



# Emerson Electric Company (EMR)

Updated May 14<sup>th</sup>, 2020 by Josh Arnold

## Key Metrics

<b>Current Price:</b>	\$52	<b>5 Year CAGR Estimate:</b>	9.0%	<b>Market Cap:</b>	\$31 B
<b>Fair Value Price:</b>	\$54	<b>5 Year Growth Estimate:</b>	5.0%	<b>Ex-Dividend Date:</b>	05/14/20
<b>% Fair Value:</b>	96%	<b>5 Year Valuation Multiple Estimate:</b>	0.8%	<b>Dividend Payment Date:</b>	06/10/20
<b>Dividend Yield:</b>	3.9%	<b>5 Year Price Target</b>	\$69	<b>Years Of Dividend Growth:</b>	63
<b>Dividend Risk Score:</b>	A	<b>Retirement Suitability Score:</b>	A	<b>Last Dividend Increase:</b>	2.0%

## 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 \$31 billion diversified global leader in technology and engineering. Its global customer base and diverse product and service offerings afford it \$16+ billion in annual revenue. The company's very impressive 63-year dividend increase streak lands it on the prestigious Dividend Kings list.

Emerson reported second quarter earnings on April 21<sup>st</sup>, with revenue coming in below expectations, but profits outperforming consensus. Net sales declined -9% year-over-year as underlying sales fell -7%, excluding unfavorable currency of -2% and no impact from acquisitions and divestitures. The company called March a period of "unforeseen and rapid" deterioration in its end markets, most of which relates to collapsing oil demand around the world.

Second quarter gross margin came to 42.1% of revenue, which was flat with the year-ago period. The company cited very aggressive cost controls as helping offset the deleveraging impact of a -9% decline in revenue. Pretax margin and EBIT margin of 16.6% and 17.4% of revenue were up 180bps and 160bps, respectively, from the year-ago period. The company saw lower stock compensation expense and its restructuring actions as drivers of strong profitability despite much lower revenue.

Earnings-per-share came in at \$0.89 on an adjusted basis, exceeding guidance of \$0.79 to \$0.83. However, guidance for the rest of the year was quite bearish, and we've cut our estimate of earnings-per-share for this year to \$3.00. We see Emerson as continuing to struggle as global oil and gas markets grapple with rapidly declining demand.

## Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
<b>EPS</b>	\$2.60	\$3.24	\$2.67	\$3.54	\$3.75	\$3.17	\$2.46	\$2.54	\$3.46	\$3.71	<b>\$3.00</b>	<b>\$3.83</b>
<b>DPS</b>	\$1.34	\$1.38	\$1.60	\$1.66	\$1.72	\$1.88	\$1.90	\$1.92	\$1.94	\$1.96	<b>\$2.00</b>	<b>\$2.32</b>
<b>Shares<sup>1</sup></b>	753	739	724	707	697	655	643	642	641	632	<b>630</b>	<b>622</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. We're estimating growth at 5% as management has become less bullish, and as there are obvious signs of organic revenue growth weakness. We see the challenging environment for fiscal 2020 as indicative of longer-term demand issues that have been building for Emerson, even without the additional headwinds of COVID-19. We still think low 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, and margins have been a positive wildcard of late, particularly so far in fiscal 2020.

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.

<sup>1</sup> 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	17.8	16.8	18.3	15.8	17.6	18.0	20.6	22.9	20.5	17.7	17.3	18.0
Avg. Yld.	2.9%	2.5%	3.3%	3.0%	2.6%	3.3%	3.8%	3.3%	2.7%	3.0%	3.9%	3.4%

Emerson's price-to-earnings ratio has decreased significantly of late due to a large decline in the stock. Emerson is back to 17.3 times earnings, which is below our estimate of fair value at 18. We are therefore forecasting a small tailwind from the valuation in the coming years. We see the yield declining over time as the share price could outpace growth in the payout. This is particularly true now that the valuation is so much lower than it was. We see the recent decline in the share price as making the stock much more attractive, even building in risks from the current economic situation.

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

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	51%	42%	60%	46%	61%	60%	77%	75%	58%	53%	67%	61%

