Eaton Corporation (ETN)

Updated May 2nd, 2018 by Nate Parsh

Key Metrics

Current Price:	$74	**5 Year CAGR Estimate:**	6.9%	**Quality Percentile:**	N/A
Fair Value Price:	$75	**5 Year Growth Estimate:**	3.0%	**Momentum Percentile:**	N/A
% Fair Value:	99%	**5 Year Valuation Multiple Estimate:**	0.3%	**Total Return Percentile:**	N/A
Dividend Yield:	3.6%	**5 Year Price Target**	$87	**Valuation Percentile:**	N/A

Overview & Current Events

Eaton Corporation is diversified industrial equipment and parts manufacture. The company's highly engineered electrical systems and components are used by customers in the industrial, vehicle, commercial, aerospace and construction markets. The Ireland based Eaton was founded in 1916 and has a current market cap of almost $33 billion. The company employs more than 95,000 people. Eaton is considered a cyclical company because its products are sold to industries that are in high demand in strong economic climates and in low demand when the economy is weak. Eaton has 6 divisions: Electrical Products, Electrical Systems and Services, Hydraulics, Aerospace, Vehicle and eMobility.

Eaton reported 1st quarter 2018 earnings on 5/1/2018. The company earned $1.10 per share, $0.03 ahead of analysis' expectations. The company generated $5.25 billion in revenue, 8.2% higher from Q1 2017 and $140 above estimates. Eaton had 6% organic sales growth, its highest total since 2011. Each division of the company had growth year over year, led by Hydraulics (up 21%) and Vehicle (up 14%). Eaton also raised its 2018's EPS forecast to $5.10 to $5.30 from $5.00 to $5.20.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$3.42	$1.30	$2.73	$3.96	$3.96	$4.19	$4.67	$4.30	$4.21	$4.65	***$5.20***	***$6.03***
DPS	$1.00	$1.00	$1.08	$1.36	$1.52	$1.68	$1.96	$2.20	$2.28	$2.40	***$2.64***	***$3.06***

Eaton has grown earnings per share at a rate of 3% over the past decade. The company saw its earnings drop dramatically during the last recession and took Eaton several years to recover. Using the midpoint of the company's updated guidance and the historical growth rate, Eaton could earn $6.03 per share by 2023. One area that could help accelerate growth is the company's new division, eMobility. This division will focus on parts and systems for electric vehicles. This division saw sales climb 22% (including 19% organic growth) in Q1 because of higher market share in Europe and the adoption of electrical products inside of the internal combustion engine in the U.S. While a small component today ($77 million in sales), Eaton believes that this could be a $2-$4 billion opportunity in the future.

Eaton has increased its dividend for the past 9 years. The company paused growth in 2009, as this was the prudent thing to do given the earnings decline. Eaton raised its dividend on 2/28/2018 by 10%, which is very close to the 10-year average increase of almost 11%. The company will most likely need to increase earnings at a faster pace if it wants to keep this level of dividend growth up in future years. If DPS were to grow at the historical earnings growth rate of 3%, then shares of Eaton could produce $3.06 of income by 2023.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	10.5	19.4	14.2	12.1	11.8	15.6	15.2	14.6	14.6	16.1	***14.2***	***14.4***
Avg. Yld.	2.8%	4.0%	2.8%	2.8%	3.2%	2.6%	2.8%	3.5%	3.7%	3.2%	***3.6%***	***3.5%***

Eaton has an average price to earnings multiple of 14.4 over the past decade. Given the steep drop in earnings that the company had in 2009, it appears that investors haven't been willing to pay a high multiple for shares. Eaton has a P/E of 14.2 based off of the updated earnings guidance for 2018. If shares were to trade with the average P/E, the stock could have multiple expansion of 0.3% per year through 2023. Eaton has a current yield of almost 3.6%, which is above the stock's 10-year average yield of 3.1%. The current yield is also much higher than the yield of the S&P 500 and the 10-Year Treasury Bond.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	25.1%	19%	23.7%	26.8%	13.6%	18.8%	20.6%	21.1%	20.8%	20.4%	***20.5%***	***21%***
Debt/A	61.8%	58.1%	57.1%	58.1%	57.6%	52.5%	52.8%	50.9%	50.8%	47%	***48.5%***	***48.5%***
Int. Cov.	8	3	8.6	14.2	7.4	7.9	10.8	10	9.6	10.2	***9.9***	***9.0***
Payout	29.2%	76.9%	39.6%	34.3%	38.4%	40.1%	42%	51.2%	54.2%	51.6%	***50.8%***	***50.7%***
Std. Dev.	41.8%	46.1%	28.5%	35.5%	29.9%	19.4%	22.4%	23.2%	22.3%	15.2%	***17.8%***	***28.4%***

Eaton suffered an extreme earnings decline during the last recession that forced the company to pause its dividend growth. Eaton would likely experience a decline in earnings in another recession due to the nature of its business and could pause its dividend increases again. The company is definitely not recession proof.

Eaton has seen its debt to asset ratio show sharp improvements over the past decade. The company has managed its debt levels well and isn't overleveraged. The company's gross profit to asset ratio has varied somewhat over the same time frame, but has stabilized in recent years.

Outside of 2009, Eaton has maintained a fairly low payout ratio. As dividend growth has climbed in recent years, that ratio has moved to the 50% range. Outside of a steep earnings decline, this ratio is not likely to climb much higher than current levels. If Eaton wishes to maintain its double-digit dividend increases, the company will have to grow earnings at a faster rate than they have over the past decade.

Final Thoughts & Recommendation

Eaton is expected to offer a total annual return of 6.9% through 2023. This return is a combination of earnings growth (3%), dividends (3.6%) and a slight multiple expansion (0.3%). Eaton's 1st quarter showed growth throughout the company and organic growth was impressive. Though small now, the company's eMobility division could prove to be a valuable enterprise. Eaton can offer decent yearly returns given the yield and growth estimates. Eaton is a hold at current prices. Investors interested in owning Eaton for the long run should wait for a better entry point.

Total Return Breakdown by Year