EMERSON ELECTRIC CO
Form 10-Q
August 08, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2018

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ____________________ to __________________

Commission file number 1-278

EMERSON ELECTRIC CO.
(Exact name of registrant as specified in its charter)

Missouri	43-0259330
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
8000 W. Florissant Ave. P.O. Box 4100 St. Louis, Missouri	63136
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (314) 553-2000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes ý No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ý	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨
	Emerging growth company ¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date. Common stock of $0.50 par value per share outstanding at July 31, 2018: 628,465,551 shares.

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

Consolidated Statements of Earnings
EMERSON ELECTRIC CO. & SUBSIDIARIES

Three and nine months ended June 30, 2017 and 2018
(Dollars in millions, except per share amounts; unaudited)

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2017	2018	2017	2018
Net sales	$4,039	4,456	10,829	12,520
Costs and expenses:				
Cost of sales	2,361	2,507	6,229	7,125
Selling, general and administrative expenses	931	1,054	2,621	3,078
Other deductions, net	87	88	203	275
Interest expense (net of interest income of $10, $10, $25 and $35, respectively)	39	39	126	113
Earnings from continuing operations before income taxes	621	768	1,650	1,929
Income taxes	202	49	477	327
Earnings from continuing operations	419	719	1,173	1,602
Discontinued operations, net of tax	6	—	(133)	—
Net earnings	425	719	1,040	1,602
Less: Noncontrolling interests in earnings of subsidiaries	12	7	26	16
Net earnings common stockholders	$413	712	1,014	1,586
Earnings common stockholders:				
Earnings from continuing operations	$407	712	1,147	1,586
Discontinued operations, net of tax	6	—	(133)	—
Net earnings common stockholders	$413	712	1,014	1,586
Basic earnings per share common stockholders:				
Earnings from continuing operations	$0.63	1.13	1.77	2.50
Discontinued operations	0.01	—	(0.20)	—
Basic earnings per common share	$0.64	1.13	1.57	2.50
Diluted earnings per share common stockholders:				
Earnings from continuing operations	$0.63	1.12	1.77	2.49
Discontinued operations	0.01	—	(0.20)	—
Diluted earnings per common share	$0.64	1.12	1.57	2.49

Cash dividends per common share	$0.48	0.485	1.44	1.455

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Comprehensive Income
EMERSON ELECTRIC CO. & SUBSIDIARIES

Three and nine months ended June 30, 2017 and 2018
(Dollars in millions; unaudited)

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2017	2018	2017	2018
Net earnings	$425	719	1,040	1,602
Other comprehensive income (loss), net of tax:				
Foreign currency translation	74	(273)	230	(118)
Pension and postretirement	35	22	155	67
Cash flow hedges	5	(14)	37	(22)
Total other comprehensive income	114	(265)	422	(73)
Comprehensive income	539	454	1,462	1,529
Less: Noncontrolling interests in comprehensive income of subsidiaries	11	7	24	16
Comprehensive income common stockholders	$528	447	1,438	1,513

See accompanying Notes to Consolidated Financial Statements.

Consolidated Balance Sheets
EMERSON ELECTRIC CO. & SUBSIDIARIES

(Dollars in millions, except per share amounts; unaudited)

	Sept 30, 2017	June 30, 2018
ASSETS		
Current assets		
Cash and equivalents	$3,062	3,411
Receivables, less allowances of $91 and $98, respectively	3,072	3,027
Inventories	1,696	1,805
Other current assets	422	333
Total current assets	8,252	8,576
Property, plant and equipment, net	3,321	3,260
Other assets		
Goodwill	5,316	5,745
Other intangible assets	1,890	2,157
Other	810	749
Total other assets	8,016	8,651
Total assets	$19,589	20,487
LIABILITIES AND EQUITY		
Current liabilities		
Short-term borrowings and current maturities of long-term debt	$862	2,862
Accounts payable	1,776	1,647
Accrued expenses	2,342	2,392
Income taxes	65	53
Total current liabilities	5,045	6,954
Long-term debt	3,794	3,126
Other liabilities	1,980	1,947
Equity		
Common stock, $0.50 par value; authorized, 1,200,000,000 shares; issued, 953,354,012 shares; outstanding, 641,691,971 shares and 628,411,667 shares, respectively	477	477
Additional paid-in-capital	297	332
Retained earnings	21,995	22,660
Accumulated other comprehensive income (loss)	(1,019)	(1,092)
Cost of common stock in treasury, 311,662,041 shares and 324,942,345 shares, respectively	(13,032)	(13,964)
Common stockholders' equity	8,718	8,413
Noncontrolling interests in subsidiaries	52	47
Total equity	8,770	8,460
Total liabilities and equity	$19,589	20,487

