CEO SANDY CUTLER SET
A GROWTH TARGET OF
10 PERCENT PER YEAR.

POWERED UP

Using cutting-edge technologies and diversifying to grow market share, CEO Sandy Cutler says Eaton has moved onto a faster track.

BY ANN C. LOGUE ▸ PHOTOGRAPHS BY PETER ROSS

WHEN EATON CORP. (ETN) veteran Alexander M. "Sandy" Cutler became chairman and CEO five years ago, he set a goal, he says: to grow the industrial conglomerate an average of 10 percent per year, throughout the economic cycle. That pace, he points out, is considerably greater than the average 4 percent annual growth projections of his end-market users and beyond the goals of other manufacturers to grow at the same rate as the U.S. economy as a whole.

How has Eaton gone about accomplishing this aggressive target? By emphasizing customer-driven, new-market opportunities and an M&A strategy that, Cutler says, has added 19 acquisitions since he took charge. "We needed to get into businesses that could grow quickly and that had a higher degree of intellectual property," he notes. "More than 66 percent of Eaton's current revenues were not even part of the company seven or eight years ago," he says, adding that the reported 2004 net income of $648 million represented a 68 percent increase over the previous year, on $9.8 billion in sales, up 22 percent from 2003.

EATON CORP.'S POWER DIVISION SUPPLIES THE JUICE FOR CLEVELAND BROWNS STADIUM.

Now based in Cleveland, Eaton was founded in 1911 in Bloomfield, N.J., by J. O. Eaton, his brother-in-law Henning O. Taube and another young entrepreneur, Viggo V. Torbensen, as Torbensen Gear and Axle Co. The company made a rear truck axle that Torbensen had patented in 1902 and supplied

RIGHT: COURTESY OF CLEVELAND BROWNS STADIUM

to U.S. automakers. After selling the company in 1917, Eaton formed the Eaton Axle Co. in 1919, repurchased Torbensen in 1922, and by 1931 had bought 11 more auto-parts businesses. In 1932 the combined company became Eaton Manufacturing Co., and it took its current name in 1971.

Today, the company says, its 56,000 employees serve customers in 125 countries through four business groups: Electrical, which generated $3.1 billion in 2004 sales of electrical control and distribution systems used in residential, commercial and industrial applications; Fluid Power, which designs and makes high-efficiency hydraulic systems used in aircraft, agriculture and construction, with $3.1 billion in 2004 revenues; Truck, which designs drivetrain components for commercial vehicles and had $1.8 billion in 2004 revenues; and Automotive, which develops components for passenger cars, SUVs and light trucks, with $1.8 billion in 2004 sales.

INTELLECTUAL PROPERTY

Combined, Eaton's auto and truck businesses represent 37 percent of revenues, down from 42 percent in 1999, the year before Cutler became CEO, he notes. In all its markets, the company says, its products contain high levels of intellectual property that help customers solve problems. The result, Cutler adds: higher prices and margins.

As an example, he points to high-pressure hydraulic systems that **LOCKHEED MARTIN CORP.** (LMT) uses in large passenger and military aircraft. He adds that Eaton's electrical systems help stadiums, airports and commercial buildings meet continuous energy demands in the face of natural disasters and weaknesses along the electrical grid.

Another emerging technology is the hydraulic-launch assist, notes Craig Arnold, Eaton senior vice president and president, Fluid Power Group. He explains that Eaton is working with vocational markets such as those for refuse trucks designed to improve fuel efficiencies and to reduce noise pollution and excessive brake wear. The system, he says, captures energy generated during normal braking; the energy is temporarily stored and then released when the vehicle accelerates.

> FedEx Express delivery trucks using a hybrid engine developed by Eaton produce 96 percent fewer particulate emissions.

Beyond heading Eaton's second largest business, Arnold oversees all four of the company's businesses in the growing Asia-Pacific region. The regional responsibility role, Eaton asserts, is one of several organizational structures that allow it to function effectively as an integrated operating company.

Even in its auto segment, Eaton's fortunes are no longer tied solely to conventional internal combustion engine applications, says Cutler. He points to a displacement-on-demand (DOD) system developed with **GENERAL MOTORS CORP.** (GM) that is meant to boost fuel efficiency in light-load situations by shutting down half the engine. Eaton says that 2005 Chevy TrailBlazers and GMC Envoys employ DOD technology.

