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EMR.N - Emerson Electric Co To Discuss 4th Quarter Orders

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OVERVIEW:

Co. provided an update on its operations.

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PRESENTATION

Operator

Good day, ladies and gentlemen. Thank you for standing by. Welcome to the Special Emerson Conference Call. (Operator Instructions)

This conference is being recorded today, December 17, 2020. Emerson's commentary and responses to your questions may contain forward-looking statements, including the company's outlook for the remainder of the year. Information on factors that could cause actual results to vary materially from those discussed today is available on -- at Emerson's most recent annual report on Form 10-K as filed with the SEC.

At this time, I would now like to turn the conference over to our host, Pete Lilly, Director of Investor Relations at Emerson. Please go ahead.

Pete Lilly - *Emerson Electric Co. - Director of IR*

Good morning, and good afternoon, good evening, everyone around the world joining us. Today, I'm joined by our Chairman and Chief Executive Officer, David Farr; our Chief Financial Officer, Frank Dellaquila; Executive President of Automation Solutions, Lal Karsanbhai; as well as our Executive President of Commercial and Residential Solutions, Jamie Froedge. Thank you for joining us.

And with that, I'll turn it over to Mr. Farr.

David N. Farr - *Emerson Electric Co. - Chairman & CEO*

Thank you very much, Pete. Frank, you must have been referring to that famous 10-K that we have that's 6 pages of risk that -- if we don't do anything. That's where I was just referring to, I just thought you'd like to hear that.

Frank J. Dellaquila - *Emerson Electric Co. - Senior EVP & CFO*

Okay.

David N. Farr - *Emerson Electric Co. - Chairman & CEO*

Welcome, everybody. I'm referring to the 10-K where you list every risk that happens in a world like we don't develop new products, we don't go out and sell, we just source it back in a bunker.

I welcome everybody. The reason we're having a call is it's a commitment we made back in November at the November earnings call that after we got 2 months into the new fiscal year, we would give you an update on what we see going on in the world. So as you've seen in the order pattern in the chart -- did they have this chart here? The chart going out there, the V has formed extremely hard at this point in time. Clearly, the Commercial Residential Solutions business has continued to strengthen, and I'll let Jamie talk about that in a few minutes, but it's strengthening pretty much around the world and more and more of the segments other than the Professional Tools are starting to take hold in this recovery, which is good to see.

From the standpoint of Auto Solutions, we know historically, we have bounced around the bottom. If you look back at -- in the late '16 time period going into '17. We do bounce around the bottom for a while, then we'll spike. Also keep in mind, in both these businesses, it's not uncommon for them to have a month or 2 where it flattens out, dips a little bit. It's not a straight line as it looks there. But from my perspective, I would expect this, that we're ahead of where we thought we'd be at this point in time, probably a month or maybe 1.5 months ahead where we thought we'd be. Where -- we have a large December, obviously, and Lal will talk about that. But the trend line is the right trend line at this point in time, and we're continuing to seeing pretty good strength around the world and by more and more of our segments.

So I'm -- it's really good to see that. I think at this point in time, if I look at the hard blue dot that we put in the middle back in November, and we're in the upper right-hand corner of that box, my feeling is that we're going to be somewhere in the upper right-hand corner to the -- that blue dot will be somewhere in that middle. I would say that we could flatten out and Lal will talk a little bit about -- we had some very big orders last December. If you look at his last 3-month roll in December, you'll see that he had a little spike up. And that was from that -- from some of the big orders they had in that kind of chart of the previous year. But still, the trend line is good.

I'm going to turn it over to Lal to talk a little bit about it. But again, we just wanted to update everyone and give you a feel. I'll let these guys go first, and I'll add some comments at the end if necessary. So Lal, why don't you give them a little update?

Surendralal Lanca Karsanbhai - *Emerson Electric Co. - Executive President of Emerson Automation Solutions*

Sure, I'll try to give you a little bit of color. I think, David, it's fair to say that we're close to flattening our trailing 3-month order run rate. The last 3 months have yielded encouraging signs, particularly related to the civilization of day-to-day process business, a recovery of discrete industrial activity really driven by Europe and China right now.

However, it is also a fact that with the exception of a few KOB 2 projects and a number of power projects, the environment around the world remains precarious and lacks any significant KOB 1 FID activity.

So I'll touch on the orders from 3 dimensions: geography, end industry and end market as well as I'll give you an update on KOB 1, 2 and 3 out there.

Let's start with North America, which remains soft for us, although the 3-month trend has stabilized in North America. Upstream oil and gas customers are still depleting inventory despite an approximate 40% increase in completion activity, which has resulted in a moderate increase in book-to-ship instrument orders for us here in North America. We are, however, seeing infield drilling activity. It feels like the Permian, which leverages equipment such as separation equipment and compression equipment versus moving and expanding the field activity, which we saw obviously during the growth phase.