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Cash Flows
EMERSON ELECTRIC CO. & SUBSIDIARIES

Nine months ended June 30, 2017 and 2018
(Dollars in millions; unaudited)

	Nine Months Ended June 30, 2017	2018
Operating activities		
Net earnings	$ 1,040	1,602
Loss from discontinued operations, net of tax	133	—
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	454	557
Changes in operating working capital	16	(286)
Other, net	142	(5)
Cash from continuing operations	1,785	1,868
Cash from discontinued operations	(727)	—
Cash provided by operating activities	1,058	1,868
Investing activities		
Capital expenditures	(300)	(314)
Purchases of businesses, net of cash and equivalents acquired	(2,991)	(770)
Divestitures of businesses	40	223
Other, net	(80)	(71)
Cash from continuing operations	(3,331)	(932)
Cash from discontinued operations	5,022	—
Cash provided by (used in) investing activities	1,691	(932)
Financing activities		
Net increase (decrease) in short-term borrowings	(1,136)	1,581
Payments of short-term borrowings greater than three months	(90)	—
Payments of long-term debt	(253)	(251)

Dividends paid	(930	)	(924	)
Purchases of common stock	(400	)	(1,000	)
Other, net	32		34	
Cash used in financing activities	(2,777	)	(560	)
Effect of exchange rate changes on cash and equivalents	(14	)	(27	)
Increase (Decrease) in cash and equivalents	(42	)	349	
Beginning cash and equivalents	3,182		3,062	
Ending cash and equivalents	$ 3,140		3,411	
Changes in operating working capital				
Receivables	$ 119		39	
Inventories	(125	)	(133	)
Other current assets	(24	)	(27	)
Accounts payable	(7	)	(97	)
Accrued expenses	(17	)	(83	)
Income taxes	70		15	
Total changes in operating working capital	$ 16		(286	)

See accompanying Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements
EMERSON ELECTRIC CO. & SUBSIDIARIES

(Dollars in millions, except per share amounts or where noted)

1. In the opinion of management, the accompanying unaudited consolidated financial statements include all adjustments necessary for a fair presentation of operating results for the interim periods presented. Adjustments consist of normal and recurring accruals. The consolidated financial statements are presented in accordance with the requirements of Form 10-Q and consequently do not include all disclosures required for annual financial statements presented in conformity with U.S. generally accepted accounting principles (GAAP). For further information, refer to the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended September 30, 2017. Certain prior year amounts have been reclassified to conform to current year presentation.

On December 22, 2017, the U.S. government enacted tax reform, the Tax Cuts and Jobs Act (the “Act”), which made comprehensive changes to federal income tax laws by moving from a global to a modified territorial tax regime. The Act includes a reduction of the U.S. corporate income tax rate from 35 percent to 21 percent along with the elimination of certain deductions and credits, and a one-time “deemed repatriation” of accumulated foreign earnings. In the first fiscal quarter, the Company recognized a net tax benefit of $43 ($0.07 per share) due to impacts of the Act, consisting of a $98 benefit on revaluation of net deferred income tax liabilities to the lower tax rate, and $185 of expense for the tax on deemed repatriation of accumulated foreign earnings and withholding taxes partially offset by $130 accrued in previous periods for the planned repatriation of non-U.S. cash. Subsequent to the enactment of the Act, the U.S. Treasury Department and the Internal Revenue Service issued additional guidance, particularly with respect to the calculation of the tax on deemed repatriation of accumulated foreign earnings. As a result of the additional guidance and actions taken in the third fiscal quarter, the Company updated its initial estimates and recognized a benefit of $150 ($0.24 per share), primarily related to an increase in foreign tax credit carryforwards. These updates resulted in a net tax benefit due to the impacts of the Act of $193 ($0.30 per share) for the nine months ended June 30, 2018.

