

# Financial Review

## Results of Operations

### Net Sales

Sales for 2001 were \$15.5 billion, a decrease of \$65 million, or 0.4 percent, from 2000. Strong sales growth in the Process Control business from PlantWeb and solutions activities was negated by weakness in the Industrial Automation; Heating, Ventilating, and Air Conditioning (HVAC); and Appliance and Tools businesses. In addition, robust gains in the Electronics and Telecommunications business in the first half of 2001 reversed in the second half. Sales also were impacted by divestitures and a stronger U.S. dollar, with each reducing reported sales by more than 2 percent. Underlying sales realized slight growth excluding acquisitions, divestitures and the unfavorable impact from currency. U.S. sales decreased by approximately \$360 million, or 4 percent, while international sales increased approximately \$295 million, or 5 percent. New product sales, from products introduced in the past five years, were \$5.4 billion, representing 35 percent of sales.

In 2000, sales were \$15.5 billion, up \$1,275 million, or 8.9 percent, from 1999. The strong sales growth was driven by robust demand for network power and connectivity products and services, the continued success of other major growth initiatives, and the contribution of acquisitions. Excluding the impact of divestitures, all businesses reported sales increases. U.S. sales increased approximately \$1,094 million, or 13 percent, while international sales increased approximately \$181 million, or 3 percent. Underlying sales growth was led by robust demand in the Electronics and Telecommunications business worldwide, while the HVAC business achieved a very strong performance internationally. New product sales, from products introduced in the past five years, increased approximately \$614 million, to a record \$5.6 billion, representing 36 percent of sales.

### International Sales

International sales, including U.S. exports, increased 5 percent, to a record \$6.2 billion in 2001, representing 40 percent of the Company's total sales. U.S. exports were in line with a year ago, at \$1.0 billion. Sales by non-U.S. subsidiaries were \$5.3 billion in 2001, up 7 percent from 2000. International subsidiary sales increased 8 percent excluding acquisitions, divestitures and the unfavorable impact of currency translation of approximately \$310 million. Very strong growth in Asia and Latin America and moderate growth in Europe was slightly offset by the impact of currency exchange.

In 2000, international sales increased over 3 percent to \$5.9 billion, representing 38 percent of the Company's total sales. U.S. exports increased 9 percent to \$1.0 billion. Sales by non-U.S. subsidiaries were \$5.0 billion in 2000, up 3 percent from 1999. International subsidiary sales increased 8 percent excluding acquisitions, divestitures and the unfavorable impact of currency translation of approximately \$320 million. Strong growth in Canada, Asia and Latin America and moderate growth in Europe was dampened by the impact of currency exchange.

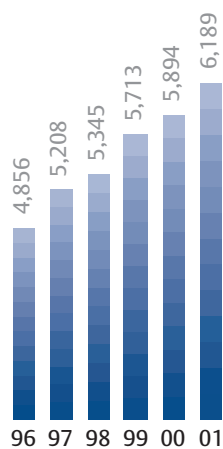
### Business Segment Sales – 2001 vs. 2000

The Process Control business sales increased 8 percent to \$3.3 billion in 2001, reflecting continued high customer demand for PlantWeb technology and strong growth in the solutions and services areas. These capabilities have dramatically increased the Company's end-market opportunity, and the uniqueness of Emerson's offerings has allowed the Company to firmly establish a leading position. The Company's product strength in control systems, valve and measurement devices also played a key role in the growth, as general maintenance and repair spending returned to more normalized levels after a challenging 2000 and 1999. Very strong growth in the United States and Asia and moderate growth in Europe were dampened by the impact of currency exchange.

Sales of the Industrial Automation business declined 7 percent to \$3.0 billion in 2001, due to a modest decline in underlying sales, unfavorable currency exchange and the Krautkramer and Sweco divestitures. U.S. capital goods markets showed considerable weakness, while underlying European sales increased moderately and Asian sales grew modestly versus 2000.

The Electronics and Telecommunications business reported a 9 percent increase in sales, to \$3.6 billion in 2001, due to the acquisitions of Jordan Telecommunication Products, Inc. and Ericsson Energy Systems in 2000. Underlying sales increased modestly, excluding the impact of acquisitions, divestitures and currency exchange. After a 30 percent underlying increase in the first half of 2001, sales declined over 20 percent in the second half. Fiber-optic and embedded power products were the first to be impacted by the overall downturn in computing and communications markets, and systems sales declined as the year progressed. U.S. sales declined slightly, partially offsetting very strong growth in Europe, Asia and Latin America, with all regions slowing dramatically in the second half of the year.