The refining spend remains stagnant. However, we do expect some end-of-year budget spending in chemical, in pulp and paper, which will take place as well as power continuing to be strong as we finish the quarter and into the second quarter.

We've talked about this in the past. Customer site access is challenged as the COVID-19 restrictions fluctuate across the North America environment. The Google mobility data indicates that approximately 30% decline from the March 9 basis of where we are, you may recall, we talked about a 56% trough in mid-April when we started looking at that data. So it has stayed relatively stagnant as we went through the fall months.

We also have assessed that the large portion of our customers in North America have less than 40% of personnel on-site with many stating to return to the plants no earlier than spring. So again, we need more folks on-site to move beyond the break fix environment. So we're seeing some of that. But still not enough, but there are some small signs there. This has translated into some increased quotation activity, but we're yet to see that uplift in the order activity, but at a minimum of stabilization.

Turning to Latin America. It is stressed, driven predominantly by the Mexican economic position, which impacts both PEMEX and downstream spending across Mexico. I will highlight some significant activity around LNG, particularly in the Baja Peninsula in Mexico. With a project by Sempra that's been FID-ed, and we have been awarded. This is a -- an LNG facility for export of gas into Asia. It bypasses the Panama Canal. So from a speed perspective, has a significant number of advantages over the Gulf of Mexico.

There is also a bright light in the southern comb with the metals and mining activity. We've seen what's occurred in metal prices, and we've seen that activity pick up in Argentina, Chile and Brazil.

Europe has seen a recovering daily run rates, driven predominantly by life sciences, automotive and discrete OEM activity in Germany, predominantly in power activity across the Western European sphere. Germany is experiencing broad growth in industrial activity in their strong OEM economy. And that's one of our early-cycle discrete businesses in Germany being up close to 30% right now. So encouraging signs there.

Coming off of a flat year in 2020 for Asia and China, which as David and I have talked often, felt a lot better than flat for us. We expect moderate growth in 2021 for both China and Asia. And we're off to a pretty decent start, particularly in China, as indicated in our 8-K release. We are seeing continued momentum both in process and discrete markets as well as life sciences, medical and semiconductor industries that are driving strength. The good news is that customer site presence is nearly at 100% in China. We have trade shows that are taking place, public marathons, things of that sort. So normalized activity levels in China, which obviously helps the business dynamics.

And then finally, the Middle East and Africa is impacted by KOB 1 delays, but we have benefited from KOB 2 activity, driven mostly by digital transformation.

Just a couple of end markets to highlight, if I may. Three perspectives. Life sciences continues to be a differentiating story for us. We have direct involvement in over 20 vaccine efforts around the world at a number of therapeutics. There's a very high probability that when each of you take that COVID-19 vaccine, it will have been made by DeltaV. The medical PP&E equipment also remained strong, masks and oxygen therapy machines predominantly.

The discrete activity in automotive has picked up, particularly in Germany and China, semiconductors driven by consumer electronics as well. The electrical channel in North America is yet to see the same type of recovery, however, as we've seen in Germany. Although the daily order run rates in that market space have improved to nearly 2x what they were in the summer troughs. So some encouragement there.

If there is an industry that we're watching very carefully, we spend a lot of time talking about is the refining space. COVID-19 has impacted approximately 4% of capacity -- of global refining capacity. It is actively being converted to biofuels, idled or closed, or in some kind of economic evaluation. If I just zero in on the United -- on the North America specifically, North America had approximately 19 million barrels per day refining capacity pre-COVID and approximately 6% of that is either being idled, that's 5 refineries; closed, 3 refineries; or undergoing biofuels conversion, which is a good opportunity for us. And there are 4 notable projects in pre-FID stage right now with 2 large California refineries undergoing those conversions. So that's one industry on the downside that we're watching very, very carefully. So we will yield opportunities in those conversions.

And then lastly, on KOBs. We finished -- we closed 2020 with KOB 3 at 57% of sales; 2 at 23%; and 1 at 20%. We did expect higher KOB 3 as we went through the second half of the year, but our book-to-ship instrument business has weakened significantly as we went through Q4.

KOB 2 pace of business is improving. More customers are engaging in activity is driven by our digital transformation business. It's predominantly software, data lakes and connections to the digital twin environment that we've created. So there's very good momentum there.

And then lastly, KOB 3 has stabilized, as I mentioned. It is, albeit, at lower levels right now. We need to continue to see a recovery in daily booking rates as we go through December and through the early part of Q2.

David N. Farr - *Emerson Electric Co. - Chairman & CEO*

The one thing, Lal, I'd like you -- I mean, based on these numbers here, I'm going to have Lal talk a little bit about OSI and how it's really strong. It started out really from a synergistic basis. But before I say that, I think as I look at the first 2 months and the current pace and the activity we're hearing from our customers, I would say, Lal is banking on a pretty strong second half recovery. I -- as I look at this order trend chart in the way it's turned, which is good, it does give us a lot more confidence that his second half recovery is going to happen because he needs to build the backlog. He's building the orders and he's starting to get the day-to-day stuff improving, which is very, very important.

