Kadant Inc. (KAI)

Published August 6th, 2024, by Kody Kester

Key Metrics

Current Price:	$303	**5 Year CAGR Estimate:**	6.1%	**Market Cap:**	$3.6B
Fair Value Price:	$248	**5 Year Growth Estimate:**	10.0%	**Ex-Dividend Date[1]:**	10/09/24
% Fair Value:	123%	**5 Year Valuation Multiple Estimate:**	-4.0%	**Dividend Payment Date:**	11/07/24
Dividend Yield:	0.4%	**5 Year Price Target**	$399	**Years Of Dividend Growth:**	11
Dividend Risk Score:	C	**Retirement Suitability Score:**	F	**Rating:**	Hold

Overview & Current Events

Kadant Inc. is a supplier of technologies and engineered systems worldwide. In 1991, the company (then Thermo Fibertek Inc.) was incorporated as a wholly owned subsidiary of Thermo Electron (now Thermo Fisher Scientific). Nine years later, Thermo opted to spin off the business to prioritize its scientific instruments business. In August 2001, the spinoff to become a completely independent company was completed.

KAI operates in the following three segments:

1. Flow Control: This segment designs, manufactures, and markets fluid-handling systems and equipment, including syphons, rotary joints, and turbulator bars. The segment also sells doctoring, cleaning, and filtration systems like doctor blades, cleaning shower and fabric-conditioning systems, and water filtration systems. These products are purchased by customers from the packaging, food, and metals industries. The segment contributed 38% of KAI's $957.7 million in total 2023 revenue.
2. Industrial Processing: This segment develops, manufactures, and sells chippers, industrial automation and control systems, and recycling and approach flow systems. Products are sold to customers in the packaging, tissue, wood products, and alternative fuel industries. The segment made up another 37% of the company's total 2023 revenue.
3. Material Handling: The Material Handling segment designs, manufactures, and markets conveying and vibratory equipment to the mining food processing, packaging, and paper industries. This segment chipped in the remaining 25% of the total 2023 revenue.

On July 30, KAI shared its financial results for the second quarter that ended June 29. The company's total revenue surged 12.1% year-over-year to a record of $274.8 million during the quarter. Industrial Processing segment revenue soared by 27.6% in the quarter to $114.8 million via growth in the wood processing line and the acquisition of Key Knife in January. The Material Handling segment posted $67.7 million in revenue, which was up 14.1% over the year-ago period. This growth was fueled by the acquisition of KWS Manufacturing Company in January and strength from the underlying business. These results were partially offset by a 3.6% decline in Flow Control segment revenue to $92.3 million for the quarter. The acquisition of Dynamic Sealing Technologies LLC in June was counteracted by weaker manufacturing activity in Europe and China. KAI's adjusted EPS climbed by 10.6% year-over-year to $2.81 during the second quarter. This was $0.38 ahead of the analyst consensus in the quarter.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	$2.78	$3.13	$3.10	$4.49	$5.34	$5.36	$5.00	$7.83	$9.24	$10.04	***$9.90***	***$15.94***
DPS	$0.58	$0.66	$0.74	$0.82	$0.87	$0.91	$0.95	$0.99	$1.03	$1.13	***$1.28***	***$2.06***
Shares[2]	10.9	10.8	10.9	11.0	11.1	11.4	11.5	11.6	11.7	11.7	***11.8***	***12.2***

[1] Estimate

[2] Share count is in millions.

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In the past 10 years, KAI's adjusted EPS has compounded at a mid-teens rate annually. Moving forward, we expect adjusted EPS to grow by around 10% annually. This is because KAI's size in its market and recent acquisitions show there is still plenty of room for bolt-on acquisitions. Coupled with organic growth in its markets over a full economic cycle, that should keep revenue moving higher. As KAI incorporates recent acquisitions into its business, there is also a runway for additional growth in adjusted EBITDA margins (adjusted EBITDA expanded from 21.0% in Q2 2023 to 22.5% in Q2 2024).

Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Avg. P/E	15.2	13.0	19.7	22.4	15.2	20.2	28.2	29.4	19.2	27.9	***30.6***	***25.0***
Avg. Yld.	1.4%	1.6%	1.2%	0.8%	1.1%	0.8%	0.7%	0.4%	0.6%	0.4%	***0.4%***	***0.5%***

Over the past decade, KAI's P/E ratio has varied from the low teens to around the low 30s range. In the past five years, the valuation multiple has expanded to an average of around 25. We believe that as KAI's margins continue to improve, this multiple can be justified in the years to come. For perspective, the current P/E ratio of 30.6 is well above our fair value estimate.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	21%	21%	24%	18%	16%	17%	19%	13%	11%	11%	***13%***	***13%***

KAI possesses several factors competitively that set it apart from its peers. These include a worldwide customer base, a reputation for high-performance, high-reliability products, product innovation, and competitive pricing.

