United Technologies Corporation (UTX)

Updated July 24th, 2018 by Nate Parsh

Key Metrics

Current Price:	$134	**5 Year CAGR Estimate:**	1.3%	**Volatility Percentile:**	27.4%
Fair Value Price:	$110	**5 Year Growth Estimate:**	3.0%	**Momentum Percentile:**	55.2%
% Fair Value:	122%	**5 Year Valuation Multiple Estimate:**	-3.9%	**Valuation Percentile:**	25.2%
Dividend Yield:	2.2%	**5 Year Price Target**	$127	**Total Return Percentile:**	9.3%

Overview & Current Events

United Technologies is a commercial aerospace and defense company. UTX is composed of four business divisions: Pratt & Whitney manufactures and services engines for commercial and military customers; Otis is the world's largest producer and servicer of elevators and escalators; UTC Climate produces HVAC equipment; and UTC Aerospace creates aerospace and industrial products. UTX has a current market capitalization of almost $98 billion and generated sales of more than $60 billion in 2017. The company was founded in 1934 and has more than 200,000 employees.

United Technologies' $30 billion purchase of Rockwell Collins is expected to close next quarter. Rockwell Collins' portfolio of products will diversify UTX's aerospace businesses and add ~$8 billion to sales.

UTX reported 2nd quarter earnings on July 24th. The company earned $1.97, $0.12 ahead of analysts' estimates and a 6.5% improvement from the previous year. Revenue grew 9.4% to $16.7 billion, a $440 million beat of expectations.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$4.90	$4.12	$4.74	$5.49	$5.34	$6.21	$6.82	$6.29	$6.61	$6.60	***$7.18***	***$8.32***
DPS	$1.35	$1.54	$1.70	$1.87	$2.03	$2.20	$2.36	$2.56	$2.62	$2.72	***$2.80***	***$3.25***

UTX saw a decline in earnings per share during the last recession that took the company until 2011 to recover from. Over the past decade, UTX has seen earnings growth of 3% per year. Along with 9% sales growth in the 2nd quarter, UTX had organic growth of 6% and has now posted four quarter in a row with at least 5% organic growth. All four businesses showed growth in the quarter, led by Pratt & Whitney's 16% revenue growth. Military sales were up 22%. Aftermarket services, a high margin business, increased 12%. Increases in aftermarket services were a theme for other divisions as well, including UTC Aerospace Systems which saw an increase of 12% in this area to help grow organic sales 8% altogether. In total, between 40%-45% of revenues come from aftermarket services, which are very high margin.

After raising its guidance last quarter, UTX once again increased its forecast this quarter. The company now expects a midpoint for EPS of $7.18, up from $7.05. UTX increased the lower end of its sales range by $500 million to $63.5-$64.5 billion. Organic sales growth for the year is expected to fall in the range of 5%-6%, up from 4%-6%. After a second straight raise of earnings estimates and robust organic growth, we are tempted to increase our expected earnings growth rate. If UTX continues to produce similar results, we will consider doing so. For now, we are comfortable expecting 3% annual earnings growth through 2023.

While UTX has raised its dividend 24 consecutive years, it has been sometime since the company gave shareholders an increase. The September payment will mark five quarters in a row with the same payment, but this isn't highly unusual for UTX. The company has varied the timing of the increase in the past, so shareholders shouldn't be concerned.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	13.1	13.4	15.0	14.6	14.7	16	16.4	17.0	15.3	17.7	***18.7***	***15.3***
Avg. Yld.	2.1%	2.8%	2.4%	2.3%	2.6%	2.2%	2.1%	2.4%	2.6%	2.3%	***2.2%***	***2.6%***

Disclosure: This analyst has no position in the security discussed in this article, and no plans to initiate one in the next 72 hours.

Shares of UTX trade at $134, a $14 (11.7%) increase from our April 29th report. Based off of updated guidance, the stock has a forward price to earnings multiple of 18.7, up from 17.4 earlier. UTX's stock has traded with an average multiple of 15.3 over the past decade. If shares were to revert to their average P/E, then shareholders could see the stock's multiple contract 3.9% per year through 2023, compared with a 2.5% reversion previously. UTX shares have a current yield of 2.2%. This yield is just above that of the S&P 500 and well below the 10-Year Treasury Bond.

