



Eaton Corporation

Company Profile

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COMPANY OVERVIEW

Eaton is a diversified industrial manufacturer with global leadership in electrical systems and components for power quality, distribution and control; fluid power systems and services for industrial, mobile and aircraft equipment; intelligent truck drivetrain systems for safety and fuel economy; and automotive engine air management systems, powertrain solutions and specialty controls for performance, fuel economy and safety. The company primarily operates in the US It is headquartered in Cleveland, Ohio and employs 60,000 people.

The company recorded revenues of \$12,370 million in the fiscal year ended December 2006, an increase of 12.3% over 2005. The operating profit of the company was \$1,053 million in the fiscal year 2006, an increase of 0.8% over 2005. The net profit was \$950 million in fiscal year 2006, an increase of 18% over 2005.

KEY FACTS

Head Office	Eaton Corporation Eaton Center 1111 Superior Avenue Cleveland Ohio 44114 USA
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Web Address	http://www.eaton.com
Revenue / turnover (USD Mn)	12,370.0
Financial Year End	December
Employees	60,000
New York Stock Exchange Ticker	ETN

SWOT ANALYSIS

Eaton Corporation (Eaton) is a diversified industrial company. The company is engaged in fluid power systems, electrical systems and automotive components. Eaton has diversified business operations. The company operates four business divisions, electrical, fluid power, truck and automotive. Diversified portfolio of businesses limits the company's exposure to business risks rising from any particular business. However, Eaton faces intense competition across its markets which could lead to a loss of market share and lower margins.

Strengths	Weaknesses
Diversified business operations Strong performance of fluid power Strong operating cash flows	Weak performance of the automotive division
Opportunities	Threats
Strategic acquisitions Expanding electrical business Expanding presence in India Growing global automotive market	Intense competition Declining global aerospace market Rising steel prices

Strengths

Diversified business operations

Eaton has diversified business operations. The company operates four business divisions: electrical, fluid power, truck and automotive. The electrical division is into industrial automation products and services. The division manufactures switches, circuit breakers, control relay timers, sensors and electronic and electrochemical tools.

The fluid power division manufactures hydraulic systems and components for several industries such as mobile, industrial and aerospace applications. This division produces a wide range of fluid conveying and fluid connecting products such as avionic switches, cockpit controls, fluid sensors, hose assemblies, gear, vane and piston pumps and many other hydraulic and pneumatic systems.

Eaton's truck division is a designer, manufacturer and marketer of drive train systems and components for medium-duty and heavy-duty commercial vehicles. The truck division manufactures vehicle components such as anti-lock brake systems, drive shafts, clutches, brakes and several other accessories. This segment also produces manual and automatic transmission systems.

The automotive division of the company manufactures a range of components and accessories for cars and light trucks, including superchargers, engine valves, valve train systems, sensors, precision gears, and fuel level controllers.

In fiscal 2006, the electrical division contributed 33.8%, fluid power contributed 32.2%, truck division contributed 20.4% and automotive division contributed 13.6% to the company's total revenues.

Diversified portfolio of businesses limits the exposure of the company from business risks rising from any of the four businesses.

Strong performance of fluid power

The fluid power segment of Eaton performed well in fiscal 2006. The segment's revenues grew by 22.9% in fiscal 2006 over fiscal 2005. The acquired businesses contributed 16%, organic growth contributed 6% and favorable exchange rates contributed 1% to the segment's overall growth. The acquisitions which made a significant impact on the segment's revenues included Ronningen-Petter filtration business in September 2006 and Synflex thermoplastic hose and tubing business in March 2006. Further, growth of 6% in fluid power market drove the segment's performance.

The segment also recorded strong operating profit. The segment's operating profit grew by 24% in fiscal 2006 over fiscal 2005 to \$ 422 million. The increase in operating profit was mainly due to the growth in sales, continued improvements in productivity, implemented price increases, the benefits of integrating acquired businesses, and favorable business mix.

Fluid power is one of the major contributors to the company's revenues with a contribution of 32.2% in fiscal 2006. The strong performance of the segment could boost the company's overall performance.

Strong operating cash flows

The company recorded strong operating cash flows for the fiscal 2006. Cash flow from operations increased by 26.1% in fiscal year 2006 over 2005 to \$ 1,431 million. Free cash flow has increased by 38.7% to \$1,071 million in 2006 over fiscal 2005. An increase in free cash flow increases the company's capacity to pay dividends to its shareholders and could in turn affect investor confidence. In addition, strong cash flows enable the company to fund its expansion programs and meet its commitments towards its capital expenditures.

Weaknesses

Weak performance of the automotive division

Eaton's automotive division recorded weak performance in fiscal 2006. The division's revenues declined 2.9% in fiscal 2006 over fiscal 2006 to reach \$1,683 million. The decline in sales was due

to a 6% decrease in sales volume, offset by a meager 2% increase from acquisitions of businesses and a 1% increase due to foreign exchange rates.