The one key area that we've really seen a strong strength, and we've been winning some very major projects around the world is with OSI and the combination of our PWS, our Power Water Solutions business. And it's really running well. You might want to give color, in particularly we won a couple of big ones outside against one of our competitors, which is great to see.

Surendralal Lanca Karsanbhai - *Emerson Electric Co. - Executive President of Emerson Automation Solutions*

Yes, David. I'll give you a little color. Very strong start as...

David N. Farr - *Emerson Electric Co. - Chairman & CEO*

And those numbers are not in our chart. We do not put those in until next year. So there's no OSI order. So these are...

Surendralal Lanca Karsanbhai - *Emerson Electric Co. - Executive President of Emerson Automation Solutions*

This is the underlying basis here. So a very strong start to the year. We've booked $55 million in orders through November. And I think we'll exceed $85 million of bookings in Q1. This was, you may recall, in our acquisition deck, $160 million company in sales a year ago. So tremendous start.

The technology is truly differentiated as we continue to learn more and more about it and is incredibly well-timed as an acquisition to capture the opportunities as T&D customers continue to modernize their great assets and address renewables and distributed energy resources.

The integration, David, is going very well. We held our first Board meeting on Tuesday. And I will tell you that the cultural and the operating fit is very, very strong with this company. Specifically to the project wins, there have been 3 very important projects. Exelon here in the United States, which is an upgrade on our ADMS and EMS system. We have put our first significant transmission stake in the ground in Europe in the Netherlands and Northern Germany. This is 1 of 42 transmission companies on that continent, but a very important point of relevance. And not only that, but we competed against one of the key incumbents and key players in that space and we're able to win the project. That will book actually, David, in Q3. We've been awarded the job.

We've all been awarded a hydro job in Australia, again, versus a very strong incumbent in the space, but that gives us a stakeholder on renewables and in Asia as well. We remain very focused on the top 20 utilities and capturing the synergies of PWS. That's great progress by Bob Yeager and the team on that. And we're also pursuing significant opportunities in gas distribution with a recent win in North America versus a SCADA incumbent at a utility in the central U.S.

So a lot of good activity. Business looks good. We are working, honestly, right now on '22 revenue already in terms of where the funnel sits. So very excited about the momentum with the team.

David N. Farr - *Emerson Electric Co. - Chairman & CEO*

Good. A lot of opportunities out there. And I think with the combination of Alan and Bob and his team and with us, I think we have a lot of strength that we offer, especially the financial strength, which is something they didn't have exactly from that standpoint. So now we can go against the big incumbents.

With that, I'm going to turn it over to Jamie. Obviously, if you look at Jamie's curve, nothing grows that sharply forever. It's just a matter of time. Obviously, we do know this thing will flatten out a little bit and dip and move forward. But we still feel a very good year. And clearly, I would say, Jamie is ahead where we thought he'd be at the beginning of this year.

But the most important thing I see on Jamie is it's not just 1 market, not just 1 customer, it's broad-based from an Asia standpoint or a European standpoint, a U.S. standpoint. A couple of industries are starting to kick in, in orders. And I think this is very, very important. And in particular, Jim, I want you to talk about Asia and China a little bit because I think this is -- for the first -- start of this year, things are going well. So Jamie, I'll turn it over to you now. Thanks.

James P. Froedge - *Emerson Electric Co. - Executive VP of Commercial & Residential Solutions Business*

Yes. Thanks, David. I really appreciate that. Good morning, everyone. As David said, I think that's the key story is when we talked at our -- during the earnings presentation, it was really a story about North America, largely about the residential space and what we were seeing in the AC heating markets as well as the big box retailer markets where we sweat -- we sell our wet dry vacs or our InSinkErator products.

But what we saw since the earnings announcement is steady and consistent improvement in other areas around the world. So our Asia climate businesses are up over double-digit in orders the last 2 months. Overall, Asia is growing. We didn't expect it to come back quite this quickly. We continue to see the professional tools business stabilize. Still negative on an overall orders basis, but the Europe business turned positive in this last month. So very, very positive signs for us.

As we look at the overall residential marketplace in North America, too, David, we don't see the momentum slowing down in the interim. As we look at the channel inventory position, we look at the market signals that we're getting from end users as well as our channel partners. There's an expectation that the growth and the opportunity here is going to continue over the next several months.

And so the accelerated growth that we've seen in those markets, as David said, it won't stay on that trajectory forever. But we do expect there to be growth -- continued growth in that space for at least the next few months. Second half, we'll see. But if markets continue to improve at the pace that they're improving, our hope is that we'll see the professional tools, the commercial and the light industrial markets start to come back for us in the second half of the year, at the same time that Lal's businesses are starting to gain some momentum.

