

Parker-Hannifin (PH)

\$165.14 (As of 05/18/20)

Price Target (6-12 Months): **\$176.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 01/21/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: B

Growth: B

Momentum: D

Summary

Robust backlog level, unique Win Strategy and Parker-Hannifin's growth investments are likely to drive its top-line performance in the quarters ahead. Also, the company is likely to benefit from acquired assets (including Exotic Metals Forming and LORD). In addition, it is on track to boost shareholder return over time. Moreover, the company has been executing several cost-control measures to maintain a healthy capital structure. However, the coronavirus outbreak-led market downturn and the volatile oil market will likely adversely impact Parker-Hannifin's near-term results. Also, foreign exchange headwinds are expected to hurt its fiscal 2020 sales. In addition, rise in debt levels can increase the company's financial obligations and hurt profitability. Notably, in the past three months, the stock has underperformed the industry.

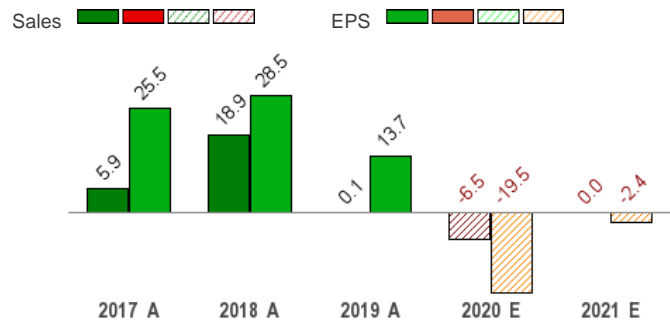
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$215.94 - \$93.00
20 Day Average Volume (sh)	1,496,380
Market Cap	\$21.2 B
YTD Price Change	-19.8%
Beta	1.65
Dividend / Div Yld	\$3.52 / 2.1%
Industry	Manufacturing - General Industrial
Zacks Industry Rank	Bottom 13% (222 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	29.2%
Last Sales Surprise	5.7%
EPS F1 Est- 4 week change	7.3%
Expected Report Date	08/06/2020
Earnings ESP	0.0%
P/E TTM	14.3
P/E F1	17.3
PEG F1	1.9
P/S TTM	1.5

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	3,029 E	3,249 E	3,598 E	3,508 E	13,385 E
2020	3,335 A	3,498 A	3,702 A	2,847 E	13,386 E
2019	3,479 A	3,472 A	3,688 A	3,681 A	14,320 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.89 E	\$2.15 E	\$2.76 E	\$2.85 E	\$9.31 E
2020	\$2.76 A	\$2.54 A	\$2.92 A	\$1.39 E	\$9.54 E
2019	\$2.84 A	\$2.51 A	\$3.17 A	\$3.31 A	\$11.85 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 05/18/2020. The reports text is as of 05/19/2020.

Overview

Parker-Hannifin Corporation is a global diversified manufacturer of motion & control technologies and systems. The company provides precision engineered solutions for a wide variety of mobile, industrial and aerospace markets.

Diversified Industrial Segment (79.9% of third-quarter fiscal 2020 sales): This segment is engaged in the production of a wide range of motion-control and fluid systems & components. The products offered by this segment are used in transportation, mobile construction, refrigeration and air conditioning, agriculture and other markets.

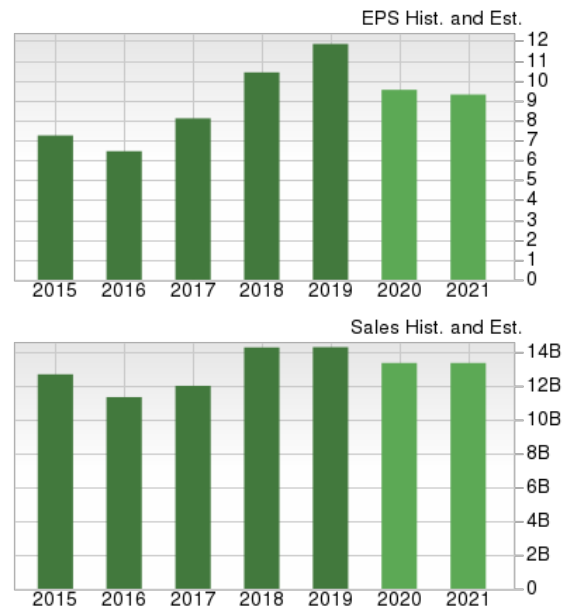
The segment sells its products through two main channels, namely, original equipment manufacturers (OEMs) and extensive distribution network to smaller OEMs and the aftermarket.

