

FINANCIAL REVIEW

Report of Management

The Company's management is responsible for the integrity and accuracy of the financial statements. Management believes that the financial statements for the three years ended September 30, 2007, have been prepared in conformity with U.S. generally accepted accounting principles appropriate in the circumstances. In preparing the financial statements, management makes informed judgments and estimates where necessary to reflect the expected effects of events and transactions that have not been completed. The Company's disclosure controls and procedures ensure that material information required to be disclosed is recorded, processed, summarized and communicated to management and reported within the required time periods.

In meeting its responsibility for the reliability of the financial statements, management relies on a system of internal accounting control. This system is designed to provide reasonable assurance that assets are safeguarded and transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with U.S. generally accepted accounting principles. The design of this system recognizes that errors or irregularities may occur and that estimates and judgments are required to assess the relative cost and expected benefits of the controls. Management believes that the Company's accounting controls provide reasonable assurance that errors or irregularities that could be material to the financial statements are prevented or would be detected within a timely period.

The Audit Committee of the Board of Directors, which is composed solely of independent Directors, is responsible for overseeing the Company's financial reporting process. The Audit Committee meets with management and the internal auditors periodically to review the work of each and to monitor the discharge by each of its responsibilities. The Audit Committee also meets periodically with the independent auditors who have free access to the Audit Committee and the Board of Directors to discuss the quality and acceptability of the Company's financial reporting, internal controls, as well as non-audit-related services.

The independent auditors are engaged to express an opinion on the Company's consolidated financial statements and on the Company's internal control over financial reporting. Their opinions are based on procedures which they believe to be sufficient to provide reasonable assurance that the financial statements contain no material errors and that the Company's internal controls are effective.

Management's Report on Internal Control over Financial Reporting

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. With the participation of the Chief Executive Officer and the Chief Financial Officer, management conducted an evaluation of the effectiveness of internal control over financial reporting based on the framework and the criteria established in *Internal Control – Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management has concluded that internal control over financial reporting was effective as of September 30, 2007.

The Company's auditor, KPMG LLP, an independent registered public accounting firm, has issued an audit report on the effectiveness of the Company's internal control over financial reporting.



David N. Farr

*Chairman of the Board,
Chief Executive Officer,
and President*



Walter J. Galvin

*Senior Executive Vice President
and Chief Financial Officer*

Results of Operations

Years ended September 30 | Dollars in millions, except per share amounts

	2005	2006	2007	CHANGE 2005 - 2006	CHANGE 2006 - 2007
Net sales	\$17,305	20,133	22,572	16%	12%
Gross profit	\$ 6,183	7,168	8,111	16%	13%
<i>Percent of sales</i>	35.7%	35.6%	35.9%		
SG&A	\$ 3,595	4,099	4,593		
<i>Percent of sales</i>	20.7%	20.4%	20.3%		
Other deductions, net	\$ 230	178	183		
Interest expense, net	\$ 209	207	228		
Earnings before income taxes	\$ 2,149	2,684	3,107	25%	16%
Net earnings	\$ 1,422	1,845	2,136	30%	16%
<i>Percent of sales</i>	8.2%	9.2%	9.5%		
Earnings per share	\$ 1.70	2.24	2.66	32%	19%
Return on equity	19.4%	23.7%	25.2%		
Return on total capital	15.5%	18.4%	20.1%		

Net earnings and earnings per share for 2005 include a \$63 million tax expense (\$0.07 per share) for repatriation under the American Jobs Creation Act.

OVERVIEW

Emerson achieved record sales, earnings and earnings per share in the fiscal year ended September 30, 2007. For fiscal 2007, net sales were \$22.6 billion, an increase of 12 percent; net earnings were \$2.1 billion, an increase of 16 percent; and earnings per share were \$2.66, an increase of 19 percent, over fiscal 2006. All of the business segments generated higher sales and earnings compared with the prior year. The Process Management, Network Power and Industrial Automation businesses drove gains in a favorable global economic environment as gross fixed investment expanded during 2007, while growth in the Climate Technologies and Appliance and Tools businesses was moderated by weakness in the U.S. consumer markets. Strong growth in Asia and Europe, acquisitions and favorable foreign currency translation contributed to these results. Profit margins remained strong primarily because of leverage on higher sales volume and benefits derived from previous rationalization actions. Emerson's financial position remains strong and the Company generated substantial operating cash flow in 2007 of \$3.0 billion, an increase of 20 percent, and free cash flow (operating cash flow less capital expenditures) of \$2.3 billion, an increase of 22 percent.

NET SALES

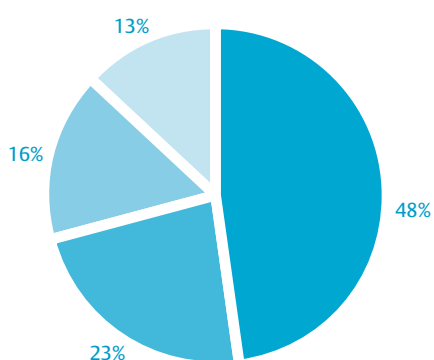
Net sales for fiscal 2007 were a record \$22.6 billion, an increase of approximately \$2.4 billion, or 12 percent, over fiscal 2006, with international sales leading the overall growth. The consoli-

dated results reflect increases in all five business segments with an approximate 7 percent (\$1,359 million) increase in underlying sales (which exclude acquisitions, divestitures and foreign currency translation), a nearly 3 percent (\$566 million) contribution from acquisitions, net of divestitures, and a more than 2 percent (\$514 million) favorable impact from foreign currency translation. The underlying sales increase for fiscal 2007 was driven by international sales growth of 12 percent and a 2 percent increase in the United States. The U.S. results reflect a modest decline in the first quarter with moderate growth during the remainder of the year. The international sales increase primarily reflects growth in Asia (16 percent) and Europe (8 percent). The Company estimates that the underlying sales growth of approximately 7 percent primarily reflects an approximate 3 percent gain from volume, an approximate 2 percent impact from penetration gains and an approximate 2 percent impact from higher sales prices.

