

# THE WALL STREET TRANSCRIPT

Connecting Market Leaders with Investors

## Eaton Corporation (ETN)



**THOMAS S. GROSS** is Vice Chairman and Chief Operating Officer, Electrical Sector, for Eaton Corporation. In this role, he is responsible for the company's global electrical business. Mr. Gross joined Eaton in 2003 as Vice President, Eaton Business System, and he most recently served as President of the company's power quality and controls business. Prior to joining Eaton, Mr. Gross was Group Executive for Danaher Corporation's motion control business. He was also President of Danaher's fluke business and Group Executive of the electronic test and measurement business. Before joining Danaher, Mr. Gross was President and Chief Executive Officer of Xycom Automation, and he worked for Rockwell Automation for 20 years. Mr. Gross has a Bachelor of Science degree in electrical and computer engineering from the University of Wisconsin. He also holds an MBA from the University of Michigan and currently serves on the board of governors of the National Electrical Manufacturers Association. Mr. Gross is located in Cleveland, Ohio.

### SECTOR — MANUFACTURING

**TWST:** Give us an overview of Eaton and a brief explanation of what you do.

**Mr. Gross:** Eaton today is best characterized as a broad power management company. We make products and provide services that help our customers manage three basic types of power — electrical certainly is one; hydraulic or fluid power, which is used in a number of areas, is the second; and the third is mechanical power that you typically find in vehicles like trucks, and commercial vehicles and automobiles. So our business is electrical, hydraulic and mechanical power systems. These are all in the spotlight today and given how important energy conservation always has been and continues to be, I think what we do matters a lot. The company is rapidly approaching its 100th anniversary. We were founded in 1911, primarily interested at that time in vehicles, and there has been a terrific transformation of Eaton from a vehicle component company to now a much broader power management company.

**TWST:** What is included in each power category? Would you give us some specific product examples?

**Mr. Gross:** Within electrical, it's best to think of it this way: We don't generate power like in a power plant, and we don't primarily sell things that consume power, like light bulbs, or motors or hair dryers, but we sell the equipment in between those two. We have broad power distribution capability and, in addition to that, we make critical backup systems for when power just can't

fail even for a fraction of a second — think about airport runway lights or the tower itself, or an operating room in a hospital or a data center. We make the backup systems for those mission-critical needs. That's essentially our electrical business. Within our industrial sector, we manufacture hydraulic systems that primarily are used on machinery. Hydraulics is an attractive power system because it's very dense and provides a lot of power in a small space. We make hydraulic systems for machinery and mobile equipment such as off-road vehicles, construction vehicles. We have, as I mentioned, a mechanical power business, and we make truck transmissions and component-related systems that are associated with the engine to make it run more efficiently, like valves and superchargers. Finally, we have a large aerospace business that principally focuses on hydraulic systems, such as the landing gear and wing controls. It also includes fuel delivery systems — getting the fuel to the engines in a safe and efficient way.

**TWST:** How does your revenue break down within each group?

**Mr. Gross:** I'll answer that at the electrical and industrial level. Industrial, by the way, is everything that's not electrical. I mentioned vehicle, hydraulics and aerospace; you put those three together, that's our industrial sector. In 2009 roughly half, almost precisely half, of Eaton's revenue was electrical and the other half was industrial. I would also highlight that Eaton's newer businesses — electrical, aerospace and hydraulics — represent 70% of the company's revenue. That's really a remarkable transition for us.

**TWST: What is your fastest-growing segment and what do you see as your largest growth areas?**

**Mr. Gross:** It's a little difficult to answer that question because it depends on the cycle. The three I just mentioned — electrical, aerospace and hydraulics — all have very attractive growth rates. Even in our traditional vehicle business, we're seeing very high growth rates in specific areas, like hybrids for commercial vehicles. I think Eaton is a growth story in general. One other point to consider is that Eaton has a pretty good balance between what we would call early-cycle, mid-cycle and late-cycle businesses. We also have a very large percentage that would be "no cycle," like services, which tend not to be dramatically affected by recessions and things like that. So at any one point in time, depending on what part of the economic cycle we're in, any of our businesses could be a real growth star. Here we are currently in the early part of the economic cycle, and we're seeing our early-cycle businesses do well. Within electrical, that would include early signs of growth in residential products and very good growth signs within the industrial sector, as customers' capital spending starts to rebound.

