

Flowserve Corporation (FLS)

\$50.36 (As of 01/16/20)

Price Target (6-12 Months): **\$53.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 08/05/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: C

Growth: A

Momentum: D

Summary

Flowserve is poised to benefit from strong chemical and thermal solar end markets as well as realignment and transformational initiatives in the long run. The company's disciplined capital-allocation policy of using funds for rewarding shareholders and investing in growth programs is likely to aid. For 2019, it anticipates adjusted earnings per share of \$2.15-\$2.20 compared with \$2.05-\$2.20 expected previously. Also, the company's strong cash position remains a tailwind. However, it is concerned about global uncertainties and adverse impacts of divestitures and forex woes. Sales are projected to rise 2.5-3.5% versus 4-5% growth mentioned earlier. Restructuring expenses, high debt levels and adverse impacts of divested businesses can be detrimental. In the past six months, its shares have underperformed the industry.

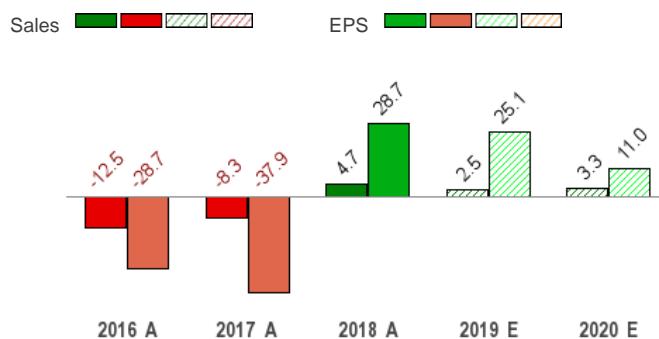
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$54.16 - \$39.75
20 Day Average Volume (sh)	518,811
Market Cap	\$6.6 B
YTD Price Change	1.2%
Beta	1.72
Dividend / Div Yld	\$0.76 / 1.5%
Industry	Manufacturing - General Industrial
Zacks Industry Rank	Bottom 21% (201 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	5.4%
Last Sales Surprise	-1.1%
EPS F1 Est- 4 week change	-0.8%
Expected Report Date	02/19/2020
Earnings ESP	0.0%
P/E TTM	23.8
P/E F1	20.7
PEG F1	1.3
P/S TTM	1.7

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	949 E	1,014 E	1,014 E	1,046 E	4,060 E
2019	890 A	990 A	997 A	1,056 E	3,928 E
2018	920 A	973 A	953 A	987 A	3,833 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$0.48 E	\$0.57 E	\$0.62 E	\$0.72 E	\$2.43 E
2019	\$0.41 A	\$0.54 A	\$0.59 A	\$0.65 E	\$2.19 E
2018	\$0.27 A	\$0.22 A	\$0.49 A	\$0.58 A	\$1.75 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 01/16/2020. The reports text is as of 01/17/2020.

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.

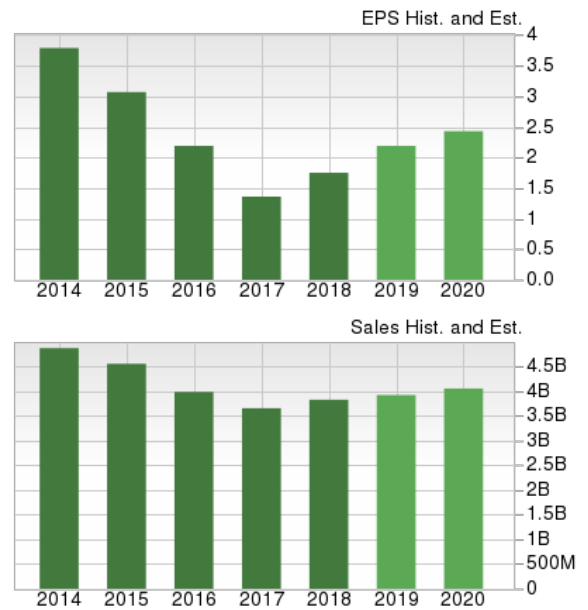
The company uses a footprint of Quick Response Centers (QRCs) around the globe to deliver these aftermarket services. The company sells products and services to more than 10,000 companies across more than 50 countries in North America, Europe, the Middle East, Africa, the Asia Pacific and Latin America.

