Donaldson Company (DCI)

Updated September 15th, 2024, by Josh Arnold

Key Metrics

Current Price:	$71	**5 Year CAGR Estimate:**	11.0%	**Market Cap:**	$8.5 B
Fair Value Price:	$77	**5 Year Growth Estimate:**	8.0%	**Ex-Dividend Date:**	11/09/24[1]
% Fair Value:	93%	**5 Year Valuation Multiple Estimate:**	1.5%	**Dividend Payment Date:**	11/28/24
Dividend Yield:	1.5%	**5 Year Price Target**	$113	**Years Of Dividend Growth:**	29
Dividend Risk Score:	A	**Retirement Suitability Score:**	B	**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 $3.6 billion in revenue this year and trades with a current market capitalization of $8.5 billion.

Donaldson posted fourth quarter and full-year earnings on August 28th, 2024, and results were mixed for the quarter. Adjusted earnings-per-share came to 94 cents, which was a nickel ahead of expectations. Revenue was up 6.4% year-over-year to $935 million, but that was almost $8 million light of estimates.

Gross margin came to 35.8% of revenue, which was up 190 basis points from the year-ago period on an adjusted basis. Operating expenses as a percentage of revenue was 19.9%, which was down fractionally from a year ago. The company noted it is renewing its efforts to optimize its real estate footprint to boost expense efficiency.

Operating income as a percentage of revenue was 16.3% on an adjusted basis, up sharply from 14.3% a year ago. Interest expense was $5.3 million, up from $4.9 million a year ago as a result of higher interest rates.

The company returned $82 million to shareholders during the quarter through repurchases and dividends. For the year, Donaldson expects earnings-per-share on an adjusted basis of $3.56 to $3.72. We've set our initial estimate near the middle at $3.65.

Growth on a Per-Share Basis

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2030
EPS	$1.49	$1.42	$1.69	$2.00	$2.05	$2.03	$2.32	$2.68	$3.04	$3.42	***$3.65***	***$5.36***
DPS	$0.67	$0.69	$0.70	$0.76	$0.82	$0.84	$0.86	$0.89	$0.96	$1.04	***$1.08***	***$1.59***
Shares[2]	135	133	131	130	130	128	126	123	121	123	***121***	***115***

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 rebound in revenue producing leverage on SG&A costs. The company saw higher operating margins in Q4 despite heavy investments for future growth once again, which we see as a bullish sign.

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

Valuation Analysis

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	Now	2030
Avg. P/E	25.5	21.9	24.9	23.9	24.7	24.2	24.6	18.0	20.7	21.9	***19.5***	***21.0***
Avg. Yld.	1.8%	2.2%	1.7%	1.6%	1.5%	1.7%	1.5%	1.8%	1.5%	1.4%	***1.5%***	***1.4%***

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 below our estimate of fair value. Shares go for 19.5 times earnings today, modestly down on our fair value estimate of 21 times.

We are forecasting the yield to stay flat in the years to come as the payout and valuation increases. 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	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2030
Payout	44%	48%	41%	38%	38%	41%	37%	33%	32%	30%	***30%***	***30%***