Just a few statistics. We have a business called Therm-O-Disc, which serves appliance markets and HVAC markets around the world. Trailing 3 months order for North America for that business, 29.4%; China, up 36.5%; Rest of Asia, up 47.4%. So it's a really good indicator for us for the general consumer health and spending, again, around appliances and HVAC products.

Our climate AC growth is led by U.S. Residential. Yes. We mentioned at the earnings call that Q1 sales for residential could be over 50%. They definitely will be at this point. They're on track to, not only be greater than 50%, they could be greater than 60% or 70% with the pace that we're on. The commercial markets are still slightly down, but we're starting to see good aftermarket health, and that's up mid-single digits.

Our Climate Europe business continues to be strong. I think that momentum around the heat pump will continue for the foreseeable future, given its alignment with, not only the market trends, but the subsidy environment. And then the do-it-yourself and big box retail channels, strong growth for North America. Our wet dry vac business was up over 35% on a trailing 3-month order basis and our InSinkErator business up 18%. So very, very positive momentum across those businesses.

So David and team, I think what we're seeing is, as Dave said is a balanced recovery here now globally in many different markets, not just North America but the North America residential momentum continues. And we expect that will continue in the near term, and we continue to see stabilization of professional tools.

Our Cold Chain business has also turned positive earlier than we expected, largely driven by our transportation and our Cold Chain business related to our life sciences and medical businesses has seen strong growth, which we expect to continue throughout the year.

So David, that's kind of a high-level summary of what we're seeing across the business. I'll pass it back to you.

David N. Farr - *Emerson Electric Co. - Chairman & CEO*

Thank you very much. The case for us right now is the early cycle stuff that Jamie sees and Lal sees are -- and we, as you guys know and have known us for a long time, it does help us forecast these curves. We've been doing these curves since I've been CEO for 20 years. I have a good sense of what's going around the curves. We do know the early cycle guys have all kicked in both in Lal's business and Jamie's business. It's a good indication that the economies are getting stronger.

The key issue for us now is watching some of these later-cycle stuff kick. And as Lal talked, KOB 2 quoting is very good. That's a good sign. On Jamie's side, I think the stabilization of the professional tools is very, very important to us. That tells us that the plants -- I'm not thinking about non-res, I'm thinking about plants right now. The industrial segment of that will start doing activity, which will drive Lal's business.

Now we're not here to talk about profitability and things like that. I know everyone wants to know, but we gave our forecast. We're not changing our forecast. I think a couple of things I want to comment on before we open the mic up for a couple of questions. The restructuring, reset programs continue to move very, very well going forward here. If we had a -- we've had a good run. Frank, what you'd see as booking, what in the first quarter for restructuring reset here?

Frank J. Dellaquila - *Emerson Electric Co. - Senior EVP & CFO*

We'll probably be around $75 million, $80 million.

David N. Farr - *Emerson Electric Co. - Chairman & CEO*

$75 million, $80 million first quarter. I mean, Lal has had some aggressive programs. They want to get ahead of this curve. The fact that things are getting better right now is a good sign for Lal. I think Jamie has got some major plant moves restructuring underway at this point in time that will move throughout the next -- this year and next year. So the longer-term restructuring reset programs are underway. We're reviewing with the Board. I see it a lot, and the platform leaders are doing -- reviewing it. And obviously, both Frank and Steve Pelch are watching this very closely, too. Very, very important.

The first couple of months, the profitability has been very good. We're getting the flow-through leverage, a good mix, which is always a good sign. The only negative that has emerged, and I talked about it a couple of times on some investor calls, is early stages on material shortages and inflation. This is something you always see in the early parts of the cycle, in particular, given a lot of our material got steel, copper, other raw materials were materials and plastics. They shut down a lot of capacity. Now the demand is coming back.

As Lal talked about automotive, they take a lot of material. So a lot -- we're starting to see some material inflation. We're going to have to deal with that in the first half of this year, in particular on Jamie's side. But the positive, as these lines come back up, and I think about this KOB 2 stuff that -- and KOB 3 that Lal is turning here, it's some of the customers that we have in the material area, be it steel, be it iron ore, be it copper. They tell me they're -- I feel they're bringing lines back up. So the chemical guys are going to bring lines back up, which we will help cover that material shortage. But we're going to have this shortage in this inflation in here most likely for 2 to 3 quarters. It's not unusual. And the key issue is Jamie has to fight it. On the positive side, I know Lal will get the business down the road, and we'll work our way through this.

But that's the only negative I see at this point in time, other than hiring people. We're hiring people. Our plants are running. On Jamie's side, he's running full out in many areas. We're having to hire to make sure our plants can keep up. And obviously, we still have the COVID-19 virus out there, so we're having to balance that from that perspective. But overall, things are moving forward very well in the first quarter. I see a lot of good momentum. I see a lot more wind to our back at this point in time with a negative win relative to the -- on the material. And, obviously, the vaccine coming out is going to be very, very helpful.

