Eaton Corporation (ETN)

Updated May 5th, 2020 by Nathan Parsh

Key Metrics

Current Price:	$81	**5 Year CAGR Estimate:**	0.2%	**Market Cap:**	$32.3 billion
Fair Value Price:	$54	**5 Year Growth Estimate:**	4.0%	**Ex-Dividend Date:**	5/14/20
% Fair Value:	149%	**5 Year Valuation Multiple Estimate:**	-7.6%	**Dividend Payment Date:**	5/29/20
Dividend Yield:	3.5%	**5 Year Price Target**	$66	**Years Of Dividend Growth:**	11 years
Dividend Risk Score:	D	**Retirement Suitability Score:**	D	**Last Dividend Increase:**	2.8%

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 today has annual sales of more than $17 billion. The company employs more than 95,000 people. Eaton has 6 divisions: Electrical Americas, Electrical Global, Hydraulics, Aerospace, Vehicle, and eMobility.

Eaton released first quarter earnings results on 4/30/2020. Earnings-per-share declined 13.5% to $1.09, though this was $0.02 higher than expected. Revenue decreased 9.7% to $4.8 billion, which was $47 million below estimates. The COVID-19 pandemic reduced earnings-per-share by an estimated $0.14. Currency exchange reduced revenues by 1.5%.

Eaton's organic revenue declined 7% during the quarter while segment margins decreased 20 basis points to 15.8%. Organic growth for the Electrical Americas segment declined 2%, but acquisitions and divestitures lowered results by another 6%. Excluding Lighting, which was sold for $1.4 billion during the quarter, organic growth increased 2%. Data center, utility and residential markets were strong during the quarter. The Electrical Global segment experienced an organic sales decline of 6%, primarily due to the ongoing pandemic. Data centers gains were more than offset by weakness in global oil and gas markets. Hydraulics sales decreased 14% due to weak demand in the global mobile equipment market. This business is being sold for $3.3 billion and the deal should close by the end of the year. Aerospace organic sales were down 1%, but acquisitions added 14% to results. Military fighters and military aftermarket demand were high, but commercial transports had significant challenges in the quarter. Organic growth declined 20% for the Vehicle segment as the global light vehicle market suffered a severe drop in production. Production for the year was reduced to 180K vehicles, down from 230K vehicles previously. eMobility sales were down 12% due to the pandemic, lower volumes and start-up costs related to the new electric vehicle programs.

Although the company pulled its guidance for 2020 due to the impact of the COVID-19 pandemic on results, Eaton appears prepared to handle the uncertain economic environment. The company had $415 million in cash at the end of the quarter and expects at least $2.3 billion in free cash flow in 2020. The company also has $2 billion in undrawn bank facilities. Maturing long-term debt is only $240 million due in the fourth quarter. Analysts expect earnings-per-share of $3.78 for the year, down from the company's guidance of $5.75.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$2.73	$3.96	$3.96	$4.19	$4.67	$4.30	$4.21	$4.65	$5.39	$5.76	***$3.78***	***$4.60***
DPS	$1.08	$1.36	$1.52	$1.68	$1.96	$2.20	$2.28	$2.40	$2.64	$2.84	***$2.84***	***$3.29***
Shares[1]	334	334	471	475	468	459	449	439	433	416	***411***	***400***

While Eaton has delivered mid-single-digit organic growth in recent years, the company's earnings-per-share decreased dramatically during the last recession. The short-term will be challenging for the company, but we expect earnings-per-

[1] In millions of shares

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.

share to grow at a slightly higher rate following a recovery. Eaton is divesting underperforming businesses to focus on its core segments, like Aerospace. We have increased our expected growth rate to 4% from 3% previously.

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. We expect dividend growth to be slightly below earnings as the payout ratio is elevated.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	14.2	12.1	11.8	15.6	15.2	14.6	14.6	16.1	13.1	16.4	***21.4***	***14.4***
Avg. Yld.	2.8%	2.8%	3.2%	2.6%	2.8%	3.5%	3.7%	3.2%	3.7%	3.0%	***3.5%***	***5.0%***

Shares of Eaton have decreased $20, or 19.8%, since our 2/4/2020 update. Based off of estimates for 2020, the stock now trades with a price-to-earnings multiple of 21.4. 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 aren't usually 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 2025, then valuation would be a 7.6% headwind to total returns over this time frame. Eaton has a current yield of 3.5%, which is above the stock's 10-year average yield of 3.1%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