Net sales for fiscal 2006 were \$20.1 billion, an increase of approximately \$2.8 billion, or 16 percent, over fiscal 2005, with both U.S. and international sales contributing to this growth. The consolidated results reflect increases in all five business segments with an underlying sales increase of more than 12 percent (\$2,119 million), an approximate 4 percent (\$766 million) contribution from acquisitions, net of divestitures, and a slightly unfavorable impact (\$57 million) from foreign currency translation. The underlying sales increase of more than 12 percent was driven by 12 percent growth in the United States and a total international sales increase of 13 percent.

The U.S. market growth was very strong in the first half of 2006 and began to moderate toward the end of the fiscal year, while Europe grew stronger as the year progressed and finished very strong in the fourth quarter. The international sales increase primarily reflects growth in Asia (20 percent) and Europe (7 percent). The Company estimates that the underlying sales growth of more than 12 percent primarily reflects a nearly 9 percent gain from volume, an approximate 3 percent impact from penetration gains and a less than 1 percent impact from higher sales prices.

SALES BY GEOGRAPHIC DESTINATION



■ United States
 ■ Asia
 ■ Europe
 ■ Other

INTERNATIONAL SALES

International destination sales, including U.S. exports, increased approximately 22 percent including acquisitions, to \$11.6 billion in 2007, representing 52 percent of the Company's total sales. U.S. exports of \$1,277 million were up 13 percent compared with 2006, reflecting the weaker U.S. dollar. International subsidiary sales, including shipments to the United States, were \$10.5 billion in 2007, up 22 percent over 2006. Excluding the net 7 percent favorable impact from acquisitions, divestitures and foreign currency translation, international subsidiary sales increased 15 percent compared with 2006. Underlying destination sales grew 16 percent in Asia during the year, driven mainly by 12 percent growth in China, while sales grew 44 percent in the Middle East, 11 percent in Latin America and 8 percent in Europe.

International destination sales, including U.S. exports, increased approximately 17 percent, to \$9.5 billion in 2006, representing 47 percent of the Company's total sales. U.S. exports of \$1,127 million were up 13 percent compared with 2005. International subsidiary sales, including shipments to the United States, were \$8.7 billion in 2006, up 17 percent over 2005. Excluding the net 1 percent unfavorable impact from acquisitions, divestitures and foreign currency translation, international subsidiary sales increased 18 percent compared with 2005. Underlying destination sales grew 20 percent in Asia during the year, driven mainly by 19 percent growth in China, and 21 percent in Latin America and the Middle East, while sales grew 7 percent in Europe.

ACQUISITIONS AND DIVESTITURES

The Company acquired Damcos Holding AS (Damcos) and Stratos International, Inc. (Stratos), as well as several smaller businesses during 2007. Damcos supplies valve remote control systems and tank monitoring equipment to the marine and shipbuilding industries. Stratos is a designer and manufacturer of radio-frequency and microwave interconnect products. Total cash paid for these businesses (net of cash and equivalents acquired of approximately \$40 million, and debt assumed of approximately \$56 million) was approximately \$295 million. Annualized sales for acquired businesses were \$240 million in 2007.

During the fourth quarter of fiscal 2007, the Company entered into a definitive agreement to acquire Motorola Inc.'s Embedded Communications Computing (ECC) business for approximately \$350 million in cash. ECC is a leading provider of embedded computing products to equipment manufacturers in telecommunications, medical imaging, defense and aerospace, and industrial automation. The transaction is expected to be completed by the end of calendar 2007 and is subject to customary closing conditions and regulatory approvals. ECC had 2006 revenue of approximately \$520 million and will be included in the Network Power segment.

In 2007, the Company divested two small business units that had total annual sales of \$113 million and \$115 million for fiscal years 2006 and 2005, respectively. In the fourth quarter of 2006, the Company received approximately \$80 million from the divestiture of the materials testing business, resulting in a pretax gain of \$31 million (\$22 million after-tax). The materials testing business represented total annual sales of approximately \$58 million and \$59 million in 2006 and 2005, respectively. These businesses were not reclassified as discontinued operations because of immateriality.

During 2006, the Company acquired Artesyn Technologies, Inc. (Artesyn), Knürr AG (Knürr) and Bristol Babcock (Bristol), as well as several smaller businesses. Artesyn is a global manufacturer of advanced power conversion equipment and board-level computing solutions for infrastructure applications in telecommunication and data-communication systems. Knürr is a manufacturer of indoor and outdoor enclosure systems and cooling technologies for telecommunications, electronics and computing equipment. Bristol is a manufacturer of control and measurement equipment for oil and gas, water and wastewater, and power industries. Total cash paid for these businesses (net of cash and equivalents acquired of approximately \$120 million and debt assumed of approximately \$90 million) was approximately \$752 million. Annualized sales for acquired businesses were \$920 million in 2006. See Note 3 for additional information regarding acquisitions and divestitures.

COST OF SALES

Costs of sales for fiscal 2007 and 2006 were \$14.5 billion and \$12.9 billion, respectively. Cost of sales as a percent of net sales was 64.1 percent for 2007, compared with 64.4 percent in 2006. Gross profit was \$8.1 billion and \$7.2 billion for fiscal 2007 and 2006, respectively, resulting in gross profit margins of 35.9 percent and 35.6 percent. The gross profit margin improvement was diminished as higher sales prices, together with the benefits received from commodity hedging of approximately \$115 million, were substantially offset by higher material costs and wages. The increase in the gross profit amount primarily reflects higher sales volume, acquisitions, foreign currency translation and savings from cost reduction actions.

Costs of sales for fiscal 2006 and 2005 were \$12.9 billion and \$11.1 billion, respectively. Cost of sales as a percent of net sales was 64.4 percent for 2006, compared with 64.3 percent in 2005. Gross profit was \$7.2 billion and \$6.2 billion for fiscal 2006 and 2005, respectively, resulting in gross profit margins of 35.6 percent and 35.7 percent. The increase in the gross profit primarily reflects higher sales volume and acquisitions. The gross profit margin was unfavorably impacted as leverage on higher sales and benefits realized from productivity improvements were more than offset by higher costs for wages and benefits (pension), negative product mix, as well as the lower profit margin on recent acquisitions. Sales price increases initiated over the past year, together with the benefits received from commodity hedging of approximately \$130 million, offset the higher level of raw material costs, but the margin was diluted.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative (SG&A) expenses for 2007 were \$4.6 billion, or 20.3 percent of net sales, compared with \$4.1 billion, or 20.4 percent of net sales for 2006. The increase of approximately \$0.5 billion was primarily due to an increase in variable costs on higher sales volume, acquisitions, foreign currency translation and a \$104 million increase in stock compensation (see Note 14). The reduction in SG&A as a percent of sales was primarily the result of leveraging fixed costs on higher sales, particularly in the Process Management and Network Power businesses.

