Eaton Corporation (ETN)

Updated November 2nd, 2021 by Nathan Parsh

Key Metrics

Current Price:	$172	**5 Year CAGR Estimate:**	-4.3%	**Market Cap:**	$65 billion
Fair Value Price:	$100	**5 Year Growth Estimate:**	4.0%	**Ex-Dividend Date:**	11/10/2021
% Fair Value:	173%	**5 Year Valuation Multiple Estimate:**	-10.4%	**Dividend Payment Date:**	11/30/2021
Dividend Yield:	1.8%	**5 Year Price Target**	$121	**Years Of Dividend Growth:**	12
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 nearly $20 billion. The company employs about 85,000 people. Eaton has 6 divisions: Electrical Americas, Electrical Global, Hydraulics, Aerospace, Vehicle, and eMobility.

On 8/2/2021, Eaton closed on its $3.3 billion sale of its Hydraulics segment to Danfoss.

Eaton reported earnings results for the third quarter on 11/2/2021. Revenue was higher by 8.2% to $4.9 billion, but was $110 million lower than expected. Adjusted earnings-per-share of $1.75 compared very favorably to adjusted earnings-per-share of $1.18 in the prior year and was $0.02 above of expectations.

Organic growth was higher by 8% with currency exchange contributing 1% to results. Electrical Americas segment was up 9% due to ongoing demand in data center and residential markets. The backlog was up more than 50% from last year. Electrical Global's sales were up 19%, once again due to strength in data center, residential and utility markets. Aerospace grew 38% due to demand in business jets. The Vehicle segment was higher by 12% due to truck gains in North and South America. eMobility grew 6% as gains in North America and APAC more than offset declines in EMEA.

Eaton once again provided updated guidance for 2021.The company expects organic revenue growth of 9% to 11% from last year, compared to 8% to 10%, 7% to 9% and 4% to 6% previously. Eaton now expects adjusted earnings-per-share in a range of $6.59 to $6.69, compared to prior guidance of $6.58 to $6.88.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	$3.96	$3.96	$4.19	$4.67	$4.30	$4.21	4.60	$5.35	$5.74	$4.24	***$6.64***	***$8.08***
DPS	$1.36	$1.52	$1.68	$1.96	$2.20	$2.28	$2.40	$2.64	$2.84	$2.92	***$3.04***	***$3.52***
Shares[1]	334	471	475	468	459	449	439	433	416	401	***401***	***390***

Prior to 2020, Eaton had delivered mid-single-digit organic growth in recent years, though 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 COVID-19 recovery. Eaton is divesting underperforming businesses to focus on its core segments, like Aerospace. We reaffirm our expected growth rate of 4%.

Eaton paused dividend growth in 2009, as this was prudent given the earnings decline. Following the 4.1% dividend increase for the 3/30/2021 payment, Eaton has increased its dividend for 12 consecutive years. We expect dividend growth to be slightly below earnings.

[1] In millions of shares

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Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	12.1	11.8	15.6	15.2	14.6	14.6	16.3	14.7	14.3	22.7	***25.9***	***15.0***
Avg. Yld.	2.8%	3.2%	2.6%	2.8%	3.5%	3.7%	3.2%	3.4%	3.5%	3.0%	***1.8%***	***2.9%***

Shares of Eaton have increased $10, or 6.2%, since our 8/5/2021 update. Based off of estimates for 2021, the stock now trades with a price-to-earnings multiple of 25.9. Eaton's stock has an average price-to-earnings ratio of 15.2 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 our target P/E of 15 by 2026, then valuation would be a 10.4% headwind to total returns over this time frame. Eaton has a current yield of 1.8%, which is well below the stock's 10-year average yield of 3.2%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