But a great start I think on both sides of businesses. In particular, the OSI. A great timing of an acquisition. And as Lal said, the culture fits us very well. Alan and Bob and his team up there are really working hard with Bob Yeager and his team. And I think we have an unusual 12- to 18-month period with these 2 guys. And so hopefully, we can get a session in Pittsburgh some time where we can share what we're excited about with that business.

With that, I'll open the mic and take some questions here. We'll probably just take 3 or 4 questions. So why don't we start off, Pete, who's on first?

QUESTIONS AND ANSWERS

Pete Lilly - *Emerson Electric Co. - Director of IR*

First up, we have Andrew Obin.

David N. Farr - *Emerson Electric Co. - Chairman & CEO*

Good.

Andrew Burris Obin - *BofA Merrill Lynch, Research Division - MD*

Yes. A question -- just getting a lot of questions from investors just trying to give more color, discrete versus process. How do you see those 2 verticals? And what are the trends specifically for discrete versus process?

David N. Farr - *Emerson Electric Co. - Chairman & CEO*

Go ahead.

Surendralal Lanca Karsanbhai - *Emerson Electric Co. - Executive President of Emerson Automation Solutions*

Yes. So clearly, Andrew, as I mentioned, early cycle implications on the Street, early cycle industries are very strong right now. Process lagging the discrete markets as I look across the world.

David N. Farr - *Emerson Electric Co. - Chairman & CEO*

That's normal.

Surendralal Lanca Karsanbhai - *Emerson Electric Co. - Executive President of Emerson Automation Solutions*

Which is normal. It's really what the cycles kind of roll in. So if you look at packaging, OEM activity, automotive, as I mentioned, medical, those are the leading industries. And obviously, we have the leading early cycle business to get source...

Pete Lilly - *Emerson Electric Co. - Director of IR*

So Lal, a follow-up on the question for Andrew. How was -- what I call ASCO valve, you guys got a new name for it, now it's called something else, but so how did daily order rates at ASCO valve come out of New Jersey? How are they doing here in North America?

Surendralal Lanca Karsanbhai - *Emerson Electric Co. - Executive President of Emerson Automation Solutions*

So in North America, they're stable. They've improved from the fall rates, but they haven't seen the -- a significant acceleration.

James P. Froedge - *Emerson Electric Co. - Executive VP of Commercial & Residential Solutions Business*

That we saw in Europe and Asia.

Surendralal Lanca Karsanbhai - *Emerson Electric Co. - Executive President of Emerson Automation Solutions*

That we saw in Europe and China. Germany is up over 30%. China is up over 15%. That's where we're seeing the early acceleration in discrete spaces, Andrew.

David N. Farr - *Emerson Electric Co. - Chairman & CEO*

Yes. Andrew, I would say, from the questions we're getting, that's the early indication that our core markets will turn around and you'll see discrete going into also some of these materials shortages in the steel and iron and things like that. So I think that's a good sign that, that marketplace is spending.

The other thing we're hearing, Andrew, is clearly, from our perspective right now, CEOs, a.k.a. me, are opening up the capital. And obviously, they clamped it down last year in March, April. As Frank and I know, we spent the first 30 days of liquidity, making sure we had liquidity. I guarantee every CEO of a major corporation around the world did the same thing. We've got our hands around it much faster, and our cash flow was good last year, so we started letting things go earlier.

We're starting to see CEOs let things go at the end of this year. And I think the budgets are being formed. Some of them may be flat, some may be down, but I think the budgets are being formed and we're going to start seeing spending at the capital level. I just think that's going to be the case at this point in time. But I think the trends are pretty good. Anything else you want to ask, Andrew?

Operator

The next question comes from Nicole DeBlase of Deutsche Bank.

Nicole Sheree DeBlase - *Deutsche Bank AG, Research Division - Director & Lead Analyst*

Yes, Dave. All right, so I guess maybe...

David N. Farr - *Emerson Electric Co. - Chairman & CEO*

So we personally like extreme weather. So very cold, very hot, is good for the automation business world and also Jamie's business too because pipes break and you got to fix them and that means you need a plumber.

Nicole Sheree DeBlase - *Deutsche Bank AG, Research Division - Director & Lead Analyst*

Yes, definitely. Long snow. Okay. So I guess maybe on the material question. So Dave, you brought up the issues around inflation and some of the shortages on raw materials. Are you trying to like send the message that this could potentially be a margin risk?

Or do you feel good about your ability to kind of push through and get pricing as raw materials see inflation?

David N. Farr - *Emerson Electric Co. - Chairman & CEO*

And I think -- I'm not -- it was not a scare risk. It's -- I think the key in the short term, I think we're okay, and I'll let Jamie talk a little bit about because he sees it more than Lal. I think the key issue for us is the way this works is there's always delays in how we recover. And I think what we are -- what we're having to do right now is having to clearly figure out other cost reductions to help offset that.

