

November 10, 2017

## ITT Corporation: ITT

Analyst: Joseph Nastasi

 Sector: Industrial Goods  
 Industry: Diversified Machinery

### Company Description:

ITT Corporation is a diversified manufacturer of highly engineered and customized technology solutions for the energy, transportation, and industrial markets. The company operates in the segments of industrial process, motion technologies, and the newly combined connect and control technologies. ITT's strong leading brand portfolio include Goulds pumps, Koni shock absorbers, Cannon electronic connectors, Enidine motion control devices, and numerous others. This is a global company with 9,500 employees in 35 countries and sales in 135 countries. The company has more than 100 facilities, which include 41 manufacturing facilities in 14 countries. ITT was founded in 1920 and listed as the new parent company ITT, Inc in 2011.

### BUY

|                         |         |
|-------------------------|---------|
| Current Price:          | \$51.02 |
| Target Price:           | \$62.90 |
| Market Cap:             | \$4.48B |
| Avg Volume:             | 570,000 |
| S&P Debt Rating:        | BBB     |
| ROE:                    | 12.8%   |
| Ke:                     | 10.0%   |
| EBIT Margin:            | 15.7%   |
| Total Asset Multiplier: | 0.69    |
| Equity Multiplier:      | 2.52    |
| Cash/Total Assets:      | 12.8%   |

### Catalysts:

- **Short Term (within the year):** Q4 earning results on February 14, 2018
- **Mid Term (1-2 years):** ITT taking advantage of the electrification of the transportation industry, especially in China. Increases in the federal budget for defense spending leading to new contracts. Normalization of the oil & gas industry
- **Long Term (3+):** Increasing segment margins toward competitors' average

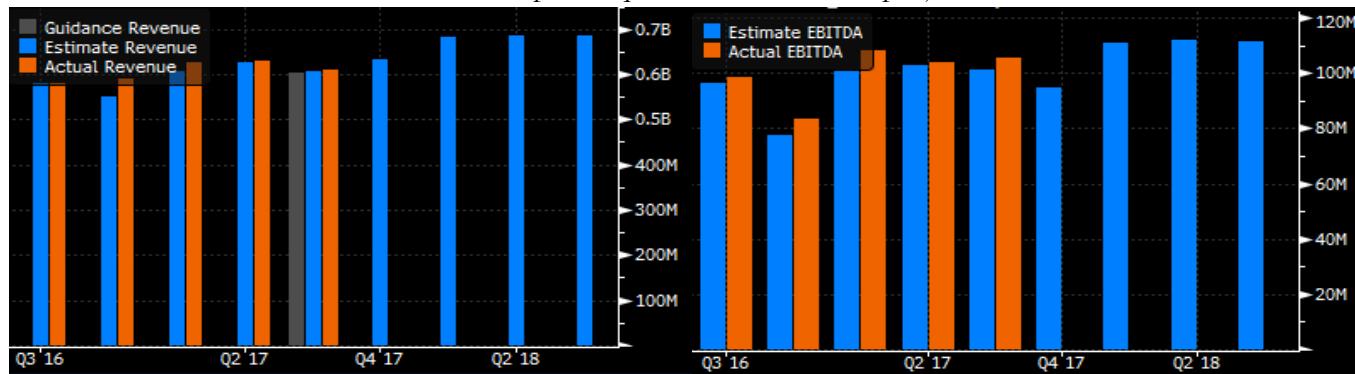


## Thesis:

ITT Corporation is diversified with its business mix, end markets, and geographic presence. The company has leading brands with a strong reputation such as Goulds Pumps, KONI, Cannon, and Enidine. ITT's 3rd quarter earnings resulted in promising segment performance leading to a share price increase of approximately 11% with a huge volume of approximately 3 million. The company will benefit from the industry trends of electrification in the transportation industry, increases in the federal budget for defense spending, and normalization in the oil & gas industry. ITT has seen increasing operating margins in the motion technologies segment due to the high performance of its KONI shock absorber and brake pads. There is an opportunity to grow in its other segments due to being below its competitors' average segment operating margins. The continued implementation of the Lean Six Sigma will continue to cut operating costs and drive margins. ITT has no long-term debt, which gives it a low probability of default and the opportunity to use debt. The company is best in class with its cash conversion cycle of 79 days. ITT's strategy along with industry trends will drive margins and increase the value of the company.

## 3<sup>rd</sup> Quarter Earnings Performance:

ITT's CEO stated during the earnings call, "Our balance results this quarter reflected double-digit operating income growth on each segment. The growth was driven by strong volume and improved productivity." Below shows the guidance, estimate, and actual revenue for the past 5 quarters along with projections. Also, the estimated and actual EBITDA for the past 5 quarters and forward projections are shown below.