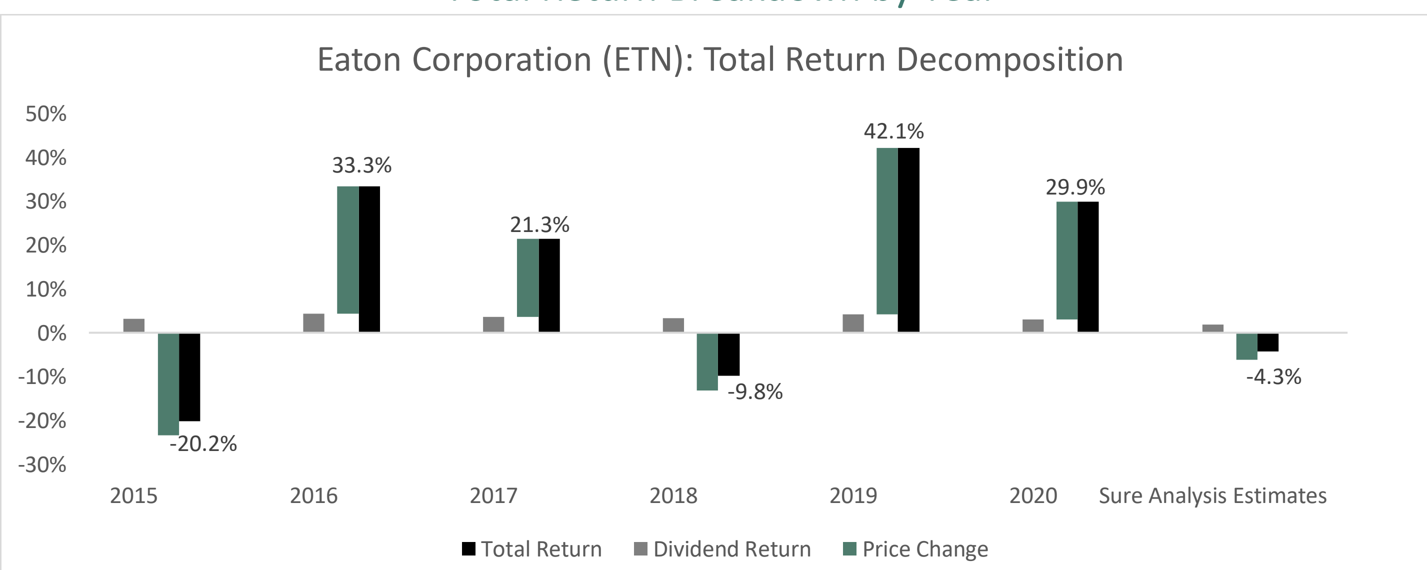
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	34%	38%	40%	42%	51%	54%	52%	49%	49%	69%	***46%***	***44%***

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 third quarter results, Eaton Corporation is expected to lose 4.3% annually through 2026, compared to our prior estimate of a loss of 3.0%. Eaton continues to see robust growth rates throughout its business. While we are enthused about the demand for the company's products, the valuation leaves much to be desired. We have lowered our 2026 price target $2 to $121, but maintain our selling rating on shares of 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	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	16049	16311	22046	22552	20855	19747	20404	21609	21390	17858
Gross Profit	4,788	4,863	6,677	6,906	6,551	6,351	6,648	7,098	7,052	5,450
Gross Margin	29.8%	29.8%	30.3%	30.6%	31.4%	32.2%	32.6%	32.8%	33.0%	30.5%
SG&A Exp.	2,738	2,894	3,886	3,810	3,596	3,464	3,526	3,548	3,583	3,075
D&A Exp.	556	598	997	983	925	929	914	903	884	
Operating Profit	1,633	1,530	2,147	2,449	2,330	2,300	2,538	2,966	2,863	1,824
Op. Margin	10.2%	9.4%	9.7%	10.9%	11.2%	11.6%	12.4%	13.7%	13.4%	10.2%
Net Profit	1,350	1,217	1,861	1,793	1,972	1,916	2,985	2,145	2,211	1,410
Net Margin	8.4%	7.5%	8.4%	8.0%	9.5%	9.7%	14.6%	9.9%	10.3%	7.9%
Free Cash Flow	680	1,071	1,671	1,246	1,903	2,073	2,146	2,093	2,864	
Income Tax	201	31	11	(42)	159	199	382	278	378	331

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	17873	35810	35491	33529	30996	30476	32623	31092	32805	31824
Cash & Equivalents	385	577	915	781	268	543	561	283	370	438
Acc. Receivable	2444	3474	3648	3667	3479	3560	3943	3858	3437	2904
Inventories	1701	2336	2382	2428	2323	2346	2620	2785	2805	2109
Goodwill & Int.	7729	22023	21681	20449	19493	18715	18833	18174	18094	17078
Total Liabilities	10381	20632	18628	17690	15765	15478	15333	14950	16672	16851
Accounts Payable	1491	1879	1960	1940	1758	1718	2166	2130	2114	1987
Long-Term Debt	3773	10836	9549	9034	8414	8277	7751	7521	8322	8058
Total Equity	7469	15113	16791	15786	15186	14954	17253	16107	16082	14930
D/E Ratio	0.51	0.72	0.57	0.57	0.55	0.55	0.45	0.47	0.52	0.54

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	7.7%	4.5%	5.2%	5.2%	6.1%	6.2%	9.5%	6.7%	6.9%	4.4%
Return on Equity	18.2%	10.8%	11.7%	11.0%	12.7%	12.7%	18.5%	12.9%	13.7%	9.1%
ROIC	12.2%	6.5%	7.1%	7.0%	8.1%	8.2%	12.4%	8.8%	9.2%	5.9%
Shares Out.	334	471	475	468	459	449	439	433	416	401
Revenue/Share	46.82	46.48	46.25	47.30	44.65	43.26	45.65	49.46	50.83	44.20
FCF/Share	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.