Emerson Electric Company (EMR)

Updated August 8th, 2018 by Josh Arnold

Key Metrics

Current Price:	$75	**5 Year CAGR Estimate:**	3.3%	**Volatility Percentile:**	39.8%
Fair Value Price:	$60	**5 Year Growth Estimate:**	5.0%	**Momentum Percentile:**	67.9%
% Fair Value:	125%	**5 Year Valuation Multiple Estimate:**	-4.3%	**Valuation Percentile:**	23.5%
Dividend Yield:	2.6%	**5 Year Price Target**	$76	**Total Return Percentile:**	16.0%

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 $47 billion diversified global leader in technology and engineering. The company serves customers all around the world.

Emerson reported Q3 earnings on 8/7/18 and investors bid the stock up sharply. Adjusted earnings-per-share rose 40% against last year's Q3 as the Automation segment produced 18% revenue growth. Order growth remains in the high single digits and continued upward pressure on revenue has boosted margins; gross margins were up 220bps to 43.7% and EBIT margins rose 180bps to 18.1%. We've raised our estimates for margins as well as earnings-per-share in sympathy with management's boost of earnings-per-share guidance after strong Q3 results.

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	***$3.35***	***$4.25***
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. 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 rose markedly in Q3 and we expect Emerson to be able to maintain that strength, with earnings-per-share being further fueled by a small amount of share repurchases. The significant amount of leverage from higher revenue the company has seen of late is the key to growth.

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 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%	***2.6%***	***2.8%***

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 2.8% 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%	***43.5%***	***44.0%***
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%	***58%***	***51%***
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%***

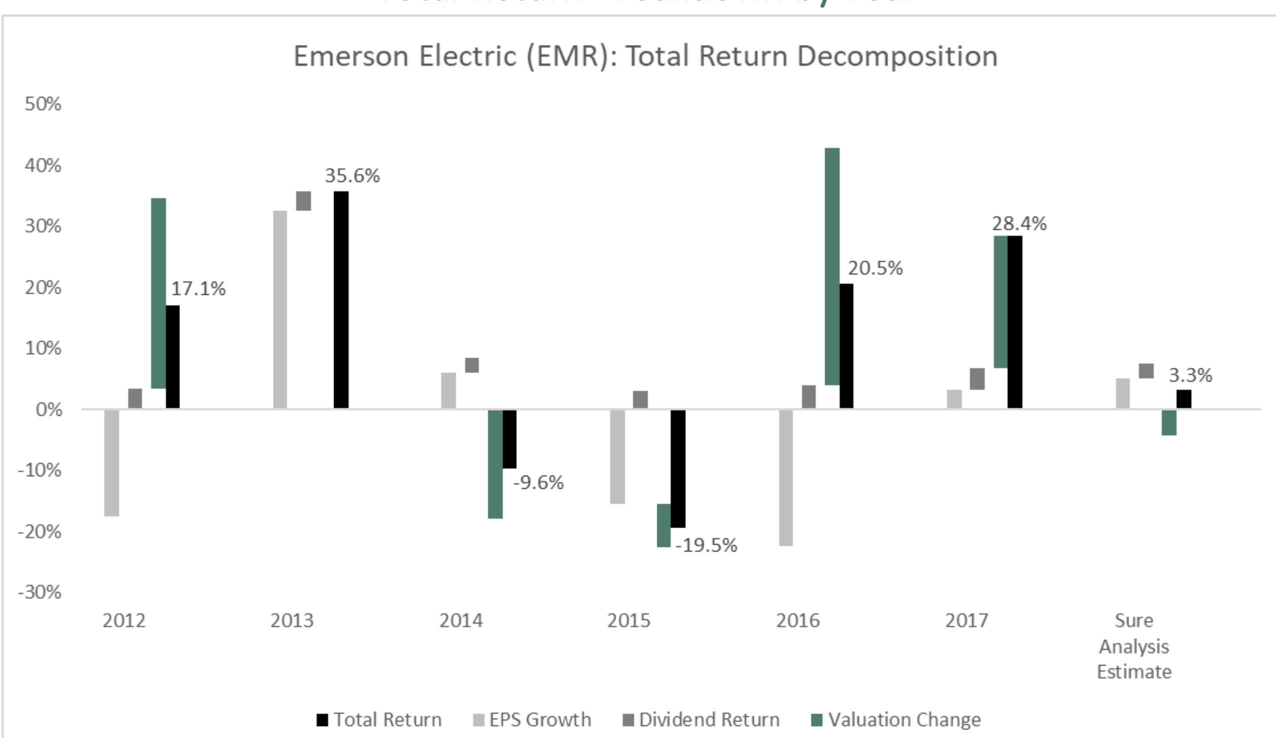
Emerson's quality metrics are strong and have improved somewhat in recent years. Margins have been roughly flat since 2016 but should rise slightly in the coming years as Emerson digests its recent acquisitions and divestitures. Just over half of its assets are financed by debt and its interest coverage is very strong, so there are no financing concerns to speak of. This will allow Emerson to complete more acquisitions 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. It is very susceptible to recessions given its oil and gas exposure, however, so any signs of economic weakness should put investors on alert.

Final Thoughts & Recommendation

With the stock looking expensive at 125% of fair value, Emerson should deliver only 3.3% total returns going forward. This will be comprised of the 2.6% 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. The stock earns a sell recommendation due to its low projected total returns.

Total Return Breakdown by Year



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