

Eaton Corporation plc (ETN)

\$102.48 (As of 02/06/20)

Price Target (6-12 Months): **\$109.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 01/23/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: B

Growth: B

Momentum: C

Summary

Eaton's fourth-quarter earnings and revenues were lower than expected, primarily due to a decline in organic sales. Despite weak results, the company's R&D investments will help it to upgrade its products and provide better electrical solutions to customers. Eaton's divestment of the Lighting and Hydraulics business to focus on core operations is in sync with long-term growth objectives. Strong cash flow generation and product innovation are likely to drive its performance. Shares of Eaton have outperformed its industry in the past six months. However, Eaton's world-wide operations expose it to negative currency translation, cyber-attacks and security breaches, all of which might impact operations. Choppy end-market conditions have compelled the company to lower organic growth projection and trim earnings expectation.

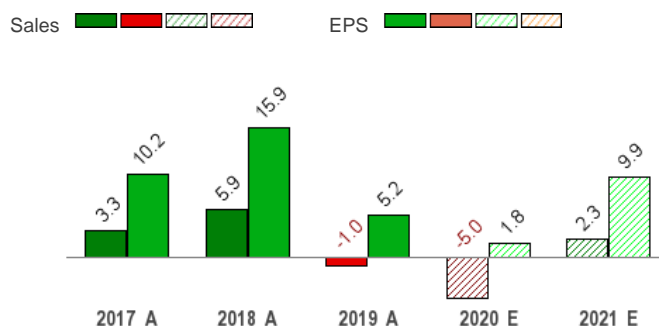
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$103.50 - \$74.29
20 Day Average Volume (sh)	2,836,714
Market Cap	\$42.4 B
YTD Price Change	8.2%
Beta	1.42
Dividend / Div Yld	\$2.84 / 2.8%
Industry	Manufacturing - Electronics
Zacks Industry Rank	Bottom 36% (164 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-2.1%
Last Sales Surprise	-1.7%
EPS F1 Est- 4 week change	-0.5%
Expected Report Date	05/05/2020
Earnings ESP	-0.0%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	4,916 E	5,237 E	5,164 E	5,216 E	20,779 E
2020	5,042 E	5,115 E	5,038 E	5,065 E	20,317 E
2019	5,305 A	5,533 A	5,314 A	5,238 A	21,390 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.36 E	\$1.70 E	\$1.78 E	\$1.73 E	\$6.34 E
2020	\$1.20 E	\$1.47 E	\$1.55 E	\$1.54 E	\$5.77 E
2019	\$1.26 A	\$1.53 A	\$1.52 A	\$1.37 A	\$5.67 A

*Quarterly figures may not add up to annual.

P/E TTM	18.0
P/E F1	17.8
PEG F1	2.0
P/S TTM	2.0

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/06/2020. The reports text is as of 02/07/2020.

Overview

Dublin, Ireland-based Eaton Corporation plc is a diversified power management company and a global technology leader in electrical components and systems for power quality, distribution and control; hydraulics components, systems and services for industrial and mobile equipment; aerospace fuel, and hydraulic and pneumatic systems for commercial and military use. The company sells its products to customers in more than 175 countries and has approximately 99,000 employees in 59 countries. The company was founded in 1916. . Eaton's reportable segments are **Electrical Products**, **Electrical Systems and Services**, **Hydraulics**, **Aerospace**, **Vehicle** and **eMobility**.

