



# Emerson Electric Company (EMR)

Updated November 8<sup>th</sup>, 2018 by Josh Arnold

## Key Metrics

<b>Current Price:</b>	\$70	<b>5 Year CAGR Estimate:</b>	6.7%	<b>Volatility Percentile:</b>	39.6%
<b>Fair Value Price:</b>	\$66	<b>5 Year Growth Estimate:</b>	5.0%	<b>Momentum Percentile:</b>	70.9%
<b>% Fair Value:</b>	105%	<b>5 Year Valuation Multiple Estimate:</b>	-1.1%	<b>Growth Percentile:</b>	30.3%
<b>Dividend Yield:</b>	2.8%	<b>5 Year Price Target</b>	\$85	<b>Valuation Percentile:</b>	45.6%
<b>Dividend Risk Score:</b>	A	<b>Retirement Suitability Score:</b>	A	<b>Total Return Percentile:</b>	35.0%

## 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 \$43 billion diversified global leader in technology and engineering. Its global customer base affords it \$19 billion in annual revenue.

Emerson reported Q4 earnings on 11/6/18 and results were strong. Total revenue was up 10% during the quarter as underlying sales rose an impressive 8%. Revenue was driven in part by acquisitions, which added 4% to the top line, and slightly reduced by a 2% headwind from currency translation. The company's order rate remained strong as well, growing in the high single digits during the quarter, continuing the strength Emerson showed in fiscal 2018. Gross margins improved in Q4 as well, rising 150bps to 42.2%, which was essentially in line with our forecast. Higher revenue led to leverage on fixed costs, in addition to gains from the company's cost-saving efforts. Operating margins fell slightly due to a one-time 401(k) contribution to US employees but diluted adjusted earnings-per-share rose 26% from the year-ago quarter. The company guided fiscal 2019 earnings-per-share to a range of \$3.55 to \$3.70; our initial estimate for this fiscal year is \$3.62 as a result of this guidance. Q4 was a strong report and we see good things ahead for Emerson.

In early October, Emerson made a meaningful acquisition from General Electric, purchasing its Intelligent Platforms business for undisclosed terms. The purchase continues Emerson's very long history of acquiring growth and should enable the company to help its customers automate more of their processes, thereby saving time and money. The acquisition is a good fit for Emerson as it expands upon existing capabilities and should be fairly easy to integrate.

## Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
<b>EPS</b>	\$2.27	\$2.60	\$3.24	\$2.67	\$3.54	\$3.75	\$3.17	\$2.46	\$2.54	\$3.46	<b>\$3.62</b>	<b>\$4.62</b>
<b>DPS</b>	\$1.33	\$1.34	\$1.38	\$1.60	\$1.66	\$1.72	\$1.88	\$1.90	\$1.92	\$1.94	<b>\$1.94</b>	<b>\$2.15</b>
<b>Shares</b>	752	753	739	724	707	697	655	643	642	641	<b>640</b>	<b>635</b>

The majority of Emerson's revenue is exposed to the oil and gas industry, where revenue and margins change significantly, introducing risk to forecasts in out years. That said, we are forecasting 5% annual growth as the company's low single digit organic growth is coupled with acquisitions to fuel top line expansion. Margins rose nicely again in Q4 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 is the key to growth, as in Q4.

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. However, growth rates will likely be unimpressive as the company continues to focus using its ample cash flow on acquisitions, not dividend growth.

## Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
<b>Avg. P/E</b>	14.8	17.8	16.8	18.3	15.8	17.6	18.0	20.6	22.9	20.5	<b>19.3</b>	<b>18.3</b>
<b>Avg. Yld.</b>	3.9%	2.9%	2.5%	3.3%	3.0%	2.6%	3.3%	3.8%	3.3%	2.7%	<b>2.8%</b>	<b>2.5%</b>

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Emerson's price-to-earnings ratio has risen markedly in the past few years despite the fact that its earnings have been volatile. At present, Emerson looks to be slightly overvalued, trading for 19.3 times this year's earnings against our fair value estimate of 18.3. Emerson's exposure to oil and gas remains a primary risk in estimates, and we are therefore forecasting a 1.1% annual headwind to total returns as the price-to-earnings ratio should come back down to 18 or so. We are forecasting the yield to fall slightly over time to 2.5% from 2.8% as the share price outpaces gains in the payout.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
GP/A	36.1%	39.6%	39.5%	40.0%	40.3%	31.6%	31.4%	43.1%	42.0%	42.0%	<b>42.0%</b>	<b>43.0%</b>
Debt/A	57%	57%	56%	57%	57%	58%	63%	65%	55%	55%	<b>55%</b>	<b>55%</b>
Int. Cov.	12.1	12.0	17.4	15.0	15.7	17.4	22.9	13.5	15.4	15.2	<b>15.0</b>	<b>16.0</b>
Payout	58%	51%	42%	60%	46%	61%	60%	77%	75%	58%	<b>54%</b>	<b>47%</b>
Std. Dev.	37.3%	27.5%	34.2%	20.9%	17.5%	17.5%	22.3%	22.8%	17.0%	22.0%	<b>20%</b>	<b>22%</b>