International Destination Sales  
(Dollars in millions)



International destination sales increased to a record \$6.2 billion in 2001.

Sales of the HVAC business declined 2 percent from the prior year to \$2.4 billion, primarily due to lower U.S. demand for air conditioning and refrigeration products at the residential, commercial and industrial levels. Underlying sales decreased slightly, excluding the unfavorable impact from currency exchange, with very strong gains in Asia and solid gains in Europe more than offset by a moderate decline in U.S. sales, which comprise approximately 65 percent of sales in this business. New growth opportunities for scroll compressor technology continue to develop, with Copeland Scroll sales reaching nearly \$900 million in 2001.

The Appliance and Tools business reported \$3.5 billion in sales in 2001, an 8 percent decrease from 2000. This decline is primarily the result of the Vermont American divestiture in fiscal 2000, the weak U.S. capital goods environment and a challenging appliances market. Underlying tools sales were flat versus 2000. A moderate overall decline in underlying sales was due to softness in both domestic and international markets.

### Business Segment Sales – 2000 vs. 1999

The Process Control business achieved a 5 percent sales increase to \$3.1 billion in 2000. This increase was driven by the Daniel Industries, Inc. acquisition and customers embracing PlantWeb technology, partially offset by difficult market conditions, particularly in Asia and Europe, and the impact of currency exchange. Underlying sales for the year decreased slightly but turned positive in the fourth quarter, the first organic sales improvement since the process markets began to cycle down in 1998.

Sales of the Industrial Automation business were \$3.2 billion in 2000, down 7 percent. Solid underlying improvement in Europe and other international regions, the late-1999 acquisitions of Kato and MagneTek's alternator operations, and stabilization in U.S. capital goods markets were negatively impacted by the stronger U.S. dollar and the F.G. Wilson and Krautkramer divestitures.

The Electronics and Telecommunications business achieved outstanding performance, with sales increasing 59 percent, to \$3.3 billion. The increase was the result of underlying growth of nearly 30 percent, reflecting strong worldwide demand for reliable power and networking products, and two strategic acquisitions in 2000 – Jordan and Ericsson. All product and service areas increased sharply, with particular strength in large UPS and precision air conditioning systems for Web-hosting centers and DC/DC embedded modules for applications such as next-generation routers and telecom switching.

Sales of the HVAC business were \$2.5 billion in 2000, a 5 percent increase from 1999, dampened slightly by unfavorable currency exchange. Europe, Asia and Latin America all achieved very strong underlying sales growth, primarily due to improved market conditions and continued penetration of Copeland's scroll compressor technology.

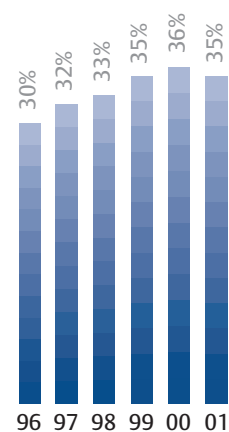
Sales of the Appliance and Tools business increased 1 percent to \$3.8 billion. Very strong underlying growth in the tools operations was offset by the impact of the Vermont American divestiture and unfavorable currency exchange. Tools sales through the rapidly growing home centers channel increased in 2000, particularly the successful relationship with The Home Depot, which capitalizes on the RIDGID-branded line of professional quality tools. Underlying appliance-related sales were relatively flat for the year, due in part to distribution issues faced by some key customers.

### Acquisitions, Divestitures and Repositioning

The Company continued to reposition into faster-growth markets, acquiring several businesses, divesting two slower-growth businesses and contributing another business into a joint venture in 2001. Subsequent to year-end, the Company agreed to exchange its ENI semiconductor equipment division for an equity interest in MKS Instruments, Inc. of 12 million common shares. The Company also announced the divestiture of its Chromalox industrial heating solutions business. These five divested businesses had combined annualized sales of approximately \$500 million. Additionally, in the first quarter of 2002, the Company acquired Avansys Power Co., Ltd., a provider of network power products to the telecommunications industry in China, for approximately \$750 million in cash. The 2001 divestitures and the final F.G. Wilson proceeds resulted in total gains of \$187 million in 2001, which were offset by ongoing costs incurred for the rationalization of operations and other items.