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 (FPD: 68.4% of revenues in third quarter of 2019): This segment 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 41 manufacturing facilities and 145 QRCs. End markets served include power generation, chemical, general, and oil & gas markets.

Flow Control Division (FCD: 31.6% of revenues in third quarter of 2019): The segment is engaged in the manufacturing of valve, valve automation products, boiler controls and solutions. Notably, this 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 third-quarter 2019, Flowserve's earnings surpassed the Zacks Consensus Estimate by 5.4% and recorded 20.4% year-over-year growth. The bottom-line results gained on solid sales growth and Flowserve 2.0 transformation progress. Also, the company's adjusted operating margin increased 100 basis points (bps) driven by continued operational improvement and cost management measures. For 2019, the company anticipates gaining from its operational initiatives and Flowserve 2.0 transformation program. It now projects adjusted earnings per share of \$2.15-\$2.20 compared with \$2.05-\$2.20 expected previously.
- ▲ Flowserve follows a disciplined capital-allocation strategy. Funds are mainly invested in enhancing organic growth and Flowserve 2.0, a multiyear program. It is worth mentioning here that Flowserve 2.0 is expected to enhance the company's ability to effectively support customers and create a better workplace for employees as well as drive significant long-term value for shareholders. Also, Flowserve is committed toward rewarding shareholders handsomely. In the first nine months of 2019, it paid out dividends worth \$74.7 million and repurchased shares worth \$5.4 million. Further, capital expenditure in the period amounted to \$44.6 million. In the fourth quarter of 2019, the company intends to pay out approximately \$35 million to shareholders through dividends and share repurchases. Moreover, in 2019, the company intends to use \$75-\$85 million for capital expenditure. Further, exiting the third quarter, it is left to buy back shares worth \$155.3 million from the \$500-million program authorized in November 2014.
- ▲ Flowserve believes that prospects in its end markets are bright. The company expects to gain from a strong pipeline for near-term opportunities in the chemical market driven by an expected global demand growth, spurring investments in ethylene facilities. Business in Asia, Middle East and Gulf Coast region are likely to witness robust growth. Also, given the company's broad technical services offering, it is well positioned to gain from the renewable opportunity in growing thermal solar market. Notably, at the end of third-quarter 2019, the company's bookings recorded an increase of 13% to \$2.1 billion from 2018 end, on the back of transformation growth initiatives and strength in power and chemical markets.
- ▲ Flowserve's transformational realignment program, initiated in 2015 and largely completed in 2018, is enabling the optimization of manufacturing platform and reduction of costs. The company is also focusing on improving on-time delivery, reducing backlog, enhancing sales process and further leveraging on supplier relationships. Also, Flowserve's cash position remains impressive as evident from significant year-over-year increase in cash flow from operating activities at the end of third-quarter 2019. For 2019, the company expects to continue generating strong cash flow. All these factors bode well for Flowserve.

Strengthening power and chemical end markets, benefits from Flowserve 2.0 and a sound capital-allocation strategy will be favorable for Flowserve in the future.

Reasons To Sell:

