

Flowserve Corporation (FLS)

\$27.87 (As of 07/31/20)

Price Target (6-12 Months): **\$29.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 06/15/20)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:A

Value: A

Growth: C

Momentum: A

Summary

Flowserve seems well-poised to benefit from shareholder-friendly policies, a solid liquidity position and the Flowserve 2.0 strategy. Also, its solid backlog is reflective of impressive growth opportunities. In second-quarter 2020, the company's earnings and sales surpassed estimates by 82.8% and 3.8%, respectively. For second-half 2020, the company anticipates earnings to exceed of 73 cents per share reported in the first half of 2020. Revenues and booking are predicted to be flat sequentially but decline 15% and 20% year over year, respectively. The coronavirus outbreak-induced market downturn and energy market volatility are major concerns for the company. Also, expenses related to the realignment plan and forex woes are other headwinds. In the past three months, Flowserve's shares have underperformed the industry.

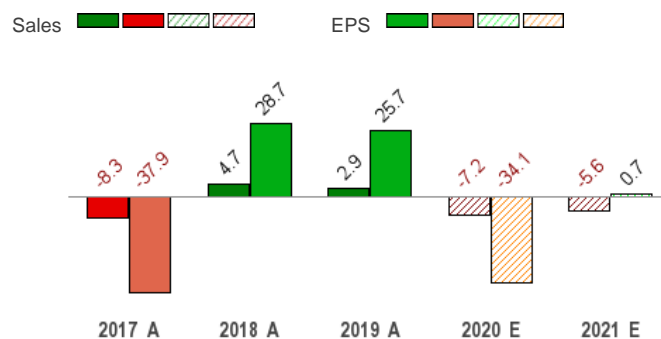
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$51.25 - \$18.98
20 Day Average Volume (sh)	855,258
Market Cap	\$3.6 B
YTD Price Change	-44.0%
Beta	1.81
Dividend / Div Yld	\$0.80 / 2.9%
Industry	Manufacturing - General Industrial
Zacks Industry Rank	Top 43% (109 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	82.8%
Last Sales Surprise	3.8%
EPS F1 Est- 4 week change	2.3%
Expected Report Date	NA
Earnings ESP	-13.6%
P/E TTM	14.0
P/E F1	19.2
PEG F1	1.2
P/S TTM	0.9

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	811 E	837 E	941 E	1,012 E	3,453 E
2020	894 A	925 A	897 E	964 E	3,659 E
2019	890 A	990 A	997 A	1,068 A	3,945 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.22 E	\$0.32 E	\$0.41 E	\$0.52 E	\$1.46 E
2020	\$0.21 A	\$0.53 A	\$0.43 E	\$0.51 E	\$1.45 E
2019	\$0.41 A	\$0.54 A	\$0.59 A	\$0.66 A	\$2.20 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 07/31/2020. The reports text is as of 08/03/2020.

Overview

Founded in 1912 and headquartered at Irving, TX, Flowserve Corporation is a leading manufacturer and aftermarket service provider of comprehensive flow control systems, globally.

The company develops and manufactures precision-engineered flow control equipment, such as pumps, valves and seals, for critical service applications that require high reliability. Flowserve uses its manufacturing platform to offer a broad array of aftermarket equipment services, such as installation, advanced diagnostics, repair and retrofitting.

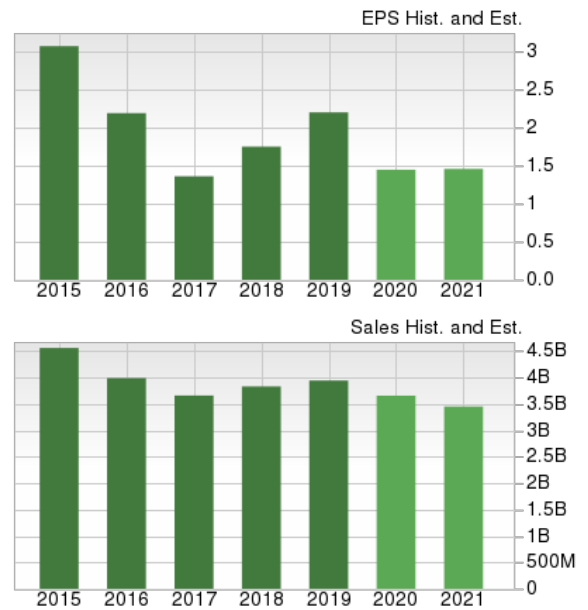
The company uses a footprint of Quick Response Centers (QRCs) around the globe to deliver these aftermarket services. The company sells products and services to more than 10,000 companies across more than 50 countries in North America, Europe, the Middle East, Africa, the Asia Pacific and Latin America.