ITT has beat analyst estimates on both revenue and EBITDA for the past 5 quarters. Total revenue was up 11% to \$645 million in Q3 2017 compared to Q3 2016. Total orders were up 15%, segment margins up 1.5%, EPS up 14%, and free cash flow up 27%. These results show stabilization in ITT's end markets, especially oil and gas, and position the company well for Q4 2017. The Q3 segment results for industrial process was total revenue increased 1% and GAAP operating income increased 130%. For motion technologies, total revenue increased 26% and GAAP operating income increased 9%. For connect and control technologies, total revenue was flat and operating income increased 1%. The operating margin by segment is discussed in more depth in the segment analysis section. ITT raised previous 2017 revenue guidance to be 4% to 5% from flat to 2%. EPS guidance was raised to \$2.50 to \$2.55 from \$2.45. The market reacted to the earnings performance by sending ITT's stock price up 11% with huge volume of approximately 3 million.

## Industry Outlook:

Based on 2016 revenue, ITT generates 60% of their revenue in the transportation end market, 30% in the industrial end market, and 10% in the oil and gas end market. The transportation end market aligns with the motion technologies segment. A major industry trend in transportation is the electrification of the auto industry. Currently, ITT's brake pads are similar in electric vehicles and traditional vehicles. There is less wear

on electric vehicles, so there are opportunities for improvement and efficiency gains. ITT has also developed EV charging stations that have grown 288% in orders in North America. There is an opportunity in China as one of the fastest growing markets with electric vehicles. ITT established an EV innovation center in China to develop better electric brake pads. The industrial end market aligns with the connect and control technologies segment. This involves aerospace, defense, and general industrial. The Trump administration promises for increases in the Federal Budget for defense spending. Recently, ITT was rewarded a \$22 million contract for the ITT's power converter used for the Bradley fighting vehicle. The oil and gas end market aligns with the industrial process. This sector has been disappointing due to the low price of oil. ITT is dependent on oil companies increasing capital expenditures, which will cause ITT's engineered products to be needed. Ramos stated how in the recent quarter there had been stabilizing conditions with increased activity in the Middle East. There has also been a reported 42% increase in general oil industry projects. With the price of oil recently increasing, the oil and gas sector is an area for margin improvement.

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## **Business Model:**

ITT Corporation has a diversified brand of highly engineered products along with diversified end markets. The geographic breakdown of revenue is 41% North America, 27% Western Europe, 14% Asia Pacific, 12% composed of Eastern Europe, Middle East & Africa, and 6% Latin America. This includes 30% of revenue coming from emerging markets. The company is also diversified in the end markets of transportation, industrial, and oil & gas. ITT's industry leading brands of the highest quality and efficiency are crucial for their growth. One brand is Goulds Pumps, which is used for extreme pressure and temperature environments for all areas of oil and gas production, transport, and refining. A second brand is Enidine, which are devices that help protect customers from unwanted shock and vibration. A third brand is Koni, which is synonymous with automotive shock absorbers that help reduce equipment wear while improving safety and performance. A fourth brand is Cannon, which is an electronic connector used in automobiles and aerospace that supports the vehicle's electrical, computer, and entertainment system. The diversity of ITT can also be shown with its customers. The main customer revenue breakdown is 9.46% Continental AG, 4.86% ZF Friedrichshafen, 2.06% Airbus SE, 1.75% Ford Motor, 1.66% Toyota Motor, 1.57% Samsung Electronics, 1.32% Caterpillar, and 1.24% Boeing Co. ITT has customers across numerous and very different industries. ITT Corporation's strategic plan is disciplined organic growth through global market expansion and new product development, combined with operational improvements that focus on the principles of Lean Six Sigma. This will drive operating margins and will increase the value of ITT.

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## **Segment Analysis:**

ITT's operates in the segments of industrial process (34% of total revenue), motion technologies (41% of total revenue), and connect and control technologies (25% of total revenue). The industrial process segment consists of designing and manufacturing pumps and valves, monitoring and control systems, and aftermarket services for chemical, oil and gas, and mining. The motion technologies segment consists of designing and manufacturing brake pads, shock absorbers and sealing solutions for the automotive and rail markets. The connect and control technologies segment consists of designing and manufacturing harsh-environment connectors and flow control components for the aerospace, industrial, and defense markets. The time-series annual and quarterly EBIT margin for each sector is shown below.

