



Powering Through The Downturn

Eaton's CEO has moved the company away from its auto-industry roots. Good timing. Now it just has to find a way to grow. **By Dyan Machan**

THE CORNER OFFICE

Alexander Cutler

EATON CORP.

NOT THAT LONG AGO, a multicar pileup like the one that wrecked the American auto industry this year might have totaled Eaton Corp., too. As recently as 2003, the Cleveland-based company earned half its profits from making transmissions, brakes and other parts for cars and trucks. If you had even heard the name Eaton, it probably conjured an image of a big, greasy axle.

Not anymore. For the past decade, CEO Alexander Cutler has been on a relentless crusade to move Eaton away from its roots as an automaker and into what actually passes for sexy and cutting-edge in a nuts-and-bolts sector like manufacturing. Since he took over in 2000, he's been on a buying spree, snapping up firms that make specialized motor controls, circuit breakers, even hydraulic power systems for fighter jets. Energy-efficient technology, international expansion—it's all part of Cutler's master plan. So far, it seems to be working: Car and truck sales now account for just 27 percent of the firm's profits, and last year more than half its revenue came from overseas, up from 30 percent when Cutler took over.

"He's rebalanced the portfolio and instilled a cultural change," says Eli Lustgarten, a Longbow Research analyst who covers manufacturing companies. "The reality for Eaton is much better than the numbers show."

Granted, those numbers aren't pretty. The global economic crisis has been disastrous for even the most flexible manufacturing companies, Eaton included. Earlier this year, the company posted its first quarterly loss in nearly 20 years. Even though sales

Photograph by Michael Nemeith for SmartMoney

in the auto and truck divisions are a smaller part of the company, they still lost \$102 million in the first half of 2009. Its stock, which fell to \$30 in March, has rebounded to around \$60—still down 45 percent from its precrash peak. And as well positioned as Eaton seems, the next 12 months may be crucial: While the economy and its effects on Eaton's customers are clearly the most important variables, corporate tax changes and the rising cost of raw materials could hamper the firm's rebound as well. No one, not even Cutler, expects to see the company grow before 2010.

An attorney's son from Milwaukee, Cutler joined the company in 1975 and made his mark turning around an Atlanta plant ready for the scrap heap. In a wood-paneled room overlooking Lake Erie, we sat down with Cutler to talk about Eaton's transformation, the effects of the government stimulus package and a rare positive benefit from a very bad recession.

■ **Used to be when you thought of Eaton, you thought of an engine valve. Now it's a circuit breaker.**

There's been a huge evolution. Seventy percent of [the company's sales] are from our nonvehicle businesses.

■ **You've focused on environmentally friendly manufacturing.**

We've created a new type of electrical power system, backed up by batteries. It uses less energy and space. Also, we figured out how to make airplanes lighter, which means they need less fuel.

■ **And you have the government grant—\$45 million for 378 vehicles.**

We already have an established hybrid power system for trucks. The grant will pay for the nation's largest commercial hybrid deployment to date. New trucks will use up to 70 percent less fuel compared to standard vehicles.

■ **That's good, especially if gas hits \$4 a gallon again.**

With our superchargers, you can get the same power out of a V-6 engine with better fuel efficiency. The U.S. has to stop its love affair with more cylinders and look for better performance.

■ **What's your forecast for energy costs?**

There's no question oil and gas prices

will be higher in 10 years. Nuclear energy, too. In a carbon-constrained world, the cost of these things will go up.

■ **How will that affect Eaton?**

Whether you're in a car, plane or truck, or turning the lights on in a building, we manage energy, and we can reduce a company's carbon footprint.

■ **Why did you move away from the auto industry?**

People associated us with the heavy-truck business cycle, which is an early indicator that the economy is picking up. The problem was, as soon as the economy recovered, our shareholders would sell. So we balanced out our product line with more medium- and late-cycle products.

A NEW TRANSMISSION

EST. 2009 SALES: \$11.6 billion

EST. 2009 NET INCOME: \$305 million

EST. 2009 EPS: \$1.96

EST. 2009 P/E: 28

MARKET VALUE: \$9.6 billion

COMMENTS: Producing circuit breakers and voltage regulators might sound boring, but electrical products now account for more than half of Eaton's revenue as customers aim to be more energy efficient.

■ **Will you continue to shrink the vehicle part of your business?**

No, but we may build in other areas, electrical in particular.

■ **In addition to the grant for the hybrid trucks, how much of the \$2 trillion government stimulus will land in Eaton's pockets?**

This will be a major source of sales for Eaton. We expect \$500 million in each of the next two years. The biggest source of funds will go to making federal buildings more energy efficient.

■ **You don't see an economic recovery until 2010. Is there a bright side to a recession?**

In a bad downturn, you'll get a pop in productivity. The question now is what kind of setback we will have from government involvement. No one knows.

■ **You're skeptical of government intervention. Should General Motors, a customer, have been allowed to fail?**

Saving car companies seems to be a matter of national pride. The question is, will these enterprises be competitive?

■ **One of Eaton's slogans is "Always on." Are you always on?**

I think everyone is these days. 

