Eaton Corporation (ETN)

Updated October 31st, 2018 by Nate Parsh

Key Metrics

Current Price:	$70	**5 Year CAGR Estimate:**	8.6%	**Volatility Percentile:**	44.8%
Fair Value Price:	$77	**5 Year Growth Estimate:**	3.0%	**Momentum Percentile:**	32.2%
% Fair Value:	91%	**5 Year Valuation Multiple Estimate:**	1.9%	**Growth Percentile:**	10.8%
Dividend Yield:	3.7%	**5 Year Price Target**	$89	**Valuation Percentile:**	59.3%
Dividend Risk Score:	D	**Retirement Suitability Score:**	C	**Total Return Percentile:**	39.3%

Overview & Current Events

Eaton Corporation is diversified industrial equipment and parts manufacture. The company's engineered electrical systems and components are used by customers in the industrial, vehicle, commercial, and aerospace markets. The Ireland based Eaton was founded in 1916 and has a current market capitalization of more than $35 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 & Services, Hydraulics, Aerospace, Vehicle, and eMobility.

Eaton reported 3rd quarter earnings results on October 30th. The company earned $1.43 per share, in line with analyst' estimates, but a 14% improvement year-over-year. This result excludes an arbitrator's decision related to the legacy Cooper business and a divestiture from a joint venture with Cummins (CMI). These two items impacted results by $0.48 per share. Revenue grew 3.8% to $5.41 billion, $80 million below estimates.

Organic sales were up 6% during the quarter, but were offset 1% by both currency and divestitures. Almost every division within Eaton saw growth during the quarter. Hydraulics revenues were up 6% on the strength of orders in North America (up 12%) and Asia Pacific (up 9%). Aerospace sales increased 9% due to a higher volume of sales in commercial and military markets. Vehicle sales grew 2% as truck production saw an increase. eMobility revenues improved 7% due to strong demand and a new contract win. Sales for the Electrical Products division were flat year-over-year. Organic sales grew 1%, but were offset 1% due to currency translation. Eaton saw growth in both industrial and residential customers in North America. Eaton increased its midpoint for EPS guidance for the year to $5.35, up from $5.30

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	***$5.35***	***$6.20***
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***
Shares	330	332.4	339.9	334.4	470.7	475.1	467.9	458.8	449.4	439	***433***	***445***

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. We expect earnings to grow at the historical rate through 2023.

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 has raised its dividend by almost 11% over the last ten years.

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	***13.1***	***14.4***
Avg. Yld.	2.8%	4.0%	2.8%	2.8%	3.2%	2.6%	2.8%	3.5%	3.7%	3.2%	***3.7%***	***3.4%***

Eaton's stock has decreased $12, or 14.6%, since our August 10th update. Based off of updated guidance, the stock now trades with a price-to-earnings multiple of 13.1, down from 15.4 previously. Eaton's stock has an average P/E multiple of

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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 given that the company is far from recession proof. If shares were to trade at the average P/E, the stock could have multiple expansion of 1.9% per year through 2023. Eaton has a current yield of almost 3.7%, which is well above the stock's 10-year average yield of 3.1%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

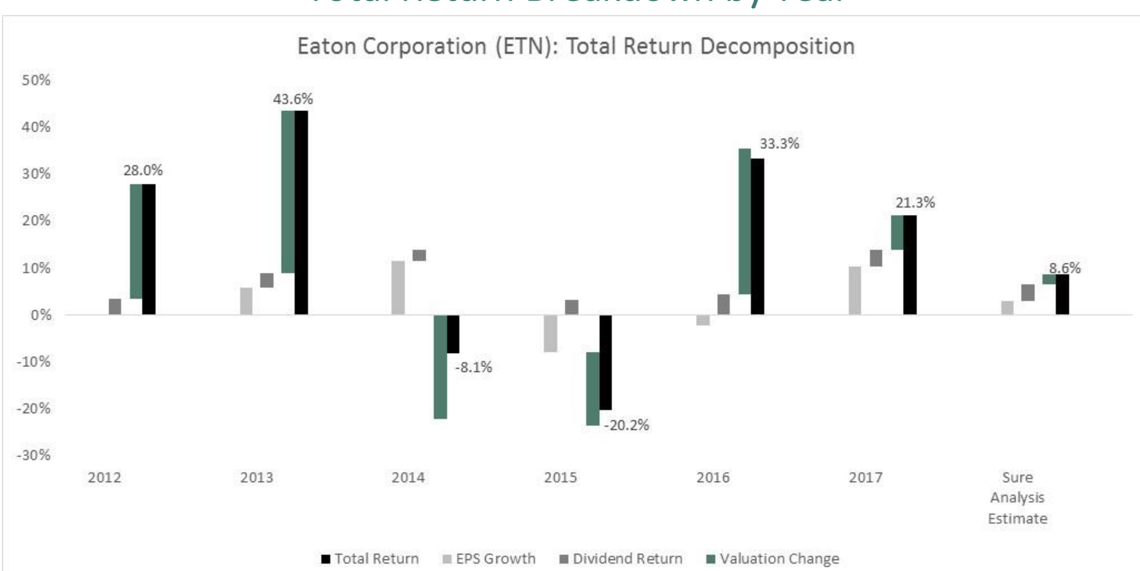
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	25.1%	19%	23.7%	26.8%	13.6%	18.8%	20.6%	21.1%	20.8%	20.4%	***20.5%***	***21%***
Debt/A	61.8%	58.1%	57.1%	58.1%	57.6%	52.5%	52.8%	50.9%	50.8%	47%	***48.5%***	***48.5%***
Int. Cov.	8	3	8.6	14.2	7.4	7.9	10.8	10	9.6	10.2	***9.9***	***9.0***
Payout	29.2%	76.9%	39.6%	34.3%	38.4%	40.1%	42%	51.2%	54.2%	51.6%	***49.3%***	***49.8%***
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. Eaton has seen its debt to asset ratio show sharp improvements over the past decade. The company has managed its debt levels well and is not 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