- ▼ In the past six months, Flowserve's shares have moved down 2%, compared with the industry's increase of 9.9%. Also, the company's shares look overvalued compared with the industry as suggested by its price-to-earnings ratio (P/E). Flowserve's P/E (TTM) ratio is currently pegged at 23.76, higher than the industry's P/E of 22.77. Also, the company's current multiple is higher than the industry's six-month highest level of 22.77x. In third-quarter 2019, the company's revenues lagged the Zacks Consensus Estimate of \$1,007 million by 1.08%. For 2019, it revised its sales growth projection from 4-5% to 2.5-3.5%, taking into account higher adverse impacts of divestitures and forex woes. This somewhat makes us cautious about the company.
- ▼ 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 third-quarter 2019, the company's net income was adversely impacted by realignment expenses of \$3.8 million or 3 cents per share. In addition, it currently suffers from adverse impacts of unfavorable movements in foreign currencies and divested businesses. For instance, the company's third-quarter 2019 sales were impacted by 2.3% from unfavorable movements in foreign currencies and 0.5% from divested businesses. For 2019, it expects transformation and realignment expenses to be roughly \$50 million. In addition to these, the company predicts divested businesses and forex woes to have an adverse impact of 0.5% and 2.5% (higher than the previously stated 2%), respectively, on sales in 2019.
- ▼ A highly leveraged balance sheet can increase financial obligations and be detrimental to Flowserve's profitability. In the last five years (2014-2018), the company's long-term debt balance grew 5.1% (CAGR). Moreover, its total debt/total equity ratio rose from 59.5% in 2014 to 89.3% in 2018. At the end of third-quarter 2019, long-term debt was approximately \$1,350.3 million and interest expenses incurred in the first nine months of 2019 was \$42 million. Fresh issuance in the quarters ahead is bound to increase this balance and inflate the company's financial obligations.
- ▼ Flowserve's business depends on capital investment and maintenance expenditure by customers. These investment decisions are impacted by numerous factors, including the state of domestic and global economies, global energy demand, the cyclical nature of the markets, liquidity and condition of global credit, and capital markets. In addition, macroeconomic and political issues may pose as threats for the company. For instance, the company noted that geopolitical uncertainties are affecting the global spending and slowing down project timing in the oil and gas end markets. Moreover, issues like commodity pricing, trade disruption and the current geopolitical situation across the globe has caused delays in capital spending.

Realignment costs as well as headwinds related to divested businesses, forex woes and high debt levels can be detrimental to Flowserve in the quarters ahead.

Last Earnings Report

Flowserve Beats Q3 Earnings Estimates, Revises View

Flowserve reported better-than-expected results in the third quarter of 2019, with earnings beating estimates by 5.36%. This was the third consecutive quarter of impressive results.

The machinery company's adjusted earnings in the reported quarter were 59 cents per share, surpassing the Zacks Consensus Estimate of 56 cents. Further, the bottom line grew 20.4% from the year-ago figure of 49 cents on sales growth, improved margins, and decline in net interest and other expenses.

Quarter Ending **09/2019**

Report Date	Oct 30, 2019
Sales Surprise	-1.08%
EPS Surprise	5.36%
Quarterly EPS	0.59
Annual EPS (TTM)	2.12

Segmental Performance Drives Revenues

In the quarter under review, Flowserve's sales were \$996.5 million, reflecting year-over-year growth of 4.6%. Organic revenues in the quarter grew 7.4% while foreign currency movements and divested businesses adversely impacted sales by 2.3% and 0.5%, respectively.

The company's revenues lagged the Zacks Consensus Estimate of \$1,007 million by 1.08%.

Aftermarket sales in the reported quarter rose 6.7% year over year (or grew 9.4% on a constant-currency basis) to \$487.6 million. Furthermore, original equipment sales totaled \$509 million, reflecting year-over-year growth of 2.6% (or 4.6% on a constant currency basis).

Bookings totaled \$1.02 billion, reflecting growth of 1.3% (or 3.5% on a constant currency basis) over the year-ago quarter. Of the end markets, booking strengthened in chemical and Power end markets. 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 \$682.7 million, improving 5.4% year over year or 7.7% on a constant-currency basis. Bookings grew 6.3% year over year to \$742.1 million.

Revenues from the Flow Control Division were \$314.8 million, rising 2.8% year over year or 4.9% on a constant-currency basis. Bookings of \$282.7 million declined 10% year over year.