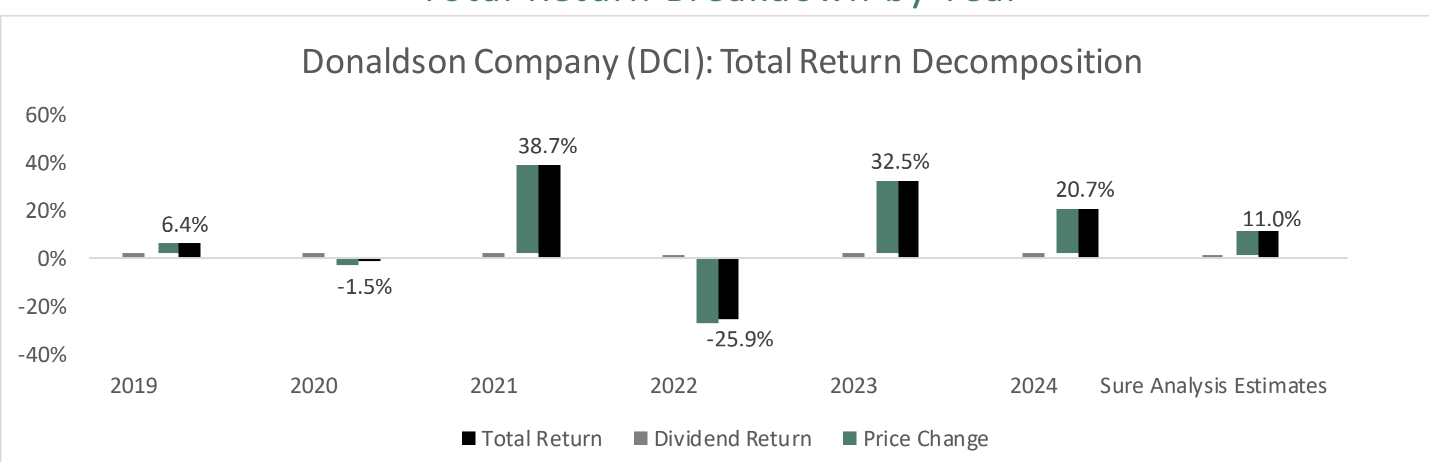
Donaldson's payout ratio remains around 30% of earnings and we expect that is where it will stay for the foreseeable future. As mentioned, Donaldson prefers to use most of its excess cash for acquisitions and a small amount of share repurchases, but it does raise the dividend regularly, as we note a 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 undervalued after 2024 results. We are forecasting total annual returns of 11%, consisting of the current 1.5% yield, a 1.5% 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 boosting the stock from hold to buy after Q4 results on strong total return potential.

Total Return Breakdown by Year



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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Income Statement Metrics

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Revenue	2,371	2,220	2,372	2,734	2,845	2,582	2,854	3,307	3,431	3,586
Gross Profit	809	755	821	936	948	872	972	1,067	1,161	1,274
Gross Margin	34.1%	34.0%	34.6%	34.2%	33.3%	33.8%	34.0%	32.3%	33.8%	35.5%
SG&A Exp.	460	425	443	499	498	470	519	555	602	637
D&A Exp.	74	75	75	77	81	88	95	94	92	98
Operating Profit	288	274	324	377	388	340	385	444	480	544
Operating Margin	12.2%	12.3%	13.6%	13.8%	13.6%	13.2%	13.5%	13.4%	14.0%	15.2%
Net Profit	208	191	233	180	267	257	287	333	359	414
Net Margin	8.8%	8.6%	9.8%	6.6%	9.4%	10.0%	10.1%	10.1%	10.5%	11.5%
Free Cash Flow	119	218	252	165	195	263	344	168	426	407
Income Tax	81	67	89	183	108	78	94	106	110	121

Balance Sheet Metrics

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Total Assets	1,810	1,787	1,980	1,977	2,143	2,245	2,400	2,600	2,771	2,914
Cash & Equivalents	190	243	308	205	178	237	223	193	187	233
Accounts Receivable	460	452	498	535	530	455	553	617	600	630
Inventories	265	234	294	334	333	323	385	502	418	477
Goodwill & Int. Ass.	262	268	279	274	374	384	384	446	669	650
Total Liabilities	1,031	1,016	1,125	1,119	1,250	1,252	1,263	1,467	1,450	1,425
Accounts Payable	179	143	194	201	238	188	294	339	305	379
Long-Term Debt	578	567	611	543	637	627	510	648	656	537
Shareholder's Equity	775	767	850	853	887	987	1,137	1,133	1,321	1,489
LTD/E Ratio	0.75	0.74	0.72	0.64	0.72	0.64	0.45	0.57	0.50	0.36

Profitability & Per Share Metrics

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Return on Assets	11.1%	10.6%	12.4%	9.1%	13.0%	11.7%	12.4%	13.3%	13.4%	14.6%
Return on Equity	23.4%	24.7%	28.8%	21.2%	30.7%	27.4%	27.0%	29.3%	29.2%	29.5%
ROIC	14.9%	14.2%	16.6%	12.6%	18.2%	16.3%	17.6%	19.4%	19.1%	20.7%
Shares Out.	135	133	131	130	130	128	126	125	124	123
Revenue/Share	17.01	16.47	17.69	20.68	21.83	20.12	22.26	26.41	27.76	29.25
FCF/Share	0.85	1.62	1.88	1.25	1.50	2.05	2.68	1.34	3.45	3.32

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