| Annual EBIT Margin             |        |        |        |        |        |        |
|--------------------------------|--------|--------|--------|--------|--------|--------|
| Segments                       | 2011   | 2012   | 2013   | 2014   | 2015   | 2016   |
| Industrial Process             | 11.93% | 10.39% | 11.59% | 10.79% | 13.10% | 7.41%  |
| Motion Technologies            | 13.45% | 13.27% | 14.87% | 17.29% | 18.18% | 18.11% |
| Connect & Control Technologies | 13.22% | 9.99%  | 13.09% | 16.93% | 11.29% | 12.19% |

| Quarterly EBIT Margin          |         |         |         |         |         |         |
|--------------------------------|---------|---------|---------|---------|---------|---------|
| Segments                       | Q2 2016 | Q3 2016 | Q4 2016 | Q1 2017 | Q2 2017 | Q3 2017 |
| Industrial Process             | 11.30%  | 2.21%   | 19.75%  | 5.37%   | 7.75%   | 5.05%   |
| Motion Technologies            | 19.26%  | 18.94%  | 14.60%  | 19.42%  | 18.20%  | 16.36%  |
| Connect & Control Technologies | 11.73%  | 11.68%  | 17.45%  | 11.68%  | 13.77%  | 11.71%  |

The industrial process segment EBIT margin is at an annual low in 2016. This is due to the challenging oil and gas market. ITT is dependent on capital expenditure in the oil and gas market, which was lagging in 2016. The quarterly margin has increased from 2.21% in Q3 2016 to most recently at 5.05%. There is a seasonality impact in Q3 of lower demand due to manufacturing shutdowns and planned maintenance activities. The annual EBIT margin for the motion technologies segment has generally increased. It is the highest margin at 18.11% annually for 2016 and also generates the largest amount of revenue. The connect & control technologies segment has seen a generally constant EBIT margin, most recently at 12.19%. There was an increase from Q3 2016 to Q3 2017. One way to show the opportunity for future increased segment margins is to look at competitors' similar segment margins. The annual EBIT margin by segment for Curtiss-Wright Corp, ITT's closest competitor, is shown below. Also, the average EBIT margin, per segment, of ITT's competitors with similar segments is shown below.

| Annual EBIT Margin Curtiss-Wright Corp (CW) |        | Annual EBIT Margin Competitors |        |    |  |
|---|--------|--------------------------------|--------|----|--|
| Segments                                    | 2016   | Segments                       | 2016   | N  |  |
| Power (Industrial)                          | 14.57% | Industrial Process             | 12.83% | 10 |  |
| Commercial/Industrial( Motion)              | 13.98% | Motion Technology              | 13.05% | 2  |  |
| Defense (Connect)                           | 20.92% | Connect and Control Technology | 18.03% | 4  |  |

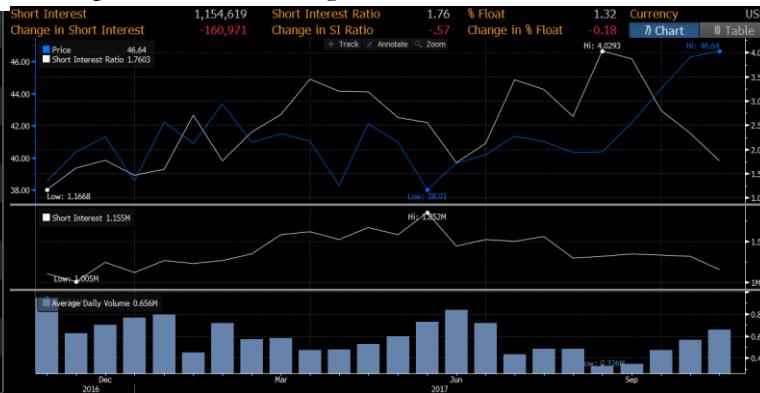
Curtiss-Wright Corp has a higher EBIT margin than ITT in the similar segments of industrial process and connect & control technologies. The industrial process margin and connect & control technologies margin are almost double ITT's. ITT has a greater motion technology margin due to their more recognized brand, better performing, and more efficient KONI shock absorber and brake pad technology. Other competitors of ITT also have higher EBIT margins in the industrial process and connect & control technology segments. These sectors for ITT will grow closer to its competitors in the future. Another way to show the opportunity for increased segment margins is with recent segment success and planned segment expenditures. In the industrial process segment, there was a 17% improvement in oil & gas and a 42% increase in general industry projects. Also, the backlog for the sector has improved 8% compared to the beginning of 2017 to \$376 million. There has been an increasing amount of orders from the Saudi region. The normalization of this industry with increasing oil prices will lead to increased margins. In the motion technologies segment, ITT is reacting to the shift of the electrification of automobiles. There has been a focus on expanding in China with new friction EV innovation and testing capabilities there. ITT also developed EV charging stations that have grown 288% in orders in North America. ITT acquired Wolverine Automotive Holdings in 2015, which was a manufacturer of customized automotive braking systems. Then, Axtone Railway Components was acquired in January 2017 to give ITT a greater presence in the railway industry. These synergies and new end markets will drive margin growth. In the connect & control technologies segment, there is room to grow in the defense