Safety, Quality, Competitive Advantage, & Recession Resiliency

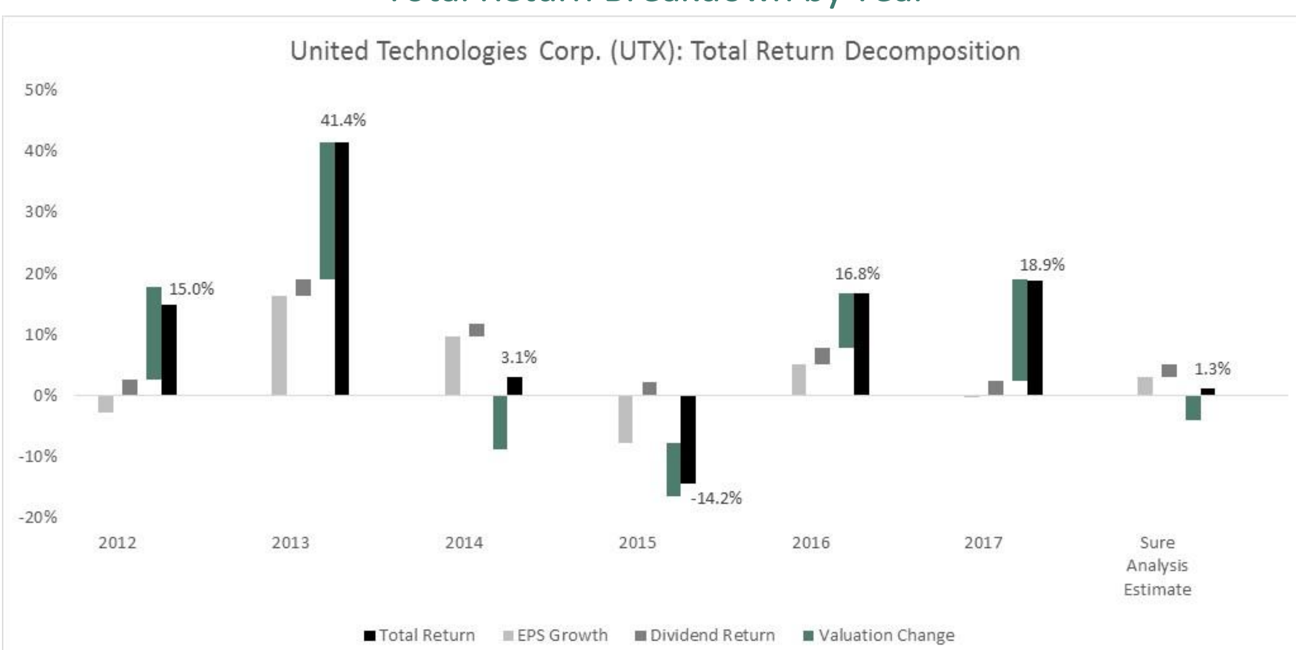
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	28.4%	24.3%	24.5%	25%	17.4%	17.8%	18.6%	17.9%	17.6%	16.4%	***17.3%***	***20.8%***
Debt/A	70.7%	61.6%	61.3%	62.9%	69.7%	63.3%	64.3%	67%	67.5%	67.6%	***75.8%***	***65.6%***
Int. Cov.	11.1	10.5	10.8	16.2	10.1	9.7	11.1	9.0	8.0	9.7	***9.8***	***10.6***
Payout	27.6%	37.4%	35.9%	34.1%	38%	35.4%	34.6%	40.7%	39.6%	41.2%	***39%***	***39.9%***
Std. Dev.	27.9%	30.6%	19.9%	25.5%	17.7%	14.3%	15.5%	19.1%	19.9%	12.8%	***14.3%***	***20.3%***

UTX did see a decline in earnings during the last recession that took several years to recover from. This would likely be the case again in an adverse economic climate. UTX's products, like elevators and jet engines, are in high demand when the economy is growing. Shareholders can expect that the company will perform well as long as the economy continues to improve. One item investors need to be aware of is that UTX does a significant amount of business in China, especially its Otis division. A potential trade war with China could impact UTX's earnings results. While rhetoric from respective leaders hasn't translated into official policy, investors need to keep this issue in mind. UTX has kept its dividend payout ratio to below 40% for much of the past 10 years. This has allowed the company to raise its dividend even as earnings have declined. Shareholders can be confident that the company will continue to increase payments regardless of the condition of the economy.

Final Thoughts & Recommendation

After taking into consideration the company's 2nd quarter earnings report, we expect shares of United Technologies to return 1.3% annually through 2023, down from 2.8% earlier. This expected return is derived from earnings growth (3%), dividends (2.2%) and multiple reversion (3.9%). While UTX has performed well as of late, the company's long term growth rate is low. We have raised our price target $2 to $127 due to increases in EPS forecasts. We suggest that investors wait for a pullback before purchasing shares of UTX.

Total Return Breakdown by Year



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