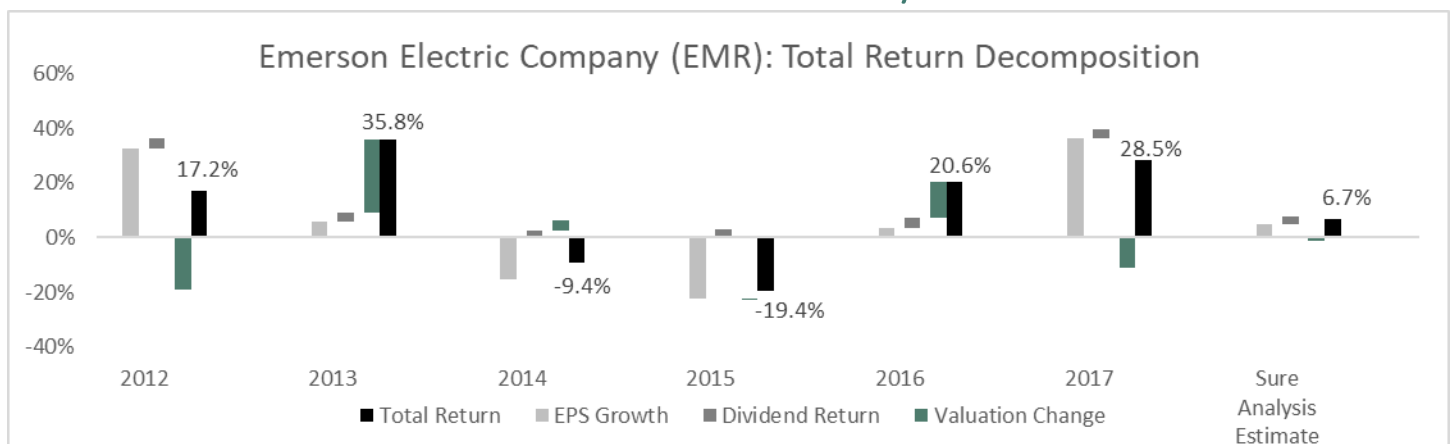
Emerson's quality metrics are strong and have improved somewhat in recent years. Margins have been roughly flat since 2016 but should rise slightly in the coming years as Emerson digests its recent acquisitions and divestitures, as we saw in the back half of fiscal 2018. Just over half of its assets 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, such as the GE Intelligent Platforms purchase. The payout ratio has come back down to more normalized levels after years of outsized dividend growth, and we expect it will remain around 50% of earnings.

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 slightly overvalued at 105% of fair value, Emerson should deliver 6.7% total returns going forward. This will be comprised of the 2.8% current yield, earnings-per-share growth of 5.0% and a 1.1% headwind from the valuation. While Emerson is much cheaper than it was at the time of our last report, it is still slightly overvalued. It would be suitable for those seeking a high current yield but those looking for high rates of earnings growth or dividend growth should pass on Emerson. We're upgrading the stock to a hold given the more favorable valuation.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Revenue</b>	20102	21039	24222	24412	24669	17733	16249	14522	15264	17408
<b>Gross Profit</b>	7560	8326	9557	9768	9952	7762	7008	6262	6404	7460
<b>Gross Margin</b>	37.6%	39.6%	39.5%	40.0%	40.3%	43.8%	43.1%	43.1%	42.0%	42.9%
<b>SG&amp;A Exp.</b>	4416	4817	5328	5436	5648	4164	3735	3464	3618	4258
<b>D&amp;A Exp.</b>	727	816	867	823	819	569	573	568	636	758
<b>Operating Profit</b>	3144	3509	3849	3881	3942	3426	3081	2600	2578	2891
<b>Op. Margin</b>	15.6%	16.7%	15.9%	15.9%	16.0%	19.3%	19.0%	17.9%	16.9%	16.6%
<b>Net Profit</b>	1724	2164	2480	1968	2004	2147	2710	1635	1518	2203
<b>Net Margin</b>	8.6%	10.3%	10.2%	8.1%	8.1%	12.1%	16.7%	11.3%	9.9%	12.7%
<b>Free Cash Flow</b>	2555	2768	2586	2388	2971	3041	1941	2434	1436	2275
<b>Income Tax</b>	688	848	1127	1091	1130	953	1267	697	660	443

## Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Total Assets</b>	19763	22843	23861	23818	24711	24177	22088	21732	19589	20390
<b>Cash &amp; Equivalents</b>	1560	1592	2052	2367	3275	3149	3054	3182	3062	1093
<b>Acc. Receivable</b>		4087	4611	4983	4808	5019	2870	2701	3072	3344
<b>Inventories</b>	1855	2105	2100	2125	1895	2057	1265	1208	1696	1813
<b>Goodwill &amp; Int.</b>	8222	10806	10740	9864	9181	8871	4785	4811	7206	9206
<b>Total Liabilities</b>	11057	12891	13310	13376	13993	14010	13960	14114	10819	11400
<b>Accounts Payable</b>	1949	2409	2677	2767	2725	2951	1537	1517	1776	1943
<b>Long-Term Debt</b>	4575	5066	5201	5293	5642	6024	6841	6635	4656	4760
<b>Total Equity</b>	8555	9792	10399	10295	10585	10119	8081	7568	8718	N/A
<b>D/E Ratio</b>	0.5348	0.5174	0.5001	0.5141	0.533	0.5953	0.8466	0.8767	0.5341	N/A

## Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Return on Assets</b>	8.5%	10.2%	10.6%	8.3%	8.3%	8.8%	11.7%	7.5%	7.3%	11.0%
<b>Return on Equity</b>	19.5%	23.6%	24.6%	19.0%	19.2%	20.7%	29.8%	20.9%	18.6%	N/A
<b>ROIC</b>	12.8%	15.3%	16.1%	12.5%	12.5%	13.2%	17.4%	11.2%	11.0%	N/A
<b>Shares Out.</b>	752	753	739	724	707	697	655	643	642	641
<b>Revenue/Share</b>	26.50	27.79	32.15	33.23	34.13	25.19	24.02	22.45	23.72	27.40
<b>FCF/Share</b>	3.37	3.66	3.43	3.25	4.11	4.32	2.87	3.76	2.23	3.58

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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