SG&A expenses for 2006 were \$4.1 billion, or 20.4 percent of net sales, compared with \$3.6 billion, or 20.7 percent of net sales for 2005. The increase of approximately \$0.5 billion was primarily due to the increase in variable costs on higher sales and acquisitions. The reduction in SG&A as a percent of sales was primarily the result of leveraging fixed costs on higher sales.

OTHER DEDUCTIONS, NET

Other deductions, net were \$183 million in 2007, a \$5 million increase from the \$178 million in 2006. Gains in 2007 included approximately \$32 million related to the sale of the Company's remaining shares in MKS Instruments, Inc. (MKS) and approximately \$24 million related to a payment received under the U.S. Continued Dumping and Subsidy Offset Act (Offset Act). Ongoing costs for the rationalization of operations were \$83 million in 2007, compared with \$84 million in 2006. The higher gains and lower other costs were more than offset by higher amortization of intangibles related to acquisitions.

Other deductions, net were \$178 million in 2006, a \$52 million decrease from the \$230 million in 2005. The decrease primarily reflects \$42 million of higher gains in 2006 compared with 2005 and lower rationalization costs. Gains in 2006 included approximately \$31 million related to the divestiture of the materials testing business and approximately \$26 million related to the sale of shares in MKS. Ongoing costs for the rationalization of operations were \$84 million in 2006, down from \$110 million in 2005, reflecting lower costs, particularly for the Network Power segment. The higher gains and lower rationalization costs were partially offset by higher amortization of intangibles related to acquisitions. See Notes 4 and 5 for further details regarding other deductions, net and rationalization costs.

INTEREST EXPENSE, NET

Interest expense, net was \$228 million, \$207 million and \$209 million in 2007, 2006 and 2005, respectively. The increase of \$21 million from 2006 to 2007 was primarily due to higher average borrowings.

EARNINGS BEFORE INCOME TAXES

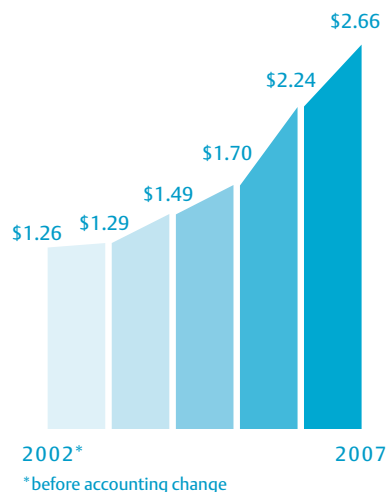
Earnings before income taxes were \$3.1 billion for 2007, an increase of 16 percent, compared with \$2.7 billion for 2006. The earnings results reflect increases in all five business segments, including \$188 million in Process Management, \$161 million in Network Power and \$96 million in Industrial Automation. The higher earnings also reflect leverage from higher sales, benefits realized from cost containment, and higher sales prices, partially offset by higher raw material and wage costs.

Earnings before income taxes were \$2.7 billion for 2006, an increase of 25 percent, compared with \$2.1 billion for 2005. The earnings results reflect increases in all five business segments, including \$207 million in Process Management, \$111 million in Network Power and \$105 million in Industrial Automation. The higher earnings also reflect leverage from higher sales, benefits realized from productivity improvements, and higher sales prices, partially offset by higher raw material, wage and benefit costs.

INCOME TAXES

Income taxes were \$971 million, \$839 million and \$727 million for 2007, 2006 and 2005, respectively, resulting in effective tax rates of 31 percent, 31 percent and 34 percent. The change in the effective tax rate from 2005 to 2006 was primarily due to a 3 percentage point decrease resulting from a \$63 million tax expense in 2005 related to the one-time opportunity during 2005 to repatriate foreign earnings at a favorable rate under the American Jobs Creation Act of 2004 (the Act). See Note 13 for further discussion regarding the impact of the Act.

EARNINGS PER SHARE



Earnings per share were a record \$2.66 in 2007, a 19 percent increase over the prior year.

NET EARNINGS, RETURN ON EQUITY AND RETURN ON TOTAL CAPITAL

Net earnings were a record \$2.1 billion and earnings per share were a record \$2.66 per share for 2007, increases of 16 percent and 19 percent, respectively, compared with net earnings and earnings per share of \$1.8 billion and \$2.24, respectively, in 2006. Net earnings as a percent of net sales were 9.5 percent in 2007 compared with 9.2 percent in 2006. The 19 percent increase in earnings per share also reflects the purchase of treasury shares. Return on stockholders' equity (net earnings divided by average stockholders' equity) reached 25.2 percent in 2007 compared with 23.7 percent in 2006. The Company achieved return on total capital of 20.1 percent in 2007 compared with 18.4 percent in 2006 (net earnings excluding interest income and expense, net of taxes, divided by average stockholders' equity plus short- and long-term debt less cash and short-term investments). The Company consummated a two-for-one stock split in December 2006. All share and per share data have been restated to reflect this split.

Net earnings and earnings per share for 2006 increased 30 percent and 32 percent, respectively, to \$1.8 billion and \$2.24 per share, compared with \$1.4 billion and \$1.70 per share in 2005. Net earnings as a percent of net sales were 9.2 percent in 2006 compared with 8.2 percent in 2005. Net earnings for 2005 included a tax expense of \$63 million, or \$0.07 per share, related to the one-time opportunity to repatriate foreign earnings at a favorable rate. The 32 percent increase in earnings per share also reflects the purchase of treasury shares. Return on stockholders' equity was 23.7 percent and 19.4 percent for 2006 and 2005, respectively. Return on total capital was 18.4 percent and 15.5 percent for 2006 and 2005, respectively.