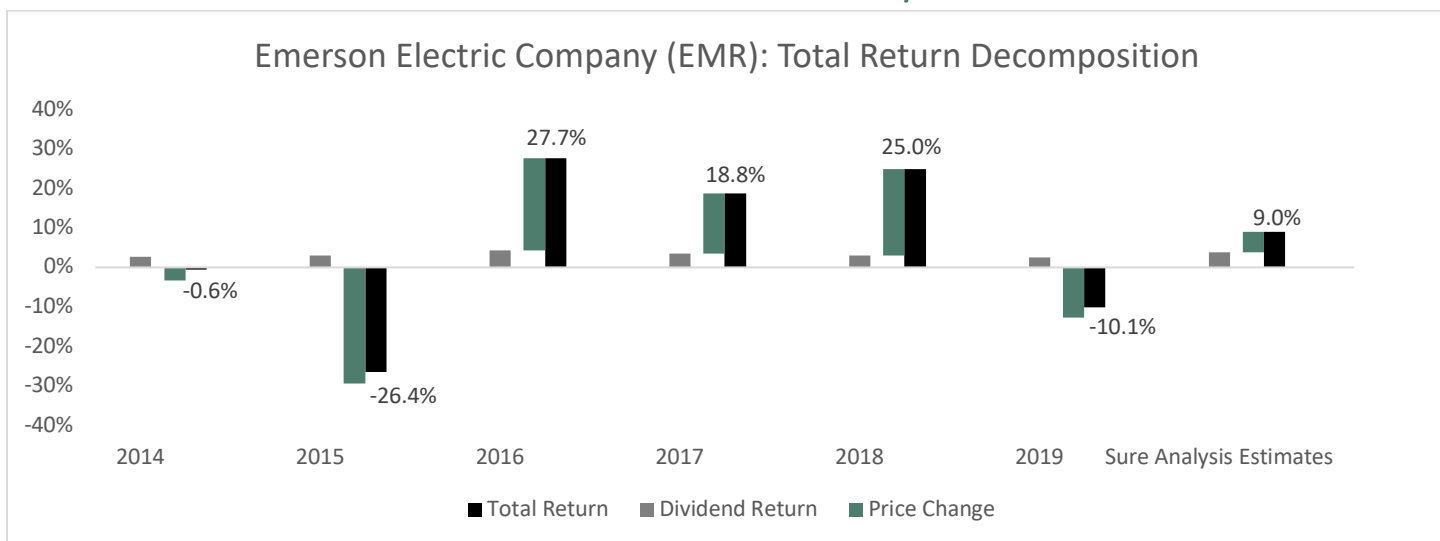
Emerson's payout ratio remains around half of earnings, and we believe it will continue to drift lower over time as Emerson focuses on acquisitions instead of boosting the payout by large amounts. The dividend is very safe as it is well covered by free cash flow, and the yield is strong, so it is certainly 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, as we've seen in 2020.

## Final Thoughts & Recommendation

With the decline in shares in recent weeks, Emerson looks slightly undervalued. Our growth forecast, combined with shares at 96% of our estimate of fair value, and a higher dividend yield, means we see 9% total annual returns in the coming years. We think fiscal 2020 will disappoint investors, but we also see the lower valuation as accounting for risks to Emerson. We are reiterating Emerson at a hold rating, noting that its exceptional dividend history, it's high yield, and the lower valuation have made shares much more attractive since our last update.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	21,039	24,222	24,412	24,669	17,733	16,249	14,522	15,264	17,408	18,372
Gross Profit	8,326	9,557	9,768	9,952	7,762	7,008	6,262	6,431	7,432	7,815
Gross Margin	39.6%	39.5%	40.0%	40.3%	43.8%	43.1%	43.1%	42.1%	42.7%	42.5%
SG&A Exp.	4,817	5,328	5,436	5,648	4,164	3,735	3,464	3,607	4,269	4,457
D&A Exp.	816	867	823	819	569	573	568	636	758	822
Operating Profit	3,509	3,887	3,972	4,006	3,503	3,179	2,714	2,688	2,952	3,120
Op. Margin	16.7%	16.0%	16.3%	16.2%	19.8%	19.6%	18.7%	17.6%	17.0%	17.0%
Net Profit	2,164	2,480	1,968	2,004	2,147	2,710	1,635	1,518	2,203	2,306
Net Margin	10.3%	10.2%	8.1%	8.1%	12.1%	16.7%	11.3%	9.9%	12.7%	12.6%
Free Cash Flow	2,768	2,586	2,388	2,971	3,041	1,941	2,434	1,436	2,275	2,412
Income Tax	848	1,127	1,091	1,130	953	1,267	697	660	443	531

## Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	22,843	23,861	23,818	24,711	24,177	22,088	21,732	19,589	20,390	20,497
Cash & Equivalents	1,592	2,052	2,367	3,275	3,149	3,054	3,182	3,062	1,093	1,494
Acc. Receivable	4,087	4,611	4,983	4,808	5,019	2,870	2,701	3,072	3,023	2,985
Inventories	2,105	2,100	2,125	1,895	2,057	1,265	1,208	1,696	1,813	1,880
Goodwill & Int.	10,806	10,740	9,864	9,181	8,871	4,785	4,811	7,206	9,206	9,151
Total Liabilities	12,891	13,310	13,376	13,993	14,010	13,960	14,114	10,819	11,400	12,224
Accounts Payable	2,409	2,677	2,767	2,725	2,951	1,537	1,517	1,776	1,943	1,874
Long-Term Debt	5,066	5,201	5,293	5,642	6,024	6,841	6,635	4,656	4,760	5,721
Total Equity	9,792	10,399	10,295	10,585	10,119	8,081	7,568	8,718	8,947	8,233
D/E Ratio	0.52	0.50	0.51	0.53	0.60	0.85	0.88	0.53	0.53	0.69

## Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	10.2%	10.6%	8.3%	8.3%	8.8%	11.7%	7.5%	7.3%	11.0%	11.3%
Return on Equity	23.6%	24.6%	19.0%	19.2%	20.7%	29.8%	20.9%	18.6%	24.9%	26.8%
ROIC	15.3%	16.1%	12.5%	12.5%	13.2%	17.4%	11.2%	11.0%	16.2%	16.6%
Shares Out.	753	739	724	707	697	655	643	642	641	632
Revenue/Share	27.79	32.15	33.23	34.13	25.19	24.02	22.45	23.72	27.40	29.60
FCF/Share	3.66	3.43	3.25	4.11	4.32	2.87	3.76	2.23	3.58	3.89

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

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