During the first quarter of 2019, the company combined operations of Engineered Product Division and Industrial Product Division under one segment — Flowserve Pump Division (FPD). The changes will enable the company to better control operations and serve customers.

Flowserve currently has two reportable segments:

Flowserve Pump Division is engaged in the manufacturing of highly engineered pumps, pump systems, industrial pumps, mechanical seals and auxiliary systems. Also, the segment provides parts of replacement purposes and related services. The segment has 39 manufacturing facilities and 141 QRCs. End markets served include power generation, chemical, general, and oil & gas markets.

Flow Control Division is engaged in the manufacturing of valve, valve automation products, boiler controls and solutions. Notably, the segment has 49 manufacturing facilities and QRCs in 22 countries throughout the world. Several end markets served by the segment include power generation, water management, chemical as well as oil and gas.



Reasons To Buy:

- ▲ In second-quarter 2020, Flowserve's earnings and sales surpassed estimates by 82.8% and 3.8%, respectively. Backlog at the end of the quarter was \$2.1 billion. The company stands to benefit from solid backlog level and its multi-year Flowserve 2.0 strategy in 2020. Notably, the Flowserve 2.0 strategy will likely help in simplifying the operating model and spur growth. For the second half of 2020, the company anticipates earnings to exceed 73 cents per share reported in the first half of 2020.
- ▲ Flowserve's solid liquidity position helps it deal with the present difficult environment. Exiting the second quarter of 2020, the company had total available liquidity of more than \$1.3 billion. Notably, this consists of cash and cash equivalents of about \$562 million, and around \$722 million of available capacity under the company's revolving credit facility. Also, in response to the coronavirus crisis, some of the actions taken by Flowserve include the reduction of discretionary expenses and the re-prioritization of its capital expenditure. In the quarters ahead, the measures will likely help the company to maintain a healthy margin performance amid the crisis. For 2020, the company anticipates achieving cost savings of \$100 million.
- ▲ Flowserve is committed toward rewarding shareholders handsomely. In the first half of 2020, it paid out dividends of \$52.1 million and repurchased shares worth \$32.1 million (no buybacks were made in the second quarter). In addition, exiting the second quarter of 2020, it is left to buy back shares worth \$113.6 million from the \$500-million program authorized in November 2014.

Benefits from Flowserve 2.0, a sound capital-allocation strategy and robust liquidity will likely be favorable for Flowserve in the future.

Reasons To Sell:

- ▼ In the past three months, Flowserve's shares have gained 3.6% compared with the industry's growth of 18.3%. In second-quarter 2020, the company's earnings decreased 1.9% from the year-ago quarter due to weak sales generation, partially offset by improved operating margin. Bookings were down 26.9% (or 25.1% on a constant-currency basis) due to weakness in both aftermarket and original equipment businesses. Of the end markets, booking decreased in oil & gas. For the quarters ahead, the company is wary about the pandemic-related woes and energy market volatility. It expects flat bookings and revenues in the second half of 2020 as compared with the first half. However, on a year-over-year basis, bookings are expected to decline 20% and revenues to fall 15%.
- ▼ Flowserve's realignment plan is likely to provide benefits in the long run. However, the plan is fuelling expenses and adversely impacting profitability in the near term. In second-quarter 2020, the company's net income was adversely impacted by realignment expenses of 37 cents per share. In addition, in the second quarter, its cost of sales increased 6% on a year-over-year basis. Rising costs and expenses, if unchecked, can dent its profitability in the quarters ahead. Given Flowserve's extensive geographic presence, its business is exposed to social and environmental risks as well as forex woes. In the second quarter, the company's sales were adversely impacted by 2.4% from forex woes.
- ▼ A highly leveraged balance sheet can be detrimental to Flowserve's profitability. At the end of second-quarter 2020, its long-term debt was \$1,367.5 million, up 0.8% sequentially. Net interest and other expenses in the quarter also grew 4.7% year over year. Its total debt to total capital was a 47.8% at the end of the quarter, while its times interest earned weakened from 6.6x in the first quarter to 5.5x in the second quarter. Notably, times interest earned reflect the company's ability to meet financial obligations. We believe that fresh issuances of debts instruments in the quarters ahead might inflate the company's financial obligations and impact profitability.

The coronavirus-led difficult market conditions, realignment expenses, high-debt levels, and unfavorable movements in foreign currencies can be detrimental to Flowserve in the quarters ahead.

Last Earnings Report

Flowserve Beats on Q2 Earnings & Sales, Updates View

Flowserve reported better-than-expected results in the second quarter of 2019, with earnings beating estimates by 82.8%. Also, sales in the quarter surpassed estimates by 3.8%.