Business Segments

PROCESS MANAGEMENT

(DOLLARS IN MILLIONS)	2005	2006	2007	CHANGE '05 - '06	CHANGE '06 - '07
Sales	\$4,200	4,875	5,699	16%	17%
Earnings	\$ 671	878	1,066	31%	21%
Margin	16.0%	18.0%	18.7%		

2007 vs. 2006 - The Process Management segment sales were \$5.7 billion in 2007, an increase of \$824 million, or 17 percent, over 2006, reflecting higher volume and acquisitions. Nearly all of the businesses reported higher sales, with sales and earnings (defined as earnings before interest and taxes for the business segments discussion) particularly strong for the measurement, systems and valves businesses, reflecting very strong worldwide growth in oil and gas and power projects, and expansion in the Middle East. Underlying sales increased 11 percent, reflecting 8 percent from volume, and approximately 3 percent collectively from penetrating global markets and slightly higher sales prices. Foreign currency translation had a 4 percent (\$169 million) favorable impact and the Bristol and Damcos acquisitions contributed 2 percent (\$120 million). The underlying sales increase reflects growth in nearly all of the major geographic regions, including the United States (10 percent), Asia (12 percent), Europe (6 percent) and Latin America (6 percent), as well as the Middle East (63 percent), compared with the prior year. Earnings increased 21 percent to \$1,066 million from \$878 million in the prior year, primarily reflecting the higher sales volume and prices, as well as acquisitions. The margin increase reflects leverage on the higher sales and cost containment actions, which were partially offset by higher wages and an \$11 million adverse commercial litigation judgment.

2006 vs. 2005 - Sales in the Process Management segment were \$4.9 billion in 2006, an increase of \$675 million, or 16 percent, over 2005, reflecting higher volume and acquisitions. All of the businesses, including measurement, valves and systems, reported higher sales and earnings because of worldwide growth in oil and gas and power projects, as well as expansion in China. The increasing demand for energy is driving capacity expansion and upgrades to existing facilities in the energy sector. Underlying sales increased 13 percent, driven by the strong market demand and aided by approximately 2 percent from penetration gains and price, while the Bristol, Tescom and Mobrey acquisitions contributed 3 percent (\$147 million). The underlying sales increase reflects

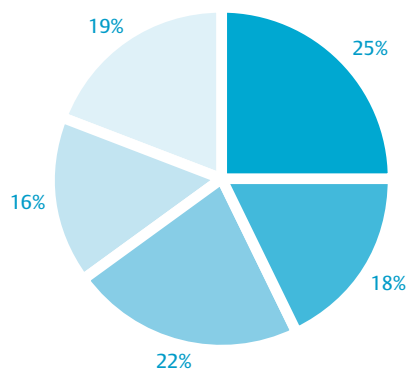
growth in all major geographic regions, including the United States (15 percent), Asia (15 percent), Latin America (20 percent) and Europe (6 percent), compared with 2005. Earnings increased 31 percent to \$878 million from \$671 million in 2005, primarily reflecting higher sales volume, as well as acquisitions. The margin increase was primarily due to leverage on higher sales. Sales price increases and material cost containment were offset by higher wages.

INDUSTRIAL AUTOMATION

(DOLLARS IN MILLIONS)	2005	2006	2007	CHANGE '05 - '06	CHANGE '06 - '07
Sales	\$3,242	3,767	4,269	16%	13%
Earnings	\$ 464	569	665	23%	17%
Margin	14.3%	15.1%	15.6%		

2007 vs. 2006 - The Industrial Automation segment increased sales by 13 percent to \$4.3 billion in 2007, compared with \$3.8 billion in 2006. Nearly all of the businesses reported higher sales in 2007, with particular strength in the power generating alternator, the electrical distribution and the electronic drives businesses, as the favorable economic environment for capital goods continued. The very strong growth in the U.S. and European alternator businesses was driven by increased demand for backup generators and alternative power sources, such as wind turbines. The underlying sales growth of 10 percent and the favorable impact from foreign currency translation of 4 percent (\$143 million) was slightly offset by an unfavorable impact of 1 percent from divestitures, net of acquisitions. Underlying sales grew 13 percent internationally and 5 percent in the United States. The international sales growth primarily reflects increases in Europe (12 percent) and Asia (19 percent). The underlying growth reflects 7 percent from volume caused by increased global industrial demand and an approximate 3 percent combined positive impact from price and slight penetration gains. Earnings increased 17 percent to \$665 million for 2007, compared with \$569 million in 2006, reflecting leverage from higher sales volume and benefits from cost containment, as nearly all of the businesses reported higher earnings. The margin increase was primarily due to leverage on higher sales volume. The earnings increase was also aided by an approximate \$24 million payment received by the power transmission business from dumping duties related to the Offset Act in the current year, compared with an \$18 million payment received in 2006. Sales price increases were offset by higher material and wage costs, as well as unfavorable product mix.

SALES BY SEGMENT



- Process Management
- Industrial Automation
- Network Power
- Climate Technologies
- Appliance and Tools

2006 vs. 2005 - Sales in the Industrial Automation segment were \$3.8 billion in 2006, an increase of 16 percent compared with 2005. Sales grew in all of the major geographic regions and in nearly all of the businesses, reflecting the continued favorable economic environment for capital goods. Underlying sales grew 11 percent; the Numatics, Safronics and Jaure acquisitions contributed 6 percent (\$208 million); and foreign currency translation had a 1 percent (\$41 million) unfavorable impact. Underlying sales grew 12 percent in the United States and 11 percent internationally. The increase in international sales primarily reflects growth in Europe (10 percent) and Asia (13 percent). The results reflect growth in nearly all of the businesses, with particular strength in the power generating alternator and electrical distribution businesses. The underlying growth reflects both increased global industrial demand and a nearly 3 percent positive impact from price and penetration gains. In addition, the electrical distribution business's strong growth was driven by increased demand in North America, particularly along the Gulf Coast of the United States. Earnings increased 23 percent to \$569 million for 2006, compared with \$464 million in 2005, reflecting higher sales volume and prices, as well as acquisitions. The margin increase was primarily due to leverage on higher sales volume. Sales price increases and benefits from prior cost reduction efforts were offset by higher material, wage and benefit (pension) costs, as well as dilution from acquisitions. The earnings increase was also aided by an approximate \$18 million payment received by the power transmission business from dumping duties related to the Offset Act in 2006, compared with a \$13 million payment received in 2005, and lower litigation settlement costs compared with 2005.

