Eaton Corporation (ETN)

Updated May 3rd, 2023 by Nathan Parsh

Key Metrics

Current Price:	$172	**5 Year CAGR Estimate:**	4.2%	**Market Cap:**	$69 B
Fair Value Price:	$143	**5 Year Growth Estimate:**	6.0%	**Ex-Dividend Date:**	05/05/23
% Fair Value:	120%	**5 Year Valuation Multiple Estimate:**	-3.7%	**Dividend Payment Date:**	05/26/23
Dividend Yield:	2.0%	**5 Year Price Target**	$191	**Years Of Dividend Growth:**	14
Dividend Risk Score:	D	**Retirement Suitability Score:**	F	**Rating:**	Hold

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 about $21 billion. The company employs about 85,000 people. Eaton has 5 divisions: Electrical Americas, Electrical Global, Aerospace, Vehicle, and eMobility.

On February 23rd, 2023, Eaton raised its quarterly dividend 6.2% to $0.88 for the March 24th, 2023 payment date.

On May 2nd, 2023, Eaton reported first quarter results for the period ending March 31st, 2023. For the quarter, revenue grew 13.2% to $5.48 billion, which was $250 million above estimates. Adjusted earnings-per-share of $1.88 compared to $1.62 in the prior year and was $0.10 better than expected.

For the quarter, organic growth was 15% with currency exchange acting as a 2% headwind to results. Quarterly earnings and segment operating margin of 19.7% were a first quarter record. The Electrical Americas segment grew 21%, due to strength in data center, utility, and industrial markets. The backlog was up 51%. Electrical Global was up 4% with 8% organic growth due to demand from across the customer spectrum. Aerospace was up 12% with organic growth of 13% due to demand across end-markets. The backlog grew 27%. The Vehicle segment increased 10% due to demand in North America and EMEA. eMobility grew 17% and experienced higher orders for OEM in Europe.

Eaton provided an updated outlook for 2023 as well, with the company now forecasting adjusted earnings-per-share in a range of $8.30 to $8.50 for the year, compared to $8.04 to $8.44 previously. At the midpoint, this would be an 11% improvement from 2022. We have updated our forecast accordingly.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	$4.19	$4.67	$4.30	$4.21	4.60	$5.35	$5.74	$4.24	$6.62	$7.57	***$8.40***	***$11.24***
DPS	$1.68	$1.96	$2.20	$2.28	$2.40	$2.64	$2.84	$2.92	$3.04	$3.24	***$3.44***	***$4.60***
Shares[1]	475	468	459	449	439	433	416	401	398	400	***400***	***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 following the pandemic was challenging for the company, but our expect earnings-per-share growth has already returned. We are raising our expected earnings growth to 6% from 4% to better reflect the quality of earnings recently. This is also closer to the average growth rate of 6.8% since 2013.

Eaton paused dividend growth in 2009, as this was prudent given the earnings decline. We now expect dividends to grow in-line with earnings as the payout ratio is very reasonable.

[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.

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Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	15.6	15.2	14.6	14.6	16.3	14.7	14.3	22.7	26.1	20.7	***20.5***	***17.0***
Avg. Yld.	2.6%	2.8%	3.5%	3.7%	3.2%	3.4%	3.5%	3.0%	1.8%	2.1%	***2.0%***	***2.4%***

Shares of Eaton have increased $5, or 3.0%, since our February 10th, 2023 update. Based off of updated estimates for 2023, the stock now trades with a price-to-earnings multiple of 20.5. Eaton's stock has an average price-to-earnings ratio of 17.5 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. We have a target valuation of 17 times earnings for the stock. If shares were to trade at our target P/E by 2028, then valuation would be a 3.7% headwind to total returns over this time frame. Eaton has a current yield of 2.0%, which is well below the stock's 10-year average of more than 3.0%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