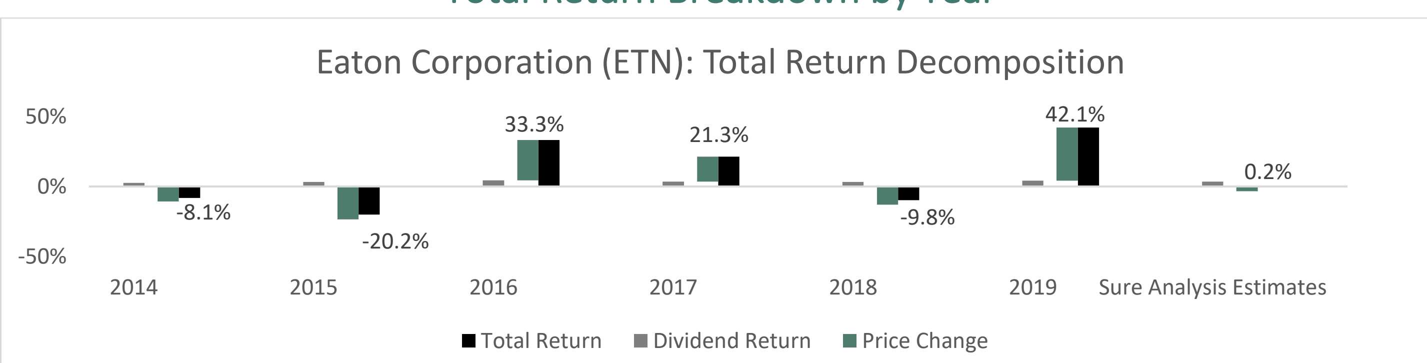
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	40%	34%	38%	40%	42%	51%	54%	52%	49%	49%	***75%***	***72%***

Eaton suffered an extreme decline in earnings 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 first quarter results, Eaton Corporation is projected to return just 0.2% annually through 2025, down from our prior estimate of 2.0%. While we applaud Eaton's divestiture of non-core assets, the company is likely to face significant challenges in the short term. The stock's yield is attractive, but Eaton receives a sell recommendation from Sure Dividend due to projected returns. We have lowered our 2025 price target $30 to $66 due to EPS estimates for the year.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	13715	16049	16311	22046	22552	20855	19747	20404	21609	21390
Gross Profit	4082	4788	4863	6677	6906	6551	6351	6648	7098	7052
Gross Margin	29.8%	29.8%	29.8%	30.3%	30.6%	31.4%	32.2%	32.6%	32.8%	33.0%
SG&A Exp.	2486	2738	2894	3886	3810	3596	3464	3526	3548	3583
D&A Exp.	551	556	598	997	983	925	929	914	903	884
Operating Profit	1171	1633	1530	2147	2449	2330	2300	2538	2966	2863
Op. Margin	8.5%	10.2%	9.4%	9.7%	10.9%	11.2%	11.6%	12.4%	13.7%	13.4%
Net Profit	929	1350	1217	1861	1793	1972	1916	2985	2145	2211
Net Margin	6.8%	8.4%	7.5%	8.4%	8.0%	9.5%	9.7%	14.6%	9.9%	10.3%
Free Cash Flow	888	680	1071	1671	1246	1903	2073	2146	2093	2864
Income Tax	99	201	31	11	(42)	159	199	382	278	378

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	17252	17873	35810	35491	33529	30996	30476	32623	31092	32805
Cash & Equivalents	333	385	577	915	781	268	543	561	283	370
Acc. Receivable	2239	2444	3474	3648	3667	3479	3560	3943	3858	3437
Inventories	1564	1701	2336	2382	2428	2323	2346	2620	2785	2805
Goodwill & Int.	7726	7729	22023	21681	20449	19493	18715	18833	18174	18094
Total Liabilities	9849	10381	20632	18628	17690	15765	15478	15333	14950	16672
Accounts Payable	1408	1491	1879	1960	1940	1758	1718	2166	2130	2114
Long-Term Debt	3458	3773	10836	9549	9034	8414	8277	7751	7521	8322
Total Equity	7362	7469	15113	16791	15786	15186	14954	17253	16107	16082
D/E Ratio	0.47	0.51	0.72	0.57	0.57	0.55	0.55	0.45	0.47	0.52

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	5.5%	7.7%	4.5%	5.2%	5.2%	6.1%	6.2%	9.5%	6.7%	6.9%
Return on Equity	13.1%	18.2%	10.8%	11.7%	11.0%	12.7%	12.7%	18.5%	12.9%	13.7%
ROIC	8.8%	12.2%	6.5%	7.1%	7.0%	8.1%	8.2%	12.4%	8.8%	9.2%
Shares Out.	334	334	471	475	468	459	449	439	433	416
Revenue/Share	40.40	46.82	46.48	46.25	47.30	44.65	43.26	45.65	49.46	50.83
FCF/Share	2.62	1.98	3.05	3.51	2.61	4.07	4.54	4.80	4.79	6.81

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