The Company continues to review the impacts of the Act and subsequent interpretations. Given its complexities, the ultimate effects on repatriation cost and other tax items may differ from these provisional amounts due to additional regulatory guidance expected to be issued and further evaluation of the Company’s actions, assumptions and interpretations.

The effective tax rate for full year 2018 is currently expected to be approximately 19 percent, which includes 7 percentage points of benefit from the Act. In 2019 and thereafter, the tax rate is expected to be approximately 25 percent.

In February 2018, the FASB issued updates to ASC 220, Comprehensive Income, which permit reclassification of stranded tax effects resulting from the Act from accumulated other comprehensive income to retained earnings. These updates are effective in the first quarter of fiscal 2020, with early adoption permitted, and are not expected to materially impact the Company's financial statements.

In the first quarter of fiscal 2018, the Company adopted updates to ASC 330, Inventory, which changed the measurement principle for inventory from the lower of cost or market to the lower of cost and net realizable value. These updates did not materially impact the Company's financial statements.

In the first quarter of fiscal 2018, the Company adopted updates to ASC 740, Income Taxes, requiring recognition of the income tax effects of intra-entity transfers of assets other than inventory when the transfer occurs. These updates were adopted on a modified retrospective basis and did not materially impact the Company's financial statements.

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2. Reconciliations of weighted-average shares for basic and diluted earnings per common share follow. Earnings allocated to participating securities were inconsequential.

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2017	2018	2017	2018
Basic shares outstanding	642.8	629.4	643.1	633.4
Dilutive shares	1.0	3.5	1.2	3.1
Diluted shares outstanding	643.8	632.9	644.3	636.5

3. Other Financial Information

	Sept 30, 2017	June 30, 2018
Inventories		
Finished products	$560	610
Raw materials and work in process	1,136	1,195
Total	$1,696	1,805

	Sept 30, 2017	June 30, 2018
Property, plant and equipment, net		
Property, plant and equipment, at cost	$7,873	8,066
Less: Accumulated depreciation	4,552	4,806
Total	$3,321	3,260

	Sept 30, 2017	June 30, 2018
Goodwill by business segment		
Automation Solutions	$4,704	5,018
Climate Technologies	555	671
Tools & Home Products	57	56
Commercial & Residential Solutions	612	727
Total	$5,316	5,745

The increase in goodwill reflects the acquisitions of Paradigm and Cooper-Atkins. See Note 11.

	Sept 30, 2017	June 30, 2018
Accrued expenses include the following		
Employee compensation	$531	578
Customer advanced payments	$505	503
Product warranty	$120	122

	Sept 30, 2017	June 30, 2018
Other liabilities		
Pension and postretirement liabilities	$664	647
Deferred income taxes	425	274
Asbestos litigation	340	346
Other	551	680
Total	$1,980	1,947

Other long-term assets include $136 of asbestos-related insurance receivables.

4. Following is a discussion regarding the Company’s use of financial instruments:

Hedging Activities – As of June 30, 2018, the notional amount of foreign currency hedge positions was approximately $2.3 billion, and commodity hedge contracts totaled approximately $142 (primarily 53 million pounds of copper and aluminum). All derivatives receiving deferral accounting are cash flow hedges. The majority of hedging gains and losses deferred as of June 30, 2018 are expected to be recognized over the next 12 months as the underlying forecasted transactions occur. Gains and losses on foreign currency derivatives reported in Other deductions, net reflect hedges of balance sheet exposures that do not receive deferral accounting. The following gains and losses are included in earnings and other comprehensive income (OCI) for the three and nine months ended June 30, 2018 and 2017:

		Into Earnings				Into OCI			
		3rd Quarter		Nine Months		3rd Quarter		Nine Months	
Gains (Losses)	Location	2017	2018	2017	2018	2017	2018	2017	2018
Commodity	Cost of sales	$4	2	6	13	2	(3)	17	1
Foreign currency	Sales, cost of sales	—	(1)	(17)	(1)	10	(15)	32	(19)
Foreign currency	Other deductions, net	(22)	28	(22)	16				
Total		$(18)	29	(33)	28	12	(18)	49	(18)

Regardless of whether derivatives receive deferral accounting, the Company expects hedging gains or losses to be essentially offset by losses or gains on the related underlying exposures. The amounts ultimately recognized will differ from those presented above for open positions, which remain subject to ongoing market price fluctuations until settlement. Derivatives receiving deferral accounting are highly effective and no amounts were excluded from the assessment of hedge effectiveness. Hedge ineffectiveness was immaterial for the three and nine months ended June 30, 2018 and 2017.

