

Flowserve Corporation (FLS)

\$23.00 (As of 03/25/20)

Price Target (6-12 Months): **\$24.00**

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:A

Value: B

Growth: B

Momentum: C

Summary

We believe that Flowserve is poised to benefit from strengthening end markets — including oil and gas, chemical, and thermal solar — and transformational initiatives in the long run. For 2020, the company anticipates adjusted earnings per share of \$2.30-\$2.45, suggesting an increase from \$2.20 recorded in 2019. Revenues are anticipated to increase 3-5%. However, it is wary about geopolitical and macroeconomic issues. Particularly, the coronavirus outbreak in China might have adverse impacts on manufacturing and supplier network. This, in turn, might postpone revenues generation in the first half. In addition, restructuring expenses and high debt levels can be detrimental to the company. In the past three months, its shares have underperformed the industry. Also, its earnings estimates have been lowered for 2020 in the past 60 days.

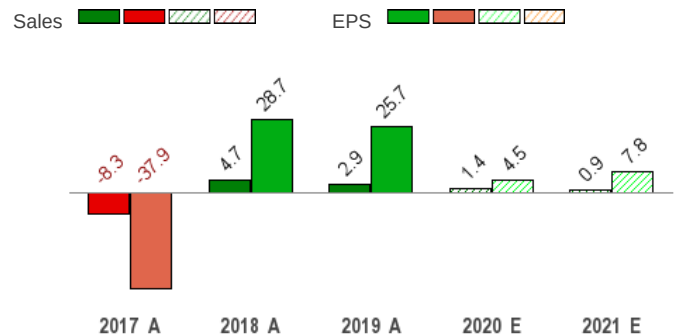
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$54.16 - \$18.98
20 Day Average Volume (sh)	2,097,698
Market Cap	\$3.0 B
YTD Price Change	-53.8%
Beta	1.66
Dividend / Div Yld	\$0.80 / 3.3%
Industry	Manufacturing - General Industrial
Zacks Industry Rank	Bottom 39% (154 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	1.5%
Last Sales Surprise	1.9%
EPS F1 Est- 4 week change	-5.1%
Expected Report Date	05/07/2020
Earnings ESP	-2.7%
P/E TTM	10.5
P/E F1	10.0
PEG F1	0.6
P/S TTM	0.8

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					4,039 E
2020	912 E	1,008 E	1,028 E	1,112 E	4,001 E
2019	890 A	990 A	997 A	1,068 A	3,945 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.29 E	\$0.21 E	\$0.39 E	\$0.61 E	\$2.48 E
2020	\$0.45 E	\$0.53 E	\$0.62 E	\$0.70 E	\$2.30 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 03/25/2020. The reports text is as of 03/26/2020.

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.

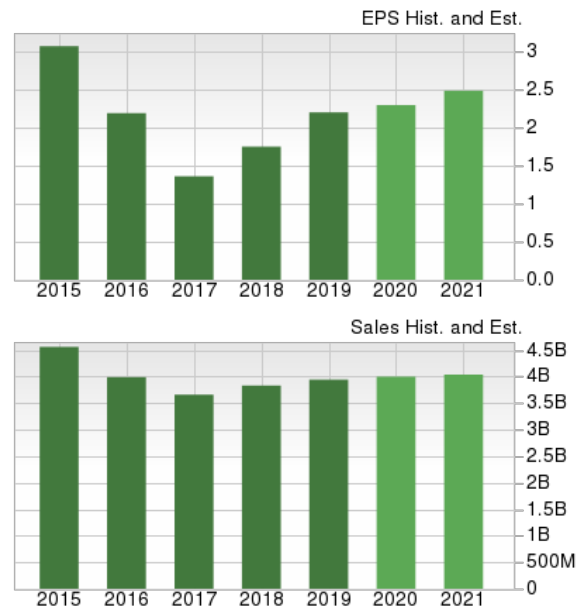
The company uses a footprint of Quick Response Centers (QRCs) around the globe to deliver these aftermarket services. The company sells products and services to more than 10,000 companies across more than 50 countries in North America, Europe, the Middle East, Africa, the Asia Pacific and Latin America.

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: 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 39 manufacturing facilities and 144 QRCs. End markets served include power generation, chemical, general, and oil & gas markets.

