



Emerson Electric Company (EMR)

Updated August 19th, 2019 by Josh Arnold

Key Metrics

Current Price:	\$58	5 Year CAGR Estimate:	10.9%	Volatility Percentile:	47.9%
Fair Value Price:	\$66	5 Year Growth Estimate:	5.0%	Momentum Percentile:	19.5%
% Fair Value:	88%	5 Year Valuation Multiple Estimate:	2.5%	Growth Percentile:	38.1%
Dividend Yield:	3.4%	5 Year Price Target	\$84	Valuation Percentile:	69.6%
Dividend Risk Score:	A	Retirement Suitability Score:	A	Total Return Percentile:	61.4%

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 \$36 billion diversified global leader in technology and engineering. Its global customer base affords it \$18+ billion in annual revenue. The company's very impressive dividend increase streak lands it on the prestigious Dividend Kings list.

Emerson reported Q3 earnings on 8/6/19 and results were largely in line with expectations, with the company maintaining its guidance for the full-year. Total sales were up 5% with underlying sales contributing 2%, while an unfavorable currency impact offset that with a 2% headwind. Acquisitions made up the entirety of the revenue gain in Q3, adding 5% to the top line. Emerson cited lower than expected global growth, as well as cooler, wetter weather than expected in North America, which impacts its construction and air conditioning markets. These factors also impacted underlying orders growth for Emerson.

Gross margins came to 42.7% of revenue, down 90bps from the year-ago period. The decline is primarily attributable to dilution from recent acquisitions and unfavorable mix movement. Pretax margin of 16.4% and EBIT margin of 17.3% both showed declines of 90bps against last year's Q3. Operating cash flow was up 2% to \$946 million, and free cash flow was up 3% to \$825 million. Conversion of net earnings to free cash flow was 135 percent in the quarter.

Earnings-per-share came to \$0.97 in Q3, down 13% year-over-year, but excluding a sizable tax benefit in last year's Q3, adjusted earnings-per-share would have been up 7% year-over-year.

Emerson continues to expect \$3.60 to \$3.70 in earnings-per-share for this year, so our estimate is unchanged at \$3.65.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	\$2.27	\$2.60	\$3.24	\$2.67	\$3.54	\$3.75	\$3.17	\$2.46	\$2.54	\$3.46	\$3.65	\$4.66
DPS	\$1.33	\$1.34	\$1.38	\$1.60	\$1.66	\$1.72	\$1.88	\$1.90	\$1.92	\$1.94	\$1.96	\$2.20
Shares¹	752	753	739	724	707	697	655	643	642	641	633	625

The majority of Emerson's revenue is exposed to the oil and gas industry, where revenue and margins change significantly, introducing risk to forecasts. That said, we are expecting 5% annual growth as the company's low single-digit organic growth is coupled with acquisitions to fuel top line expansion. Emerson's Q3 results were better than this forecast on an adjusted basis, but peaks and valleys in the company's results are not unusual. We still think low to mid-single-digit growth in revenue and a small tailwind from the buyback will be the key drivers of earnings-per-share growth in the coming years.

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

¹ Share count in millions

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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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	14.8	17.8	16.8	18.3	15.8	17.6	18.0	20.6	22.9	20.5	15.9	18.0
Avg. Yld.	3.9%	2.9%	2.5%	3.3%	3.0%	2.6%	3.3%	3.8%	3.3%	2.7%	3.4%	2.6%

Emerson's price-to-earnings ratio has declined significantly of late due to weakness in the stock. Indeed, Emerson is trading for closest to the cheapest valuation it has seen in the past decade. We are therefore forecasting a 2.5% tailwind from the valuation in the coming years as Emerson is trading well below our fair value estimate for the first time in a few years. We see the yield falling over time to 3.4% from 2.6% as the share price could outpace the payout, as has been the case for the past few years on average. This is particularly true now that the valuation is so much lower.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	58%	51%	42%	60%	46%	61%	60%	77%	75%	58%	54%	47%

