EMERSON ELECTRIC CO. & SUBSIDIARIES

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

(1) Summary of Significant Accounting Policies

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its controlled affiliates. Intercompany transactions, profits and balances are eliminated in consolidation. Other investments of 20 percent to 50 percent are accounted for by the equity method. Investments in nonpublicly-traded companies of less than 20 percent are carried at cost. Investments in publicly-traded companies of less than 20 percent are carried at fair value, with changes in fair value reflected in accumulated other comprehensive income.

FOREIGN CURRENCY TRANSLATION

The functional currency of a vast majority of the Company's non-U.S. subsidiaries is the local currency. Adjustments resulting from the translation of financial statements are reflected in accumulated other comprehensive income.

CASH EQUIVALENTS

Cash equivalents consist of highly liquid investments with original maturities of three months or less.

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.

PROPERTY, PLANT AND EQUIPMENT

The Company records investments in land, buildings, and machinery and equipment at cost. Depreciation is computed principally using the straight-line method over estimated service lives. Service lives for principal assets are 30 to 40 years for buildings and 8 to 12 years for machinery and equipment. Long-lived assets are reviewed for impairment whenever events or changes in business circumstances indicate that the carrying value of the assets may not be recoverable. Impairment losses are recognized based on fair value if expected future undiscounted cash flows of the related assets are less than their carrying values.

GOODWILL AND INTANGIBLE ASSETS

Assets and liabilities acquired in business combinations are accounted for using the purchase method and recorded at their respective fair values. Substantially all goodwill is assigned to the reporting unit that acquires a business. A reporting unit is an operating segment as defined in Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information," or a business one level below an operating segment if discrete financial information is prepared and regularly reviewed by the segment manager. The Company conducts a formal impairment test of goodwill on an annual basis and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. Under the impairment test, if a reporting unit's carrying amount exceeds its estimated fair value, a goodwill impairment is recognized to the extent that the reporting unit's carrying amount of goodwill exceeds the implied fair value of the goodwill. Fair values of reporting units are estimated using discounted cash flows and market multiples.

All of the Company's intangible assets (other than goodwill) are subject to amortization. Intangibles consist of intellectual property (such as patents and trademarks), customer relationships and capitalized software and are amortized on a straight-line basis. These intangibles are also subject to evaluation for potential impairment if an event occurs or circumstances change that indicate the carrying amount may not be recoverable.

WARRANTY

The Company's product warranties vary by each of its product lines and are competitive for the markets in which it operates. Warranty generally extends for a period of one to two years from the date of sale or installation. Provisions for warranty are determined primarily based on historical warranty cost as a percentage of sales or a fixed amount per unit sold based on failure rates, adjusted for specific problems that may arise. Product warranty expense is less than 1 percent of sales.

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.

FINANCIAL INSTRUMENTS

All derivative instruments are reported on the balance sheet at fair value. The accounting for changes in fair value of a derivative instrument depends on whether it has been designated and qualifies as a hedge and on the type of hedge. For each derivative instrument designated as a cash flow hedge, the effective portion of the gain or loss on the derivative is deferred in accumulated other comprehensive income until recognized in earnings with the underlying hedged item. For each derivative instrument designated as a fair value hedge, the gain or loss on the derivative and the offsetting gain or loss on the hedged item are recognized immediately in earnings. Currency fluctuations on non-U.S. dollar obligations that have been designated as hedges on non-U.S. net asset exposures are included in accumulated other comprehensive income. Regardless of type, a fully effective hedge will result in no net earnings impact while the derivative is outstanding. To the extent that any hedge is ineffective at offsetting cash flow or fair value changes in the underlying hedged item, there could be a net earnings impact. Gains and losses from the ineffective portion of any hedge, as well as the gains and losses on derivative instruments not designated as a hedge, are recognized in the income statement immediately.

INCOME TAXES

No provision has been made for U.S. income taxes on the undistributed earnings of non-U.S. subsidiaries of approximately $2.6 billion at September 30, 2007. 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.

COMPREHENSIVE INCOME

Comprehensive income is primarily comprised of net earnings and changes in foreign currency translation, minimum pension liability and cash flow hedges. Accumulated other comprehensive income, after-tax, consists of foreign currency translation credits of $728 and $269, pension and postretirement adjustments of $384 and $57, and cash flow hedges and other credits of $38 and $94 at September 30, 2007 and 2006, respectively.