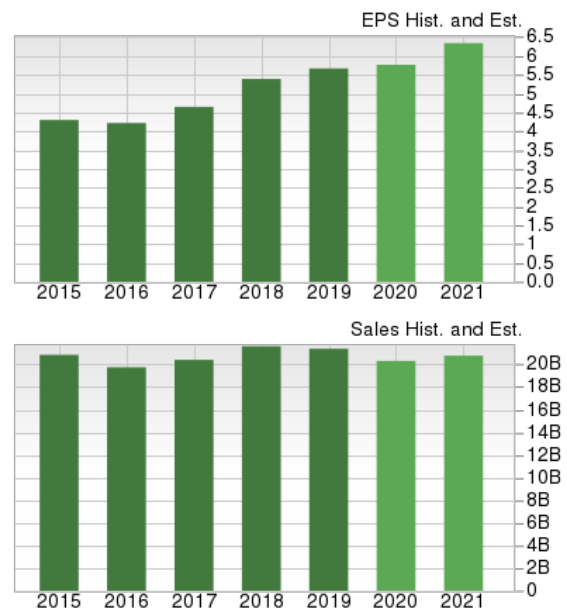
Electrical Products segment consists of electrical components, industrial controls, residential products, single phase power quality, emergency lighting, fire detection, wiring devices, structural support systems, circuit protection, and lighting products. **Electrical Systems and Services** segment consists of power distribution and assemblies, three phase power quality, hazardous duty electrical equipment, intrinsically safe explosion-proof instrumentation, utility power distribution, power reliability equipment and services.

Vehicle segment includes the company's erstwhile truck and automotive segments. The truck segment designs, manufactures and markets powertrain systems and other components for commercial vehicle markets. **Hydraulics** segment manufactures and markets a comprehensive line of reliable, high-efficiency hydraulic systems and components. **Aerospace** segment is a supplier of aerospace fuel, hydraulics and pneumatic systems for commercial and military use.

The **eMobility** segment was launched in the first quarter of 2018. This segment will focus on two technologies within electrical vehicles, namely Power electronics & conversion and Power distribution & circuit protection.

Eaton has decided to sell the Hydraulics and the Lighting business.

Eaton's segments — Electrical Products, Electrical Systems and Services, Vehicle, Hydraulics, Aerospace and eMobility — had contributed 33.4%, 27.9%, 16.1%, 12.8%, 8.8% and 1%, respectively, to total 2019 revenues.



Reasons To Buy:

- ▲ In the past six months, Eaton's shares have gained 28.5% compared with its industry's rally of 24.9%. Eaton has been investing consistently in its R&D programs to introduce new products, including power management solutions which will reduce energy consumption and carbon emissions. The company has been upgrading the existing systems to maintain its strong position in global markets. In 2019, the company's R&D expenses amounted to \$606 million, up 3.8% from 2018.

The company continues to churn out new products aiming to facilitate effective and easy power management. Eaton's strategy to manufacture in the zone of sale has helped to offset the impact of tariff on material prices. Orders in Electrical Systems and Services, and Aerospace were up 2.5% and 6% year over year, which reflected strong demand for high-quality products offered by the company.

Eaton's wide market reach, acquisitions, spin-off of less profitable business, strong cash flow generation, share buybacks and product innovation are likely to drive its performance.

- ▲ Eaton operates in a number of markets and faces a wide array of competitors in varied niches. The quality of products supplied by the company enables it to retain a strong market position. In addition, Eaton's strategic acquisitions allow it to foray into new markets and enhance its revenue stream. Eaton supplies its products to around 175 countries and most importantly, this in a sense provides stability to the revenue generation ability of the company, as the loss of a customer will not have any significant impact on revenues and margins. Moreover, a diversified product portfolio offering energy efficient solutions helps to serve a wide customer base.
- ▲ The company made accretive acquisitions like Turkey-based Ulusoy Elektrik Imalat Taahhut ve Ticaret A.S., Souriau-Sunbank Connection Technologies from TransDigm Group and announced the intention to acquire Power Distribution, Inc. The company is set to sell off the less profitable lighting business. It also announced that it has entered into a definite agreement to sell the Hydraulics business for \$3.3 billion in cash. Eaton also entered into an agreement to sell the Lighting business to Signify N.V. for a cash price of \$1.4 billion. These divestitures will allow Eaton to focus on higher-margin core businesses.

Eaton expects 2020 operating margins in the range of 17.8-18.2%, indicating a 40-basis point improvement from 2019, primarily as a result of the Lighting divestiture. The strategic acquisitions are likely to add 2% to total revenue growth in 2020.

- ▲ Eaton continues to generate a stable cash inflow through proficient handling of operating activities. In 2019, The company's operating cash flow and free cash flow was \$3.5 billion and \$2.9 billion, respectively. It expects 2020 operating and free cash flow in the range of \$3.4-\$3.6 and \$2.8-\$3 billion, respectively. In addition to utilizing funds for growth ventures and several other activities, a strong cash generating capacity supports the company's systematic debt reduction initiatives and shareholder friendly moves.