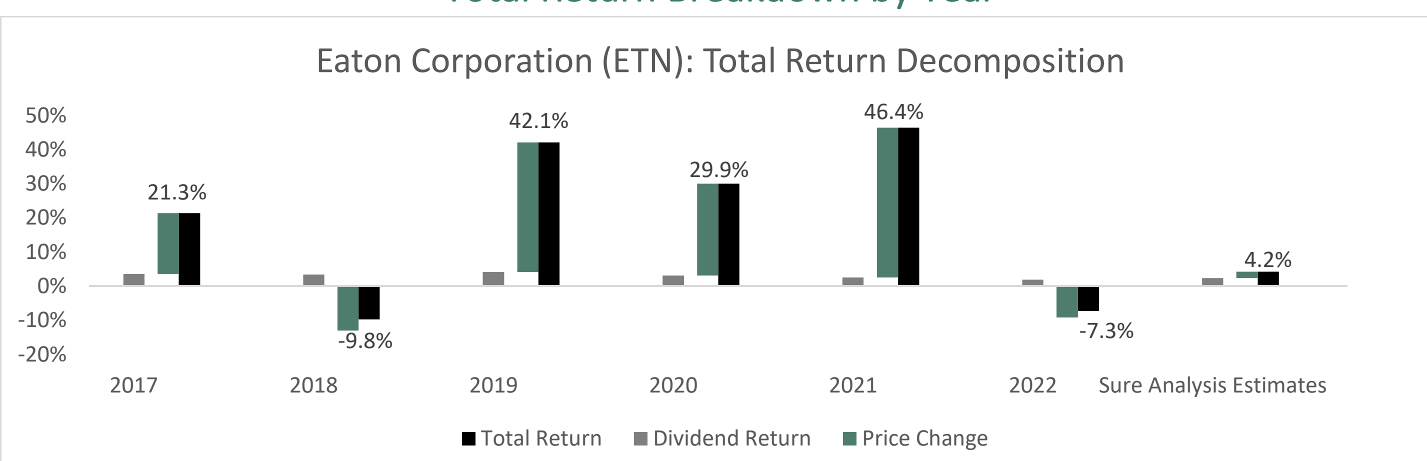
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	40%	42%	51%	54%	52%	49%	49%	69%	46%	43%	***41%***	***41%***

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 first quarter results, Eaton Corporation is expected to return 4.2% annually through 2028, down slightly from our prior estimate of 4.4%. Our projection stems from a 6% earnings growth rate and a 2.0% starting dividend yield that are partially offset by a low single-digit headwind from multiple compression. Eaton's businesses continue to perform very well, with most segments showing strong growth rates from the prior year. Backlog activity over the past several quarters has been robust as the company's products are in high demand. That said, Eaton's valuation continues to leave a lot to be desired. Shares earn a hold recommendation due to projected returns.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	22046	22552	20855	19747	20404	21609	21390	17858	19628	20752
Gross Profit	6677	6906	6551	6351	6648	7098	7052	5450	6335	6887
Gross Margin	30.3%	30.6%	31.4%	32.2%	32.6%	32.8%	33.0%	30.5%	32.3%	33.2%
SG&A Exp.	3886	3810	3596	3464	3526	3548	3583	3075	3256	3227
D&A Exp.	997	983	925	929	914	903	884	811	922	
Operating Profit	2147	2449	2330	2300	2538	2966	2863	1824	2463	2995
Op. Margin	9.7%	10.9%	11.2%	11.6%	12.4%	13.7%	13.4%	10.2%	12.5%	14.4%
Net Profit	1861	1793	1972	1916	2985	2145	2211	1410	2144	2462
Net Margin	8.4%	8.0%	9.5%	9.7%	14.6%	9.9%	10.3%	7.9%	10.9%	11.9%
Free Cash Flow	1671	1246	1903	2073	2146	2093	2864	2555	1588	
Income Tax	11	(42)	159	199	382	278	378	331	750	445

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	35491	33529	30996	30476	32623	31092	32805	31824	34027	35029
Cash & Equivalents	915	781	268	543	561	283	370	438	297	294
Acc. Receivable	3648	3667	3479	3560	3943	3858	3437	2904	3297	4076
Inventories	2382	2428	2323	2346	2620	2785	2805	2109	2969	3430
Goodwill & Int.	21681	20449	19493	18715	18833	18174	18094	17078	20606	20281
Total Liabilities	18628	17690	15765	15478	15333	14950	16672	16851	17576	17954
Accounts Payable	1960	1940	1758	1718	2166	2130	2114	1987	2797	3080
Long-Term Debt	9549	9034	8414	8277	7751	7521	8322	8058	8579	8655
Total Equity	16791	15786	15186	14954	17253	16107	16082	14930	16413	17038
LTD/E Ratio	0.57	0.57	0.55	0.55	0.45	0.47	0.52	0.54	0.52	0.51

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	5.2%	5.2%	6.1%	6.2%	9.5%	6.7%	6.9%	4.4%	6.5%	7.1%
Return on Equity	11.7%	11.0%	12.7%	12.7%	18.5%	12.9%	13.7%	9.1%	13.7%	14.7%
ROIC	7.1%	7.0%	8.1%	8.2%	12.4%	8.8%	9.2%	5.9%	8.9%	9.7%
Shares Out.	475	468	459	449	439	433	416	401	398	400
Revenue/Share	46.25	47.30	44.65	43.26	45.65	49.46	50.83	44.20	48.87	51.78
FCF/Share	3.51	2.61	4.07	4.54	4.80	4.79	6.81	6.32	3.95	

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