Eaton Corporation (ETN)

Updated February 4th, 2019 by Nathan Parsh

Key Metrics

Current Price:	$77	**5 Year CAGR Estimate:**	8.3%	**Volatility Percentile:**	35.8%
Fair Value Price:	$84	**5 Year Growth Estimate:**	3.0%	**Momentum Percentile:**	37.8%
% Fair Value:	92%	**5 Year Valuation Multiple Estimate:**	1.8%	**Growth Percentile:**	11.1%
Dividend Yield:	3.5%	**5 Year Price Target**	$98	**Valuation Percentile:**	64.8%
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Total Return Percentile:**	39.5%

Overview & Current Events

Eaton Corporation is a 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 $33 billion. The company employs more than 95,000 people. Eaton is 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 released financial results for the fourth quarter and full year 2018 on January 31st. The company earned $1.46 per share during the quarter, $0.03 above estimates and an improvement of 13.2% from the previous year. Revenue increased 4.8% to $5.5 billion, $30 million above estimates. Adjusted earnings-per-share grew 16% for the year to $5.39, $0.04 above guidance. 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 for the year increased 6% to $21.6 billion.

Fourth quarter organic sales were up 7%, slightly ahead of the company's guidance of 6%. Currency translation reduced organic sales growth by 2%. After posting flat results in the previous quarter, the Electrical Products segment had 3% growth due to demand in both industrial and residential markets in the Americas region. Electrical Systems & Services Segment had 8% sales growth, driven by a 12% increase in orders in all major end markets in the Americas and EMEA regions. Revenues increased 6% for the Hydraulics segment. The Asia-Pacific region had 10% growth, but this was offset by flat sales in the Americas and a 24% decline in the EMEA region. Aerospace's sales grew 13% on an organic basis. High double-digit growth in commercial transports, military fights and aftermarket services were the main contributors to growth. Vehicle sales declined 2% due to currency translation. The global light vehicle market suffered a slight decline in the quarter. eMobility grew 10% as Eaton's new products have seen an increase in demand.

Eaton expects to earn $5.85 in 2019, a 9% increase from the prior year. Organic growth is expected to be in the 4%-5% range, largely due to strength in the Aerospace, Electrical Products and Electrical Systems & Services divisions.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$1.30	$2.73	$3.96	$3.96	$4.19	$4.67	$4.30	$4.21	$4.65	$5.39	***$5.85***	***$6.78***
DPS	$1.00	$1.08	$1.36	$1.52	$1.68	$1.96	$2.20	$2.28	$2.40	$2.64	***$2.64***	***$3.06***
Shares	332.4	339.9	334.4	470.7	475.1	467.9	458.8	449.4	439	433	***430***	***425***

While Eaton has delivered mid digit organic growth in recent years, the company's earnings-per-share decreased dramatically during the last recession. To strike a balance between current organic growth and the company's performance during the last recession, we expect earnings-per-share to grow at a rate of 3% through 2024.

Eaton has increased its dividend for the past 9 years. The company paused growth in 2009, as this was prudent given the earnings decline. Eaton will likely announce a dividend increase near the end of February.

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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	19.4	14.2	12.1	11.8	15.6	15.2	14.6	14.6	16.1	13.1	***13.2***	***14.4***
Avg. Yld.	4.0%	2.8%	2.8%	3.2%	2.6%	2.8%	3.5%	3.7%	3.2%	3.7%	***3.5%***	***3.4%***

Eaton's stock has increased $7, or 10%, since our October 31st update. Based off of guidance for 2019, the stock now trades with a price-to-earnings multiple of 13.2. Eaton's stock has an average price-to-earnings ratio 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 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 1.8% per year through 2024. Eaton has a current yield of almost 3.5%, which is well above the stock's 10-year average yield of 3.1%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	76.9%	39.6%	34.3%	38.4%	40.1%	42%	51.2%	54.2%	51.6%	49%	***45.1%***	***45.1%***