Flow Control Division: 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 fourth-quarter 2019, Flowserve's earnings surpassed the Zacks Consensus Estimate by 1.5% and increased 13.8% year over year. The bottom-line results were driven by progress on the Flowserve 2.0 transformation strategy and improved operating leverage. For 2020, the company anticipates gaining from its solid backlog and the Flowserve 2.0 transformation program. It now projects adjusted earnings per share of \$2.30-\$2.45 in 2020, suggesting rise from \$2.20 recorded in 2019.
- ▲ Flowserve follows a disciplined capital-allocation strategy. Funds are mainly invested in enhancing organic growth and Flowserve 2.0, a multi-year 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 2019, it paid out dividends of \$99.6 million and repurchased shares worth \$15 million. Further, capital expenditure in the period amounted to \$66.2 million. In 2020, the company intends to pay out approximately \$100 million as dividends to shareholders. Moreover, in 2020, it intends to use \$90-\$100 million for capital expenditure. Further, exiting 2019, it is left to buy back shares worth \$145.7 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 in the chemical market, driven by expected global demand growth, spurring investments in ethylene facilities. Business in Asia, Middle East and North America 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 the growing thermal solar market. Further, growth opportunities exist in downstream oil & gas as well as liquefied natural gas markets. Notably, bookings in the fourth quarter strengthened in oil & gas, chemical, and water end markets. Backlog, exiting the quarter, was at \$2.16 billion.
- ▲ For four years (between 2019 and 2022), Flowserve anticipates revenues to rise roughly 200 basis points above the industry's growth rate. Operating margin is predicted to be 15-17% in 2022. Further, after-tax return on invested capital is projected to be 15-20% in 2022 while free cash flow will likely be more than 100% of net income.

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

Reasons To Sell:

- ▼ In the past three months, Flowserve's shares have moved down 53.7% compared with the industry's decline of 31.5%. For the quarters ahead, the company is wary about geopolitical and macroeconomic issues. In particular, it believes that adverse impacts of the coronavirus outbreak in China might impact its manufacturing and supplier network in the region. This situation, in turn, might defer some revenue generation in the first six months of the year. In the past 60 days, the company's earnings estimates have been decreased by 6.5% for 2020 and 7.8% for 2021.
- ▼ 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 fourth-quarter 2019, the company's net income was adversely impacted by realignment expenses of \$3.1 million or 2 cents per share. In addition, it currently suffers from adverse impacts of unfavorable movements in foreign currencies. In the fourth quarter, the company's sales were adversely impacted by 1.1% from forex woes. For 2020, it expects transformation and realignment expenses of \$40 million.
- ▼ A highly leveraged balance sheet can be detrimental to Flowserve's profitability. At the end of fourth-quarter 2019, the company's long-term debts were at \$1,366 million, reflecting sequential increase of 1.2%. Net interest and other expenses increased 4.2% year over year to \$12.8 million in the quarter. Fresh issuance in the quarters ahead is bound to increase this balance and inflate the company's financial obligations. For 2020, the company predicts net interest expenses of \$45-\$50 million, with the mid-point coming in higher than \$46.6 million recorded in 2019.
- ▼ 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. In the first half of 2020, it believes that MRO bookings will be challenging in North America.

Realignment costs as well as headwinds related to coronavirus outbreak in China and high debt levels can be detrimental to Flowserve in the quarters ahead.

Last Earnings Report

Flowserve Q4 Earnings & Sales Beat Estimates, Rise Y/Y

Flowserve reported better-than-expected results in the fourth quarter of 2019, with earnings beating estimates by 1.5%. This was the fourth consecutive quarter of impressive results.

The machinery company's adjusted earnings in the reported quarter were 66 cents per share, surpassing the Zacks Consensus Estimate of 65 cents. Further, the bottom line grew 13.8% from the year-ago figure of 58 cents, driven by progress on the Flowserve 2.0 transformation strategy and improved operating leverage.

For 2019, the company's adjusted earnings per share were \$2.20, beating the Zacks Consensus Estimate of \$2.19. Also, the bottom line improved 25.7% year over year.