In 2019, the company had returned \$2.2 billion through share buybacks and dividends. Strong cash flow generating capacity will allow the company to continue with share-repurchase initiatives. Eaton aims to repurchase shares in the range of \$2.4-\$2.8 billion in 2020.

Reasons To Sell:

- ▼ Eaton operates in nearly 175 countries and has manufacturing facilities worldwide. This definitely enhances the revenue stream of the company but at the same time exposes it to disruptions like natural disaster, labor strike, war, political unrest, terrorist activity and economic upheaval. Such disturbances could delay shipments, stop production process and result in cancellation of orders. It expects organic revenue growth between down 1% and up 1% in 2020, primarily due to weak contribution from the Hydraulics and Vehicle segments. Softness in global mobile equipment and the light vehicles market is adversely impacting the performance of these segments.
- ▼ To conduct its business in an efficient manner, the company depends on its information technology network. These technology networks and systems may be susceptible to damage, disruptions or shutdowns due to failures during the process of upgrading or replacing software, databases or components; power outages; hardware failures; or computer viruses. In addition, cyber-attacks and security breaches could impact the operations of the company affecting its financial performance.
- ▼ Eaton utilizes a variety of raw materials and components in its businesses and has to depend on others for the supply of raw materials. So, any significant shortage, price increase, or supplier insolvencies could increase operating costs and adversely impact Eaton's competitive position.

Widespread operation exposes it to geo-political risks. Weakness in some end markets served and shortage of raw materials can impact the company's performance.

Last Earnings Report

Eaton's Earnings and Revenues Miss Estimates in Q4

Eaton Corporation reported fourth-quarter 2019 earnings of \$1.37 per share, which lagged the Zacks Consensus Estimate of \$1.40 by 2.1%. The reported earnings were at the lower end of management's guided range of \$1.36-\$1.46 per share.

During the fourth quarter, the company recorded a pre-tax charge of \$50 associated with warranty costs in the Vehicle business segment. The costs were being incurred to correct the performance of a product that incorporated a defective part from a supplier.

GAAP earnings in the reported quarter were \$1.09 per share compared with \$1.46 in the year-ago period. The difference between GAAP and operating earnings in the reported quarter was due to a one-time charge of 28 cents associated with acquisition and divestiture transaction.

Quarter Ending **12/2019**

Report Date	Feb 04, 2020
Sales Surprise	-1.69%
EPS Surprise	-2.14%
Quarterly EPS	1.37
Annual EPS (TTM)	5.68

Revenues

Total revenues in the quarter came in at \$5,238 million, lagging the Zacks Consensus Estimate of \$5,328 million by 1.7%. Quarterly revenues also decreased 4% from the year-ago quarter.

The year-over-year decline in revenues was due to 4% fall in organic sales and negative currency translation of 0.5%. These negatives were partially offset by a 0.5% gain from acquired assets.

Segment Details

Electrical Products' total fourth-quarter sales were \$1,753 million, down 2% from the year-ago level.

Electrical Systems and Services' total sales were \$1,669 million, up 4% from the year-ago quarter. Organic sales were also up 2% from the year-ago quarter. The acquisition of Ulusoy and Innovative Switchgear added 2% to its sales.

Hydraulics' total sales were \$565 million, down 13% from the year-ago quarter. Revenues declined due to continued weakness in the global mobile equipment market, and destocking at both OEMs and distributors.

Aerospace total sales were \$512 million, up 3% from the year-ago quarter due to 2% organic sales growth and 1% contribution from the acquisition of Souriau-Sunbank.

Vehicle total sales were \$664 million, down 19% from the year-ago quarter, owing to 18% decline in organic sales and 1% negative currency translation.

eMobility segment's total sales were \$75 million, down 6% from the year-ago quarter. The drop in the top line was entirely due to decline in organic sales.

Highlights of the Release

Eaton continues to make changes in its portfolio. The company sold the Automotive Fluid Conveyance business and signed an agreement to sell the Lighting business. It also acquired three businesses in 2019, which were in sync with the long-term growth strategy.