end market. ITT was awarded a record \$22 million contract for suspension technology for the Bradley fighting vehicle. Oil and gas connectors improved by 28%, this segment also benefits from the normalization in the oil industry. ITT acquired Environmental Control Systems in 2015, which was a designer and manufacturer of products to support aerospace applications. There is a large opportunity for EBIT margin growth across all segments for ITT.

## Management/Ownership:

The ownership type chart is shown below. The majority of ITT's shares outstanding are held by Investment Advisors at 88.05% and Hedge Fund Managers at 5.41%. There has not been much of an overall year-to-year ownership type change. The institutional owners are Vanguard Group (9.1%), Capital Research Global Investors (8.9%), and BlackRock (7.4%). The greatest change was Sovereign Wealth Funds increasing from 0.13% to 1.14% of shares outstanding. ITT has 99.63% of its shares outstanding as freely floated. The short interest chart is shown below. The short interest days to cover is low at 1.76 days. As the price of ITT has increased, the short interest ratio has declined. It has declined from a high of 4.03 in August to currently 1.76 days. There has also been a decline in the volume from short interest to approximately 1.1 million. This shows investors are more optimistic in ITT after its impressive Q3 earnings results.

| 54) Ownership Type    | 11/27/16 | Curr  | Change  |
|-----------------------|----------|-------|---------|
| Investment Advisor    | 87.92    | 88.05 | +0.13 ▲ |
| Hedge Fund Manager    | 5.67     | 5.41  | -0.26 ▼ |
| Pension Fund          | 2.73     | 2.51  | -0.22 ▼ |
| Bank                  | 1.10     | 1.17  | +0.07 ▲ |
| Sovereign Wealth Fund | 0.13     | 1.14  | +1.01 ▲ |
| Individual            | 0.65     | 0.69  | +0.04 ▲ |
| Insurance Company     | 0.40     | 0.65  | +0.25 ▲ |
| Government            | 1.05     | 0.23  | -0.82 ▼ |
| Endowment             | 0.07     | 0.07  | 0.00 ▲  |



Denise Ramos was appointed CEO of ITT in October 2011. She previously served as senior vice president and CFO of ITT since 2007. The CEO was internally appointed. Prior to ITT, she served as CFO of Furniture Brands International. From 2000 to 2005, she served as senior vice president and corporate treasurer at Yum! Brands. Ramos has a financial background thus knows the importance of generating cash flows. She has seen an increase in executive compensation at a CAGR from 2012 to 2016 of 8.75%. The total key executive increase in compensation has grown at a CAGR from 2012 to 2016 of 10.26%. While the stock price of ITT has grown annually at approximately from 2012 to 2017 at 15%, 75%, -18%, -10%, 24%, and 25% most recently. During the years of negative annual returns, compensation pay did not align; however, the recent 2-year stock growth has outperformed compensation growth. The problem is that ITT has underperformed compared to the industrial sector.

| Name/Title  | 2012      | 2013       | 2014       | 2015       | 2016       |
|---|-----------|------------|------------|------------|------------|
| ► Key Executive Compensation  | 9,217,997 | 10,379,213 | 13,581,706 | 14,406,045 | 13,622,100 |
| ► Denise L. Ramos/Chief Executive Officer and President                 | 4,773,322 | 5,487,224  | 6,613,071  | 6,821,608  | 6,677,540  |
| ► Thomas Scalera/Executive Vice President and Chief Financial Officer   | 1,480,255 | 1,586,417  | 1,684,913  | 2,000,908  | 1,805,450  |
| ► Luca Savi/Executive Vice President and President, Motion Technologies | 1,278,771 | 1,390,461  | 1,584,951  | 2,361,880  | 2,212,173  |