And then at the pricing time, we'll deal with it at the right price in time. We don't do spot pricing. The only time we ever did spot pricing, I think, was around the most recent last this year when -- on the logistics, we had some spot prices for logistics when price of oil and we couldn't ship stuff. So I think right now, Nicole, we have the ability to deal with it. I think that as a company, I still feel very good about our leverage this year.

The key issue is it's just one of those things we have to deal with. And as I tell Jamie, it's a good thing because business is stronger, and therefore, it's a positive. But we will have to work through the price-cost ratios. I would say that this year, we thought we'd be, I would say, slightly green, which means we're positive. Now we're probably going to be slightly negative, and that means we've got to work it in many different levers at this point in time. So we're going to work to offset it.

The one good thing that we have is we did assume that in our plan that we would have, what, CHF 75 million, coming back from the COVID, now because we wouldn't be able to travel. We were going to have meetings. I think that will help Jamie that help us as a company because I don't think that's going to come back anytime.

Maybe this summer, they'll start coming back. So I think we're -- I feel good about it. Just -- I just want to make sure you have a fit -- a fair and balanced approach that we -- there's pluses and minuses out there. There's more pluses, but that's one of the big minuses we see right now, Nicole.

Operator

The next question comes from Steve Tusa of JPMorgan.

Charles Stephen Tusa - *JPMorgan Chase & Co, Research Division - MD*

So I'm just kind of struggling with the messaging here. The stuff that's bouncing back should be pretty high-margin from a mix perspective, but you're talking about a little bit of price cost headwind and -- but maybe clarity on savings.

And then you're talking about some of the temporary costs not coming back as much. I mean, are you like reaffirming EPS guidance this morning? Are you saying that the sales will flow through on kind of a normal incremental? I mean I'm just kind of struggling with what the messaging is here on EPS.

David N. Farr - *Emerson Electric Co. - Chairman & CEO*

See, there's no message around. I mean our guidance we set in early November, we're not changing. It's after 2 months, we're not changing it. The message here is that the pace of sales and orders are better than we said. I said the first 2 months of the [product] is very good. So we are getting early cycle, very good leverage.

You're right. The mix of business right now is favorable for us. That's a good sign. I mean, I'm not making any statement about profitability. I -- all I'm telling you is that we're ahead of plan for the top line and orders of this, and sales and orders at this point in time. We're on par. The only thing I see coming at us is a negative, and I try to get balanced the -- is the material inflation, which is something that was a strong recovery. But there is no change up or down relative to that guidance and why we're having this call.

This call was to give you update on our orders and the pace of business, as I said we would in early November. So I mean, from what I see right now, I like what we're seeing from a profitability. I'd like to see from a cash flow, and I like what I see from sales. But we're 2 months into it. And the big month of the quarter is obviously December. But I think the trend lines are good, and we have our costs in line. So I feel very good about where we are at this point in time. So there's not a negative [there].

Charles Stephen Tusa - *JPMorgan Chase & Co, Research Division - MD*

But I mean, to be clear, like KOB 3 and some of the stuff that you're selling through on the climate side is some of your like highest like margin, most favorable mix business, correct?

David N. Farr - *Emerson Electric Co. - Chairman & CEO*

Correct. Correct. But I'm not going to say or make a statement that our margins are going to be better than I said forecasted just a month ago. I mean, you can make your own assumptions. As I said, we had a very -- too good first month. Our order patterns are good. The cycle -- the numbers, you're talking about the right businesses. And I like where we are right now. I think we're ahead of what we thought it would be at this point in time. So I'll -- I feel good about it.

Charles Stephen Tusa - *JPMorgan Chase & Co, Research Division - MD*

Got it. And then just thinking about the trends in automation. I mean, it seems like the U.S. is fine, but the upside seems to me to be kind of more international, China, maybe a little bit in Europe.

That seems to be kind of the profile here and that you guys, with your strength in those markets, should be kind of outperforming others, especially in process -- those that in process are more narrowly exposed, perhaps to more marginal parts of the chain in the U.S. in process.

David N. Farr - *Emerson Electric Co. - Chairman & CEO*

That's a very good statement. That's a true statement. Our global presence has given us a big plus. The fact that where our international markets are more open than the U.S. markets, we don't have the governmental shutdowns that we see as much here. The other -- I -- the good thing I do see about the North America market and Lal's business right now is we are hearing, for the first time, that inventories are where they need to be relative to the current pace of business.

We're hearing a lot of quoting around KOB 3 and Lal's KOB 2. We are hearing that people want to bring lines back up, Steve, from -- so if they took down facilities to say, 30%, 40% operational levels to keep them open, but not shut them all the way. We are hearing that they're going to start doing some of the work on the lines, which is a good sign for us.