Quarter Ending **12/2019**

Report Date	Feb 17, 2020
Sales Surprise	1.90%
EPS Surprise	1.54%
Quarterly EPS	0.66
Annual EPS (TTM)	2.20

Segmental Revenues

In the quarter under review, Flowserve's sales were \$1,068.2 million, reflecting year-over-year growth of 8.2%. Notably, unfavorable movements in foreign currencies adversely impacted sales by 1.1%.

The company's revenues surpassed the Zacks Consensus Estimate of \$1,048 million by 1.9%.

Aftermarket sales in the reported quarter rose 5.3% year over year (or grew 6.6% on a constant-currency basis) to \$522 million. Furthermore, original equipment sales totaled \$546 million, reflecting year-over-year growth of 11.3% (or 12.1% on a constant-currency basis).

Bookings totaled \$1.05 billion in the quarter, reflecting a marginal increase of 0.7% (or 1.7% on a constant-currency basis) from the year-ago quarter. Of the end markets, booking strengthened in oil & gas, chemical, and water end markets. Backlog at the end of the reported quarter was \$2.16 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 \$739.5 million, improving 11.6% year over year or 12.7% on a constant-currency basis. Bookings grew 3.8% year over year to \$756 million.

Revenues from the **Flow Control Division** were \$330.2 million, rising 1.3% year over year or 2.2% on a constant-currency basis. Bookings of \$298.6 million declined 6.1% year over year.

For 2019, the company's sales totaled \$3.94 billion, reflecting growth of 2.9% from the previous year. Also, the top line surpassed the Zacks Consensus Estimate of \$3.92 billion.

Margin Profile

In the quarter under review, Flowserve's adjusted cost of sales increased 9.2% year over year to \$714 million. It represented 66.8% of sales compared with 66.3% in the year-ago quarter. Adjusted gross profit grew 6.4% year over year to \$354.2 million, while margin fell 50 basis points (bps) year over year to 33.2%. Selling, general and administrative expenses rose 5.3% year over year to \$230.2 million. It represented 21.6% of sales.

Adjusted operating income in the quarter under review improved 7.5% year over year to \$126.5 million. Moreover, adjusted operating margin fell 10 bps to 11.8%. Net interest and other expenses in the quarter grew 4.2% year over year to \$12.8 million. Effective tax rate was 22.2% versus 26.1% in the year-ago quarter.

Balance Sheet and Cash Flow

Exiting the fourth quarter of 2019, Flowserve had cash and cash equivalents of \$671 million, up 22.6% from \$547.3 million at the end of the last reported quarter. Long-term debt grew 1.2% sequentially to \$1,366 million.

During 2019, the company repaid debts of \$105 million.

In 2019, it generated net cash of \$312.7 million from operating activities, up 63.9% from the previous year. Capital expenditure in the year totaled \$66.2 million, declining 21.2% from \$84 million spent in 2018.

During the year, the company used \$99.6 million for distributing dividends and \$15 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, geopolitical and macroeconomic issues are concerning.

The company anticipates adjusted earnings per share of \$2.30-\$2.45 for 2020. Revenues are anticipated to increase 3-5%.

Net interest expenses in the year will likely be \$45-\$50 million, while adjusted tax rate for the year is expected to be 24-26%. Capital expenditure is predicted to be \$90-\$100 million.

Recent News

Dividend

On **Feb 24, 2020**, Flowserve's board of directors approved the payment of a quarterly cash dividend of 20 cents per share to shareholders of record as of Mar 27. The payment will be made on Apr 9, 2020. The company's previous quarterly dividend rate was 19 cents.

Valuation

Flowserve shares are down 53.7% and 48% 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 31.2% and 32.5% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and the sector are down 21.5% and 26.9%, respectively.

The S&P 500 index has moved down 23.7% year to date and 13.3% in the past year.

