Eaton Corporation (ETN)

Updated November 3rd, 2020 by Nathan Parsh

Key Metrics

Current Price:	$111	**5 Year CAGR Estimate:**	-5.2%	**Market Cap:**	$44.3 billion
Fair Value Price:	$57	**5 Year Growth Estimate:**	4.0%	**Ex-Dividend Date:**	11/5/20
% Fair Value:	195%	**5 Year Valuation Multiple Estimate:**	-12.5%	**Dividend Payment Date:**	11/20/20
Dividend Yield:	2.6%	**5 Year Price Target**	$69	**Years Of Dividend Growth:**	11 years
Dividend Risk Score:	D	**Retirement Suitability Score:**	F	**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 announced earnings results for the third quarter on 11/3/2020. Adjusted earnings-per-share decreased 22% to $1.18, but was $0.14 better than expected. Revenue decreased 14.7% to $4.5 billion, but was $320 million above estimates. Organic revenue was lower by 9%. Divestitures lowered sales by 8% and acquisitions added 2% to growth. Operating margins decreased 110 basis points to 17.6%.

Sales for the Electrical Americas segment were down 17%. Excluding the impact of divestitures, sales were higher by 3%. Residential and data center products were in high demand and the backlog grew by 11% year-over-year. Electrical Global sales were down 8% due to lower demand from oil & gas and industrial markets partially offset by gains in residential and data center markets. Hydraulics fell 15% due to weakness in OEMs and distributors. This business is being sold for $3.3 billion and the deal should close by the end of the first quarter of 2021. Aerospace revenues declined 13% year-over-year. This segment has been negatively impacted by lower volumes in commercial markets. The Vehicle segment decreased 25% due to declines in global production for light vehicles. Production forecasts for the year were raised to 200K vehicles, up from 175K vehicles at the end of the second quarter. eMobility sales were flat. The company expects $2.5 billion of free cash flow in 2020. Analysts now expect adjusted earnings-per-share of $3.95 for 2020, up from $3.65 previously.

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	***$3.95***	***$4.81***
DPS	$1.08	$1.36	$1.52	$1.68	$1.96	$2.20	$2.28	$2.40	$2.64	$2.84	***$2.92***	***$3.39***
Shares[1]	334	334	471	475	468	459	449	439	433	416	***401***	***390***

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

[1] In millions of shares

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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	***28.1***	***14.4***
Avg. Yld.	2.8%	2.8%	3.2%	2.6%	2.8%	3.5%	3.7%	3.2%	3.7%	3.0%	***2.6%***	***4.9%***

Shares of Eaton have increased $16, or 16.8%, since our 7/29/2020 update. Based off of updated estimates for 2020, the stock now trades with a price-to-earnings multiple of 28.1. 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 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 12.5% headwind to total returns over this time frame. Eaton has a current yield of 2.6%, which is just below the stock's 10-year average yield of 3.1%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

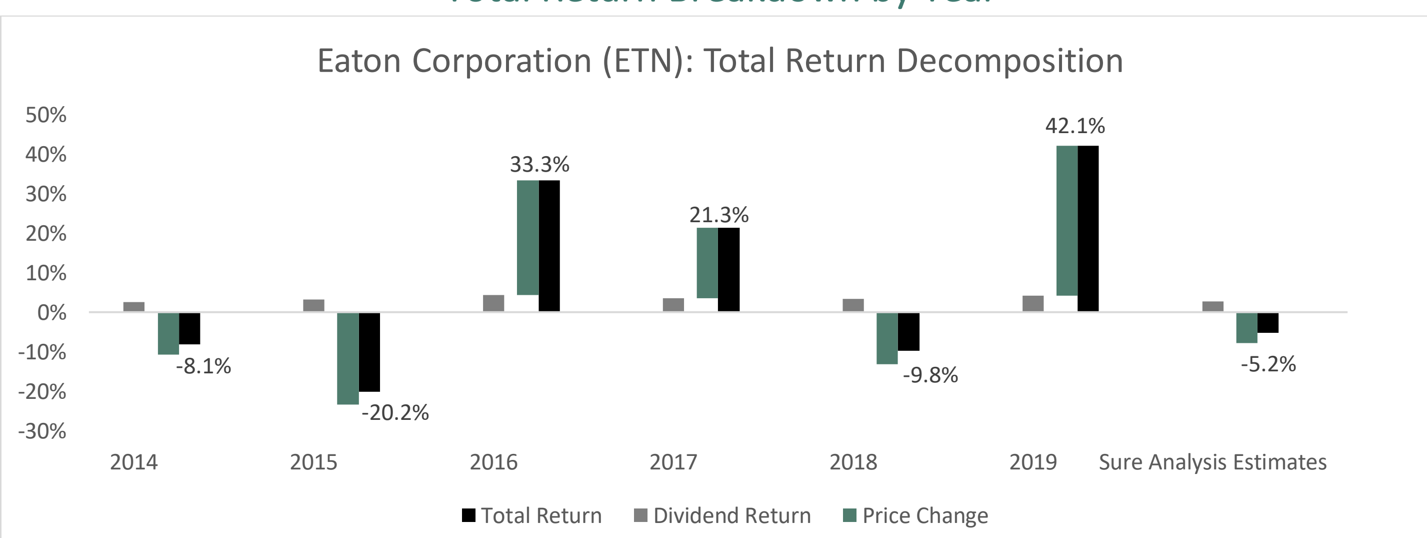
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	40%	34%	38%	40%	42%	51%	54%	52%	49%	49%	***74%***	***70%***

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

After third quarter results, Eaton Corporation is expected to lose 5.2% annually through 2025, down from our prior estimate of a loss of 3.5%. The company managed to beat top and bottom-line estimates. Most segments improved sequentially, but still produced lower sales year-over-year. Much of this was due to the ongoing pandemic, especially in aerospace. Shares of Eaton are up almost 35% over the past six months. We have raised our 2025 price target $5 to $69 due to updated EPS estimates, but maintain our sell rating on Eaton due to projected returns.

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	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.