



Emerson Electric Company (EMR)

Updated August 17th, 2020 by Josh Arnold

Key Metrics

Current Price:	\$69	5 Year CAGR Estimate:	4.6%	Market Cap:	\$42 B
Fair Value Price:	\$59	5 Year Growth Estimate:	5.0%	Ex-Dividend Date:	08/13/20
% Fair Value:	117%	5 Year Valuation Multiple Estimate:	-3.0%	Dividend Payment Date:	09/10/20
Dividend Yield:	2.9%	5 Year Price Target	\$76	Years Of Dividend Growth:	63
Dividend Risk Score:	A	Retirement Suitability Score:	A	Last Dividend Increase:	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 \$42 billion diversified global leader in technology and engineering. Its global customer base and diverse product and service offerings afford it nearly \$17 billion in annual revenue. The company's very impressive 63-year dividend increase streak lands it on the prestigious Dividend Kings list.

Emerson reported third quarter earnings on August 4th, 2020 with results beating expectations on the top and bottom lines, and by wide margins. Total revenue was down -16% year-over-year while underlying sales declined -15%. The difference between the two was a -1% unfavorable impact from currency translation, which is something Emerson has struggled with for years. Particular weakness was seen in North American markets, while China was up 3%. Trailing three-month underlying orders were down -19%, reflective of customers across industrial, commercial and residential markets cutting budgets in the face of high levels of uncertainty.

Gross margin was 41.3% of revenue, down 140bps year-over-year due to manufacturing plant deleverage. Pretax margin was 11.7% of revenue, down 470bps year-over-year. Adjusted for non-cash charges, EBIT margin was down 240bps.

GAAP earnings were \$0.67 per share, and on an adjusted basis, earnings-per-share came to \$0.80 in Q3.

Operating cash flow was \$842 million, down \$104 million, or -11% year-over-year. Free cash flow was \$738 million in Q3, down \$87 million year-over-year. We've boosted our estimate of earnings-per-share for this year to \$3.30, up from \$3.00, after stronger than expected Q3 results.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	\$2.60	\$3.24	\$2.67	\$3.54	\$3.75	\$3.17	\$2.46	\$2.54	\$3.46	\$3.71	\$3.30	\$4.21
DPS	\$1.34	\$1.38	\$1.60	\$1.66	\$1.72	\$1.88	\$1.90	\$1.92	\$1.94	\$1.96	\$2.00	\$2.32
Shares¹	753	739	724	707	697	655	643	642	641	632	630	622

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.

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	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	21.0	18.0
Avg. Yld.	2.9%	2.5%	3.3%	3.0%	2.6%	3.3%	3.8%	3.3%	2.7%	3.0%	2.9%	3.1%

Emerson's price-to-earnings ratio has decreased significantly of late due to a large decline in the stock. Still, Emerson is back to 21 times earnings, which is meaningfully ahead of our estimate of fair value at 18. We are therefore forecasting a modest headwind from the valuation in the coming years. We see the yield as remaining about where it is around 3%, given the valuation could moderate, largely offsetting dividend growth.

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%	61%	55%

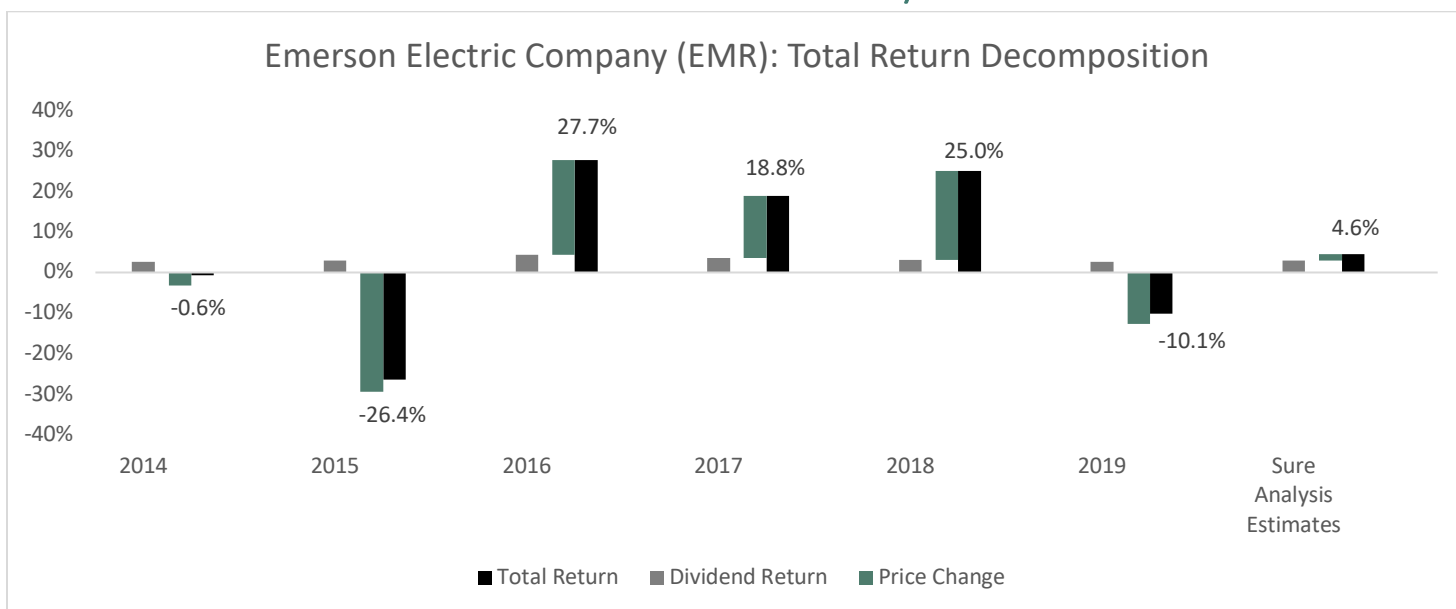
Emerson's payout ratio remains around three-fifths of earnings, and we believe it will continue to drift lower over time as Emerson focuses on acquisitions instead of boosting the payout by large amounts. The dividend is very safe as it is well covered by free cash flow, and the yield is strong, so it 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 increase in shares in recent weeks, Emerson looks overvalued. Our growth forecast, combined with shares at 117% of our estimate of fair value, and a lower dividend yield, means we see 4.6% total annual returns in the coming years. We are reiterating Emerson at a hold rating, noting that its exceptional dividend provides some amount of safety, but is offset by the higher valuation.

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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