Products offered include sealing devices (dynamic and static); filters, systems and instruments to monitor and remove contaminants from fuel, air, oil, water and other liquids and gases; fluid connectors that control, transmit and contain fluid; hydraulic components and systems for builders and users of industrial and mobile machinery and equipment; and high-quality flow control solutions.

Aerospace Systems (20.1%): This segment supervises the designing and manufacturing of products and also provides aftermarket support for a broad range of aerospace products including commercial, business jet, military and general aviation aircraft and missile.

Products offered include control actuation systems & components, fluid metering, delivery & atomization devices, fuel systems & components, pneumatic control components, hydraulic systems & components and lubrication components among others.

The segment's products and services are offered to OEM and maintenance, repair and overhaul (MRO) customers throughout the world. Notably, the products are marketed by field sales employees and are sold to manufacturers as well as end customers.



Reasons To Buy:

- ▲ Parker-Hannifin's robust backlog level at the Aerospace Systems segment is likely to support its top-line performance in the quarters ahead. Also, continued strength in end markets like power, semiconductor, marine and mining end-markets is likely to supplement the company's top-line performance. Moreover, benefits of its unique Win Strategy are expected to support the company's revenue growth. Further, in response to the coronavirus crisis, the company has been executing several cost-control measures to maintain a healthy capital structure. Some of the actions being taken by the company include the reduction of discretionary expenses, a hiring freeze and reduction of capital expenditure. In the quarters ahead, the measures will help the company to maintain a healthy margin performance amid the crisis.
- ▲ Parker-Hannifin intends to finance new growth-based investments, acquire businesses and boost shareholders' remuneration with increased liquidity. In September 2019, the company completed the acquisition of Exotic Metals Forming Company. Exotic Metals' unique products and proprietary manufacturing capabilities have been enhancing Parker-Hannifin's aerospace products and solutions. Moreover, the company's buyout of LORD Corporation (completed in October 2019) has been enhancing its engineered materials' product and solutions offerings. It believes that both the buyouts will continue to be accretive to organic growth and margins. Notably, buyouts had a positive contribution of 9.3% to the company's sales in third-quarter fiscal 2020.
- ▲ Parker-Hannifin is steadily improving its cash position. In the last five fiscal years (2015-2019), the company's cash flow from operations increased 5.9% (CAGR). Notably, in the first nine months of fiscal 2020, Parker-Hannifin's cash flow from operations was up 18.1% on a year-over-year basis. In addition, the company remains highly committed toward increasing wealth of its shareholders through dividend payouts. In this regard, in the first nine months of fiscal 2020, the company paid out cash dividends of \$340.3 million, up 13.8% on a year-over-year basis. Notably, it increased the quarterly dividend rate by 16% or 12 cents per share to 88 cents in April 2019. On an annualized basis, the dividend increased to \$3.52 from \$3.04 per share.

Strong backlog level, acquisition benefits and ongoing Win Strategy are likely to drive Parker-Hannifin's near-term performance.

Reasons To Sell:

- ▼ In the past three months, Parker-Hannifin's shares have moved down 24.2% compared with the industry's decline of 23.3%. The company's realignment plan might prove beneficial over the long run but will affect its near-term financials. For instance, in the second and third quarters of fiscal 2020, business realignment expenses hurt its adjusted earnings by 8 cents and 10 cents per share, respectively. Also, the challenged end market conditions, particularly at aerospace, and oil and gas space will likely adversely impact its top-line performance, going forward. Notably, the duration of the coronavirus pandemic and the impacts of the governmental regulations imposed in response to the crisis will likely have a bearing on the company's results. On uncertainties, regarding the impacts of the outbreak on financial and operating results, the company has withdrawn its previously-issued guidance for fiscal 2020.
- ▼ Parker-Hannifin's long-term debt in the last five fiscal years (2015-2019) increased 19.1% (CAGR). Although, the company's long-term debt was down 0.5% sequentially to \$8,097.9 million at the end of third-quarter fiscal 2020, we find the company more leveraged than the industry. The stock's long-term debt-to-capital ratio is 0.56, higher than the industry's ratio of 0.51. Also, net interest expenses in the fiscal third quarter were high at \$80.8 million. We believe that a highly leveraged balance sheet can inflate its financial obligations and hurt profitability.
- ▼ Parker-Hannifin intends to boost its revenues and profitability on the back of overseas business expansion. However, this exposes the company to several political, economic and environmental headwinds. For instance, a stronger U.S. dollar is currently weighing over the company's international revenues. Notably, adverse foreign currency translation impact had hurt Parker-Hannifin's fiscal second and third-quarter revenues by 0.4% and 1.5%, respectively, on a year-over-year basis. A stronger U.S. dollar might further depress the company's overseas business's results in the quarters ahead.