Fair Value Measurement – Valuations for all derivatives and the Company's long-term debt fall within Level 2 of the GAAP valuation hierarchy. As of June 30, 2018, the fair value of long-term debt was $4.0 billion, which exceeded the carrying value by $152. At June 30, 2018, the fair values of commodity contracts and foreign currency contracts were reported in other current assets and accrued expenses. Valuations of derivative contract positions are summarized below:

	September 30, 2017		June 30, 2018	
	Assets	Liabilities	Assets	Liabilities
Foreign Currency	$ 26	18	27	24
Commodity	$ 12	—	3	4

Counterparties to derivatives arrangements are companies with investment-grade credit ratings. The Company has bilateral collateral arrangements with counterparties with credit rating-based posting thresholds that vary depending on the arrangement. If credit ratings on the Company's debt fall below pre-established levels, counterparties can require immediate full collateralization of all derivatives in net liability positions. The maximum amount that could potentially have been required was $13. The Company also can demand full collateralization of derivatives in net asset positions should any counterparty credit ratings fall below certain thresholds. No collateral was posted with counterparties and none was held by the Company as of June 30, 2018.

5. The change in equity for the first nine months of 2018 is shown below:

	Common Stockholders' Equity	Noncontrolling Interests in Subsidiaries	Total Equity
Balance at September 30, 2017	$ 8,718	52	8,770
Net earnings	1,586	16	1,602
Other comprehensive income (loss)	(73)	—	(73)
Cash dividends	(924)	(21)	(945)

Purchases of treasury stock, net of issuances	(897)	—	(897)
Adoption of accounting standard update	3	—	3
Balance at June 30, 2018	$ 8,413	47	8,460

6. Activity in Accumulated other comprehensive income (loss) for the three and nine months ended June 30, 2018 and 2017 is shown below:

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2017	2018	2017	2018
Foreign currency translation				
Beginning balance	$(655)	(214)	(812)	(369)
Other comprehensive income (loss) before reclassifications	75	(273)	(153)	(101)
Reclassified to gain/loss on sale of businesses	—	—	385	(17)
Ending balance	(580)	(487)	(580)	(487)
Pension and postretirement				
Beginning balance	(1,042)	(617)	(1,162)	(662)
Amortization of deferred actuarial losses into earnings	35	22	105	67
Reclassified to gain/loss on sale of businesses	—	—	50	—
Ending balance	(1,007)	(595)	(1,007)	(595)
Cash flow hedges				
Beginning balance	7	4	(25)	12
Deferral of gains (losses) arising during the period	7	(13)	30	(13)
Reclassification of realized (gains) losses to sales and cost of sales	(2)	(1)	7	(9)
Ending balance	12	(10)	12	(10)
Accumulated other comprehensive income (loss)	$(1,575)	(1,092)	(1,575)	(1,092)

Activity above is shown net of income taxes for the three and nine months ended June 30, 2018 and 2017, respectively, as follows: amortization of pension and postretirement deferred actuarial losses: $(8), $(18), $(24), and $(54); pension and postretirement divestiture: $-, $-, $-, and $(22); deferral of cash flow hedging gains (losses): $5, $(5), $5, and $(19); reclassification of realized cash flow hedging (gains) losses: $-, $2, $3 and $(4).

7. Total periodic pension and postretirement expense is summarized below:

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2017	2018	2017	2018
Service cost	$21	19	63	57
Interest cost	42	46	126	139
Expected return on plan assets	(86)	(87)	(258)	(262)
Net amortization	53	30	159	91
Total	$30	8	90	25

8. Other deductions, net are summarized below:

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2017	2018	2017	2018
Amortization of intangibles	$41	47	84	154
Restructuring costs	21	14	45	38
Other	25	27	74	83
Total	$87	88	203	275

The increase in amortization for the three and nine months ended June 30, 2018 is due to acquisitions. On a year-to-date basis, Other included higher acquisition/divestiture-related costs of $16, partially offset by lower bad debt expense of $11.