FINANCIAL STATEMENT PRESENTATION

The preparation of the financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts and related disclosures. Actual results could differ from those estimates.

On December 11, 2006, a two-for-one split of the Company's common stock was effected in the form of a 100 percent stock dividend (shares began trading on a post-split basis on December 12, 2006). This stock split resulted in the issuance of approximately 476.7 million additional shares of common stock and was accounted for by the transfer of approximately $161 from additional paid-in capital and $77 from retained earnings to common stock. All share and per share data have been retroactively restated to reflect this split.

Effective September 30, 2007, Emerson 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 over- or under-funded status of defined benefit plans and other postretirement plans in the balance sheet and to recognize changes in the funded status in the year in which the changes occur through comprehensive income. The incremental effect of adopting FAS 158 was a reduction in other assets of $425, an increase in other liabilities of $97 and an after-tax charge to accumulated other comprehensive income of $329 (See Notes 10 and 11).

Certain prior year amounts have been reclassified to conform to the current year presentation.

(2) Weighted Average Common Shares

Basic earnings per common share consider only the weighted average of common shares outstanding while diluted earnings per common share consider the dilutive effects of stock options and incentive shares. Options to purchase approximately 1.1 million, 1.0 million and 5.1 million shares of common stock were excluded from the computation of diluted earnings per share in 2007, 2006 and 2005, respectively, because their effect would have been antidilutive. Reconciliations of weighted average common shares for basic earnings per common share and diluted earnings per common share follow:

(SHARES IN MILLIONS)	2005	2006	2007
Basic	829.9	816.5	**793.8**
Dilutive shares	7.8	8.0	**10.1**
Diluted	837.7	824.5	**803.9**

(3) Acquisitions and Divestitures

The Company acquired Damcos Holding AS (Damcos) during the second quarter of fiscal 2007, and Stratos International, Inc. (Stratos) during the fourth quarter of fiscal 2007. Damcos supplies valve remote control systems and tank monitoring equipment to the marine and shipbuilding industries and is included in the Process Management segment. Stratos is a designer and manufacturer of radio-frequency and microwave interconnect products and is included in the Network Power segment. In addition to Damcos and Stratos, the Company acquired several smaller businesses during 2007 mainly in the Process Management and Appliance and Tools segments. Total cash paid for these businesses (net of cash and equivalents acquired of approximately $40 and debt assumed of approximately $56) and annualized sales were approximately $295 and $240, respectively. Goodwill of $189 (none of which is expected to be deductible for tax purposes) and identifiable intangible assets (primarily technology and customer relationships) of $106, which are being amortized on a straight-line basis over a weighted-average life of nine years, were recognized from these transactions in 2007. Third-party valuations of assets are in-process; purchase price allocations are subject to refinement for fiscal year 2007 acquisitions.

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

The Company acquired Artesyn Technologies, Inc. (Artesyn) during the third quarter of fiscal 2006, and Knürr AG (Knürr) and Bristol Babcock (Bristol) during the second quarter of fiscal 2006. Artesyn is a global manufacturer of advanced power conversion equipment and board-level computing solutions for infrastructure applications in telecommunication and data-communication systems and is included in the Network Power segment. Knürr is a manufacturer of indoor and outdoor enclosure systems and cooling technologies for telecommunications, electronics and computing equipment and is included in the Network Power segment. Bristol is a manufacturer of control and measurement equipment for oil and gas, water and wastewater, and power industries and is included in the Process Management segment. In addition to Artesyn, Knürr and Bristol, the Company acquired several smaller businesses during 2006 mainly in the Industrial Automation and Appliance and Tools segments. Total cash paid for these businesses (net of cash and equivalents acquired of approximately $120 and debt assumed of approximately $90) and annualized sales were approximately $752 and $920, respectively. Goodwill of $481 ($54 of which is expected to be deductible for tax purposes) and identifiable intangible assets (primarily technology and customer relationships) of $189, which are being amortized on a straight-line basis over a weighted-average life of nine years, were recognized from these transactions in 2006.