NETWORK POWER

(DOLLARS IN MILLIONS)	2005	2006	2007	CHANGE '05 - '06	CHANGE '06 - '07
Sales	\$3,317	4,350	5,150	31%	18%
Earnings	\$ 373	484	645	30%	33%
Margin	11.2%	11.1%	12.5%		

2007 vs. 2006 - Sales in the Network Power segment increased 18 percent to \$5.2 billion in 2007 compared with \$4.4 billion in 2006. The sales increase was driven by continued strong demand in the uninterruptible power supplies, precision cooling and inbound power businesses and the full year impact of the Artesyn and Knürr acquisitions. Underlying sales grew 9 percent, while acquisitions, net of divestitures, contributed approximately 7 percent (\$332 million) and favorable foreign currency translation had a 2 percent (\$98 million) favorable impact. The underlying sales increase of 9 percent reflects a more than 5 percent gain from higher volume and a more than 3 percent impact from penetration gains, which were partially offset by a slight decline in sales prices. Geographically, underlying sales reflect a 20 percent increase in Asia, a 7 percent increase in the United States, while sales in Europe were flat compared with the prior year. The Company's market penetration gains in China and other Asian markets continued. The U.S. growth reflects strong demand for data room and non-residential computer equipment. Earnings increased 33 percent, or \$161 million, to \$645 million, compared with \$484 million in 2006, primarily because of the Artesyn and Knürr acquisitions and the higher sales volume. The margin increase reflects leverage on higher sales volume, savings from integrating acquisitions and improvement over the prior year in the DC power business. These benefits were partially offset by higher material and wage costs.

2006 vs. 2005 - The Network Power segment sales increased 31 percent to \$4.4 billion in 2006 compared with \$3.3 billion in 2005. End markets were strong across the segment with particular strength in the computing and data-center markets, which led to strong growth in the AC power system and precision cooling businesses. The sales increase reflects 21 percent growth in underlying sales and a 10 percent (\$341 million) contribution from the Artesyn and Knürr acquisitions. The underlying sales increase of 21 percent reflects higher volume of approximately 23 percent, of which more than one-third is estimated to be from market penetration gains. These increases were partially offset by an estimated 2 percent impact from lower sales prices. Geographically, underlying sales reflect a 22 percent increase in the United States, a 37 percent increase in Asia (primarily China) and a 3 percent increase in Europe. The Company continues to build upon its Emerson Network Power

China division resulting in market penetration in China and other Asian markets. Earnings increased 30 percent, or \$111 million, to \$484 million, compared with \$373 million in 2005, primarily because of higher sales volume. The margin was primarily diluted by the Artesyn acquisition and declines in sales prices, partially offset by material cost containment. Negative product mix in the embedded power business and higher costs related to inventory and warranty in the North American DC power business in the fourth quarter also diluted the margin. Leverage on higher sales volume, savings from prior period cost reduction efforts and a \$16 million reduction in rationalization costs versus 2005 mitigated the margin decline.

CLIMATE TECHNOLOGIES

(DOLLARS IN MILLIONS)	2005	2006	2007	CHANGE '05 - '06	CHANGE '06 - '07
Sales	\$3,041	3,424	3,614	13%	6%
Earnings	\$ 453	523	538	15%	3%
Margin	14.9%	15.3%	14.9%		

2007 vs. 2006 - The Climate Technologies segment reported sales of \$3.6 billion for 2007, representing a 6 percent improvement over 2006. Underlying sales increased approximately 1 percent, while acquisitions contributed 3 percent (\$86 million) and foreign currency translation had a 2 percent (\$53 million) favorable impact. Lower sales volume of 4 percent was more than offset by an approximate 5 percent combined positive impact from sales price increases and penetration gains. The underlying sales growth reflects a 16 percent increase in international sales, led by growth in Europe (18 percent) and Asia (17 percent). This growth was partially offset by a 7 percent decline in U.S. sales, which is primarily attributable to difficult comparisons to a very strong prior year for the air-conditioning compressor business (as noted below), as well as an impact from the downturn in the U.S. housing market. The volume decline in the U.S. air-conditioning business was only partially offset by a modest increase in U.S. refrigeration sales. The very strong growth in Europe and Asia reflects overall favorable market conditions, penetration in the European heat pump market, and penetration gains in Asia, particularly in digital scroll compressor products. Earnings increased 3 percent to \$538 million in 2007 compared with \$523 million in 2006, primarily because of savings from cost reduction efforts and lower restructuring costs of \$5 million. The profit margin declined as the result of deleverage on the lower volume and an acquisition, while higher sales prices were offset by higher material and wage costs. The Company

continued its capacity expansion begun last year in Mexico where the next generation scroll compressor design and hermetic motors for the North American market will be produced.

2006 vs. 2005 - Sales in the Climate Technologies segment were \$3.4 billion in 2006, an increase of 13 percent compared with 2005. Underlying sales grew 13 percent, which reflects a 14 percent increase in the United States, a 20 percent increase in Europe and a 1 percent increase in Asia. The underlying sales growth was largely due to strong demand in the air-conditioning compressor business and an estimated 1 percent positive impact from higher sales prices. The volume increase of 12 percent, one-fourth of which is estimated to be from market share gains, was primarily related to scroll compressors. The air-conditioning compressor business was very strong during 2006 primarily because of demand relating to the transition in the United States to higher efficiency standards that became effective January 23, 2006, as well as weather related demand. Earnings increased 15 percent to \$523 million in 2006 compared with \$453 million in 2005, primarily due to higher volume. The margin increase reflects leverage on higher sales and savings from prior period cost reduction efforts, partially offset by higher wages and benefits (pension). The margin increase was negatively impacted as the higher sales prices were more than offset by higher material costs.