9. Restructuring expense reflects costs associated with the Company's ongoing efforts to improve operational efficiency and deploy assets globally in order to remain competitive on a worldwide basis. The Company expects full year 2018 restructuring expense to be approximately $80, which includes costs related to the Tools & Test and Aventics acquisitions. See Note 13. The full year expense includes $38 incurred to date, as well as costs to complete actions initiated before the end of the third quarter and actions anticipated to be approved and initiated during the remainder of the year. Costs for the three and nine months ended June 30, 2018 largely relate to restructuring of the global cost structure consistent with the current level of economic activity, as well as the redeployment of resources for future growth.

Restructuring expense by business segment follows:

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2017	2018	2017	2018
Automation Solutions	$20	9	35	26
Climate Technologies	1	4	8	11
Tools & Home Products	—	—	1	—
Commercial & Residential Solutions	1	4	9	11
Corporate	—	1	1	1
Total	$21	14	45	38

Details of the change in the liability for restructuring costs during the nine months ended June 30, 2018 follow:

	Sept 30, 2017	Expense	Utilized/Paid	June 30, 2018
Severance and benefits	$ 60	24	48	36
Lease and other contract terminations	4	2	2	4
Asset write-downs	—	1	1	—

Vacant facility and other shutdown costs	1	4	3	2
Start-up and moving costs	—	7	6	1
Total	$ 65	38	60	43

10. Business Segments – The Company designs and manufactures products and delivers services that bring technology and engineering together to provide innovative solutions for customers in a wide range of industrial, commercial and consumer markets around the world.

The Automation Solutions segment enables process, hybrid and discrete manufacturers to maximize production, protect personnel and the environment, and optimize their energy efficiency and operating costs through a broad offering of integrated solutions and products, including measurement and analytical instrumentation, industrial valves and equipment, and process control systems. Significant end markets serviced include oil and gas, refining, chemicals and power generation, as well as pharmaceuticals, food and beverage, automotive, pulp and paper, metals and mining, and municipal water supplies. The segment's major product offerings are described below.

- Measurement & Analytical Instrumentation products measure the physical properties of liquids or gases in a process stream and communicate this information to a process control system or other software applications, and analyze the chemical composition of process fluids and emissions to enhance quality and efficiency, as well as environmental compliance.
- Valves, Actuators & Regulators consists of control, isolation and pressure relief valves which respond to commands from a control system to continuously and precisely modulate the flow of process fluids, smart actuation and control technologies, pressure management products, and industrial and residential regulators that reduce the pressure of fluids moving from high-pressure supply lines into lower pressure systems.
- Industrial Solutions provides fluid power and control mechanisms, electrical distribution equipment, and materials joining and precision cleaning products which are used in a variety of manufacturing operations to provide integrated solutions to customers.
- Process Control Systems & Solutions provides a digital ecosystem that controls plant processes by communicating with and adjusting the "intelligent" plant devices described above to provide precision measurement, control, monitoring, asset optimization, and plant safety and reliability for plants that produce power, or process fluids or other items.

The Commercial & Residential Solutions business consists of the Climate Technologies and Tools & Home Products segments. This business provides products and solutions that promote energy efficiency, enhance household and commercial comfort, and protect food quality and sustainability through heating, air conditioning and refrigeration technology, as well as a broad range of tools and appliance solutions.

The Climate Technologies segment provides products, services and solutions for all areas of the climate control industry, including residential heating and cooling, commercial air conditioning, commercial and industrial refrigeration, and cold chain management. Products include compressors, temperature sensors and controls, thermostats, flow controls, and stationary and mobile remote monitoring technologies and services that enable homeowners and businesses to better manage their heating, air conditioning and refrigeration systems for improved control and comfort, and lower energy costs.

The Tools & Home Products segment offers tools for professionals and homeowners and appliance solutions. Products include professional pipe-working tools, residential and commercial food waste disposers, and wet-dry vacuums.

Summarized information about the Company's results of operations by business segment follows:

Three Months Ended June 30,				Nine Months Ended June 30,			
Sales		Earnings		Sales		Earnings	
2017	2018	2017	2018	2017	2018	2017	2018