Flowserve Corporation (FLS)

$27.22 (As of 06/25/20)

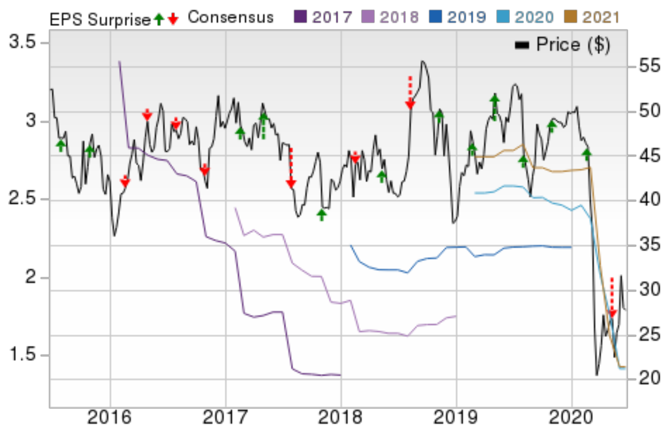
Price Target (6-12 Months): **$29.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 06/15/20) Prior Recommendation: Underperform	**Neutral**
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	**3-Hold**
	Zacks Style Scores:	VGM:B
	Value: B | Growth: B | Momentum: B	

Summary

We believe that Flowserve is poised to benefit from its solid backlog in the quarters ahead. For instance, backlog at the end of first-quarter 2020 was $2.18 billion, reflecting an increase of 1.2% on a sequential basis. Also, the company follows a disciplined capital-allocation strategy. Its investments in enhancing organic growth and Flowserve 2.0, a multi-year transformation program, will likely act as tailwinds. However, the coronavirus outbreak-induced market downturn, and the weak oil and gas end markets will likely affect its near-term results. The company withdrew its guidance for 2020 on end-market uncertainties, stemming from the virus outbreak. Flowserve's realignment plan is fuelling expenses and adversely impacting profitability in the near term. In the past six months, Flowserve's shares have underperformed the industry.

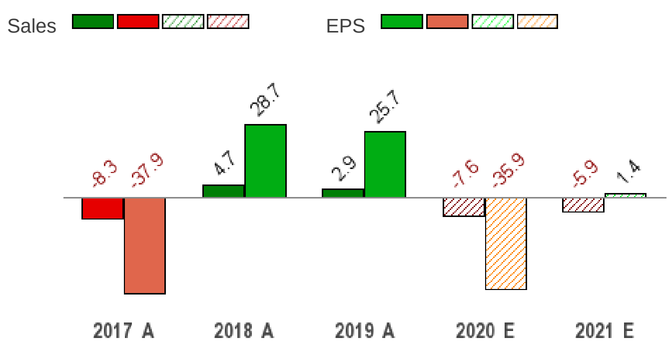
Price, Consensus & Surprise



Data Overview

52 Week High-Low	$53.98 - $18.98
20 Day Average Volume (sh)	1,915,666
Market Cap	$3.5 B
YTD Price Change	-45.3%
Beta	1.80
Dividend / Div Yld	$0.80 / 2.9%
Industry	Manufacturing - General Industrial
Zacks Industry Rank	Bottom 40% (151 out of 253)
Last EPS Surprise	-48.8%
Last Sales Surprise	-0.3%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	07/29/2020
Earnings ESP	0.0%
P/E TTM	13.6
P/E F1	19.3
PEG F1	1.2
P/S TTM	0.9

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021	811 E	837 E	941 E	1,012 E	3,430 E
2020	894 A	889 E	890 E	956 E	3,644 E
2019	890 A	990 A	997 A	1,068 A	3,945 A