The Company acquired Do+Able, a manufacturer of ready-to-assemble wood and steel home and garage organization and storage products, which is included in the Appliance and Tools segment, in the second quarter of 2005 and Numatics, a manufacturer of pneumatic and motion control products for industrial applications, which is included in the Industrial Automation segment, in the fourth quarter of 2005. In addition to Do+Able and Numatics, the Company acquired several smaller businesses during 2005, mainly in the Process Management and Appliance and Tools segments. Total cash paid (including assumed debt of approximately $100, which was repaid in October 2005) and annualized sales for these businesses were approximately $466 and $430, respectively. Goodwill of $236 ($58 of which is expected to be deductible for tax purposes) and identifiable intangible assets of $122, which are being amortized on a straight-line basis over a weighted-average life of ten years, were recognized from these transactions in 2005.

The results of operations of these businesses have been included in the Company's consolidated results of operations since the respective dates of acquisition and prior to the respective dates of divestiture.

(4) Other Deductions, Net

Other deductions, net are summarized as follows:

	2005	2006	2007
Rationalization of operations	$110	84	83
Amortization of intangibles (intellectual property and customer relationships)	28	47	63
Other	118	115	111
Gains, net	(26)	(68)	(74)
Total	$230	178	183

Other is comprised of several items that are individually immaterial, including minority interest expense, foreign currency gains and losses, bad debt expense, equity investment income and losses, as well as one-time items, such as litigation and disputed matters, insurance recoveries and interest refunds.

Gains, net for 2007 includes the following items. The Company recorded gains of approximately $32 in 2007 related to the sale of its remaining 4.5 million shares of MKS Instruments, Inc. (MKS), a publicly-traded company. The Company also recorded a gain of approximately $24 in 2007 for payments received under the U.S. Continued Dumping and Subsidy Offset Act (Offset Act).

Gains, net for 2006 includes the following items. The Company recorded gains of approximately $26 in 2006 related to the sale of 4.4 million shares of MKS. In the fourth quarter of 2006, the Company recorded a pretax gain of approximately $31 related to the divesture of the materials testing business. Also during the fourth quarter of 2006, the Company recorded a pretax charge of $14 related to the write-down of two businesses that were sold in 2007 to their net realizable values. The Company also recorded a gain of approximately $18 in 2006 for payments received under the Offset Act.

Gains, net for 2005 includes the following items. An approximate $13 gain from the sale of a manufacturing facility and an approximate $13 gain for a payment received under the Offset Act were recorded in 2005.

(5) Rationalization of Operations

The change in the liability for the rationalization of operations during the years ended September 30 follows:

	2006	EXPENSE	PAID / UTILIZED	2007
Severance and benefits	$31	40	43	28
Lease/contract terminations	12	4	8	8
Fixed asset write-downs	–	2	2	–
Vacant facility and other shutdown costs	1	8	8	1
Start-up and moving costs	1	29	30	–
	$45	83	91	37

	2005	EXPENSE	ACQUISITIONS	PAID / UTILIZED	2006
Severance and benefits	$22	38	16	45	31
Lease/contract terminations	11	5	4	8	12
Fixed asset write-downs	–	2	–	2	–
Vacant facility and other shutdown costs	–	9	–	8	1
Start-up and moving costs	–	30	–	29	1
	$33	84	20	92	45

Rationalization of operations by segment is summarized as follows:

	2005	2006	2007
Process Management	$ 20	14	15
Industrial Automation	15	12	14
Network Power	35	19	23
Climate Technologies	15	14	9
Appliance and Tools	24	25	22
Corporate	1	–	–
Total	$110	84	83

Rationalization of operations comprises expenses associated with the Company's efforts to continually improve operational efficiency and to expand globally in order to remain competitive on a worldwide basis. These expenses result from numerous individual actions implemented across the divisions on a routine basis. Rationalization of operations includes ongoing costs for moving facilities, starting up plants from relocation as well as business expansion, exiting product lines, curtailing/downsizing operations because of changing economic conditions, and other items resulting from asset redeployment decisions. Shutdown costs include severance, benefits, stay bonuses, lease/contract terminations and asset write-downs. Start-up and moving costs include employee training and relocation, movement of assets and other items. Vacant facility costs include security, maintenance and utility costs associated with facilities that are no longer being utilized.