To accelerate cost reductions and better position the Company for the global economic environment, in the fourth quarter of 2001, the Company recognized a pretax incremental repositioning charge of \$377 million (\$260 million after-tax, or \$0.61 per share). Cost of sales, selling, general and administrative expenses and other deductions, net include charges of \$89 million, \$51 million and \$237 million, respectively. The charge was primarily non-cash and was mainly associated with the planned disposition of facilities, exiting the manufacturing of non-strategic product lines and the writedown of inventory. See note 3 for additional information.

New Product Sales as a Percent of Sales



Emerson continues to expand market opportunities, with new products representing 35 percent of sales in 2001.

### Total Costs and Expenses

Cost of sales was \$10.1 billion in 2001, an increase of 1.0 percent. In 2000, cost of sales was \$10.0 billion, compared with \$9.2 billion in 1999. Cost of sales as a percent of net sales was 65.4 percent in 2001 and 64.4 percent in 2000 and 1999. Despite slowing business conditions, the impact of recent acquisitions and the repositioning charge, gross profit margins have remained at high levels as a result of a disciplined ongoing focus on cost reductions, including the companywide intranet-based consolidation of material purchases and other e-business activities, which continue to drive solid margins.

Selling, general and administrative (SG&A) expenses were \$3.1 billion, \$3.0 billion and \$2.8 billion in 2001, 2000 and 1999, respectively. As a percent of net sales, SG&A expenses were 19.9 percent, 19.2 percent and 19.4 percent in 2001, 2000 and 1999, respectively. The increase in SG&A as a percent of net sales in 2001 was primarily due to the impact of recent acquisitions and the effect of the repositioning charge. The Company continued its commitment to technology investment with engineering and development expense of \$594 million in 2001 and 2000, and \$510 million in 1999.

Interest expense increased to \$304 million in 2001 from \$288 million in the prior year. In 2000, interest expense increased from \$190 million in 1999. These increases primarily reflect higher average borrowings resulting from acquisitions and share repurchases.

Other deductions, net, including amortization of intangibles, were \$386 million in 2001, compared with \$75 million and \$95 million in 2000 and 1999, respectively. The increase in 2001 was primarily due to the repositioning charge discussed above. Fiscal 2001 included a gain of \$60 million from the disposition of the Sweco specialty separation business and a gain of \$55 million from the disposition of the Xomox valve business. Also in 2001, the Company and Crane Co. formed a joint venture combining Emerson's Commercial Cam Co. subsidiary and Crane Co.'s Ferguson Company division, which resulted in a gain of \$24 million. Fiscal 2000 included a gain of \$80 million from the disposition of the Company's interest in the Krautkramer non-destructive testing business and a gain of approximately \$37 million due to the disposition of the Company's interest in Vermont American. Fiscal 1999 included a gain of \$64 million from the disposition of the Company's interest in F.G. Wilson. These gains were offset by costs incurred for the rationalization of operations and other items.

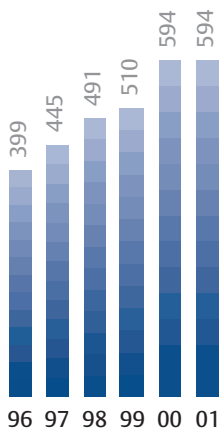
### Income Before Income Taxes

Income before income taxes decreased \$590 million, or 27.1 percent, to \$1.6 billion in 2001. These results were led by a sharp decline in second-half sales, reflecting an unprecedented decline in customer demand for network power products in the Electronics and Telecommunications business, and rationalization and other charges. The following discussions of segment earnings exclude the incremental repositioning charges. Earnings before interest and income taxes in the Process Control business were \$360 million in 2001, a 28 percent increase from 2000, reflecting broad strength across virtually all areas of the business and rationalization of the cost structure completed over the past two years. The Industrial Automation business earnings were \$400 million in 2001, a decrease of 14 percent from 2000, due to the steep downturn in industrial capital goods spending, divestitures and a stronger U.S. dollar. Earnings of the Electronics and Telecommunications business were \$359 million in 2001, a decrease from 2000, reflecting the deleverage impact on profits resulting from the declining sales volume and higher costs for the rationalization of operations. Earnings of the HVAC business decreased \$35 million, or 9 percent, to \$347 million in 2001, due to lower U.S. demand for air conditioning and refrigeration products in all markets. The Appliance and Tools business earnings decreased to \$503 million, or 13 percent, from 2000, primarily due to decreases in volume and the Vermont American divestiture. See note 12 for additional information by business segment and geographic area.