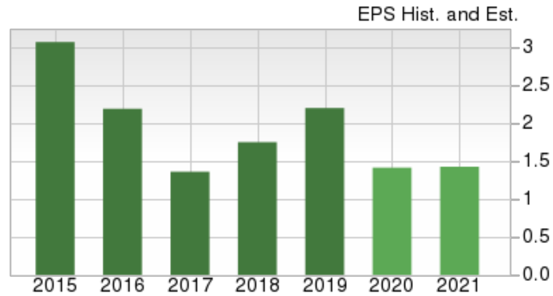
EPS Estimates

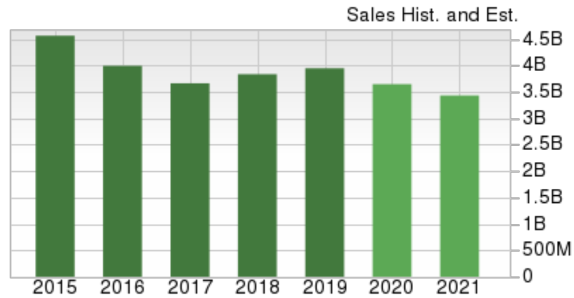
	Q1	Q2	Q3	Q4	Annual*
2021	$0.22 E	$0.32 E	$0.41 E	$0.52 E	$1.43 E
2020	$0.21 A	$0.29 E	$0.42 E	$0.50 E	$1.41 E
2019	$0.41 A	$0.54 A	$0.59 A	$0.66 A	$2.20 A

*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 06/25/2020. The reports text is as of 06/26/2020.

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 (70.9% of total revenues in first-quarter 2020): 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 142 QRCs. End markets served include power generation, chemical, general, and oil & gas markets.

Flow Control Division (29.1%): 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:

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

- Flowserve will likely benefit from its solid backlog in the quarters ahead. For instance, backlog at the end of first-quarter 2020 was $2.18 billion, reflecting an increase of 1.2% on a sequential basis. Also, the company follows a disciplined capital-allocation strategy. Funds are primarily invested in enhancing organic growth and Flowserve 2.0, a multi-year transformation 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.

- Flowserve's solid liquidity position enables it to cover its immediate liabilities. For instance, exiting the first 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 $622 million, and around $721 million of available capacity under the company's revolving credit facility. Also, in response to the coronavirus crisis, some of the actions taken by the company 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.

- Flowserve is committed toward rewarding shareholders handsomely. In the first quarter, it paid out dividends of $26 million and repurchased shares worth $32.1 million. In addition, exiting the first quarter of 2020, it is left to buy back shares worth $113 million from the $500-million program authorized in November 2014.

Reasons To Sell:

- In the past six months, Flowserve's shares have lost 45.2% compared with the industry's decline of 18.5%. In first-quarter 2020, the company's overall bookings declined 8.4% on year-over-year basis (or 6.6% on a constant-currency basis), with bookings down in both aftermarket and original equipment businesses. Notably, bookings were adversely impacted by low demand environment on account of the weakness in upstream, midstream and downstream oil and gas end markets. It expects overall demand to remain considerably weak along with witnessing persistent weakness in the oil and gas end markets in the quarters ahead. Also, it expects challenging conditions at the chemical end markets amid the coronavirus outbreak to affect its performance. Also, several of the company's manufacturing facilities have been suffering from temporary shutdowns, owing to the outbreak. Notably, the duration of the coronavirus pandemic and the impacts on the demand for the company's products and services will likely have a bearing on its results. It is worth mentioning here that it withdrew its guidance for 2020 on end-market uncertainties, owing to the outbreak.

The coronavirus-led market downturn, weak oil and gas end markets, high-debt levels, and unfavorable movements in foreign currencies can be detrimental to Flowserve in the quarters ahead.

- 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 first-quarter 2020, the company's net income was adversely impacted by realignment and transformation expenses of 10 cents per share. In addition, in the first quarter, its cost of sales, and selling, general and administrative expenses increased 5.5% and 18.7%, respectively, 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. For instance, it currently suffers from the adverse impacts of unfavorable movements in foreign currencies. In the first quarter, the company's sales were adversely impacted by 1.7% from forex woes. In addition, analysts have become increasingly bearish about Flowserve. In the past 60 days, the company's earnings estimates have declined 19.9% for 2020 and 11.7% for 2021.

- A highly leveraged balance sheet can be detrimental to Flowserve's profitability. At the end of first-quarter 2020, its long-term debt edged down 0.7% sequentially to $1,357.1 million. Despite the sequential fall in the long-term debt level, the company's high leverage ratio and a decline in its ability to meet obligations (lower times interest earned) are concerning. Notably, at the end of the first quarter of 2020, Flowserve's total debt-to-capital increased to 47.9% from 46.3% recorded at the end of the fourth quarter of 2019. Net interest and other expenses in the quarter also grew 8.1% year over year to $13.4 million. Moreover, the company's ability to meet its debt obligations based on its current income has weakened over the past quarter. Notably, its times interest earned is 6.6, lower than 7.2 in the previous quarter. Notably, the metric is also lower than the industry's times interest earned of 9.1. Fresh issuance in the quarters ahead is bound to increase the balance and inflate the company's financial obligations.