*"Frankly, there is just too much electrical energy that's lost between where it's generated and where it's consumed. And remember, Eaton is in between those two endpoints. Efficiency of that distribution equipment, safety of that distribution equipment and reliability of that distribution equipment is on the top of our customers' minds everywhere in the world."*

**TWST: What is the Eaton Business System?**

**Mr. Gross:** First of all, Eaton prides itself on being an integrated operating company, and that may be contrasted with being more of a holding company. We're not a holding company. We have a teachable point of view of how to run an Eaton business or an Eaton function, like human resources or IT, and that teachable point of view is a series of best practices that we deploy pretty rigorously across the company. The Eaton Business System is simply the collection of all of those standardized best practices that we deploy and that we teach every employee about. It's the way we run our business. There are aspects of each of our businesses that are unique, but where they are not unique and can be standardized, we try to find the best practice or process. And we don't talk about it anymore, we just do it that way. That's the Eaton Business System.

**TWST: You are active all over the world. Are some of those international markets growing more quickly than others?**

**Mr. Gross:** Yes, if you look at a statistic we like to highlight because it's critical, the percentage of our business that's coming from developing economies is another great success story for Eaton. In the first quarter, our revenue from developing economies was 24% of our total. In the year 2000, that was 8%; in 2009 it was 22%. So you can see the transition — 8% to 22% to 24%, clearly indicating we're growing faster in these developing economies. Our stated goal for 2014 is that revenue from

developing economies will be 30% of our total. We continue to diversify the company geographically and outside of our core markets of North America and Western Europe. We're seeing broad acceptance of our technology all over the world because energy conservation and safety of energy are global themes. I don't know of any place in the world that isn't concerned about these issues. It creates a terrific backdrop for us to highlight Eaton as a global company that is particularly successful in these faster-growing developing economies.

**TWST: What are your other goals over the next several years? How are you positioning Eaton to meet those goals?**

**Mr. Gross:** There are many goals, but let me bring it down to the electrical level. The electrical industry is going through a very interesting transformation because the cost of power is going to go up in general, and it's going to go up in electricity. We're going to see broad interest in demand management in saving electricity. At the same time, there's a backdrop of the basic electrical grid that needs to become smart because with a smart grid, you can take that conservation and energy manage-

ment to the next level. Then let's throw in a few wild cards like electric vehicles, which are going to put an even greater strain on the electrical grid. These problems take on unique characteristics depending on where you are. In India, for example, it's all about the shortage of electricity availability. Fifty-seven percent of the people in India do not have access to electricity, and the grid is already behind the current demand by 8%. So you see this rapid build-up of electrical infrastructure. It's a terrific business to be in because the world is becoming an electric world — in our homes, in our businesses, maybe even in our vehicles. Our goals for the electrical business are to continue to put Eaton in a position to take advantage of this, where we can grow by a larger proportion, given these megatrends and these big drivers that are going to hit our industry. Frankly, there is just too much electrical energy that's lost between where it's generated and where it's consumed. And remember, Eaton is in between those two endpoints. Efficiency of that distribution equipment, safety of that distribution equipment and reliability of that distribution equipment is on the top of our customers' minds everywhere in the world. So our goals are associated with being the clear leader in efficiency, reliability and safety for those systems as they go through these pretty significant transformations.