Income before income taxes increased \$157 million, or 7.8 percent, to \$2.2 billion in 2000, reflecting a strong sales increase, programs to generate improvement in underlying margins and the negative impact of currency translation. Earnings before interest and income taxes in the Process Control business were \$281 million in 2000, a decrease from 1999, reflecting weak demand in the process markets and a stronger U.S. dollar. The Industrial Automation business earnings were \$466 million in 2000, in line with 1999, due to moderate sales growth and acquisitions, offset by divestitures and currency exchange. Earnings of the Electronics and Telecommunications business increased \$213 million, or 91 percent, to \$447 million in 2000, due to robust sales growth and acquisitions. Earnings of the HVAC business increased \$21 million, or 6 percent, to \$382 million in 2000, driven by very strong sales growth in international markets. The Appliance and Tools business earnings decreased \$7 million, to \$581 million, with increased underlying sales volume in the tools operations offset by the Vermont American divestiture.

### Engineering and Development Investment

(Dollars in millions)



Emerson's commitment to technology is reflected in the sustained investment in engineering and development.

### Income Taxes

Income taxes were \$557 million, \$756 million and \$707 million in 2001, 2000 and 1999, respectively. The effective tax rate was 35.1 percent in 2001, compared with 34.7 percent in 2000 and 35.0 percent in 1999, reflecting the net effect of ongoing global tax planning strategies and the impact of acquisitions and divestitures.

### Net Earnings and Return on Equity

Net earnings for 2001 were \$1.0 billion, down 27.5 percent from \$1.4 billion in 2000. Net earnings as a percent of sales was 6.7 percent in 2001 and 9.2 percent in 2000. Diluted earnings per common share were \$2.40 in 2001, down 27.3 percent from \$3.30 in 2000. Excluding the repositioning charge, earnings were \$1.3 billion and earnings per share were \$3.01 in 2001, both down 9 percent from 2000. Earnings per share excluding the charge and goodwill amortization were \$3.36 in 2001, down 7 percent from \$3.63 in 2000. Return on average stockholders' equity was 16.5 percent, 22.6 percent and 21.9 percent in 2001, 2000 and 1999, respectively. Net earnings for 2000 were up 8.3 percent from \$1.3 billion in 1999. Diluted earnings per common share in 2000 were up 10.0 percent from \$3.00 in 1999. Earnings per share excluding goodwill amortization in 2000 were up 11.0 percent from \$3.27 in the prior year.

## Financial Position, Capital Resources and Liquidity

The Company continues to generate substantial cash from operations and remains in a strong financial position with resources available for reinvestment in existing businesses, strategic acquisitions and managing the capital structure on a short- and long-term basis.

### Cash Flow

Emerson generated operating cash flow of \$1.7 billion in 2001, down 7.2 percent from the prior year. Operating cash flow in 2000 increased 1.6 percent compared with 1999. Decreases in operating working capital as a percentage of sales have been offset by increased pension contributions. In 2001, average operating working capital as a percentage of sales was 14.1 percent compared with 14.7 percent and 15.8 percent in 2000 and 1999, respectively.

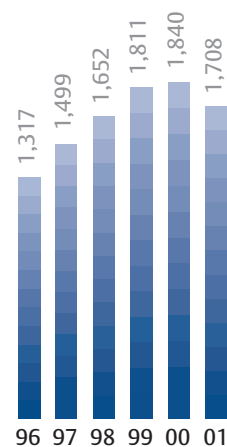
Free cash flow (operating cash flow less capital expenditures) increased in 2001, driven by a 20 percent decrease in capital spending. Capital expenditures were \$554 million, \$692 million and \$592 million in 2001, 2000 and 1999, respectively. The Company expects to again reduce capital spending in 2002. Cash paid in connection with Emerson's purchase acquisitions was \$200 million, \$1,972 million and \$1,202 million in 2001, 2000 and 1999, respectively.