Last Earnings Report

Flowserve Q1 Earnings Miss Estimates, Decline Y/Y

Quarter Ending	03/2020
Report Date	May 07, 2020
Sales Surprise	-0.28%
EPS Surprise	-48.78%
Quarterly EPS	0.21
Annual EPS (TTM)	2.00

Flowserve reported first-quarter 2020 results, with earnings missing estimates by 48.8%.

The machinery company's adjusted earnings in the reported quarter were 21 cents per share, lagging the Zacks Consensus Estimate of 41 cents. Further, the bottom line fell 48.8% from the year-ago figure of 41 cents due to temporary site closures on account of the coronavirus outbreak.

Segmental Revenues

In the quarter under review, Flowserve's sales were $894.5 million, reflecting year-over-year growth of 0.5%. However, the company's revenues missed the Zacks Consensus Estimate of $897 million by 0.3%.

Aftermarket sales in the reported quarter fell 6% year over year (or down 4.3% on a constant-currency basis) to $442.2 million. However, original equipment sales totaled $452.3 million, reflecting year-over-year growth of 7.7% (or up 9.5% on a constant-currency basis).

Bookings totaled $976.9 million in the quarter, reflecting a decline of 8.4% (or 6.6% on a constant-currency basis) from the year-ago quarter. Notably, bookings were down for both aftermarket and original equipment businesses. Backlog at the end of the reported quarter was $2.18 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 $635.7 million, improving 4.3% year over year or 6.2% on a constant-currency basis. Bookings fell 8.7% year over year to $685.1 million.

Revenues from the **Flow Control Division** were $260.3 million, declining 7.7% year over year or 6.4% on a constant-currency basis. Bookings of $296.3 million declined 7.3% year over year.

Margin Profile

In the quarter under review, Flowserve's cost of sales increased 5.5% year over year to $628.5 million. It represented 70.3% of sales compared with 67% in the year-ago quarter. Adjusted gross profit declined 8.1% year over year to $275.4 million, while adjusted margin fell 290 basis points (bps) year over year to 30.8%. Selling, general and administrative expenses rose 18.7% year over year to $243.6 million. It represented 27.2% of sales.

Adjusted operating income in the quarter under review declined 40.3% year over year to $ 52.4 million. Moreover, adjusted operating margin fell 400 bps to 5.9%. Net interest and other expenses in the quarter grew 8.1% year over year to $13.4 million. Effective tax rate was 24.5% versus 25.6% in the year-ago quarter.

Balance Sheet and Cash Flow

Exiting the first quarter of 2020, Flowserve had cash and cash equivalents of $622.3 million, down 7.3% from $671 million at the end of the last reported quarter. Long-term debt fell 0.7% sequentially to $1,357.1 million.

In the first three months of 2020, it generated net cash of $47.3 million from operating activities, up 22.9% from the year-ago comparable period. Capital expenditure in the quarter totaled $17.3 million, increasing 63.2% from $10.6 million spent in the year-ago quarter.

During the quarter, the company used $26 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. However, the duration of the coronavirus pandemic and the impacts on the demand for the company's products and services will likely have a bearing on its results.

Notably, it has withdrawn its guidance for 2020 on end-market uncertainties, owing to the outbreak.

Recent News

Dividend

On **May 20, 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 Jun 19. The dividend will be paid out on Jul 6, 2020.

Guidance Withdrawn

On **Apr 6, 2020**, Flowserve announced the withdrawal of its earlier announced guidance for 2020 on end-market uncertainties due to the coronavirus pandemic.

The company noted that several of its manufacturing facilities, global technology and engineering centers, quick response centers, and corporate headquarters have suffered temporarily shutdowns, owing to the coronavirus outbreak. However, it remains committed to protect the safety, health and well-being of employees, customers and partners amid the crisis.

Valuation

Flowserve shares are down 45.3% and 47.2% 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 18.1% and 15.4% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry declined 11.4%, while the sector decreased 11.8%.

The S&P 500 Index has moved down 5.2% year to date and increased 4.5% in the past year.