## Capital Allocation Comparison:

ITT Corporation uses the minimal amount of debt compared to its industry. For FY 2017, ITT had \$395M in debt compared to \$395.6M in cash. Cash represents approximately 12.58% of ITT's total assets. Total debt recently has decreased from \$245.7M in 2015 to \$191.1M in 2017. ITT is highly unlevered, which gives them the opportunity for future opportunities. The debt to equity of ITT is 5% compared to its competitors' average at 23%. This high amount of equity compared to debt results in ITT having a greater WACC than its competitors. This results in ITT having a lower return on capital to WACC compared to its competitors. ITT has the ability to leverage itself, thus reducing its WACC and increasing its value. However, the low probability of default that ITT currently has, due to its low amount of debt, also increases its value.

| In Millions of USD    | FY 2013    | FY 2014    | FY 2015    | FY 2016    | Current/LTM |
|-----------------------|------------|------------|------------|------------|-------------|
| 12 Months Ending      | 12/31/2013 | 12/31/2014 | 12/31/2015 | 12/31/2016 | 09/30/2017  |
| Market Capitalization | 3,951.2    | 3,681.9    | 3,250.6    | 3,409.6    | 4,481.0     |
| - Cash & Equivalents  | 507.3      | 584.0      | 480.6      | 460.7      | 395.6       |
| + Preferred & Other   | 5.9        | 5.4        | 3.3        | 2.0        | 1.6         |
| + Total Debt          | 10.9       | 1.4        | 245.7      | 214.3      | 191.1       |
| Enterprise Value      | 3,460.7    | 3,104.7    | 3,019.0    | 3,165.2    | 4,278.1     |

| Capitalization (Debt/Equity) |                | WACC       |             | ROC /WACC      |            |
|------------------------------|----------------|------------|-------------|----------------|------------|
|                              | <i>History</i> | <i>LTM</i> |             | <i>History</i> | <i>LTM</i> |
| ITT                          | 0.04           | 0.05       | ITT         | 11.0%          | 9.7%       |
| Competitors                  | 0.27           | 0.23       | Competitors | 9.7%           | 8.8%       |

## Profitability Comparison:

ITT for the past 2 years has been facing declining revenue. This is largely due to the challenging oil & gas industry. However, this year has been more promising. In the Q3 earnings results, revenue growth guidance was increased from a previous guidance of flat to 2% to a revised guidance of 4% to 5%. This large increase in revenue growth will drastically benefit the bottom line. ITT has a focus on operational improvements by implementing the principles of Lean Six Sigma to reduce costs and cycle times while improving productivity. Cutting operational costs along with increased revenue growth will lead to increased EBITA and net income thus better company-wide margins. ITT has a larger cost of revenue to revenue at 68.5% compared to competitors' average at 61.3%. The Lean Six Sigma will bring this closer to its competitors. ITT has increased productivity with its revenue to total employees increasing from \$0.22 to \$0.26. All of ITT's competitors have been facing challenging revenue growth, which is shown below in the comparative revenue growth table. ITT has the opportunity to improve its ROE to align more closely with its competitors. ITT's cash conversion cycle shows how it is best-in-class of the industry. ITT has a cash conversion cycle of 78.77 days compared to its closest competitor of Curtiss-Wright having a cash conversion cycle of 128.58. ITT stands out with its high inventory turnover and low payable turnover. The cash conversion cycle is critical for observing the operational efficiencies of a company and its ability to generate cash flow.

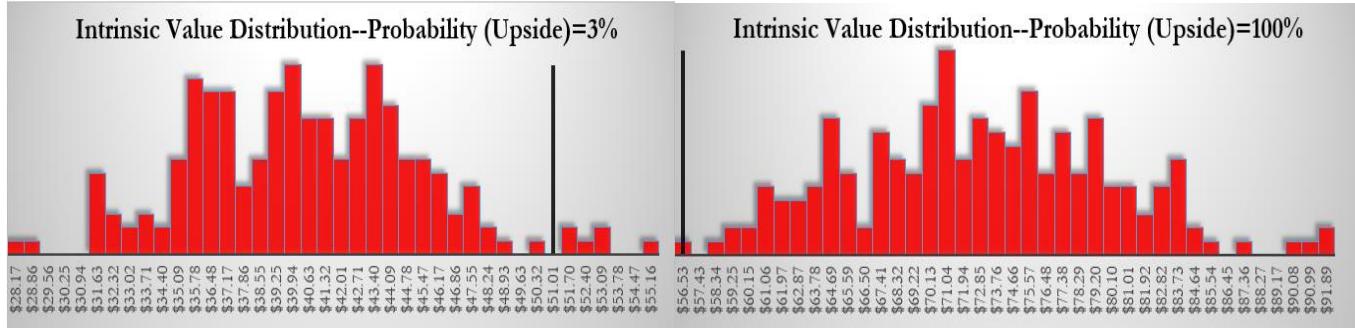
| COR/Revenue |                | Revenue/Total Employees |             |                |            |
|-------------|----------------|-------------------------|-------------|----------------|------------|
|             | <i>History</i> | <i>LTM</i>              |             | <i>History</i> | <i>LTM</i> |
| ITT         | 68.2%          | 68.5%                   | ITT         | \$ 0.22        | \$ 0.26    |
| Competitors | 62.1%          | 61.3%                   | Competitors | \$ 0.27        | \$ 0.28    |