The machinery company's adjusted earnings in the reported quarter were 53 cents per share, surpassing the Zacks Consensus Estimate of 29 cents. Further, the bottom line decreased 1.9% from the year-ago figure of 54 cents due to weak sales generation, partially offset by improved operating margin.

Revenue Details

In the quarter under review, Flowserve's sales were \$925 million, reflecting a year-over-year decline of 6.6%. Notably, unfavorable movements in foreign currencies adversely impacted sales by 2.4%.

However, the company's revenues surpassed the Zacks Consensus Estimate of \$890.9 million.

Aftermarket sales in the reported quarter were down 7.1% year over year (or 5% on a constant-currency basis) to \$462.2 million. Furthermore, original equipment sales totaled \$462.8 million, reflecting a year-over-year decrease of 6.1% (or 3.3% on a constant-currency basis).

Bookings totaled \$808.3 billion in the quarter, reflecting a decline of 26.9% (or 25.1% decline on a constant-currency basis) from the year-ago quarter. Of the end markets, booking decreased in oil & gas. Backlog at the end of the reported quarter was \$2.1 billion.

The company currently has two reportable segments — Flowserve Pump Division and Flow Control Division. A brief discussion on the segments is provided below:

Revenues from the Flowserve Pump Division were \$674.1 million, decreasing 0.1% year over year or increasing 2.8% on a constant-currency basis. Bookings fell 29.6% year over year to \$536.5 million.

Revenues from the Flow Control Division were \$252.2 million, declining 20.4% year over year or down 19.1% on a constant-currency basis. Bookings of \$274.6 million declined 20.7% year over year.

Margin Profile

In the quarter under review, Flowserve's adjusted cost of sales increased 6% year over year to \$628 million. It represented 67.9% of sales compared with 67.5% in the year-ago quarter. Adjusted gross profit decreased 7.7% year over year to \$297 million, while margin fell 40 basis points (bps) year over year to 31.2%. Selling, general and administrative expenses fell 9.6% year over year to \$193.1 million. It represented 20.9% of sales.

Adjusted operating income in the quarter under review decreased 4.4% year over year to \$107 million. However, adjusted operating margin improved 30 bps to 11.6%. Net interest and other expenses in the quarter grew 4.7% year over year to \$12.6 million. Effective tax rate was 24.7% versus 26% in the year-ago quarter.

Balance Sheet and Cash Flow

Exiting the second quarter of 2020, Flowserve had cash and cash equivalents of \$561.7 million, down 9.7% from \$622.3 million at the end of the last reported quarter. Long-term debt grew 0.8% sequentially to \$1,367.5 million.

In the first half of 2020, it generated net cash of \$21.23 million from operating activities, down 57% from the year-ago comparable period. Capital expenditure in the period totaled \$32 million, increasing 26.5% from \$25.3 million spent in the first half of 2019.

During the period, the company used \$52.1 million for distributing dividends and \$32.1 million for repurchasing shares.

Outlook

Flowserve is progressing well with transformation initiatives. The multi-year Flowserve 2.0 strategy will likely help in simplifying the operating model and spur growth. This along with solid backlog will help drive performance in 2020. However, the pandemic-related woes and energy market volatility are concerning.

The company kept its projections suspended for 2020. However, it expects earnings to exceed the first-half 2020 number of 73 cents per share. Revenues and bookings in the second half are expected to be flat compared with the first half.

Also, a cost-reduction of \$100 million is anticipated to be realized in 2020.

Quarter Ending **06/2020**

Report Date	Jul 30, 2020
Sales Surprise	3.83%
EPS Surprise	82.76%
Quarterly EPS	0.53
Annual EPS (TTM)	1.99

Recent News

Dividend

On **Jul 6, 2020**, Flowserve paid a quarterly cash dividend of 20 cents per share to shareholders of record as of Jun 19.

Valuation

Flowserve shares are down 44% and 37.6% in the year-to-date period and over the trailing 12-month period, respectively. Stocks in the Zacks sub-industry and the Zacks Industrial Products sector are down 9.8% and 7.3% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry increased 4% and the sector grew 7.5%.

The S&P 500 Index has moved up 1.7% year to date and 15.4% in the past year.

The stock is currently trading at 19.18x forward 12-month earnings per share, which compares to 26.46x for the Zacks sub-industry, 21.43x for the Zacks sector and 22.64x for the S&P 500 index.

Over the past five years, the stock has traded as high as 31.5x and as low as 8.18x, with a 5-year median of 20.64x. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$29 price target reflects 20.14x forward 12-month earnings per share.

The table below shows summary valuation data for FLS.