During 2007, rationalization of operations primarily related to the exit of approximately 25 production, distribution, or office facilities, including the elimination of approximately 2,200 positions, as well as costs related to facilities exited in previous periods. Noteworthy rationalization actions during 2007 are as follows. Process Management included start-up costs related to capacity expansion in China to serve the Asian market, as well as severance and start-up and moving costs related to the movement of certain operations in Western Europe to Eastern Europe and Asia to improve profitability. Industrial Automation included severance and start-up and moving costs related to the consolidation of certain power transmission facilities in Asia and North America to obtain operational efficiencies and serve Asian and North American markets. Network Power included severance related to the closure of certain power conversion facilities acquired with Artesyn, as well as severance and start-up and moving costs related to the shifting of certain power systems production from the United States and Europe to Mexico to remain competitive on a global basis. Climate Technologies included start-up costs related to capacity expansion in Mexico and Eastern Europe to improve profitability and to serve these markets, and start-up and moving costs related to the consolidation of certain production facilities in the United States to obtain operational efficiencies. Appliance and Tools included severance and start-up and moving costs related to the consolidation of certain North American production, and severance related to the closure of certain motor production in Europe to remain competitive on a global basis. The Company expects rationalization expense for 2008 to be approximately $90 to $100, including the costs to complete actions initiated before the end of 2007 and actions anticipated to be approved and initiated during 2008.

During 2006, rationalization of operations primarily related to the exit of approximately 10 production, distribution, or office facilities, including the elimination of approximately 1,700 positions, as well as costs related to facilities exited in previous periods. Noteworthy rationalization actions during 2006 are as follows. Process Management included severance related to the shifting of certain regulator production from Western Europe to Eastern Europe. Industrial Automation included start-up and moving costs related to shifting certain motor production in Western Europe to Eastern Europe, China and Mexico to leverage costs and remain competitive on a global basis and to serve these markets. Network Power included severance related to the closure of certain power conversion facilities acquired with Artesyn, severance, start-up and vacant facility costs related to the consolidation of certain power systems operations in North America and the consolidation of administrative operations in Europe to obtain operational synergies. Climate Technologies included severance related to the movement of temperature sensors and controls production from Western Europe to China and start-up and moving costs related to a new plant in Eastern Europe in order to improve profitability. Appliance and Tools included primarily severance and start-up and moving costs related to the shifting of certain tool and motor manufacturing operations from the United States and Western Europe to China and Mexico in order to consolidate facilities and improve profitability.

During 2005, rationalization of operations primarily related to the exit of approximately 25 production, distribution, or office facilities, including the elimination of approximately 2,100 positions, as well as costs related to facilities exited in previous periods. Noteworthy rationalization actions during 2005 are as follows. Process Management included severance and plant closure costs related to consolidation of instrumentation plants within Europe and consolidation of valve operations within North America, the movement of major distribution facilities to Asia, as well as several other cost reduction actions. Network Power included severance and lease termination costs related to certain power systems operations in Western Europe shifting to China and Eastern Europe in order to leverage product platforms and lower production and engineering costs to remain competitive on a global basis. This segment also included severance and start-up and moving costs related to the consolidation of North American power systems operations into the Marconi operations acquired in 2004. Appliance and Tools included severance, plant closure costs and start-up and moving costs related to consolidating various industrial and hermetic motor manufacturing facilities for operational efficiency. Severance costs in this segment also related to shifting certain appliance control operations from the United States to Mexico and China in order to consolidate facilities and improve profitability.

(6) Goodwill and Other Intangibles

Acquisitions are accounted for under the purchase method, with substantially all goodwill assigned to the reporting unit that acquires the business. Under the annual impairment test, if a reporting unit's carrying amount exceeds its estimated fair value, a goodwill impairment is recognized to the extent that the reporting unit's carrying amount of goodwill exceeds the implied fair value of the goodwill. Fair values of reporting units are estimated using discounted cash flows and market multiples.