| In Millions of USD<br>12 Months Ending | FY 2013<br>12/31/2013 | FY 2014<br>12/31/2014 | FY 2015<br>12/31/2015 | FY 2016<br>12/31/2016 | Current/LTM<br>09/30/2017 |
|--|-----------------------|-----------------------|-----------------------|-----------------------|---------------------------|
| <b>Revenue, Adj</b>                    | <b>2,496.9</b>        | <b>2,654.6</b>        | <b>2,485.6</b>        | <b>2,405.4</b>        | <b>2,490.1</b>            |
| Growth %, YoY                          | 12.1                  | 6.3                   | -6.4                  | -3.2                  | 0.3                       |
| <b>Gross Profit, Adj</b>               | <b>799.8</b>          | <b>866.4</b>          | <b>809.1</b>          | <b>758.2</b>          | <b>783.2</b>              |
| Margin %                               | 32.0                  | 32.6                  | 32.6                  | 31.5                  | 31.5                      |
| <b>EBITDA, Adj</b>                     | <b>340.5</b>          | <b>407.7</b>          | <b>399.7</b>          | <b>371.3</b>          | <b>502.3</b>              |
| Margin %                               | 13.6                  | 15.4                  | 16.1                  | 15.4                  | 20.2                      |
| <b>Net Income, Adj</b>                 | <b>542.7</b>          | <b>222.9</b>          | <b>268.5</b>          | <b>166.5</b>          | <b>226.2</b>              |
| Margin %                               | 21.7                  | 8.4                   | 10.8                  | 6.9                   | 9.1                       |

| Name<br>(BICS Best Fit)  | Mkt Cap<br>(USD) | Rev - 1<br>Yr Gr:Y | ROE:Y  | EBITA<br>Mrgn:Y | Ast<br>TO:Y | Inv<br>Turnover:Y | A/R<br>Trnovr:Y | A/P<br>Turnover:Y | Cash<br>Conversion<br>Cycle:Y | LTD/Capital:Y |
|--------------------------|------------------|--------------------|--------|-----------------|-------------|-------------------|-----------------|-------------------|-------------------------------|---------------|
| <b>Median</b>            | 4.49B            | 0.27%              | 13.23% | 10.30%          | 0.71        | 4.75              | 5.74            | 8.51              | 103.51                        | 39.41%        |
| ITT INC                  | 4.49B            | -3.23%             | 11.94% | 11.09%          | 0.66        | 5.60              | 4.47            | 5.35              | 78.77                         | 0.00%         |
| CURTIS WRIGHT CORP       | 5.22B            | -4.39%             | 14.87% | 16.19%          | 0.70        | 4.26              | 4.10            | 7.86              | 128.58                        | 36.13%        |
| ALTRA INDUSTRIAL MOTI... | 1.36B            | -5.06%             | 17.43% | 7.88%           | 0.94        | 3.73              | 6.59            | 10.00             | 117.01                        | 49.92%        |
| INDEX CORP               | 9.78B            | 4.57%              | 19.75% | 19.20%          | 0.71        | 4.81              | 7.93            | 9.28              | 82.84                         | 39.63%        |
| CRANE CO                 | 4.91B            | 0.27%              | 22.08% | 8.28%           | 0.81        | 4.89              | 6.92            | 7.72              | 80.35                         | 39.41%        |
| NORDSON CORP             | 7.15B            | 7.13%              | 35.38% | 23.08%          | 0.76        | 3.66              | 4.42            | 11.30             | 150.47                        | 51.57%        |
| CSW INDUSTRIALS INC      | 737.80M          | 2.27%              | 9.46%  | 9.30%           | 0.83        | 3.79              | 5.74            | 15.78             | 136.84                        | 21.02%        |
| SPX FLOW INC             | 1.76B            | -16.43%            | 4.47%  | -18.29%         | 0.68        | 4.75              | 4.29            | 6.21              | 103.51                        | 56.70%        |
| NN INC                   | 723.80M          | 24.91%             | 6.09%  | 10.30%          | 0.61        | 5.29              | 6.35            | 8.51              | 83.78                         | 70.47%        |