After 3rd quarter earnings, we now forecast that Eaton can offer a total annual return of 8.6% through 2023, up from 4.9% previously. This return is a combination of earnings growth (3%), dividends (3.7%) and multiple expansion (1.9%). Eaton again reported solid numbers throughout almost all of its divisions. The stock also has a yield that is above its decade long average. We raise our 2023 price target $1 to $89 and rate Eaton as a hold at current prices.

Total Return Breakdown by Year



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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.

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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	15376	11873	13715	16049	16311	22046	22552	20855	19747	20404
Gross Profit	4185	3091	4082	4788	4863	6677	6906	6551	6338	6648
Gross Margin	27.2%	26.0%	29.8%	29.8%	29.8%	30.3%	30.6%	31.4%	32.1%	32.6%
SG&A Exp.	2513	2252	2486	2738	2894	3886	3810	3596	3505	3565
D&A Exp.	571	573	551	556	598	997	983	925	929	914
Operating Profit	1255	444	1171	1633	1530	2147	2449	2330	2244	2499
Op. Margin	8.2%	3.7%	8.5%	10.2%	9.4%	9.7%	10.9%	11.2%	11.4%	12.2%
Net Profit	1058	383	929	1350	1217	1861	1793	1972	1916	2985
Net Margin	6.9%	3.2%	6.8%	8.4%	7.5%	8.4%	8.0%	9.5%	9.7%	14.6%
Free Cash Flow	993	1213	888	680	1071	1671	1246	1903	2073	2146
Income Tax	73	-82	99	201	31	11	-42	159	199	382

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	16655	16282	17252	17873	35810	35491	33529	30996	30476	32623
Cash & Equivalents	188	340	333	385	577	915	781	268	543	561
Acc. Receivable	2295	1899	2239	2444	3474	3648	3667	3479	3560	3943
Inventories	1554	1326	1564	1701	2336	2382	2428	2323	2346	2620
Goodwill & Int.	7750	7876	7726	7729	22023	21681	20449	19493	18715	18833
Total Liabilities	10290	9464	9849	10381	20632	18628	17690	15765	15478	15333
Accounts Payable	1121	1057	1408	1491	1879	1960	1940	1758	1718	2166
Long-Term Debt	4271	3467	3458	3773	10836	9549	9034	8414	8277	7751
Total Equity	6317	6777	7362	7469	15113	16791	15786	15186	14954	17253
D/E Ratio	0.68	0.51	0.47	0.51	0.72	0.57	0.57	0.55	0.55	0.45

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	7.0%	2.3%	5.5%	7.7%	4.5%	5.2%	5.2%	6.1%	6.2%	9.5%
Return on Equity	18.4%	5.9%	13.1%	18.2%	10.8%	11.7%	11.0%	12.7%	12.7%	18.5%
ROIC	11.0%	3.7%	8.8%	12.2%	6.5%	7.1%	7.0%	8.1%	8.2%	12.4%
Shares Out.	330	332.4	339.9	334.4	470.7	475.1	467.9	458.8	449.4	439
Revenue/Share	47.37	35.36	40.40	46.82	46.48	46.25	47.30	44.65	43.26	45.65
FCF/Share	3.06	3.61	2.62	1.98	3.05	3.51	2.61	4.07	4.54	4.80

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