The change in goodwill by business segment follows:

	PROCESS MANAGEMENT	INDUSTRIAL AUTOMATION	NETWORK POWER	CLIMATE TECHNOLOGIES	APPLIANCE AND TOOLS	TOTAL
Balance, September 30, 2005	$1,699	997	1,780	380	623	5,479
Acquisitions	58	27	351	25	20	481
Divestitures		(24)	(3)			(27)
Impairment			(5)			(5)
Foreign currency translation and other	21	16	39	3	6	85
Balance, September 30, 2006	$1,778	1,016	2,162	408	649	6,013
Acquisitions	146	1	26	3	13	189
Divestitures			(5)			(5)
Impairment		(7)				(7)
Foreign currency translation and other	61	60	76	9	16	222
Balance, September 30, 2007	**$1,985**	**1,070**	**2,259**	**420**	**678**	**6,412**

The gross carrying amount and accumulated amortization of intangibles (other than goodwill) by major class follow:

	GROSS CARRYING AMOUNT		ACCUMULATED AMORTIZATION		NET CARRYING AMOUNT	
	2006	2007	2006	2007	2006	2007
Intellectual property and customer relationships	$ 794	925	324	381	470	544
Capitalized software	647	729	484	558	163	171
	$1,441	1,654	808	939	633	715

Total intangible amortization expense for 2007, 2006 and 2005 was $131, $107 and $90, respectively. Based on intangible assets as of September 30, 2007, amortization expense will approximate $126 in 2008, $115 in 2009, $96 in 2010, $82 in 2011 and $72 in 2012.

(7) Financial Instruments

The Company selectively uses derivative financial instruments to manage interest costs, commodity prices and currency exchange risk. The Company does not hold derivatives for trading purposes. No credit loss is anticipated as the counterparties to these agreements are major financial institutions with high credit ratings.

To efficiently manage interest costs, the Company utilizes interest rate swaps as cash flow hedges of variable rate debt or fair value hedges of fixed rate debt. Also as part of its hedging strategy, the Company utilizes purchased option and forward exchange contracts and commodity swaps as cash flow or fair value hedges to minimize the impact of currency and commodity price fluctuations on transactions, cash flows, fair values and firm commitments. Hedge ineffectiveness during 2007, 2006 and 2005 was immaterial. At September 30, 2007, substantially all of the contracts for the sale or purchase of European and other currencies and the purchase of copper and other commodities mature within two years; contracts with a fair value of approximately $60 mature in 2008.

Notional transaction amounts and fair values for the Company's outstanding derivatives, by risk category and instrument type, as of September 30, 2007 and 2006, are summarized as follows. Fair values of the derivatives do not consider the offsetting underlying hedged item.

	2006		2007	
	NOTIONAL AMOUNT	FAIR VALUE	NOTIONAL AMOUNT	FAIR VALUE
Foreign currency:				
Forwards	$1,310	11	1,922	35
Options	$ 4	–	266	2
Interest rate swaps	$ 110	(4)	113	(3)
Commodity contracts	$ 457	130	509	45

Fair values of the Company's financial instruments are estimated by reference to quoted prices from market sources and financial institutions, as well as other valuation techniques. The estimated fair value of long-term debt (including current maturities) exceeded the related carrying value by $2 and $40 at September 30, 2007 and 2006, respectively. The estimated fair value of each of the Company's other classes of financial instruments approximated the related carrying value at September 30, 2007 and 2006.

(8) Short-Term Borrowings and Lines of Credit

Short-term borrowings and current maturities of long-term debt are summarized as follows:

	2006	2007
Current maturities of long-term debt	$ 2	251
Commercial paper	819	113
Payable to banks	28	19
Other	49	21
Total	$898	404
Weighted-average short-term borrowing interest rate at year-end	4.9%	3.2%

In 2000, the Company issued 13 billion Japanese yen of commercial paper and simultaneously entered into a ten-year interest rate swap, which fixed the rate at 2.2 percent.

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 and to assure availability of funds at prevailing interest rates. 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. There were no borrowings against U.S. lines of credit in the last three years.

(9) Long-Term Debt

Long-term debt is summarized as follows:

	2006	2007
5 1/2% notes due September 2008	$ 250	250
5% notes due October 2008	175	175
5.85% notes due March 2009	250	250
7 1/8% notes due August 2010	500	500
5.75% notes due November 2011	250	250
4.625% notes due October 2012	250	250
4 1/2% notes due May 2013	250	250
5 5/8% notes due November 2013	250	250
5% notes due December 2014	250	250
4.75% notes due October 2015	250	250
5.125% notes due December 2016	–	250
5.375% notes due October 2017	–	250
6% notes due August 2032	250	250
Other	205	198
	3,130	3,623
Less current maturities	2	251
Total	$3,128	3,372

During the first and third quarters of 2007, the Company issued $250 of 5.125%, ten-year notes, and $250 of 5.375%, ten-year notes, respectively, under a shelf registration statement filed with the Securities and Exchange Commission. During the fourth quarter of 2005, the Company issued $250 of 4.75%, ten-year notes under a shelf registration statement filed with the Securities and Exchange Commission. In 1999, the Company issued $250 of 5.85%, ten-year notes that were simultaneously swapped to U.S. commercial paper rates. The Company terminated the swap in 2001, establishing an effective interest rate of 5.7 percent.