Margins Improve Y/Y

In the quarter under review, Flowserve's adjusted cost of sales rose 3.7% year over year to \$659.4 million. It represented 66.2% of sales compared with 66.8% in the year-ago quarter. Adjusted gross margin grew 60 basis points (bps) year over year to 33.8%. Selling, general and administrative expenses rose 2.2% year over year to \$219.8 million. It represented 22.1% of sales.

Adjusted operating income in the quarter under review improved 13.7% year over year to \$119.4 million. Moreover, adjusted operating margin grew 100 bps to 12%. Net interest and other expenses in the quarter declined 8.1% year over year to \$12.4 million.

Effective tax rate was 25.9% versus 28.8% in the year-ago quarter. Provision for income taxes in the quarter under review grew to \$27.7 million from \$26.4 million in the year-ago quarter.

Balance Sheet and Cash Flow

Exiting the third quarter of 2019, Flowserve had cash and cash equivalents of \$547.3 million, down 8.3% from \$596.5 million at the end of the last reported quarter. Long-term debt declined 2.6% sequentially to \$1,350.3 million.

In the first three quarters of 2019, the company generated net cash of \$144 million from operating activities compared with cash inflow of \$26.3 million in the year-ago period. Capital expenditure totaled \$44.6 million, declining 10.7% from \$50 million spent in the previous year's comparable period.

During the first three quarters of 2019, the company used \$74.7 million for distributing dividends and \$5.4 million for repurchasing shares.

Outlook

Flowserve is progressing well with transformation initiatives. The multi-year Flowserve 2.0 strategy will help in simplifying the operating model and spur growth.

The company anticipates adjusted earnings per share of \$2.15-\$2.20 versus the previously stated \$2.05-\$2.20. Revenues are anticipated to increase 2.5-3.5%, down from 4-5% stated earlier. Divestitures and forex woes are predicted to adversely impact sales by 3%.

Adjusted tax rate for the year is expected to be 25-27% versus 26-28% mentioned earlier. Capital expenditure is predicted to be \$75-\$85 million, down from \$90-\$100 million stated earlier.

Recent News

Dividend

On **Jan 10, 2020**, Flowserve paid out a quarterly cash dividend of 19 cents per share to shareholders on record as of Dec 27.

Business

On **Oct 22, 2019**, Flowserve announced that it will provide pumps to large sea water reverse osmosis (SWRO) desalination plants, Taweelah (based in the United Arab Emirates) and Rabigh-3 (based in Saudi Arabia). Per the agreement, Flowserve will supply 135 pumps—including HP and ERD boosters, High Pressure (HP) pumps, and second pass HP pumps.

Valuation

Flowserve shares are up 16.8% over the trailing 12-month period. Over the past year, the Zacks sub-industry and the Zacks Industrial Products sector are up 26.8% and 15.4%, respectively.

The S&P 500 index has moved up 23.3% in the past year.

The stock is currently trading at 20.65x forward 12-month earnings per share, which compares to 21.48x for the Zacks sub-industry, 18.4x for the Zacks sector and 19.13x for the S&P 500 index.

Over the past five years, the stock has traded as high as 31.5x and as low as 11.87x, with a 5-year median of 20.54x. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$53 price target reflects 21.73x 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	20.65	21.48	18.4	19.13
	5-Year High	31.5	22.52	19.9	19.34
	5-Year Low	11.87	15.16	12.59	15.17
	5-Year Median	20.54	18.9	16.54	17.44
EV/EBITDA F12M	Current	12.55	12.73	17.8	12.66
	5-Year High	15.59	12.73	18.2	12.66
	5-Year Low	7.66	8.25	10.68	9.08
	5-Year Median	12.25	10.62	14.01	10.78
EV/Sales F12M	Current	1.85	2.76	3.14	3.26
	5-Year High	2.13	2.77	3.14	3.37
	5-Year Low	1.4	1.66	1.76	2.3
	5-Year Median	1.79	2.3	2.28	2.79

As of 01/16/2020

Industry Analysis Zacks Industry Rank: Bottom 21% (201 out of 254)