The stock is currently trading at 9.77x forward 12-month earnings per share, which compares to 15.34x for the Zacks sub-industry, 12.83x for the Zacks sector and 14.72x 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 20.54x. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$24 price target reflects 10.26x 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	9.77	15.34	12.83	14.72
	5-Year High	31.5	23.5	19.96	19.34
	5-Year Low	8.18	15.34	12.57	14.72
	5-Year Median	20.54	19.39	16.48	17.42
EV/EBITDA F12M	Current	6.2	9.29	12.01	9.82
	5-Year High	15.59	13.95	18.21	14.18
	5-Year Low	6.2	8.2	10.61	9.07
	5-Year Median	12.29	11.03	14.11	10.84
EV/Sales F12M	Current	0.88	2.17	2.11	2.35
	5-Year High	2.13	3.26	3.13	3.52
	5-Year Low	0.88	1.81	1.77	2.3
	5-Year Median	1.79	2.58	2.3	2.8

As of 03/25/2020

Industry Analysis Zacks Industry Rank: Bottom 39% (154 out of 253)



Top Peers

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

Industry Comparison Industry: Manufacturing - General Industrial				Industry Peers		
	FLS Neutral	X Industry	S&P 500	AIT Neutral	CFX Neutral	MXCYY Neutral
VGM Score	A	-	-	A	C	D
Market Cap	3.01 B	1.01 B	17.53 B	1.73 B	2.29 B	3.25 B
# of Analysts	7	4	13	2	9	1
Dividend Yield	3.30%	0.00%	2.47%	2.86%	0.00%	1.89%
Value Score	B	-	-	A	B	B
Cash/Price	0.25	0.12	0.07	0.09	0.06	0.24
EV/EBITDA	7.69	8.22	10.68	7.48	11.33	6.99
PEG Ratio	0.66	1.74	1.64	NA	1.02	NA
Price/Book (P/B)	1.66	1.55	2.32	1.80	0.65	1.98
Price/Cash Flow (P/CF)	7.64	7.64	9.40	6.43	4.18	9.57
P/E (F1)	10.21	13.25	14.14	10.41	9.48	10.61
Price/Sales (P/S)	0.76	0.90	1.82	0.50	0.63	1.02
Earnings Yield	10.00%	7.54%	7.02%	9.61%	10.57%	9.43%
Debt/Equity	0.84	0.51	0.70	0.91	0.69	0.54
Cash Flow (\$/share)	3.01	2.74	7.01	6.96	4.64	0.57
Growth Score	B	-	-	B	D	F
Hist. EPS Growth (3-5 yrs)	-14.64%	7.61%	10.85%	13.61%	6.78%	-4.58%
Proj. EPS Growth (F1/F0)	4.35%	0.42%	3.53%	-2.49%	-12.21%	292.31%
Curr. Cash Flow Growth	15.12%	1.78%	5.93%	35.35%	27.59%	58.45%
Hist. Cash Flow Growth (3-5 yrs)	-8.93%	4.53%	8.55%	13.96%	3.20%	-9.15%
Current Ratio	2.25	2.01	1.23	2.72	1.64	1.74
Debt/Capital	45.52%	33.99%	42.57%	47.61%	40.96%	34.99%
Net Margin	6.43%	6.24%	11.64%	3.85%	-14.45%	10.61%
Return on Equity	16.44%	11.10%	16.74%	17.79%	9.12%	16.60%
Sales/Assets	0.82	0.77	0.54	1.46	0.39	0.77
Proj. Sales Growth (F1/F0)	1.42%	-0.97%	2.51%	-0.89%	-5.84%	0.00%
Momentum Score	C	-	-	B	F	D
Daily Price Chg	7.78%	0.33%	2.41%	12.92%	13.79%	3.05%
1 Week Price Chg	-20.57%	-13.15%	-16.96%	-21.55%	-30.21%	-18.00%
4 Week Price Chg	-44.67%	-26.05%	-23.98%	-29.51%	-44.25%	-36.20%
12 Week Price Chg	-53.79%	-28.06%	-27.80%	-32.88%	-46.70%	-44.68%
52 Week Price Chg	-48.05%	-27.26%	-18.55%	-22.39%	-31.92%	-33.62%
20 Day Average Volume	2,097,698	76,820	4,285,848	341,676	2,512,395	4,963
(F1) EPS Est 1 week change	-1.39%	0.00%	0.00%	0.00%	-4.31%	0.00%
(F1) EPS Est 4 week change	-5.06%	-0.59%	-1.83%	0.00%	-5.95%	-12.07%
(F1) EPS Est 12 week change	-7.16%	-6.14%	-2.90%	-1.49%	-6.76%	-19.05%
(Q1) EPS Est Mthly Chg	-0.44%	-0.24%	-1.37%	0.00%	-7.51%	NA

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	B
Growth Score	B
Momentum Score	C
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.

Disclosures

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