Again, a good mix for us. But most importantly, I think that the day-to-day order patterns have moved the right way in North America. And I think that if they continue that trend line, I think that's a good sign for Lal. I think he has a tough order comparison for the month of December because you booked what, Golden Pass last year?

Surendralal Lanca Karsanbhai - *Emerson Electric Co. - Executive President of Emerson Automation Solutions*

We got 3 large KOB 1s that totaled almost $110 million in booking.

David N. Farr - *Emerson Electric Co. - Chairman & CEO*

Yes. So I think as tough as booking month is right now and as a comparison to the basis, Steve, but I -- what I'm really more interested in and what I'm trying to convey and what Lal is trying to convey is that we see the early signs, even in the process world, that money is starting to be released.

And there is every indication that people have some money to spend this last month. And so I think that's the key issue for us. And you're right, it's the best type of business we have for us. And...

Charles Stephen Tusa - *JPMorgan Chase & Co, Research Division - MD*

Right. And you're -- yes. And you're still guiding kind of negative 1% to negative 4% for the year versus maybe others that are in kind of the mid-single digits. So your kind of -- like yours is a bit of an easier bridge to cross. It sounds like.

David N. Farr - *Emerson Electric Co. - Chairman & CEO*

Correct. Correct. So I mean from my perspective, I'm much more comfortable in Lal's business. We had a negative 1%, negative 4%. I mean, I've always felt that things could turn our way early on and we could get some really big cycles business, things will get closer to 0.

I just always felt that with Lal's business. But until -- and when you're down the bottom like, Lal, was it minus 20%, it's hard to say I'm going to start growing plus 2%, plus 3%. So I think that from our standpoint he -- the trend lines are good. The type of customers he's getting right now, the type of core activity he's getting right now it's very good. And so I feel very good about that. And the question is, I think that we -- and the other thing is -- not in this chart, is just the work we're doing with OSI and compete in the U.S. We're building a pretty strong platform to grow for the second half of this year and then also for 2022, too.

Surendralal Lanca Karsanbhai - *Emerson Electric Co. - Executive President of Emerson Automation Solutions*

I know you're a hockey guy, Steve, but the analogy that my North America selling organization uses is that we've been living on bunts and singles, and we're moving to singles and doubles. That's the way that we...

David N. Farr - *Emerson Electric Co. - Chairman & CEO*

So what's the hockey analogy to that? So you stayed in one leg? What is this -- what's the analogy for hockey?

Surendralal Lanca Karsanbhai - *Emerson Electric Co. - Executive President of Emerson Automation Solutions*

Value. it's dump and chase. That's the analogy...

David N. Farr - *Emerson Electric Co. - Chairman & CEO*

Well, he was dumping, not chasing. Like now he's at least chasing, okay?

Surendralal Lanca Karsanbhai - *Emerson Electric Co. - Executive President of Emerson Automation Solutions*

Or checked at the blue line.

David N. Farr - *Emerson Electric Co. - Chairman & CEO*

I hear you were getting tripped up in the blue line. Thank you, Steve, for that analogy.

Operator

It will come from John Walsh of Crédit Suisse.

John Fred Walsh - *Crédit Suisse AG, Research Division - Director*

Well, I guess, maybe shifting back to this inventory comment. You've probably obviously seen a lot of cycles where we've seen the inventory drawdown and the snapback. I mean, is there any reason to think this cycle is any different, just given that there's probably some additional pressure on some of those energy customers going forward? Or would you expect normal traditional recovery in that channel as customers spend some more money?

David N. Farr - *Emerson Electric Co. - Chairman & CEO*

Yes. So let me give you -- I'm going to go 2 platforms. I mean, let's go to Jamie's platform first. The snapback is happening viciously right now. I mean, Jamie's customers, be it the big boxes, be it the small distributors, be it the big OEM guys all took their inventory down way too low for this. And now we're all struggling and fighting hard to get back up.

I mean if you look at Jamie's numbers right now, Jamie is actually building backlog, which is very unusual in his segment. I mean, I can probably name one other time in my 20-year history as CEO that he's built -- they built inventory backlog. And he's doing that right now because of the snapback and the inventories were way too low, but they're coming on strong.

And I think, as Jamie said, and I'll let Jamie comment before Lal comes in, but what we're seeing, we think they're going to have to keep building because they've got to get the inventory levels back up with the pace of demand right now. The demand is higher than the inventory is going to support so they've got to get both working. We got a positive going there. So Jamie, anything you want to answer there before we go to Lal's side because I think...

James P. Froedge - *Emerson Electric Co. - Executive VP of Commercial & Residential Solutions Business*

Yes. Yes, look, I mean, eventually, it will happen, right? Eventually, we'll get back to a point where we get to equilibrium and then we know we're in the building inventory phase. And whether or not they overshoot it or not, it's way too soon to tell, but we're not there yet. And the best indications we can tell is that we're several months away from getting to a point where that would even begin based on the demand that's out there and the lack of inventory in the channel.