Dividends were a record \$654 million (\$1.53 per share, up 7 percent) in 2001, compared with \$613 million (\$1.43 per share) in 2000, and \$566 million (\$1.30 per share) in 1999. In November 2001, the Board of Directors voted to increase the quarterly cash dividend to an annualized rate of \$1.55 per share and authorized an additional 40 million shares of the Company's outstanding common stock to be repurchased over approximately the next five years. Nearly all of the 40 million shares, previously authorized in November 1996, were repurchased by the end of 2001. Net purchases of treasury stock totaled \$534 million, \$376 million and \$324 million in 2001, 2000 and 1999, respectively.

### Leverage/Capitalization

Total debt increased to \$4.7 billion in 2001, from \$4.6 billion in 2000 and \$3.3 billion in 1999, reflecting the impact of acquisitions and the Company's share repurchase program. The total debt-to-capital ratio was 43.5 percent at year-end 2001, compared with 41.8 percent in 2000 and 34.6 percent in 1999. At September 30, 2001, net debt (total debt less cash and equivalents and short-term investments) was 41.5 percent of net capital, compared with 40.2 percent of net capital in 2000 and 32.7 percent in 1999. The Company's interest coverage ratio (income before income taxes and interest expense divided by interest expense) was 6.2 times in 2001, compared with 8.6 times in 2000 and 11.7 times in 1999, primarily reflecting lower earnings and higher average borrowings resulting from acquisitions and share repurchases. See notes 3, 5 and 6 for additional information.

Operating Cash Flow  
(Dollars in millions)



Emerson continued to generate substantial operating cash flow of \$1.7 billion in 2001.

At year-end 2001, the Company and its subsidiaries maintained lines of credit amounting to \$3 billion to support commercial paper and had available non-U.S. bank credit facilities of \$440 million to support non-U.S. operations. Lines of credit totaling \$1.5 billion are effective until 2005, with the remainder through April 2002. These lines of credit and bank credit facilities assure the availability of funds at prevailing interest rates. In addition, as of September 30, 2001, the Company could issue up to \$2 billion of additional debt securities under its shelf registration with the Securities and Exchange Commission. Subsequent to year-end, the Company issued \$250 million of 5.75%, 10-year notes and \$250 million of 5 <sup>5</sup>/<sub>8</sub>%, 12-year notes which were used to reduce commercial paper borrowings.

#### Financial Instruments

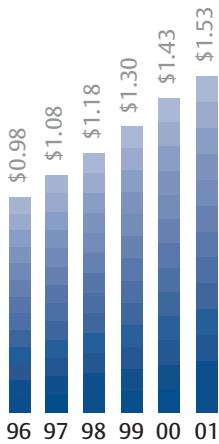
The Company is exposed to market risk related to changes in interest rates, copper and other commodity prices and European and other foreign currency exchange rates, and selectively uses derivative financial instruments, including forwards, swaps and purchased options, to manage these risks. The Company does not hold derivatives for trading purposes. The value of market risk sensitive derivative and other financial instruments is subject to change as a result of movements in market rates and prices. Sensitivity analysis is one technique used to evaluate these impacts. Based on a hypothetical ten-percent increase in interest rates, ten-percent decrease in commodity prices or ten-percent weakening in the U.S. dollar across all currencies, the potential losses in future earnings, fair value and cash flows are immaterial. This method has limitations; for example, a weaker U.S. dollar would benefit future earnings through favorable translation of non-U.S. operating results and lower commodity prices would benefit future earnings through lower cost of sales. See notes 1, 4, 5 and 6.

#### Recent Accounting Pronouncements

In July 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets." FAS 142, which Emerson has the option to adopt in fiscal 2002 or 2003, requires, among other things, the discontinuance of goodwill amortization for business combinations before July 1, 2001, and completion of a transitional goodwill impairment test within six months from the date of adoption. The Company is in the process of reviewing the provisions of this statement and evaluating its impact on the financial statements. Goodwill amortization was \$164 million in 2001, and will be discontinued upon adoption.

In August 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which addresses the impairment or disposal of long-lived assets and the reporting of discontinued operations. The Company is in the process of reviewing the provisions of this statement, which must be adopted by 2003, to evaluate its impact on the financial statements.

Dividends Per Share



Dividends per share increased 7 percent in 2001, representing the 45th consecutive annual increase.