Segment margins in the reported quarter were 17.8%, up 40 basis points (bps) from the year-ago level.

Cost of products sold in the reported quarter was \$3,556 million, down 3.1% from the year-ago figure. Selling and administrative expenses were \$874 million, down 0.6% from the year-ago quarter.

The company's research and development expenses in 2019 were \$606 million, up 3.8% from the prior-year period. Interest expenses in 2019 were \$236 million, down 12.9% from 2018 levels.

Orders in Electrical Systems and Services, and Aerospace were up 2.5% and 6% year over year, respectively. On the contrary, Hydraulics' orders and Electrical Products (excluding Lighting) were down 11% and 2% year over year, respectively, due to weakness in the global mobile equipment market.

Share repurchases in 2019 totaled \$1.0 billion, representing 3% of shares outstanding at the beginning of the year.

Financial Update

Eaton's cash was \$370 million as of Dec 31, 2019 compared with \$283 million in the corresponding period of 2018.

As of Dec 31, 2019, long-term debt of the company was \$7,819 million, up from \$6,768 million in the comparable period of 2018.

Guidance

First-quarter 2020 earnings per share are expected between \$1.16 and \$1.26, indicating a 4% decline at the midpoint from first-quarter 2019 earnings.

The company expects 2020 earnings within \$5.60-\$5.90 per share, flat year over year at the midpoint, excluding 2019 vehicle warranty costs.

Segment operating margin for 2020 is expected within 17.8-18.2%.

Eaton has plans to repurchase shares worth \$2.4-\$2.8 billion in 2020. Acquired assets are expected to add 2% to total revenues in 2020, while divested assets are likely to have a 7.5% negative impact on the same.

The company expects organic revenues for 2020 between down 1% and up 1%.

Recent News

Eaton to Sell Hydraulics for \$3.3B, Focus on Core Business - Jan 22, 2020

Eaton Corporation Plc announced that it has entered into a definite agreement to sell the Hydraulics business for \$3.3 billion in cash to Danfoss A/S, a Danish industrial company. This deal is part of Eaton's ongoing transformation that will propel the company to boost growth and lead to earnings consistency.

The deal is expected to close by the end of this year, and is subject to customary closing conditions and regulatory approvals. Earlier this year, Eaton announced that it has completed the sale of the Automotive Fluid Conveyance Division to Quantum Capital Partners.

Valuation

Eaton Corporation shares are up 28.5% in the last six months period and 35.1% over the trailing 12-month period. Stocks in the Zacks sub-industry was up 24.9% and the Zacks Industrial Products sector was up 13.2% in the last six months period. Over the past year, the Zacks sub-industry and sector are up 19.5% and 12.2%, respectively.

The S&P 500 index is up nearly 14.3% in the last six months period and up 22.5% in the past year.

The stock is currently trading at 17.66X forward 12-month earnings, which compares to 20.51X for the Zacks sub-industry, 18.38X for the Zacks sector and 19.17X for the S&P 500 index.

Over the past five years, the stock has traded as high as 17.82X and as low as 10.39X, with a 5-year median of 14.26X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$109 price target reflects 18.79X forward 12-month earnings.

The table below shows summary valuation data for ETN

Valuation Multiples -ETN					
		Stock	Sub-Industry	Sector	S&P 500
P/E F 12M	Current	17.66	20.51	18.38	19.17
	5-Year High	17.82	20.51	19.91	19.34
	5-Year Low	10.39	13.14	12.6	15.18
	5-Year Median	14.26	17.04	16.58	17.46
P/S F12M	Current	2.1	2.67	2.78	3.55
	5-Year High	2.1	2.67	2.78	3.55
	5-Year Low	1.08	1.45	1.51	2.54
	5-Year Median	1.52	1.96	1.98	3
P/B TTM	Current	2.66	5.27	5.66	4.56
	5-Year High	2.66	5.32	5.74	4.56
	5-Year Low	1.44	3.18	3.44	2.85
	5-Year Median	2.04	4.39	4.45	3.62

As of 2/6/2020

Industry Analysis Zacks Industry Rank: Bottom 36% (164 out of 255)