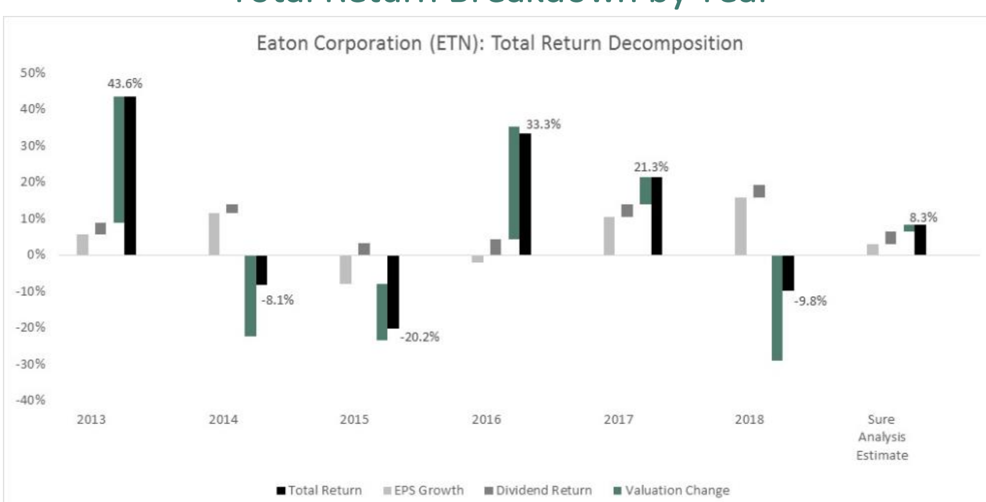
Eaton suffered an extreme earnings decline during the last recession that forced the company to pause its dividend growth. The company would likely experience a decline in earnings in another recession due to the nature of its business and could pause its dividend increases again.

Eaton's key competitive advantages are its expertise and understanding of the businesses that it operates. The company specializes in providing highly engineered products to customers in niche end markets. Switching to a different provider could prove costly and comes with a risk of failure. While Eaton is not recession proof, the company is likely to do well in an improving economy due to these factors.

Final Thoughts & Recommendation

Following the release of fourth quarter and full year financial results, we now estimate that Eaton can offer a total annual return of 8.3% through 2024, down slightly from our prior forecast of 8.6%. This return is a combination of earnings growth (3%), dividends (3.5%) and multiple expansion (1.8%). On a pullback, we would recommend investors purchase shares of the company. We have raised our 2024 price target $9 to $98 due to higher than expected earnings-per-share estimates for 2019. Eaton is a hold for now thanks to its decent-but-not-exceptional expected total returns.

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	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	11873	13715	16049	16311	22046	22552	20855	19747	20404	21609
Gross Profit	3091	4082	4788	4863	6677	6906	6551	6338	6648	7098
Gross Margin	26.0%	29.8%	29.8%	29.8%	30.3%	30.6%	31.4%	32.1%	32.6%	32.8%
SG&A Exp.	2252	2486	2738	2894	3886	3810	3596	3505	3565	3548
D&A Exp.	573	551	556	598	997	983	925	929	914	N/A
Operating Profit	444	1171	1633	1530	2147	2449	2330	2244	2499	2966
Op. Margin	3.7%	8.5%	10.2%	9.4%	9.7%	10.9%	11.2%	11.4%	12.2%	13.7%
Net Profit	383	929	1350	1217	1861	1793	1972	1916	2985	2145
Net Margin	3.2%	6.8%	8.4%	7.5%	8.4%	8.0%	9.5%	9.7%	14.6%	9.9%
Free Cash Flow	1213	888	680	1071	1671	1246	1903	2073	2146	N/A
Income Tax	-82	99	201	31	11	-42	159	199	382	278

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	16282	17252	17873	35810	35491	33529	30996	30476	32623	31092
Cash & Equivalents	340	333	385	577	915	781	268	543	561	283
Acc. Receivable	1899	2239	2444	3474	3648	3667	3479	3560	3943	3858
Inventories	1326	1564	1701	2336	2382	2428	2323	2346	2620	2785
Goodwill & Int.	7876	7726	7729	22023	21681	20449	19493	18715	18833	18174
Total Liabilities	9464	9849	10381	20632	18628	17690	15765	15478	15333	14950
Accounts Payable	1057	1408	1491	1879	1960	1940	1758	1718	2166	2130
Long-Term Debt	3467	3458	3773	10836	9549	9034	8414	8277	7751	7521
Total Equity	6777	7362	7469	15113	16791	15786	15186	14954	17253	16107
D/E Ratio	0.51	0.47	0.51	0.72	0.57	0.57	0.55	0.55	0.45	0.47

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	2.3%	5.5%	7.7%	4.5%	5.2%	5.2%	6.1%	6.2%	9.5%	6.7%
Return on Equity	5.9%	13.1%	18.2%	10.8%	11.7%	11.0%	12.7%	12.7%	18.5%	12.9%
ROIC	3.7%	8.8%	12.2%	6.5%	7.1%	7.0%	8.1%	8.2%	12.4%	8.8%
Shares Out.	332.4	339.9	334.4	470.7	475.1	467.9	458.8	449.4	439	433
Revenue/Share	35.36	40.40	46.82	46.48	46.25	47.30	44.65	43.26	45.65	49.46
FCF/Share	3.61	2.62	1.98	3.05	3.51	2.61	4.07	4.54	4.80	N/A

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