Valuation Multiples - FLS					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	19.18	26.46	21.43	22.64
	5-Year High	31.5	26.62	21.53	22.64
	5-Year Low	8.18	15.6	12.55	15.25
	5-Year Median	20.64	19.69	17.15	17.55
P/S F12M	Current	1.03	3.3	2.81	3.59
	5-Year High	1.82	3.3	2.81	3.59
	5-Year Low	0.62	1.58	1.52	2.53
	5-Year Median	1.49	2.25	2.03	3.04

As of 07/31/2020

Industry Analysis Zacks Industry Rank: Top 43% (109 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
Applied Industrial Technologies, Inc. (AIT)	Neutral	3
Colfax Corporation (CFX)	Neutral	3
GEA GROUP AG SP (GEAGY)	Neutral	2
IDEX Corporation (IEX)	Neutral	3
Ingersoll Rand Inc. (IR)	Neutral	3
The Middleby Corporation (MIDD)	Neutral	2
Roper Technologies, Inc. (ROP)	Neutral	3
Xylem Inc. (XYL)	Neutral	3

Industry Comparison Industry: Manufacturing - General Industrial				Industry Peers		
	FLS	X Industry	S&P 500	AIT	CFX	IR
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	2	-	-	3	3	3
VGM Score	A	-	-	A	B	D
Market Cap	3.63 B	1.22 B	22.59 B	2.44 B	3.44 B	13.16 B
# of Analysts	8	3	14	2	10	4
Dividend Yield	2.87%	0.00%	1.83%	2.03%	0.00%	0.00%
Value Score	A	-	-	A	C	D
Cash/Price	0.16	0.10	0.07	0.07	0.10	0.04
EV/EBITDA	8.99	11.70	12.94	9.48	14.10	35.01
PEG Ratio	1.23	3.26	3.04	NA	4.81	3.53
Price/Book (P/B)	2.15	1.98	3.17	2.94	1.03	1.50
Price/Cash Flow (P/CF)	9.26	9.66	12.51	9.06	6.27	19.17
P/E (F1)	19.22	27.24	21.87	19.07	24.88	28.02
Price/Sales (P/S)	0.93	1.18	2.44	0.72	0.99	5.00
Earnings Yield	5.20%	3.16%	4.31%	5.24%	4.02%	3.58%
Debt/Equity	0.89	0.52	0.75	1.04	0.79	0.39
Cash Flow (\$/share)	3.01	2.49	6.94	6.96	4.64	1.65
Growth Score	C	-	-	A	B	C
Hist. EPS Growth (3-5 yrs)	-11.93%	11.57%	10.85%	14.14%	8.44%	NA
Proj. EPS Growth (F1/F0)	-34.26%	-29.22%	-7.75%	-10.30%	-49.83%	-29.09%
Curr. Cash Flow Growth	15.12%	2.50%	5.39%	35.35%	27.59%	-25.03%
Hist. Cash Flow Growth (3-5 yrs)	-8.93%	7.29%	8.55%	13.96%	3.20%	5.38%
Current Ratio	2.19	2.11	1.31	2.60	1.93	2.11
Debt/Capital	47.16%	34.31%	44.32%	51.01%	44.24%	28.13%
Net Margin	3.77%	4.33%	10.44%	0.99%	-13.62%	2.86%
Return on Equity	14.82%	11.00%	14.73%	17.40%	8.89%	2.12%
Sales/Assets	0.81	0.77	0.52	1.44	0.40	0.36
Proj. Sales Growth (F1/F0)	-7.26%	-7.58%	-1.95%	-4.02%	-20.01%	104.70%
Momentum Score	A	-	-	C	C	B
Daily Price Chg	-1.67%	-0.67%	-0.92%	-1.95%	-4.53%	-1.09%
1 Week Price Chg	2.81%	0.00%	0.37%	1.28%	-1.68%	3.10%
4 Week Price Chg	-1.66%	1.89%	3.81%	2.83%	3.67%	11.00%
12 Week Price Chg	1.60%	13.63%	11.93%	21.10%	12.93%	14.13%
52 Week Price Chg	-38.63%	-15.18%	-1.92%	6.78%	10.78%	1.22%
20 Day Average Volume	855,258	61,311	1,887,986	161,342	781,107	2,607,570
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	2.30%	0.14%	0.38%	-6.10%	-3.39%	700.00%
(F1) EPS Est 12 week change	-17.83%	-4.63%	-0.07%	3.60%	-18.76%	153.33%
(Q1) EPS Est Mthly Chg	1.58%	1.50%	0.16%	NA	2.90%	100.00%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	A
Growth Score	C
Momentum Score	A
VGM Score	A

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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