Eaton Corporation (ETN)

Updated July 30th, 2019 by Nathan Parsh

Key Metrics

Current Price:	$83	**5 Year CAGR Estimate:**	6.8%	**Volatility Percentile:**	37.1%
Fair Value Price:	$84	**5 Year Growth Estimate:**	3.0%	**Momentum Percentile:**	45.7%
% Fair Value:	98%	**5 Year Valuation Multiple Estimate:**	0.4%	**Growth Percentile:**	14.5%
Dividend Yield:	3.4%	**5 Year Price Target**	$98	**Valuation Percentile:**	63.8%
Dividend Risk Score:	B	**Retirement Suitability Score:**	B	**Total Return Percentile:**	39.0%

Overview & Current Events

Eaton Corporation is a diversified industrial equipment and parts manufacturer. 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, with annual revenues in excess of $22 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 second quarter on 7/30/2019. The company earned $1.53 per share, which was $0.02 above estimates and a 10% improvement from the same quarter in the prior year. Revenue grew 0.8% to $5.5 billion, though this was $98 million below estimates. Currency translation reduce revenue totals by 1.5%.

Eaton's organic revenue was 2.5% for the quarter. Segment margins improved 90 bps to an all-time best 17.9%. The Electrical Products segment grew 2% on higher demands in residential and commercial construction markets in North America. Electrical Systems & Services improved 5% during the quarter. Orders were up 3% and up 8% when excluding the hyperscale data center business. Operating margins for this segment grew 240 bps to an all-time best 17.4%. Aerospace had 12% sales growth with a 15% increase in orders due to demand in commercial transports, military fighters and commercial aftermarkets. Segment margins reached 24.6%. The Hydraulics segment continues to struggle, with sales declining 3% year-over-year as orders for global mobile equipment market sank 8%. The backlog for this segment was down 12% as well. Sales for the Vehicle segment were down 11% as global light vehicle markets were down nearly 7% in the quarter. On a positive note, Eaton's joint venture with Cummins (CMI) had an 11% increase in revenue. eMobility sales were up 1% due to a contract for a high voltage inverter for a new plug-in hybrid platform. Eaton repurchased $260 million worth of shares in the quarter and has retired 1.2% of shares outstanding since the start of the year. The company maintained its previous guidance for a midpoint for earnings-per-share of $5.87 and organic growth of 4% to 5% for 2019.

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	***$5.87***	***$6.80***
DPS	$1.00	$1.08	$1.36	$1.52	$1.68	$1.96	$2.20	$2.28	$2.40	$2.64	***$2.84***	***$3.29***
Shares	332.4	339.9	334.4	470.7	475.1	467.9	458.8	449.4	439	433	***423***	***418***

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 paused dividend growth in 2009, as this was prudent given the earnings decline. Following the 8% dividend increase for the 3/22/2019 payment, Eaton has now increased its dividend for 10 consecutive years.

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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	***14.1***	***14.4***
Avg. Yld.	4.0%	2.8%	2.8%	3.2%	2.6%	2.8%	3.5%	3.7%	3.2%	3.7%	***3.4%***	***3.4%***

Eaton's stock price has increased $1, or 1.2%, since our 5/6/2019 update. Based off of guidance for 2019, the stock now trades with a price-to-earnings multiple of 14.1. 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 by 2024, then valuation would be a 0.4% tailwind to total returns over this time frame. Eaton has a current yield of 3.4%, which is 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	77%	40%	34%	38%	40%	42%	51%	54%	52%	49%	***48%***	***48%***

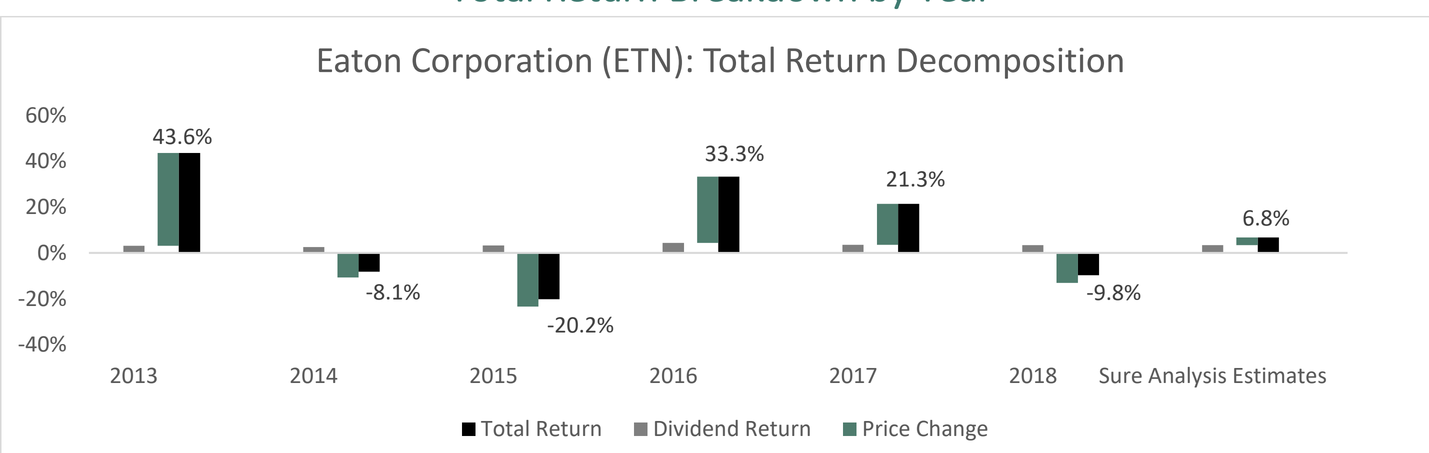
Eaton suffered an extreme earnings decline during the last recession that forced the company to pause its dividend growth. The company would likely experience a decline in earnings in another recession due to the nature of its business and could pause its dividend increases again.

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 second quarter results, we estimate that Eaton could offer a total annual return of 6.8% through 2024, down slightly from our previous estimate of 7%. This return is a combination of earnings growth (3%), dividends (3.4%) and multiple expansion (0.4%). Eaton continues to see strength in the majority of its businesses, especially in the Electrical Systems & Services and Aerospace segments. Hydraulics and Vehicles remain a headwind, but Eaton produced record segment margins in the quarter. Due to mid-single digit expected returns, Eaton continues to receive a hold rating from Sure Dividend, though income investors might be attracted to the company's high yield.

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.