Further, the automotive division's operating profit declined by 39.1% in fiscal 2006 over fiscal 2005. The decline in operating profit was partly due to net costs of \$52 million related to the Excel program, which reduced the operating margin by 3.1%. Additionally, the decline was also due to a decline in production volumes in North America and Europe.

The automotive division contributes 13.6% to the company's total revenues and a weak performance of the division could adversely affect its overall revenues.

Opportunities

Strategic acquisitions

Eaton undertook several strategic acquisitions in 2006 and 2007. For instance, in April 2006, the company acquired Synflex. The acquisition increased the hydraulic portfolio of the company with the addition of new thermoplastic fluid conveyance capabilities. Further, the acquisition also strengthens the company's participation in the oil and exploration fields.

Further, in February 2007, Eaton acquired Power Products, a Prague based distributor and service provider of 'Powerware' and other uninterruptible power systems. The acquisition strengthens the company's power quality systems offerings by providing Eaton access to established channels structures and customers in Slovak and Czech Republic markets.

These strategic acquisitions would enable the company to strengthen its product range, increases customer base and strengthens market presence.

Expanding electrical business

The company expanded its electrical business capabilities through a number of acquisitions. This included three key acquisitions: Marina Power & Lighting to extend our reach into the fast-growing recreational marine and temporary housing markets; Senyuan International Holdings to capitalize on booming Chinese electrical utility and infrastructure markets; and Schreder-Hazemeyer to deepen the company's participation in the Benelux (Belgium, Netherlands and Luxembourg) markets of Europe.

The electrical division contributes 33.8% to the company's total revenues and strengthening this business would augur well for the company.

Expanding presence in India

Eaton plans to expand its presence in India. The company is expanding its presence in India through its new Professional Services Center in Pune. The center will provide engineering support, research, product development, financial shared services and other information technology products. Eaton plans to be a \$2.5 billion business in Asia-Pacific region in 2010, with a key focus on India.

The company established its presence in India in 2003, with an initial focus on the Fluid Power business. The center at Pune has grown since 2003 in scope and size to more than 400 employees. The team now performs a full range of high-end engineering and development work for all of Eaton's business segments. It has become an integral part of Eaton's global engineering workforce, emerging as a major product engineering, design and development center for Eaton's global customers.

Of the developing economies in Asia, which are spending heavily on infrastructure development, India is expected to see the highest rate of global construction spending growth in the 2006-2008 period at about 10% per annum.

The company could leverage the growth in infrastructure spending in India to boost its revenue growth.

Growing global automotive market

The automotive and automotive parts and equipments are said to grow in the coming few years.

For instance, the global market for automotive parts and equipment grew by 2.2% for the five-year period spanning 2002-2006. This market is forecasted to accelerate, with an anticipated CAGR of 3% for the five year period 2006-2011.

The global light trucks market grew at a CAGR of 2.5% for the period spanning 2003-2007. This market is expected to grow at a CAGR of 4.1% for the five year period 2007-2012. The global new cars market grew at a CAGR of 4.6% during the period 2003-2007. The market is expected to grow at a CAGR of 5.1% during the five year period 2007-2012.

Eaton's automotive division manufactures a range of components and accessories for cars and light trucks, including superchargers, engine valves, valve train systems, sensors, precision gears, and fuel level controllers. Therefore, the growth in the automotive parts and equipment market and global light trucks and global new car market augurs well for the company.

Threats

Intense competition

Eaton faces intense competition across its market segments. In the automotive segment, the company faces stiff competition from TRW Automotive Holdings, Delphi, Borg Warner, Magna and Bosch. Other competitors in the automotive segment include INA, GKN, Toyoda, Aisin Seiki and Visteon.

In the electrical segment, the company faces competition from Schneider, Emerson Electric, GE and Siemens. In the truck segment, major competitors of Eaton include, Allison transmission and ArvinMeritor. In its fluid power segment, the company competes with Parker-Hannifin, Dana, Visteon, TI Automotive, Hamilton-Sundstrand, Crane and Honeywell International. Intense competition could lead to a loss of market share and lower margins.

Declining global aerospace market

Though the global aerospace and defense market grew at a CAGR of 4.4% for the five year period 2002–2006, the market is forecasted to decelerate at an anticipated CAGR of 3.6% for the five year period 2006-2011.

Eaton's fluid power division manufactures components for the aerospace and defense industry. The slowing down of the aerospace market could adversely affect the performance of the fluid power segment which contributes 32.2% to the company's total revenues.

Rising steel prices

Steel is one of the key raw materials for Eaton. The steel prices are likely to rise in 2008 by 7% to 8%. The rise is the result of an increase in production costs, high consumer demand mainly from infrastructure and electronics consumer goods. The demand would be driven by the BRIC countries (BRIC countries account for 41% of global steel demand), due to intense construction activity. These countries are expected to account for 71% growth in global consumption in 2008.

The increase in steel prices would lead to increase in production costs which could negatively impact the future profitability and cash flows of the company.

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