The coronavirus-led market downturn, foreign exchange headwinds, high debt level and realignment expenses might weigh on Parker-Hannifin's results in the quarters ahead.

Last Earnings Report

Parker-Hannifin Q3 Earnings and Sales Surpass Estimates

Parker-Hannifin reported better-than-expected earnings results for the third quarter of fiscal 2020 (ended Mar 31, 2020), with a beat of 29.2%. Also, its sales surpassed estimate by 5.7%. The company noted that it is working aggressively in its fight to contain the spread of the coronavirus.

Its adjusted earnings were \$2.92 per share in the quarter, surpassing the Zacks Consensus Estimate of \$2.26. However, earnings declined 7.9% from the year-ago quarter's \$3.17 per share.

Quarter Ending **03/2020**

Report Date	Apr 30, 2020
Sales Surprise	5.66%
EPS Surprise	29.20%
Quarterly EPS	2.92
Annual EPS (TTM)	11.53

Revenue Details

In the quarter under review, the company's net sales were \$3,702.4 million, reflecting 0.4% year-over-year growth. Organic sales in the quarter declined 7.4% year over year. Orders were down 2% in the quarter.

Also, the company's top line surpassed the Zacks Consensus Estimate of \$3,504 million.

Parker-Hannifin reports revenues under two segments. A brief discussion on the quarterly results is provided below:

The Diversified Industrial segment's revenues totaled \$2,957.9 million, representing 79.9% of net revenues in the quarter under review. On a year-over-year basis, the segment's revenues decreased 2.6% year over year.

It is worth mentioning that the segment's revenues generated in North America totaled \$1,775.6 million, increasing 1.4% year over year. However, the segment's International revenues were \$1,182.3 million, down 8% year over year. Orders in the quarter decreased 7% year over year for Diversified Industrial North America and that for Diversified Industrial International fell 2%.

The Aerospace Systems segment generated revenues of \$744.6 million, accounting for 20.1% of net revenues in the reported quarter. Sales grew 14.2% year over year. Orders in the quarter increased 12% year over year.

Margin Profile

In the reported quarter, the company's cost of sales was flat year over year at \$2,766.7 million. It represented 74.7% of the quarter's net sales versus 75% in the year-ago quarter. Selling, general and administrative expenses increased 14.6% year over year to \$413.5 million. It represented 11.2% of net sales in the reported quarter versus 9.8% in the year-ago quarter.

Adjusted earnings before interest, tax, depreciation and amortization (EBITDA) in the quarter increased 3.3% year over year to \$713 million. Adjusted EBITDA margin expanded 60 bps to 19.3%. Interest expenses in the quarter increased 67.5% year over year to \$80.8 million.

Balance Sheet & Cash Flow

Exiting the third quarter of fiscal 2020, Parker-Hannifin had cash and cash equivalents of \$697.6 million, down 26.4% from \$948.4 million recorded in the last reported quarter. Long-term debt was down 0.5% sequentially to \$8,097.9 million.

In the first nine months of fiscal 2020, the company generated net cash of \$1,290.9 million from operating activities, reflecting growth of 18.1% from the year-ago period. Capital spending totaled \$182.5 million versus \$145.1 million in the year-ago comparable period.

During the period, the company paid out cash dividends of \$340.3 million, up 13.8% from the first nine months of fiscal 2019.

Outlook

Due to the pandemic-related worries, the company has informed that it is withdrawing its earnings projections for fiscal 2020. However, it did mention that its present efforts (cost reduction, cash preservation and others) along with its business transformation and restructuring actions (done in the past few years) will help it tide over the difficult situation.