Top Peers

SPX FLOW, Inc. (FLOW)	Outperform
ABB Ltd (ABB)	Neutral
A. O. Smith Corporation (AOS)	Neutral
Dover Corporation (DOV)	Neutral
Emerson Electric Co. (EMR)	Neutral
Energysys (ENS)	Neutral
Regal Beloit Corporation (RBC)	Neutral
Rexnord Corporation (RXN)	Neutral

Industry Comparison Industry: Manufacturing - Electronics				Industry Peers		
	ETN Neutral	X Industry	S&P 500	ABB Neutral	DOV Neutral	EMR Neutral
VGM Score	B	-	-	D	A	B
Market Cap	42.37 B	2.33 B	24.40 B	52.89 B	17.17 B	46.04 B
# of Analysts	10	4	13	2	8	10
Dividend Yield	2.77%	0.00%	1.75%	1.99%	1.66%	2.66%
Value Score	B	-	-	C	C	B
Cash/Price	0.02	0.09	0.04	0.06	0.02	0.03
EV/EBITDA	13.81	12.37	14.17	17.67	15.92	12.60
PEG Ratio	2.03	2.03	2.05	3.95	1.62	2.56
Price/Book (P/B)	2.63	2.21	3.31	3.86	5.66	5.42
Price/Cash Flow (P/CF)	13.64	13.32	13.63	14.09	15.01	14.86
P/E (F1)	17.76	17.77	19.08	24.50	18.68	20.58
Price/Sales (P/S)	1.98	2.03	2.67	1.89	2.41	2.51
Earnings Yield	5.63%	4.93%	5.24%	4.08%	5.35%	4.86%
Debt/Equity	0.51	0.17	0.71	0.62	0.98	0.47
Cash Flow (\$/share)	7.52	1.83	6.89	1.76	7.88	5.07
Growth Score	B	-	-	D	A	B
Hist. EPS Growth (3-5 yrs)	5.47%	6.08%	10.80%	3.70%	11.69%	-1.19%
Proj. EPS Growth (F1/F0)	1.71%	7.67%	7.23%	-18.55%	6.73%	-0.92%
Curr. Cash Flow Growth	8.89%	8.89%	9.51%	7.17%	10.20%	7.06%
Hist. Cash Flow Growth (3-5 yrs)	1.88%	3.18%	8.55%	-1.95%	1.28%	-0.68%
Current Ratio	1.70	2.19	1.20	1.36	1.46	1.13
Debt/Capital	33.56%	15.93%	42.90%	38.35%	49.61%	32.20%
Net Margin	10.34%	6.86%	11.76%	5.14%	9.50%	11.79%
Return on Equity	14.75%	9.67%	16.98%	18.69%	29.46%	25.55%
Sales/Assets	0.67	0.88	0.54	0.62	0.82	0.88
Proj. Sales Growth (F1/F0)	-5.01%	0.45%	4.15%	-0.06%	2.25%	0.30%
Momentum Score	C	-	-	F	A	C
Daily Price Chg	0.14%	-0.26%	-0.11%	-1.67%	-0.82%	-1.00%
1 Week Price Chg	-2.45%	-3.40%	-2.60%	-3.09%	-2.78%	-6.61%
4 Week Price Chg	7.66%	-0.24%	1.51%	2.36%	0.95%	-3.28%
12 Week Price Chg	12.75%	10.03%	5.63%	13.02%	8.76%	3.46%
52 Week Price Chg	34.21%	15.23%	17.01%	27.79%	36.02%	13.43%
20 Day Average Volume	2,836,714	192,166	1,961,054	1,948,908	870,565	2,926,490
(F1) EPS Est 1 week change	0.37%	0.00%	0.00%	-1.94%	0.22%	1.11%
(F1) EPS Est 4 week change	-0.50%	0.00%	-0.00%	-2.42%	0.56%	1.19%
(F1) EPS Est 12 week change	-2.84%	-0.55%	-0.16%	-3.50%	0.20%	1.25%
(Q1) EPS Est Mthly Chg	-0.35%	0.00%	0.00%	NA	11.00%	-1.99%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	B
Growth Score	B
Momentum Score	C
VGM Score	B

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

Disclosures

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