The stock is currently trading at 19.17x forward 12-month earnings per share, which compares to 25.53x for the Zacks sub-industry, 20.87x for the Zacks sector and 21.87x 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 20.58x. Our Neutral recommendation indicates that the stock will perform in line with the market. Our $29 price target reflects 20.42x 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	19.17	25.53	20.87	21.87
	5-Year High	31.5	26.53	20.99	22.11
	5-Year Low	8.18	15.6	12.55	15.23
	5-Year Median	20.58	19.48	16.65	17.49
EV/EBITDA F12M	Current	11.3	10.89	16.44	12.28
	5-Year High	15.59	11.34	18.09	12.62
	5-Year Low	6.2	7.64	10.59	9.03
	5-Year Median	12.31	9.77	14.15	10.79
EV/Sales F12M	Current	1.28	3.65	3.19	3.27
	5-Year High	2.13	3.93	3.4	3.51
	5-Year Low	0.88	1.81	1.76	2.28
	5-Year Median	1.77	2.6	2.32	2.83

As of 06/25/2020

Industry Analysis **Zacks Industry Rank:** Bottom 40% (151 out of 253)

Top Peers

Company (Ticker)	Rec	Rank
Applied Industrial Technologies, Inc. (AIT)	Outperform	1
Colfax Corporation **(CFX)**	Neutral	3
GEA GROUP AG SP **(GEAGY)**	Neutral	3
IDEX Corporation **(IEX)**	Neutral	3
Ingersoll Rand Inc. **(IR)**	Neutral	2
The Middleby Corporation **(MIDD)**	Neutral	3
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	-	-	Outperform	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	1	3	2
VGM Score	B	-	-	A	B	D
Market Cap	3.54 B	1.12 B	21.24 B	2.32 B	3.05 B	11.49 B
# of Analysts	8	3	14	2	10	5
Dividend Yield	2.94%	0.00%	1.97%	2.14%	0.00%	0.00%
Value Score	B	-	-	A	C	D
Cash/Price	0.17	0.11	0.07	0.07	0.11	0.05
EV/EBITDA	8.82	11.33	12.51	9.11	13.12	31.35
PEG Ratio	1.20	3.25	2.87	NA	4.11	3.32
Price/Book (P/B)	2.10	1.50	2.90	2.79	0.91	1.31
Price/Cash Flow (P/CF)	9.04	9.68	11.34	8.60	5.55	16.73
P/E (F1)	18.73	26.38	20.76	16.04	21.27	26.31
Price/Sales (P/S)	0.90	1.09	2.18	0.68	0.88	4.36
Earnings Yield	5.18%	3.35%	4.55%	6.23%	4.70%	3.81%
Debt/Equity	0.89	0.50	0.77	1.04	0.79	0.39
Cash Flow ($/share)	3.01	2.49	7.01	6.96	4.64	1.65
Growth Score	B	-	-	A	B	D
Hist. EPS Growth (3-5 yrs)	-11.93%	11.57%	10.84%	14.14%	8.44%	NA
Proj. EPS Growth (F1/F0)	-35.74%	-33.92%	-10.73%	-15.31%	-48.07%	-34.09%
Curr. Cash Flow Growth	15.12%	4.08%	5.46%	35.35%	27.59%	-25.03%
Hist. Cash Flow Growth (3-5 yrs)	-8.93%	5.59%	8.55%	13.96%	3.20%	5.38%
Current Ratio	2.19	2.17	1.29	2.60	1.93	2.11
Debt/Capital	47.16%	33.92%	45.14%	51.01%	44.24%	28.13%
Net Margin	4.96%	4.33%	10.53%	0.99%	-13.62%	2.86%
Return on Equity	14.99%	10.81%	16.06%	17.40%	8.89%	2.12%
Sales/Assets	0.82	0.77	0.55	1.44	0.40	0.36
Proj. Sales Growth (F1/F0)	-7.63%	-8.96%	-2.70%	-5.50%	-20.67%	103.40%
Momentum Score	B	-	-	A	C	C
Daily Price Chg	5.50%	0.44%	0.93%	2.81%	-0.66%	0.25%
1 Week Price Chg	-1.00%	0.00%	0.92%	1.16%	-2.81%	-7.72%
4 Week Price Chg	1.49%	0.34%	-1.04%	1.96%	-8.30%	-4.10%
12 Week Price Chg	12.95%	19.30%	22.12%	36.47%	41.66%	19.66%
52 Week Price Chg	-47.19%	-15.25%	-8.70%	-1.43%	-4.91%	-18.67%
20 Day Average Volume	1,915,666	90,182	2,782,477	199,533	1,142,408	5,200,230
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.00%	0.00%	0.00%	1.08%	-0.09%	0.00%
(F1) EPS Est 12 week change	-29.76%	-32.24%	-12.23%	-2.86%	-35.52%	-97.96%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	5.84%	21.21%	0.00%

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	B
Growth Score	B
Momentum Score	B
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.

Disclosures

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