Emerson Electric Company (EMR)

Updated July 8th, 2018 by Josh Arnold

Key Metrics

Current Price:	$69	**5 Year CAGR Estimate:**	3.5%	**Volatility Percentile:**	42.8%
Fair Value Price:	$55	**5 Year Growth Estimate:**	5.0%	**Momentum Percentile:**	70.1%
% Fair Value:	125%	**5 Year Valuation Multiple Estimate:**	-4.3%	**Valuation Percentile:**	19.5%
Dividend Yield:	2.8%	**5 Year Price Target**	$71	**Total Return Percentile:**	15.6%

Overview & Current Events

Emerson Electric was founded in Missouri in 1890 and since that time, it has evolved through organic growth, as well as strategic acquisitions and divestitures from a regional manufacturer of electric motors and fans into a $44 billion diversified global leader in technology and engineering. The company serves customers all around the world.

Emerson's second-quarter results were robust as sales rose 19% and earnings-per-share increased 31%. Its broad-based strength from its business lines led to new orders of 8% and higher operating margins. Operating cash flow came in at 12% of revenue and the company returned $550 million to shareholders. Strength in North America as well as Asia continues to help drive Emerson's results forward and we expect this to continue. Emerson boosted 2018 guidance after the report, but earnings-per-share estimates were raised by only 2%, so our estimate for 2018 hasn't changed.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$3.11	$2.27	$2.60	$3.24	$2.67	$3.54	$3.75	$3.17	$2.46	$2.54	***$3.10***	***$3.95***
DPS	$1.20	$1.33	$1.34	$1.38	$1.60	$1.66	$1.72	$1.88	$1.90	$1.92	***$1.94***	***$2.15***

Emerson's earnings-per-share have been volatile the past decade as we've seen meaningful swings in both directions. Indeed, estimates for earnings this year are right in line with what the company produced in 2008, highlighting that growth is highly uncertain with Emerson. The majority of Emerson's revenue is exposed to the oil and gas industry. where revenue and margins change significantly. That means forward projections are always at risk for Emerson as visibility several years out is limited. That said, we are forecasting 5% annual growth for the next five years as the company's low single digit organic growth is coupled with acquisitions to fuel top line expansion. Margins are expected to rise slightly from where they are now, and earnings-per-share will be further fueled by a small amount of share repurchases.

The dividend is also expected to grow in the low single digits as recent years have seen Emerson focus more on acquisitions and share repurchases than growing the dividend. Weak earnings-per-share growth lately has led to a higher-than-normal payout ratio for Emerson and we are forecasting that this will fall back towards the historical mean. Dividend growth likely will not be significant for the foreseeable future.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	16.6	14.8	17.8	16.8	18.3	15.8	17.6	18.0	20.6	22.9	***22.3***	***17.9***
Avg. Yld.	2.3%	3.9%	2.9%	2.5%	3.3%	3.0%	2.6%	3.3%	3.8%	3.3%	***2.8%***	***3.0%***

Emerson's price-to-earnings ratio has risen markedly in the past few years despite the fact that its earnings have been volatile. This has created a situation where its current valuation is well in excess of historical norms and thus, the stock appears to be overvalued. When you add in that its forward estimates are subject to significant risk, the idea that the price-to-earnings ratio should come back down to prior levels has more credence. Emerson's exposure to oil and gas remains a primary risk in estimates. We are thus forecasting a 4.3% annual headwind to total returns as the price-to-earnings ratio should come back down to 18 or so.

We are also forecasting that the yield will rise slightly from current levels to 3.0% as the stock struggles to move higher on tame earnings growth, and as dividend growth rates are expected to remain very low.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	36.8%	36.1%	39.6%	39.5%	40.0%	40.3%	31.6%	31.4%	43.1%	42.0%	***42.5%***	***43.0%***
Debt/A	57%	57%	57%	56%	57%	57%	58%	63%	65%	55%	***55%***	***55%***
Int. Cov.	20.4	12.1	12.0	17.4	15.0	15.7	17.4	22.9	13.5	15.4	***15.8***	***16.2***
Payout	38%	58%	51%	42%	60%	46%	61%	60%	77%	75%	***63%***	***54%***
Std. Dev.	53.7%	37.3%	27.5%	34.2%	20.9%	17.5%	17.5%	22.3%	22.8%	17.0%	***22.0%***	***27.0%***

Emerson's quality metrics are strong and have improved somewhat in recent years. Margins have been roughly flat since 2016 but should rise slightly in the coming years as Emerson digests its recent acquisitions and divestitures. Just over half of its assets are financed by debt and its interest coverage is very strong, so there are no financing concerns to speak of. This will allow Emerson to complete more acquisitions should the need arise without undue stress on the balance sheet. Indeed, Emerson very recently bought Aventics in its latest bolt-on acquisition. The payout ratio has grown significantly in recent years but should begin to fall in 2018 and beyond back to historical norms.

Emerson's competitive advantage is in its many decades of experience in building customer relationships and engineering excellence. It has a global customer base that is seeing strong economic growth and that underlying sales tailwind should power results going forward.

Final Thoughts & Recommendation

With the stock looking expensive at 125% of fair value, Emerson should deliver only 3.5% total returns going forward. This will be comprised of the 2.8% current yield, earnings-per-share growth of 5.0% and a 4.3% headwind from the valuation. With low earnings and dividend growth and an expensive valuation, Emerson does not look attractive here. It would be suitable for those seeking a high current yield but those looking for high rates of earnings growth, dividend growth or value should pass on Emerson.

Total Return Breakdown by Year