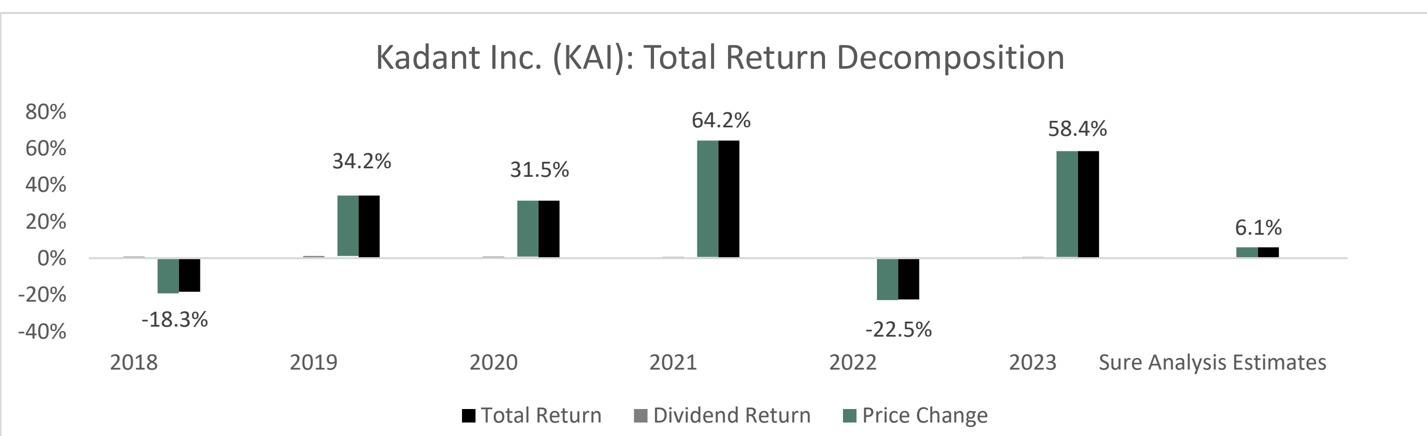
For an industrial, KAI consistently grows its adjusted EPS. Even when earnings have declined, the company hasn't experienced a double-digit percentage drop in adjusted EPS. This has enabled it to bounce back quickly the year after a decrease in earnings.

KAI's interest coverage ratio of 9.6 through the first half of 2024 also suggests that the company is on a firm financial footing. Finally, the payout ratio in the low double-digits to teens provides a buffer to keep growing the dividend in down years.

Final Thoughts & Recommendation

KAI's 0.4% dividend yield, 10.0% annual adjusted EPS growth potential, and -4.0% annual valuation multiple downside could produce 6.1% annual total returns over the next five years. The current valuation appears to be excessive, which is why we're initiating coverage with a hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	402	390	414	515	634	705	635	787	905	958
Gross Profit	178	180	189	231	278	294	277	337	390	416
Gross Margin	44.4%	46.2%	45.5%	44.9%	43.9%	41.7%	43.7%	42.9%	43.1%	43.5%
SG&A Exp.	129	123	135	160	177	193	182	209	224	236
D&A Exp.	11	11	14	19	24	32	31	34	35	33
Operating Profit	43	51	46	62	90	90	84	117	152	166
Operating Margin	10.7%	13.0%	11.2%	12.0%	14.3%	12.8%	13.2%	14.9%	16.8%	17.4%
Net Profit	29	34	32	31	60	52	55	84	121	116
Net Margin	7.1%	8.8%	7.7%	6.0%	9.5%	7.4%	8.7%	10.7%	13.4%	12.1%
Free Cash Flow	44	35	45	48	46	87	85	150	74	134
Income Tax	12	15	12	26	18	16	18	27	44	42

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	414	415	471	761	726	939	928	1,132	1,150	1,176
Cash & Equivalents	45	66	71	75	46	67	66	91	76	104
Accounts Receivable	59	64	66	90	93	96	92	117	130	134
Inventories	55	57	55	85	86	103	107	134	164	153
Goodwill & Int. Ass.	175	157	204	401	372	510	513	596	561	551
Total Liabilities	148	148	186	429	351	512	431	567	494	399
Accounts Payable	27	24	24	35	36	46	32	59	58	42
Long-Term Debt	26	31	66	242	176	301	233	270	201	111
Shareholder's Equity	264	267	283	331	373	426	495	564	654	774
LTD/E Ratio	0.10	0.12	0.24	0.73	0.47	0.71	0.47	0.48	0.31	0.14

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	6.7%	8.3%	7.2%	5.0%	8.1%	6.3%	5.9%	8.2%	10.6%	10.0%
Return on Equity	10.7%	12.9%	11.6%	10.1%	17.1%	13.0%	11.9%	15.8%	19.8%	16.2%
ROIC	9.5%	11.6%	9.9%	6.7%	10.7%	8.1%	7.6%	10.7%	14.3%	13.3%
Shares Out.	10.9	10.8	10.9	11.0	11.1	11.4	11.5	11.6	11.7	11.7
Revenue/Share	35.87	35.16	37.14	45.53	55.60	61.50	54.91	67.49	77.41	81.65
FCF/Share	3.96	3.15	4.05	4.23	4.07	7.63	7.38	12.84	6.37	11.40

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