The company also mentioned that April order trends suggest a 30-35% decline year over year. For Aerospace Systems, orders are likely to fall 40-45% in the month, and declines of 30-35% for Diversified Industrial North America and 25-30% for Diversified Industrial International are expected.

Recent News

On **Apr 22, 2020**, Parker-Hannifin declared a quarterly cash dividend of 88 cents per share to shareholders of record as of May 8, 2020. The dividend is payable on Jun 5, 2020.

On **Mar 24, 2020**, Parker-Hannifin's Hydraulic Pump and Power Systems division announced the launch of eConfigurator. The online tool will be used for the company's Gold Cup Pump and Motor Series.

On **Mar 12, 2020**, Parker-Hannifin discussed initiatives to grow organically, transforming the business, the Win Strategy 3.0, capital allocation policy and targets for fiscal 2023 (ending June 2023).

As noted, the company is poised to gain from lower costs (achieved through restructuring actions), streamlined organization structure (with 84 divisions versus 126 previously) and the Win Strategy 3.0 (implemented in fiscal 2019 — ended June 2019). It is worth noting here that the Win Strategy 3.0 comprises four goals — including engaged people, customer experience, profitable growth and financial performance.

Also, it added that its healthy balance sheet and cash positions helped in making acquisitions. Notably, the CLARCOR acquisition in March 2017 will likely yield revenue synergies of \$100 million and cost benefits of \$160 million by fiscal 2020 (ending June 2020). Also, Exotic Metals Forming Company, acquired in September 2019, will likely result in cost gains of \$13 million by the end of fiscal 2023. The buyout of LORD Corporation in October 2019 will likely generate cost synergies of \$125 million by fiscal 2023 end.

Parker-Hannifin also communicated that its adjusted earnings will exclude expenses (intangible asset amortization) related to buyouts beginning fiscal 2021 (ending June 2021). By fiscal 2023, the company predicts revenue growth of 150 basis points (bps) greater than Global Industrial Production Index (GIPI). Both adjusted segment operating margin, and adjusted earnings before interest, tax, depreciation and amortization (EBITDA) are estimated to be 21%. Free cash flow is predicted to be \$2.3 billion, while adjusted earnings per share are anticipated to be \$16.90.

From fiscal 2019 to 2023, the company anticipates using \$16.5 billion capital for dividend payments of \$2.5 billion, capital expenditure of \$1.5 billion, share buyback of \$1 billion and debt reduction of \$3.9 billion. Also, it allocated \$2.2 billion for acquisitions and other purposes. Notably, \$5.4 billion was used for the Exotic and LORD buyouts. Gross debt to EBITDA is expected to reach 2.0x in fiscal 2023 from 2.8x in fiscal 2019.

Valuation

Parker-Hannifin's shares have declined 19.4% in the year to date period and increased 1.2% over the trailing 12 months. Stocks in the Zacks sub-industry are down 20.4%, while the Zacks Industrial Products sector decreased 24.4% in the year-to-date period. Over the past year, the Zacks sub-industry and the sector decreased 11.1% and 16.9%, respectively.

The S&P 500 Index has moved down 11.1% year to date and increased 0.8% in the past year.

The stock is currently trading at 17.69x forward 12-month earnings per share, which compares to 23.22x for the Zacks sub-industry, 18.39x for the Zacks sector and 20.83x for the S&P 500 index.

Over the past five years, the stock has traded as high as 20.71x and as low as 8.87x, with a 5-year median of 16.04x. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$176 price target reflects 18.73x forward 12-month earnings per share

The table below shows summary valuation data for PH.

Valuation Multiples - PH					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	17.69	23.22	18.39	20.83
	5-Year High	20.71	23.5	19.93	20.87
	5-Year Low	8.87	15.6	12.55	15.23
	5-Year Median	16.04	19.46	16.65	17.49
EV/EBITDA F12M	Current	7.63	10.89	16.39	12.3
	5-Year High	12.89	11.34	18.05	12.65
	5-Year Low	7.63	7.64	10.56	9.05
	5-Year Median	9.95	9.71	14.08	10.81
EV/Sales F12M	Current	2.01	2.78	2.8	3.02
	5-Year High	2.32	3.28	3.12	3.51
	5-Year Low	1.11	1.81	1.76	2.28
	5-Year Median	1.72	2.59	2.31	2.82