## Sensitivity Forecast

ITT's stock price value is very sensitive to revenue, operating expenses, and capital expenditure assumptions. Under the bear case scenario, there is a 3% intrinsic value probability upside. The assumptions are that ITT is not able to decrease its operating costs to revenue. The operating cost to revenue is assumed to remain the same as it currently is. Also, there is a decrease in the projected revenue growth rate. This could be due to the oil & gas industry not normalizing and falling growth in the automobile industry. The segment margins are assumed to remain the same and not increase to the industry average. This sensitivity forecast leads to a target price of \$39.13, thus a negative return of 22.26%. Under the bull case scenario, there is a 100% intrinsic value probability upside. The assumptions are that ITT is able to continue to reduce its operating costs to revenue. Also, to increase its projected revenue growth rates. This is due to the oil & gas industry normalizing and picking up capital expenditure expansions. It is also assumed that ITT will be able to take advantage of the electrification of the auto industry and grow its rail operations in China. Segment margins will start to increase towards the industry's average margins. The sensitivity forecast leads to a target price of \$70.87, thus a 39.95%. The upside is greater than the downside for ITT.



## Summary:

In conclusion, ITT Corporation is a buy at its current price due to its upward growth potential in segment operating margins. The company's operating margins have room to increase towards its competitors' average operating margin. ITT's operations are aligned to take advantage of the electrification of the transportation industry, the increase in federal spending in the defense industry, and the stabilization in the oil & gas industry. The upside price potential is greater than the downside price potential as shown in the sensitivity forecast section. ITT's one-year target price of \$62.90, a 24.32% return, is reasonable due to their revenue growth opportunities and ability to cut operational costs with its Lean Six Sigma focus.

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**ITT Inc. (ITT)**
**CENTER FOR GLOBAL FINANCIAL STUDIES**
**BULLISH**

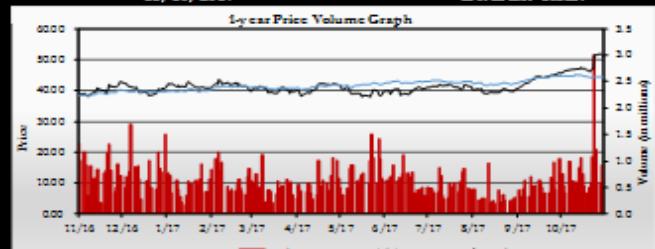
 Analysis by Joseph Nastasi  
 11/10/2017

 Current Price:  
 Dividend Yield:

 \$51.02  
 1.0%

 Intrinsic Value:  
 Target Price:

 \$55.79  
 \$62.90

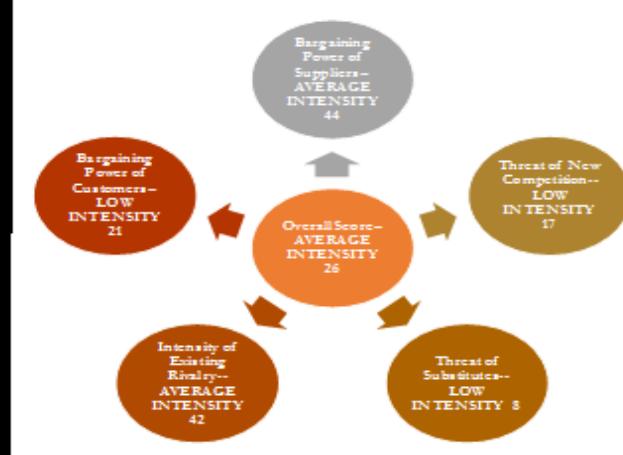
 Target 1 year Return: 24.52%  
 Probability of Price Increase: 95.5%


**Description**  
 ITT Inc. manufactures and sells engineered critical components and customized technology solutions for the energy, transportation, and industrial markets worldwide.

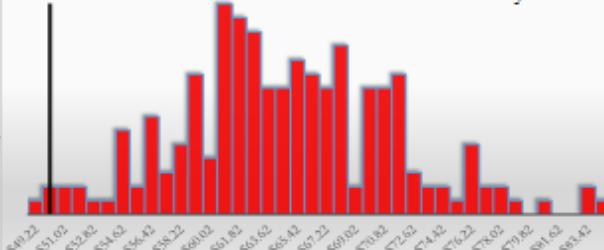
**General Information**

Sector: Industrials  
 Industry: Machinery  
 Last Guidance: November 3, 2015  
 Next earnings date: February 14, 2016  
 Estimated Country Risk Premium: 6.01%  
 Effective Tax rate: 22%  
 Effective Operating Tax rate: 12%