David N. Farr - *Emerson Electric Co. - Chairman & CEO*

And the one thing I would add to that is, John, is that the industrial inventories for like the facilities, the manufacturing, the things that Lal was talking about earlier, those numbers are still very low. We're just starting to see the early signs of orders there.

And I think that will be the next sign we want to see on Jamie's side is the industrial channels relative to professional tools and then adding that stuff because that tells me then they're getting the demand from the factories. I don't expect to see a lot of nonres construction early on, but I think the factories will be the key issue for us.

Now Lal's business, historically, we would. The inventories go down. There's a period where things are pretty stable. And then all of a sudden, as the KOB 3, KOB 2 come into play, then they'll start aggressively bringing the inventory back in. I think it's on the discrete side that's starting to happen around the world, except for the U.S. It's just starting right now. Lal was saying it earlier.

On the process, I think we're a little bit earlier, but historically, you would -- we would snap. And there's different type of snap. It's typically a more of a gradual build. They -- just they don't -- because they see their visibility relative to the projects and the day-to-day business is clearer than it is on Jamie's side. But Lal, anything you want to add to that?

Surendralal Lanca Karsanbhai - *Emerson Electric Co. - Executive President of Emerson Automation Solutions*

Yes. I think of the inventory and the channel in 2 perspectives. One is the on-hand inventory that drives day-to-day business, David. And you're absolutely right. We have stabilized there, and we're starting to see the levels increase across the distribution channels. The second category of inventory is the project-driven inventory. And that continues to be more challenging outside of automotive and OEM businesses in discrete.

David N. Farr - *Emerson Electric Co. - Chairman & CEO*

Good. So I think, John, I think from your perspective, you're right. We're in the early cycles of this, and we're keeping our ears to the ground. The way I see it right now on the industrial side, there's a couple of things I watch very carefully. We watch it with our impact partners channel and Lal spends a lot of time with them. It looks like the watch is on Jamie's side. Since I ran Ridge Tool back, I think, in 1850, when I ran Ridge Tool back few years ago, we watched that channel.

And I think the early signs of that channel is starting to talk about projects and inventories and that will staff pretty quickly. And Jamie knows. He's hearing from his guys right now that, that could be something that happens pretty quick. It could happen this month. It could happen next month. I don't know, Jamie, what are you seeing right now in day-to-day North America professional tool orders, at least? Have they stabilized? Have they improved a little bit? What are you hearing and seeing?

James P. Froedge - *Emerson Electric Co. - Executive VP of Commercial & Residential Solutions Business*

Yes. I mean over the last 3, 4 months, we've seen consistent moderate improvement. And so less negatives as we go along here the last several months. So we're -- again, I think stable is the right word right now. And we're waiting to see what the triggering event will be for the bump. And I think most of us believe that stabilization in the COVID situation is probably the trigger.

Obviously, a lot of good news and momentum right now on the vaccine front. So as we get into the spring/summer time frame, if things go as we all hope, that could be the triggering event to -- for those markets to kind of go to the next level. But right now, very stable.

David N. Farr - *Emerson Electric Co. - Chairman & CEO*

Good. So with that, I'm going to -- John, do you have another question before I wrap it up? You got any more thing you want to add?

John Fred Walsh - *Crédit Suisse AG, Research Division - Director*

No. That was very comprehensive.

David N. Farr - *Emerson Electric Co. - Chairman & CEO*

Thank you very much. Well I want to close it out here. I know that other people want to ask questions, but we're trying to -- we're just trying to give people a brief update. I -- and the key issue for us is we committed in November that we come out. We put a forecast out for our order trend lines in the chart we put out in November. I wanted to give you the first 2 months. I wanted to wait until we got 2 months to get a better indication.

1 month is something -- that doesn't always tell you that pure trend line, but 2 months tell me that the line is pretty solid. That V has formed pretty firmly. Our indicators also is a V formed pretty firmly. Again, going back to what Steve Tusa asked me, I like where we are right now from the orders. I like the first 2 months of closing, good profitability. I like the cash flow, which has been very good and very strong.

That tells me, as Frank knows, the quality of earnings is very high. Cash is growing with earnings and the good sign, and we like that. From our standpoint, we're on target relative to restructuring and repositioning the company. And I -- and we're looking at a pretty good year at this point in time. We'll get into what the year looks like. And is it shaking? Is it a different shape? But I'd like to get the first quarter behind us. But right now, the trend lines are very good for us. And I wanted to make sure the shareholders have a sense what's going on around the world from a company that does try to give you visibility to our marketplaces.

So with that, I'm going to wrap it up. I want to thank Lal. I want to thank Jamie, and I want to thank Frank for joining us this morning. And Pete, thank you very much for getting this organized. So everyone have a Merry Christmas, good holidays, and I wish you well.

And even though my dinner tonight was canceled, we'll be back to New York eventually when they unfreeze and the COVID is a little more tame. So with that, thank you very much.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.