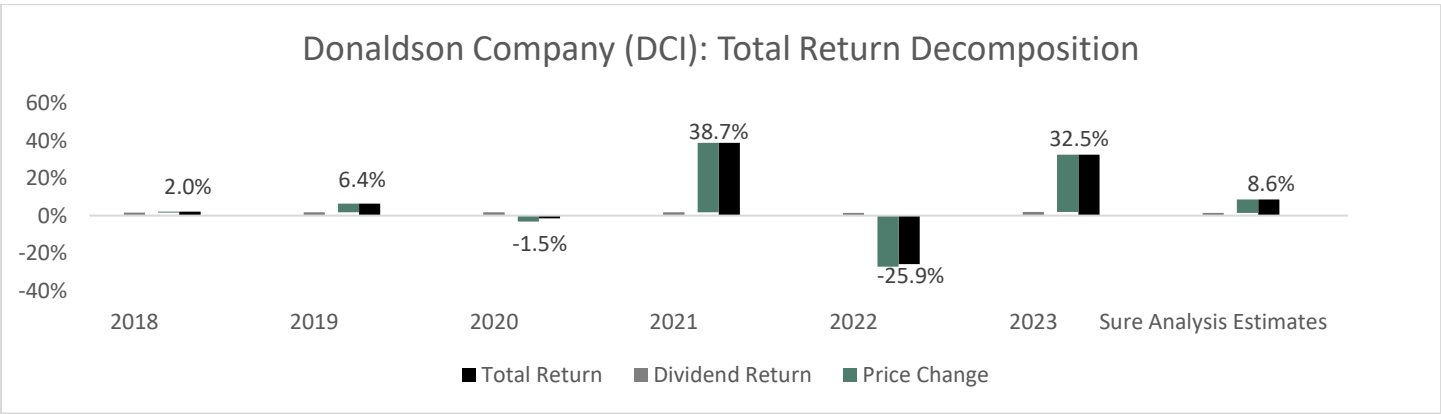
Donaldson’s payout ratio remains around 32% of earnings and we expect that is where it will stay for the foreseeable future. As mentioned, Donaldson prefers to use most of its excess cash for acquisitions and a small amount of share repurchases, but it does raise the dividend regularly, as we note a 29-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 overvalued. We are forecasting total annual returns of 8.6%, consisting of the current 1.5% yield, a -0.7% impact from the valuation, and 8% earnings growth. The stock still offers investors growth potential, but the yield is somewhat low for income investors. We’re reiterating the stock at a hold rating after Q3 results.

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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