Working with customers is key, says Cutler, 53, who joined Eaton as a division controller in 1979 from its newly acquired electrical business. Cutler, an affable Milwaukee native with a bachelor's degree from Yale and an MBA from Dartmouth, went on to run Eaton's electrical business before becoming president and chief operating officer in 1995.

Beyond the GM example, Cutler says, Eaton partnered with FedEx Express, a unit of **FEDEX CORP.** (FDX); Environmental Defense, a nonprofit organization; and the New York State Energy Research and Development Authority to introduce a new hybrid-engine delivery truck. "In Eaton we found a partner who is technically proficient and who honors environmental goals," says Mitch Jackson, managing director of environmental programs at FedEx Express, which, he says, wanted to improve fuel efficiency while reducing noise and particulate emissions from its delivery trucks. FedEx Express says its hybrid vehicles, introduced in Sacramento in the spring of 2004, use technology based on a combination diesel engine and electric motor. Jackson notes that the program now includes New York City, Tampa and Washington, D.C.

Gwen Ruta, director of corporate partnerships for Environmental Defense, says the new hybrid vehicles produce 96 percent fewer particulate emissions and travel 57 percent farther on a gallon of fuel than FedEx's typical gasoline-powered trucks. The technology is a win for all sides, Ruta says, adding: "Now Eaton is in a good position to cash in on its innovative hybrid system."

Although Eaton does not break out R&D spending, it says it views capital expenditures, which rose 21 percent from 2003 to $330 million in 2004, as a reasonable substitute. The total for 2005 is expected to increase another 20 percent, says Cutler. He points out that in the industrial business, even a small product modification requires new machine tooling, so the continual

development of products creates an ongoing need for additional capital spending.

Some of Eaton's technologies are acquired, Cutler says. "Our acquisitions during the past several years were done for new technologies, new products or geographic channels," he explains. For example, in March 2005, Eaton bought Pigozzi S.A. Engrenagens e Transmissões, a Brazilian maker of powertrain products for agricultural machines. Cutler says the $30 million purchase helped increase Eaton's presence in the agricultural machinery market and furthered its global reach. According to the company, 31 percent of revenues now come from outside the U.S. and Canada, up from 27 percent in 1999.

The investment community has noticed Cutler's success, analysts indicate. "In its four business groups, Eaton has developed products that should enable the business to grow at faster than end-market rates over the next five years," says Andrew Casey,* a senior analyst at Prudential Equity Group LLC, a division of **PRUDENTIAL FINANCIAL INC.** (PRU). In particular, he cites an emphasis on fuel economy, reductions in vehicle emissions and increased outsourcing as driving market-share growth.

DOING BUSINESS RIGHT

Despite Eaton's new emphasis, "the part that didn't change was this solid foundation in doing business right," Cutler says. The company's culture, he adds, allows it to recruit strong employees and keep existing team members motivated. One tool he points to is an employee survey that garners a 97 percent companywide participation rate and allows managers to address problems before they fester. For example, he cites a new global employee-recognition program being rolled out this year in response to the 2003 survey, which indicated that employees felt that their efforts were not sufficiently recognized.

Cutler says Eaton's approach is rooted in the belief that its employees have high standards. "Personal ethics have to be the basis from which people make decisions in business," he says. "You can't give people a guidebook on how to behave every time." The company says it offers extensive employee training at all levels to reinforce its value-based culture.

Eaton also brought in mid-career hires from other premium diversified companies. "We recruited people who were part of high-performing companies, who could teach skills we needed," Cutler says. Reputation helps, he adds, noting that recruits had often dealt with Eaton as customers or suppliers.

All but two of Cutler's senior leadership team were hired from other companies. Arnold, for example, notes that he was running **GENERAL ELECTRIC CO.**'s (GE) GE Lighting Systems Ltd. in London in 2000, when Cutler recruited him. "Sandy was turning Eaton into an integrated operating company, an experience I lived during my 17 years at GE," says Arnold.