APPLIANCE AND TOOLS

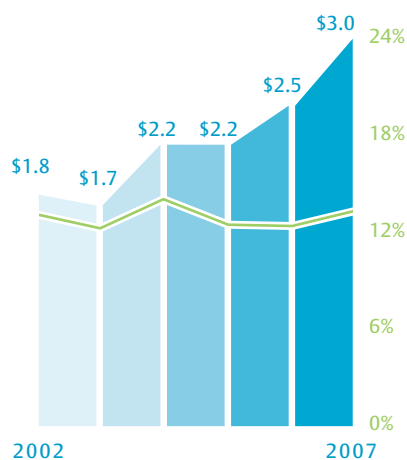
(DOLLARS IN MILLIONS)	2005	2006	2007	CHANGE '05 - '06	CHANGE '06 - '07
Sales	\$4,008	4,313	4,447	8%	3%
Earnings	\$ 534	550	578	3%	5%
Margin	13.3%	12.8%	13.0%		

2007 vs. 2006 - Sales in the Appliance and Tools segment were \$4.4 billion in 2007, a 3 percent increase from 2006. The sales increase reflects underlying sales growth of 1 percent, a favorable impact from foreign currency translation of 1 percent (\$51 million) and a contribution from acquisitions of 1 percent (\$37 million). The underlying sales increase of 1 percent reflects an estimated 4 percent decline in volume and an approximate 5 percent positive impact from higher sales prices. The results were mixed across the businesses for this segment. The tools and storage businesses showed moderate growth, while sales increased slightly in the motors businesses when compared with 2006. These increases were partially offset by declines in the appliance controls businesses. The growth in the tools businesses was driven by the professional tools and disposer businesses, reflecting the success

of new product launches. The volume declines in the appliance controls and certain motors and storage businesses were primarily caused by the downturn in U.S. residential construction. International underlying sales increased 9 percent in total, while underlying sales in the United States were down 1 percent from the prior year. Earnings for 2007 were \$578 million, a 5 percent increase from 2006. The earnings increases in tools and motor businesses were partially offset by declines in appliance component and certain storage businesses. Overall, the slight margin improvement primarily reflects the benefits from prior year actions, as well as lower restructuring inefficiencies and costs compared with the prior year. Sales price increases were offset by higher material (copper and other commodities) and wage costs, as well as deleverage from the lower volume.

2006 vs. 2005 - The Appliance and Tools segment sales increased 8 percent to \$4.3 billion for 2006. This increase reflects 6 percent growth in underlying sales and a 2 percent (\$62 million) contribution from the Do+Able acquisition. Sales grew in nearly all of the businesses with most experiencing moderate to strong growth. Particular strength in the tools, storage and hermetic motors businesses was partially offset by softness in the appliance component business. The hermetic motors business was very strong because of the air-conditioning demand during 2006. In addition, the storage businesses showed strong growth driven by the U.S. market. Strength in U.S. residential investment in the first half of 2006 and increased demand at major retailers resulted in continued growth in the storage businesses. The underlying sales increase reflects an estimated 3 percent growth from volume and an approximate 3 percent positive impact from price and penetration gains. Geographically, underlying sales increased 6 percent in the United States and 8 percent internationally. Earnings for 2006 were \$550 million, an increase of 3 percent from 2005. The overall increase in profit was partially offset by declines in certain tools, storage and motors businesses, reflecting new product introduction costs in the disposer business, foreign currency losses in the tools and residential storage businesses and restructuring inefficiencies, including costs related to plant shutdown and ramp up of Mexican capacity in the tools and motors businesses. Overall, increases in sales prices were offset by higher raw material (particularly copper, steel and plastics), wage and benefit (pension) costs and negative product mix, diluting the profit margin.

OPERATING CASH FLOW AND AS A PERCENT OF SALES *(dollars in billions)*



Operating cash flow of \$3.0 billion in 2007 enabled Emerson to pay record dividends and buy back 18.9 million shares of common stock.

Financial Position, Capital Resources and Liquidity

The Company continues to generate substantial cash from operations and is in a strong financial position with total assets of \$20 billion and stockholders' equity of \$9 billion, and has the resources available for reinvestment in existing businesses, strategic acquisitions and managing the capital structure on a short- and long-term basis.

CASH FLOW

(DOLLARS IN MILLIONS)	2005	2006	2007
Operating Cash Flow	\$2,187	2,512	3,016
<i>Percent of sales</i>	12.6%	12.5%	13.4%
Capital Expenditures	\$ 518	601	681
<i>Percent of sales</i>	3.0%	3.0%	3.0%
Free Cash Flow (Operating Cash Flow Less Capital Expenditures)	\$1,669	1,911	2,335
<i>Percent of sales</i>	9.6%	9.5%	10.3%
Operating Working Capital	\$1,643	2,044	1,915
<i>Percent of sales</i>	9.5%	10.1%	8.5%

Emerson generated operating cash flow of \$3.0 billion in 2007, a 20 percent increase from 2006, driven by higher net earnings. Cash flow in 2007 also reflects continued improvements in operating working capital management. Operating cash flow was \$2.5 billion

in 2006, a 15 percent increase from 2005, as higher net earnings were partially offset by additional working capital necessary to support the higher level of sales. At September 30, 2007, operating working capital as a percent of sales was 8.5 percent, compared with 10.1 percent and 9.5 percent in 2006 and 2005, respectively. Operating cash flow also reflects pension contributions of \$136 million, \$124 million and \$124 million in 2007, 2006 and 2005, respectively.

Free cash flow (operating cash flow less capital expenditures) was \$2.3 billion in 2007, compared with \$1.9 billion and \$1.7 billion in 2006 and 2005, respectively. The 22 percent increase in free cash flow in 2007 compared with 2006 and the 15 percent increase in 2006 compared with 2005 reflect the increases in operating cash flow, partially offset by higher capital spending. Capital expenditures were \$681 million, \$601 million and \$518 million in 2007, 2006 and 2005, respectively. The increase in capital expenditures during 2007 compared with the prior year includes capacity expansion in the Process Management and Climate Technologies segments, while the increase in 2006 compared with 2005 was primarily due to capacity expansion and acquisitions in the Network Power segment. In 2008, the Company is targeting capital spending of approximately 3 percent of net sales. Cash paid in connection with Emerson's acquisitions was \$295 million, \$752 million and \$366 million in 2007, 2006 and 2005, respectively.