|   | Past Earnings Surprise | PEM                             |
|---|------------------------|---------------------------------|
| Quarter ending  |                        |                                 |
| Q3/2016   | -0.17%                 | Flowserve Corporation           |
| Q3/2016   | 5.70%                  | Gardner Denver Holdings, Inc.   |
| Q3/2017   | 3.18%                  | Coltus Corporation              |
| Q3/2017   | 0.56%                  | Craer Co.                       |
| Q3/2017   | 6.62%                  | Grace Inc.                      |
| Mean  | 3.20%                  | IDEX Corporation                |
| Standard error  | 1.4%                   | Wabco Water Technologies, Inc.  |
| Management  |                        | Woodward, Inc.                  |
| Ramos, Denise   |                        |                                 |
| Salem, Thomas   |                        |                                 |
| Savi, Luis  |                        |                                 |
| Guarini, Mary   |                        |                                 |
| Gilmore, Steven   |                        |                                 |
| Koumousis, James  |                        |                                 |
| Profitability   |                        |                                 |
| Return on Capital (GAAP)                                | 8.4%                   | ITT (LTM)                       |
| Operating Margin  | 6%                     | ITT (5-year historical average) |
| Revenue/Capital (GAAP)                                  | 1.34                   | PEM's Median (LTM)              |
| ROE (GAAP)  | 12.8%                  |                                 |
| Net margin  | 8.0%                   |                                 |
| Revenue/Book Value (GAAP)                               | 1.44                   |                                 |
| Invested Funds  |                        |                                 |
| Cash/Capital  | 11.7%                  | ITT (LTM)                       |
| NWC/Capital   | 15.2%                  | ITT (5-year historical average) |
| Opening Assets/Capital                                  | 33.5%                  | PEM's Median (LTM)              |
| Goodwill/Capital  | 37.6%                  |                                 |
| Capital Structure                                       |                        |                                 |
| Total Debt/Market Capitalization                        | 0.11                   | ITT (LTM)                       |
| Cost of Existing Debt                                   | 4.3%                   | ITT (5-year historical average) |
| CGPS Rating (F-score, Z-score, and default Probability) | BBB                    | PEM's Median (LTM)              |
| WACC  | 10.1%                  |                                 |

**Porter's 5 forces (scores are out of 100)**


| Period        | Revenue Growth Forecast    | NOPAT Margin Forecast | Revenue to Capital Forecast |
|---------------|----------------------------|-----------------------|-----------------------------|
| Base Year     | 0%                         | 10.4%                 | 1.30                        |
| 9/30/2018     | 3%                         | 7.3%                  | 1.09                        |
| 9/30/2019     | 7%                         | 6.1%                  | 1.05                        |
| 9/30/2020     | 5%                         | 0.7%                  | 1.00                        |
| 9/30/2021     | 0%                         | 10.6%                 | 0.98                        |
| 9/30/2022     | 5%                         | 10.8%                 | 0.93                        |
| 9/30/2023     | 3%                         | 11.0%                 | 0.86                        |
| 9/30/2024     | 3%                         | 11.2%                 | 0.81                        |
| 9/30/2025     | 3%                         | 14.0%                 | 0.76                        |
| 9/30/2026     | 2%                         | 13.3%                 | 0.70                        |
| 9/30/2027     | 2%                         | 15.7%                 | 0.65                        |
| Coming Period | 2%                         | 16.1%                 | 0.61                        |
| Period        | Return on Capital Forecast | WACC Forecast         | Price per share Forecast    |
| Base Year     | 13.5%                      | 10.1%                 | \$56.29                     |
| 9/30/2018     | 8.2%                       | 9.1%                  | \$63.32                     |
| 9/30/2019     | 0.6%                       | 0.0%                  | \$69.64                     |
| 9/30/2020     | 0.7%                       | 0.0%                  | \$76.10                     |
| 9/30/2021     | 10.4%                      | 8.8%                  | \$82.69                     |
| 9/30/2022     | 10.0%                      | 8.7%                  | \$82.44                     |
| 9/30/2023     | 0.5%                       | 8.6%                  | \$76.26                     |
| 9/30/2024     | 0.1%                       | 8.6%                  | \$103.26                    |
| 9/30/2025     | 11.4%                      | 0.0%                  | \$110.60                    |
| 9/30/2026     | 10.7%                      | 8.0%                  | \$118.23                    |
| 9/30/2027     | 10.2%                      | 8.8%                  | \$125.88                    |
| Coming Period | 0.7%                       | 8.7%                  |                             |

**Intrinsic Value Distribution--Probability**

**Sensitivity Attribution Analysis**