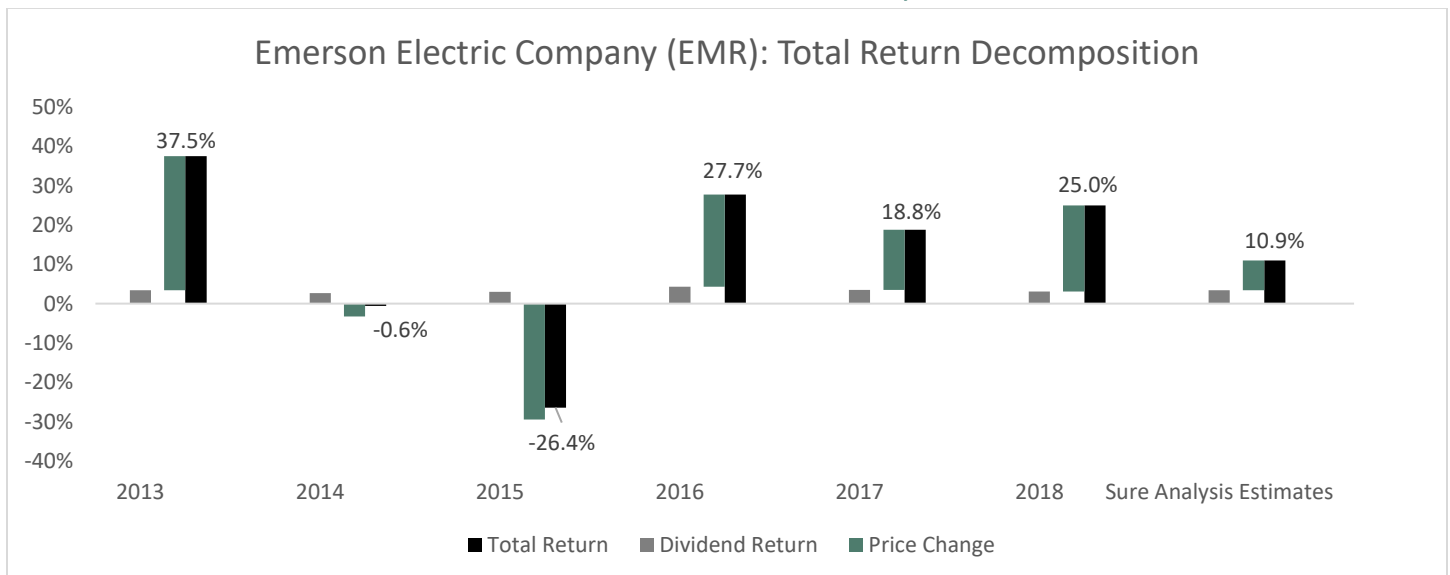
Emerson's payout ratio remains around half of earnings, and we believe it will continue to drift lower over time as Emerson focuses on acquisitions instead of boosting the payout by large amounts. The dividend is very safe as it is well covered by free cash flow, and the yield is strong, so it is certainly a suitable dividend stock.

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 under our estimate of fair value, Emerson could deliver 10.9% total returns going forward, comprised of the 3.4% current yield, earnings-per-share growth of 5% and a 2.5% tailwind from the valuation. Emerson is finally trading under our view of fair value, making it suitable for those seeking a strong current yield. We're upgrading Emerson to buy from hold given its much stronger total return forecast, and much lower valuation.

Total Return Breakdown by Year



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Income Statement Metrics

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

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	19763	22843	23861	23818	24711	24177	22088	21732	19589	20390
Cash & Equivalents	1560	1592	2052	2367	3275	3149	3054	3182	3062	1093
Acc. Receivable		4087	4611	4983	4808	5019	2870	2701	3072	3344
Inventories	1855	2105	2100	2125	1895	2057	1265	1208	1696	1813
Goodwill & Int.	8222	10806	10740	9864	9181	8871	4785	4811	7206	9206
Total Liabilities	11057	12891	13310	13376	13993	14010	13960	14114	10819	11400
Accounts Payable	1949	2409	2677	2767	2725	2951	1537	1517	1776	1943
Long-Term Debt	4575	5066	5201	5293	5642	6024	6841	6635	4656	4760
Total Equity	8555	9792	10399	10295	10585	10119	8081	7568	8718	N/A
D/E Ratio	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
Return on Assets	8.5%	10.2%	10.6%	8.3%	8.3%	8.8%	11.7%	7.5%	7.3%	11.0%
Return on Equity	19.5%	23.6%	24.6%	19.0%	19.2%	20.7%	29.8%	20.9%	18.6%	N/A
ROIC	12.8%	15.3%	16.1%	12.5%	12.5%	13.2%	17.4%	11.2%	11.0%	N/A
Shares Out.	752	753	739	724	707	697	655	643	642	641
Revenue/Share	26.50	27.79	32.15	33.23	34.13	25.19	24.02	22.45	23.72	27.40
FCF/Share	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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