As of 05/18/2020

Industry Analysis Zacks Industry Rank: Bottom 13% (222 out of 254)



Top Peers

Company (Ticker)	Rec	Rank
Broadwind Energy, Inc. (BWEN)	Neutral	2
Donaldson Company, Inc. (DCI)	Neutral	4
Danaher Corporation (DHR)	Neutral	3
Emerson Electric Co. (EMR)	Neutral	3
Eaton Corporation, PLC (ETN)	Neutral	4
Gates Industrial Corporation PLC (GTES)	Neutral	3
Honeywell International Inc. (HON)	Neutral	3
Triumph Group, Inc. (TGI)	Underperform	5

Industry Comparison Industry: Manufacturing - General Industrial				Industry Peers		
	PH	X Industry	S&P 500	DCI	DHR	ETN
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	4	3	4
VGM Score	B	-	-	B	D	C
Market Cap	21.17 B	1.06 B	20.09 B	5.76 B	113.16 B	31.31 B
# of Analysts	9	3.5	14	6	9	10
Dividend Yield	2.13%	0.00%	2.1%	1.85%	0.44%	3.73%
Value Score	B	-	-	C	D	C
Cash/Price	0.04	0.11	0.07	0.04	0.04	0.01
EV/EBITDA	11.13	10.93	12.13	13.00	28.92	10.53
PEG Ratio	1.90	3.12	2.72	3.14	3.66	1.87
Price/Book (P/B)	3.36	1.46	2.75	6.11	3.84	2.19
Price/Cash Flow (P/CF)	10.61	8.66	10.86	15.69	26.11	9.90
P/E (F1)	17.41	21.35	20.10	24.61	33.21	20.58
Price/Sales (P/S)	1.49	1.01	2.05	2.07	5.83	1.50
Earnings Yield	5.78%	4.23%	4.77%	4.07%	3.01%	4.85%
Debt/Equity	1.28	0.49	0.76	0.69	0.77	0.57
Cash Flow (\$/share)	15.57	2.24	7.01	2.89	6.21	7.91
Growth Score	B	-	-	A	C	C
Hist. EPS Growth (3-5 yrs)	17.20%	11.57%	10.87%	10.06%	2.50%	7.34%
Proj. EPS Growth (F1/F0)	-19.47%	-29.02%	-10.31%	-16.52%	10.53%	-32.93%
Curr. Cash Flow Growth	6.37%	4.08%	5.51%	8.18%	1.84%	0.36%
Hist. Cash Flow Growth (3-5 yrs)	7.55%	4.95%	8.55%	2.27%	5.87%	2.58%
Current Ratio	1.49	2.19	1.28	2.25	1.32	1.75
Debt/Capital	56.22%	33.43%	44.46%	41.12%	42.26%	36.40%
Net Margin	9.32%	4.33%	10.59%	9.47%	16.85%	10.19%
Return on Equity	24.30%	10.81%	16.29%	30.72%	11.52%	14.67%
Sales/Assets	0.72	0.74	0.55	1.25	0.32	0.65
Proj. Sales Growth (F1/F0)	-6.53%	-8.96%	-2.49%	-9.55%	2.81%	-20.28%
Momentum Score	D	-	-	D	F	D
Daily Price Chg	7.73%	5.65%	5.21%	7.76%	-0.98%	6.19%
1 Week Price Chg	-4.79%	-5.55%	-4.56%	-5.64%	1.50%	-10.38%
4 Week Price Chg	22.90%	5.81%	4.12%	8.02%	4.11%	0.49%
12 Week Price Chg	-18.69%	-21.25%	-16.39%	-9.16%	3.46%	-23.00%
52 Week Price Chg	1.27%	-17.12%	-5.84%	-7.80%	24.49%	-0.19%
20 Day Average Volume	1,496,380	76,024	2,651,378	502,420	3,897,306	2,322,717
(F1) EPS Est 1 week change	-0.16%	0.00%	0.00%	0.00%	0.00%	-1.43%
(F1) EPS Est 4 week change	7.28%	-4.28%	-4.48%	-6.90%	-1.19%	-11.00%
(F1) EPS Est 12 week change	-9.34%	-32.76%	-16.39%	-18.24%	-10.32%	-34.00%
(Q1) EPS Est Mthly Chg	18.78%	-22.38%	-9.90%	-22.84%	-17.57%	-34.74%

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	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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