Dividends were \$837 million (\$1.05 per share, up 18 percent) in 2007, compared with \$730 million (\$0.89 per share) in 2006, and \$694 million (\$0.83 per share) in 2005. In November 2007, the Board of Directors voted to increase the quarterly cash dividend 14 percent to an annualized rate of \$1.20 per share. In November 2006, the Company's Board of Directors declared a two-for-one split of the Company's common stock effected in the form of a 100 percent stock dividend to shareholders of record as of November 17, 2006, with a distribution date of December 11, 2006 (shares began trading on a post-split basis on December 12, 2006). In 2007, 18,877,000 shares were repurchased under the 2002 Board of Directors' authorization; in 2006, 21,451,000 shares were repurchased, and in 2005, 20,071,000 shares were repurchased; 14.8 million shares remain available for repurchase under the 2002 authorization. Purchases of treasury stock totaled \$849 million, \$871 million and \$671 million in 2007, 2006 and 2005, respectively.

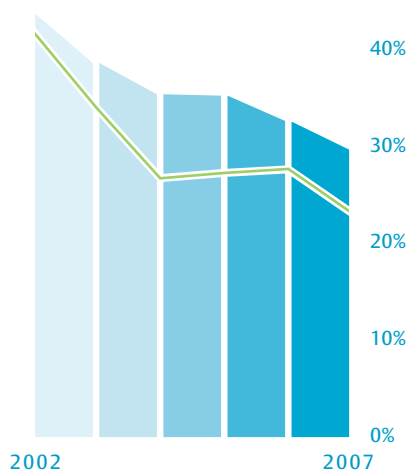
LEVERAGE/CAPITALIZATION

(DOLLARS IN MILLIONS)	2005	2006	2007
Total Assets	\$17,227	18,672	19,680
Long-term Debt	\$ 3,128	3,128	3,372
Stockholders' Equity	\$ 7,400	8,154	8,772
Total Debt-to-Capital Ratio	35.6%	33.1%	30.1%
Net Debt-to-Net Capital Ratio	27.7%	28.1%	23.6%
Operating Cash Flow-to-Debt Ratio	53.4%	62.4%	79.9%
Interest Coverage Ratio	9.8	12.9	12.9

Total debt was \$3.8 billion, \$4.0 billion and \$4.1 billion for 2007, 2006 and 2005, respectively. During 2007, the Company issued \$250 million of 5.125%, ten-year notes due December 2016 and \$250 million of 5.375%, ten-year notes due October 2017. During 2006, \$250 million of 6.3% notes matured. The total debt-to-capital ratio was 30.1 percent at year-end 2007, compared with 33.1 percent for 2006 and 35.6 percent for 2005. At September 30, 2007, net debt (total debt less cash and equivalents and short-term investments) was 23.6 percent of net capital, compared with 28.1 percent of net capital in 2006 and 27.7 percent of net capital in 2005. The operating cash flow-to-debt ratio was 79.9 percent, 62.4 percent and 53.4 percent in 2007, 2006 and 2005, respectively. The Company's interest coverage ratio (earnings before income taxes and interest expense, divided by interest expense) was 12.9 times in 2007, compared with 12.9 times in 2006 and 9.8 times in 2005. The increase in the interest coverage ratio from 2005 to 2006 reflects higher earnings and lower average borrowings. See Notes 3, 8 and 9 for additional information. The Company's strong financial position supports long-term debt ratings of A2 by Moody's Investors Service and A by Standard and Poor's.

At year-end 2007, the Company maintained a five-year revolving credit facility effective until April 2011 amounting to \$2.8 billion to support short-term borrowings. The credit facility does not contain any financial covenants and is not subject to termination based on a change in credit ratings or a material adverse change. In addition, as of September 30, 2007, the Company could issue up to \$1.75 billion in debt securities, preferred stock, common stock, warrants, share purchase contracts and share purchase units under the shelf registration statement filed with the Securities and Exchange Commission.

DEBT AS A PERCENT OF CAPITAL



Total debt was 30 percent of total capital and net debt was 24 percent of net capital at year-end 2007. Emerson maintains a conservative financial structure to provide the strength and flexibility necessary to achieve our strategic objectives.

CONTRACTUAL OBLIGATIONS

At September 30, 2007, the Company's contractual obligations, including estimated payments due by period, are as follows:

(DOLLARS IN MILLIONS)	TOTAL	PAYMENTS DUE BY PERIOD			
		LESS THAN 1 YEAR	1-3 YEARS	3-5 YEARS	MORE THAN 5 YEARS
Long-term Debt	\$3,623	251	1,074	287	2,011
Operating Leases	558	163	195	98	102
Purchase Obligations	1,720	1,156	387	177	–
Total	\$5,901	1,570	1,656	562	2,113

Purchase obligations consist primarily of inventory purchases made in the normal course of business to meet operational requirements. The above table does not include \$2.0 billion of other noncurrent liabilities recorded in the balance sheet, as summarized in Note 17, which consist primarily of deferred income tax and retirement and postretirement plan liabilities, because it is not certain when these liabilities will become due. See Notes 10, 11 and 13 for additional information.

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, 7, 8 and 9.

Critical Accounting Policies

Preparation of the Company's financial statements requires management to make judgments, assumptions and estimates regarding uncertainties that affect the reported amounts of assets, liabilities, stockholders' equity, revenues and expenses. Note 1 of the Notes to Consolidated Financial Statements describes the significant accounting policies used in preparation of the Consolidated Financial Statements. The most significant areas involving management judgments and estimates are described in the following paragraphs. Actual results in these areas could differ materially from management's estimates under different assumptions or conditions.

REVENUE RECOGNITION

The Company recognizes nearly all of its revenues through the sale of manufactured products and records the sale when products are shipped and title passes to the customer and collection is reasonably assured. In certain instances, revenue is recognized on the percentage-of-completion method, when services are rendered, or in accordance with AICPA Statement of Position No. 97-2, "Software Revenue Recognition." Sales sometimes include multiple items including services such as installation. In such instances, revenue assigned to each item is based on that item's objectively determined fair value, and revenue is recognized individually for delivered items only if the delivered items have value to the customer on a standalone basis and performance of the undelivered items is probable and substantially in the Company's control,

or the undelivered items are inconsequential or perfunctory. Management believes that all relevant criteria and conditions are considered when recognizing sales.