**TWST: You recently announced a collaboration with Takaoka Electric Manufacturing on the electric vehicle charging systems. What are the details of that collaboration and why did you feel it was an important undertaking?**

**Mr. Gross:** We entered into a license agreement for some technology Takaoka had developed for the Japanese market. We are interested in applying that technology to U.S. standards and in markets outside of Japan. This technology is interesting; it was developed through Takaoka essentially by a company named TEPCO, which is Tokyo Electric Power Company. What this involves is rapid vehicle charging. It's safe to say a lot of electric vehicles will be charged at home, but clearly that puts a radius limitation on anybody interested in an electric vehicle. And it takes a very long time to charge a car at home, given the power limits that exist today in a home. This technology is for rapid charging, which takes much more energy. There will be a lot of standards around this: For example, think about charging your car in some station and it's raining; we have to be very careful about how we do this.

**TWST: What are you most excited about with Eaton's electrical area and why?**

**Mr. Gross:** It's great to be working on the most interesting problems of our day. The significant transformation that will occur in meeting energy demands is a very interesting series of discussions, and I think it's going to be an even more interesting series of investments. There's a lot to talk about within Eaton, but one of the highlights that I'm most excited about is our mission-critical power quality business. We didn't have this business when the year 2004 started. We made a number of acquisitions, and now we're the clear number two supplier in the world of these mission-critical backup systems. As a result, we get involved with very interesting applications, including, as I mentioned, operating rooms, airports, data centers and more. Those are exciting opportunities. I'm also very excited about our solar capability. Eaton is heavily invested in solar — not the panels themselves, but everything after the panel. Now this is great from the standpoint of an alternative energy source, but what makes it particularly interesting is that the consumer can become the producer. Tying all of these alternate energy sources, whether solar or wind, back to the grid is a very dynamic field right now, and Eaton is right in the middle of that. Another area of interest is the smart grid. That's a very broad topic and a longer-term play because we're talking about very large investments to make our grid smart or smarter. But it's a very exciting prospect. Finally, we're doing so much in and around safety. I'm really proud of this because electricity, particularly as you see it running down a street or entering a building, is potentially lethal, and we are a clear leader in efforts to prevent electrocution and increase safety in our industry. I think that makes good sense from every perspective. In the United States alone, every year there are 1,100 electrocutions. That number shouldn't be 1,100, it should be zero. So we're very involved with safety, and I'm excited and proud of how we move that forward.

**TWST: Tell us about your background and how you got to Eaton.**

**Mr. Gross:** I started my career at a company named

Allen-Bradley, which was later acquired by Rockwell. I started as an engineer, an electrical and computer engineer by training, but I didn't last as an engineer very long. In pretty short order, I got involved with sales, and then marketing and then general management. I spent 21 years at Allen-Bradley/Rockwell Automation, and I was in and around manufacturing processes, which was Allen-Bradley's business. I like to say that I think I've seen how everything is made because of what we did relative to factory automation at Allen-Bradley. Then I went to work for a company named Xycom Automation as President and CEO, and subsequently, I joined Danaher. I was President of Danaher's fluke business, which is a test and measurement business. I was Group Executive for test and measurement, and also Group Executive for their motion control business. Then I joined Eaton in 2003, and my first position was a very interesting one — Vice President of the Eaton Business System. Eaton Business System at that time was quite a new concept, and I worked for Sandy Cutler, Eaton's CEO. He clearly had and still has a lot of passion around the Eaton Business System, and together we formed what is an appropriate business system. Then I joined the electrical business as we moved into the mission-critical power quality space, so I was involved in those acquisitions and the build-out of that platform. In January of 2009, I received my current position as Vice Chairman and Chief Operating Officer of the electrical sector.

**TWST: Is there anything you'd like to add?**

**Mr. Gross:** I would highlight the enormous transformation that's occurring at Eaton on a number of fronts. One of those is the transformation to a broad power management company, but I think global business expansion is another huge transformation in Eaton. About 55% of our sales are now outside the U.S., and that's an enormous shift. So we're becoming a global company. As not just the cost of energy but also the environmental impact of energy consumption becomes more clear and more costly, I think we're in a great position to capitalize on that. Eaton is a company that is broadly known for innovation, but also for applying that innovative technology to help our customers achieve a sustainable advantage. Lower energy cost, more reliable energy, safer energy can create a sustainable advantage for our customers, and we're well positioned to take advantage of that.

**TWST: Thank you. (LMR)**

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