Top Peers

Applied Industrial Technologies, Inc. (AIT)	Neutral
Colfax Corporation (CFX)	Neutral
GEA GROUP AG SP (GEAGY)	Neutral
IDEX Corporation (IEX)	Neutral
The Middleby Corporation (MIDD)	Neutral
Metso Corp. (MXCYY)	Neutral
Roper Technologies, Inc. (ROP)	Neutral
Xylem Inc. (XYL)	Neutral

Industry Comparison Industry: Manufacturing - General Industrial				Industry Peers		
	FLS Neutral	X Industry	S&P 500	AIT Neutral	CFX Neutral	MXCYY Neutral
VGM Score	B	-	-	B	C	D
Market Cap	6.59 B	2.03 B	24.61 B	2.63 B	4.50 B	5.80 B
# of Analysts	7	4	13	2	7	1
Dividend Yield	1.51%	0.00%	1.74%	1.83%	0.00%	1.06%
Value Score	C	-	-	B	C	B
Cash/Price	0.08	0.05	0.04	0.04	0.03	0.12
EV/EBITDA	21.74	13.75	14.24	10.22	22.62	12.19
PEG Ratio	1.34	2.19	2.07	NA	2.26	0.68
Price/Book (P/B)	3.72	2.63	3.38	2.83	1.44	3.53
Price/Cash Flow (P/CF)	19.25	13.34	13.75	9.76	10.46	17.10
P/E (F1)	20.85	19.00	19.09	15.56	17.42	15.85
Price/Sales (P/S)	1.71	1.39	2.68	0.76	1.20	1.44
Earnings Yield	4.83%	5.23%	5.24%	6.42%	5.73%	6.31%
Debt/Equity	0.85	0.57	0.72	0.93	1.32	0.54
Cash Flow (\$/share)	2.62	2.51	6.94	6.96	3.65	0.57
Growth Score	A	-	-	B	C	F
Hist. EPS Growth (3-5 yrs)	-17.72%	5.37%	10.56%	12.71%	4.49%	-4.93%
Proj. EPS Growth (F1/F0)	10.96%	7.58%	7.57%	-1.02%	10.75%	10.91%
Curr. Cash Flow Growth	15.24%	15.81%	14.73%	35.35%	-19.54%	58.45%
Hist. Cash Flow Growth (3-5 yrs)	-10.76%	7.16%	9.00%	13.96%	4.18%	-9.15%
Current Ratio	2.29	2.04	1.24	2.39	2.32	1.74
Debt/Capital	45.83%	37.08%	42.99%	48.10%	56.84%	34.99%
Net Margin	6.39%	6.55%	11.14%	3.86%	-12.40%	8.18%
Return on Equity	16.21%	13.61%	17.16%	18.22%	9.06%	20.00%
Sales/Assets	0.81	0.83	0.55	1.48	0.41	0.99
Proj. Sales Growth (F1/F0)	3.36%	1.94%	4.16%	0.06%	1.82%	NA
Momentum Score	D	-	-	D	B	C
Daily Price Chg	1.74%	0.75%	0.89%	1.52%	2.52%	0.00%
1 Week Price Chg	-0.14%	-0.25%	0.39%	-2.33%	-0.03%	-1.33%
4 Week Price Chg	2.65%	1.67%	2.65%	2.55%	8.55%	-0.92%
12 Week Price Chg	5.40%	8.52%	7.55%	20.48%	20.94%	7.33%
52 Week Price Chg	19.53%	13.88%	22.12%	11.38%	68.19%	37.95%
20 Day Average Volume	518,811	45,262	1,536,375	144,046	975,897	228
(F1) EPS Est 1 week change	0.12%	0.00%	0.00%	0.00%	0.03%	0.00%
(F1) EPS Est 4 week change	-0.82%	0.00%	0.00%	0.00%	-2.03%	-3.17%
(F1) EPS Est 12 week change	-1.12%	-1.11%	-0.40%	0.11%	0.71%	-2.40%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	0.00%	-3.90%	NA

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	C
Growth Score	A
Momentum Score	D
VGM Score	B

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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