Arnold explains that he served much of his GE career overseas, in Hong Kong and the Netherlands as well as in England. Now, he points out, he travels from Cleveland to China once each quarter. Rather than viewing China as a low-cost manufacturer,

CRAIG ARNOLD, WHO RUNS THE FLUID POWER GROUP, SEES CHINA, WITH ITS HUGE INFRASTRUCTURE NEEDS, AS A NATURAL CUSTOMER FOR EATON.

he says he sees it as a fast-growing market for Eaton's infrastructure products. "Everything that Eaton does today in China is focused on bringing state-of-the-art technology there. It's no different than if we were in Detroit or Paris," he notes. The company's Chinese business includes making parts for auto manufacturers located there, supplying transmissions to truck makers and building subsystems for aircraft. Eaton reports that its Asia-Pacific business, led by China, has grown steadily; 2004 revenues there were $679 million, up 34.7 percent from the $504 million posted in 2003.

Cutler, who chairs the Greater Cleveland Partnership, a consortium concerned with regional economic growth, maintains that his greatest long-run concern is finding skilled workers. Without an emphasis on education, he says, Americans may not be prepared for entry-level jobs. "It's no longer the low-wage, low-skilled job that's moving out of the U.S. and Europe," says Cutler. "Our engineering population is growing at one-third the rate of other countries, so intellectual vitality is something we need to be concerned with."

According to Eaton, its product mix allows for steady companywide growth. "We believe we are doing a good job producing new products and services and entering new markets," says Cutler. As for the future, he concludes, "we will continue to be active in acquisitions, particularly in our Electrical and Fluid Power businesses."

Of course, Cutler remarks, Eaton's culture adds value to whatever it buys. "Great companies are defined because great people work there," he says. "People who have passion work feverishly hard at whatever they do, and they enjoy it." ▯

> "Great companies are defined because great people work there. People who have passion work hard, and they enjoy it."

*Eaton Corp. is not an investment-banking client of Prudential Financial Inc. Andrew Casey, a senior analyst with Prudential Equity Group LLC, is not an officer, director, or a member of an advisory board at Eaton. Prudential may have positions in Eaton securities.

SHARING THE COO OFFICE

To maximize the efficiency of Eaton's multiple businesses while respecting specific customer needs, Cutler says, he and his team created the Eaton Business System. This approach, explains the CEO, allows for a companywide common focus on business processes as it frees each division to concentrate on better products. One component, he says, is that the leaders of each of Eaton's four divisions share the office of the chief operating officer, giving them responsibilities and stakes in the company as a whole. "We try to leverage standardized work processes where it makes sense to free up the dollars and resources to put them where it counts," Cutler says. "Our best ideas come from all over the company."

He notes that one of the program's first tools in its 2000 inauguration was a product-development system known internally as PROLaunch. By standardizing the steps of each new product's development, the company was able to speed the development process and improve its record of successful new product launches, Cutler explains. Insisting that standardization is a key advantage, he notes: "If you believe that the life of a product is getting shorter, you'd better get it right out of the box."

PROLaunch concentrates on strategic alignment by setting objectives and defining resources to streamline the project life cycle. It ensures that the timing and promotion of a new product is effective, explains Cutler. The result, he says, is repeatable, predictable and improvable. Management reports that PROLaunch has reduced new-product development time 15 percent while improving new-product launch quality by 20 percent through following techniques such as those outlined in the Six Sigma for Design and Development procedures.

Even as it embraces common processes, Eaton is adamant about maintaining flexibility and meeting customer needs. "Where the company tends to be different is around customer touch points, around sales and marketing, and where creativity is needed by the particular industry where we compete," says Arnold. Eaton's Fluid Power division, for example, with customers in many industries, has to be equally capable with the TS16949 standards for auto products and AS9000 for aerospace.

Having a common system pays off big in acquisitions, insists Cutler, because Eaton can explain to new employees how things will work right from the start. This includes standardization of benefits and introduction of the Eaton Business System. Many standards, he explains, were identified to manage the 1999 acquisition of Aeroquip-Vickers Inc., which more than doubled Eaton's Fluid Power business. The system, says Arnold, has been applied to about 20 acquisitions, including five this year.

Explaining that such an approach reduces culture shock and turmoil, Cutler adds: "We tell people on the first day what will change and what will stay the same so that we can manage their expectations."