INVENTORIES

Inventories are stated at the lower of cost or market. The majority of inventory values are based upon standard costs that approximate average costs, while the remainder are principally valued on a first-in, first-out basis. Standard costs are revised at the beginning of each fiscal year. The effects of resetting standards and operating variances incurred during each period are allocated between inventories and cost of sales. Management regularly reviews inventory for obsolescence to determine whether a write-down is necessary. Various factors are considered in making this determination, including recent sales history and predicted trends, industry market conditions and general economic conditions.

LONG-LIVED ASSETS

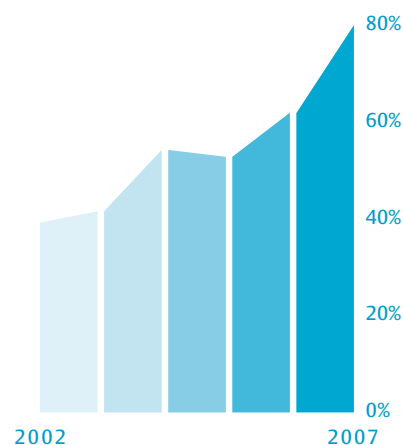
Long-lived assets, which include primarily goodwill and property, plant and equipment, are reviewed for impairment whenever events or changes in business circumstances indicate the carrying value of the assets may not be recoverable, as well as annually for goodwill. If the Company determines that the carrying value of the long-lived asset may not be recoverable, a permanent impairment charge is recorded for the amount by which the carrying value of the long-lived asset exceeds its fair value. Fair value is generally measured based on a discounted cash flow method using a discount rate determined by management to be commensurate with the risk inherent in the Company's current business model. The estimates of cash flows and discount rate are subject to change depending on the economic environment, including such factors as interest rates, expected market returns and volatility of markets served. Management believes that the estimates of future cash flows and fair value are reasonable; however, changes in estimates could materially affect the evaluations. See Notes 1, 3 and 6.

RETIREMENT PLANS

Defined benefit plan expense and obligations are dependent on assumptions used in calculating such amounts. These assumptions include discount rate, rate of compensation increases and expected return on plan assets. In accordance with U.S. generally accepted accounting principles, actual results that differ from the assumptions are accumulated and amortized over future periods. While management believes that the assumptions used are appropriate, differences in actual experience or changes in assumptions may affect the Company's retirement plan obligations and future

expense. Effective for 2008, the discount rate for the U.S. retirement plans was adjusted to 6.25 percent based on the changes in market interest rates. Defined benefit pension plan expense is expected to decrease slightly in 2008. The Company contributed \$136 million to defined benefit plans in 2007 and expects to contribute \$50 million to \$100 million in 2008. Effective September 30, 2007, the Company adopted the recognition and disclosure provisions of Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" (FAS 158). This statement requires employers to recognize the funded status of defined benefit plans and other postretirement plans in the balance sheet and to recognize changes in the funded status through comprehensive income in the year in which they occur. The incremental effect of adopting FAS 158 resulted in a pre-tax charge to accumulated other comprehensive income of \$522 million (\$329 million after-tax). Also see Notes 10 and 11 for additional disclosures regarding the adoption. Effective for fiscal year 2009, FAS 158 requires plan assets and liabilities to be measured as of year-end, rather than the June 30 measurement date that the Company presently uses.

OPERATING CASH FLOW TO TOTAL DEBT



Strong cash flow performance in 2007 increased the ratio of operating cash flow to total debt to 80 percent.

INCOME TAXES

Income tax expense and deferred tax assets and liabilities reflect management's assessment of actual future taxes to be paid on items reflected in the financial statements. Uncertainty exists regarding tax positions taken in previously filed tax returns still under examination and positions expected to be taken in future returns. Deferred tax assets and liabilities arise due to differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases, and operating loss and tax credit carryforwards. Deferred income taxes are measured using enacted tax rates in effect for the year in which the temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the period that includes the enactment date. Generally, no provision is made for U.S. income taxes on the undistributed earnings of non-U.S. subsidiaries. These earnings are permanently invested or otherwise indefinitely retained for continuing international operations. Determination of the amount of taxes that might be paid on these undistributed earnings if eventually remitted is not practicable. See Note 13.

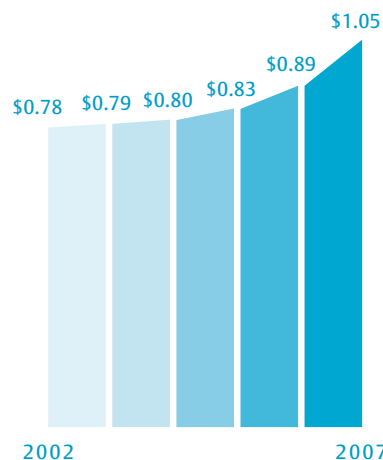
The American Jobs Creation Act of 2004 (the Act) was signed into law on October 22, 2004. The Act repeals an export tax benefit, provides for a 9 percent deduction on U.S. manufacturing income, and allows the repatriation of foreign earnings at a reduced rate for one year, subject to certain limitations. When fully phased-in, management estimates that the repeal of the export tax benefit will be offset by the deduction on manufacturing income. During 2005, the Company repatriated approximately \$1.4 billion (\$1.8 billion in total) of cash from undistributed earnings of non-U.S. subsidiaries under the Act. As a result, the Company recorded a tax expense of \$63 million, or \$0.07 per share, in 2005.

NEW ACCOUNTING PRONOUNCEMENTS

In June 2006, the Financial Accounting Standards Board issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement 109" (FIN 48). FIN 48 addresses the accounting for uncertain tax positions that a company has taken or expects to take on a tax return. The Company has analyzed FIN 48, which is required to be adopted in the first quarter of fiscal 2008, and believes it will not have a material impact on the financial statements when finalized.

In September 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" (FAS 157). FAS 157 defines fair value, establishes a formal framework for measuring fair value and expands disclosures about fair value measurements. The Company is in the process of analyzing the impact of FAS 157, which is effective for fiscal years beginning after November 15, 2007.

DIVIDENDS PER SHARE



Annual dividends increased to a record \$1.05 per share in 2007, representing the 51st consecutive year of increases.