Long-term debt maturing during each of the four years after 2008 is $474, $600, $37 and $250, respectively. Total interest paid related to short-term borrowings and long-term debt was approximately $242, $214 and $247 in 2007, 2006 and 2005, respectively.

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. The Company may sell securities in one or more separate offerings with the size, price and terms to be determined at the time of sale. The net proceeds from the sale of the securities will be used for general corporate purposes, which may include, but are not limited to, working capital, capital expenditures, financing acquisitions and the repayment of short- or long-term borrowings. The net proceeds may be invested temporarily until they are used for their stated purpose.

(10) Retirement Plans

Retirement plan expense includes the following components:

	U.S. PLANS			NON-U.S. PLANS		
	2005	2006	2007	2005	2006	2007
Defined benefit plans:						
Service cost (benefits earned during the period)	$ 48	58	43	14	19	21
Interest cost	145	145	159	31	32	38
Expected return on plan assets	(207)	(202)	(211)	(27)	(32)	(38)
Net amortization	64	100	87	13	16	11
Net periodic pension expense	50	101	78	31	35	32
Defined contribution and multiemployer plans	69	85	94	23	25	27
Total retirement plan expense	$ 119	186	172	54	60	59

The reconciliations of the actuarial present value of the projected benefit obligations and of the fair value of plan assets for defined benefit pension plans follow:

	U.S. PLANS		NON-U.S. PLANS	
	2006	2007	2006	2007
Projected benefit obligation, beginning	$2,747	2,464	707	711
Service cost	58	43	19	21
Interest cost	145	159	32	38
Actuarial loss (gain)	(386)	127	(53)	10
Benefits paid	(122)	(129)	(29)	(36)
Acquisitions/divestitures, net	17	–	24	18
Foreign currency translation and other	5	14	11	75
Projected benefit obligation, ending	$2,464	2,678	711	837
Fair value of plan assets, beginning	$2,566	2,785	492	555
Actual return on plan assets	233	475	37	50
Employer contributions	91	71	33	62
Benefits paid	(122)	(129)	(29)	(36)
Acquisitions/divestitures, net	16	–	18	1
Foreign currency translation and other	1	2	4	58
Fair value of plan assets, ending	$2,785	3,204	555	690
Plan assets in excess of (less than) benefit obligation as of June 30	$ 321	526	(156)	(147)
Unrecognized net loss	564	–	179	–
Unrecognized prior service cost (benefit)	10	–	(2)	–
Adjustment for fourth quarter contributions	1	1	1	4
Net amount recognized in the balance sheet	$ 896	527	22	(143)
The amounts recognized in the balance sheet as of September 30 consisted of:				
Noncurrent asset	$ 927	630	110	19
Noncurrent liability	$ (108)	(103)	(100)	(162)
Accumulated other comprehensive income	$ 77	365	12	185

Approximately $97 of the $550 of accumulated losses included in accumulated other comprehensive income at September 30, 2007, will be amortized into earnings in 2008.

As of the plans' June 30 measurement date, the total accumulated benefit obligation was $3,282 and $2,956 for 2007 and 2006, respectively. Also, as of the plans' June 30 measurement date, the projected benefit obligation, accumulated benefit obligation and fair value of plan assets for the retirement plans with accumulated benefit obligations in excess of plan assets were $663, $613 and $382, respectively, for 2007, and $623, $570 and $360, respectively, for 2006.

The weighted-average assumptions used in the valuations of pension benefits were as follows:

	U.S. PLANS			NON-U.S. PLANS		
	2005	2006	2007	2005	2006	2007
Weighted-average assumptions used to determine net pension expense:						
Discount rate	6.25%	5.25%	6.50%	5.4%	4.7%	4.9%
Expected return on plan assets	8.50%	8.00%	8.00%	7.4%	7.2%	7.2%
Rate of compensation increase	3.25%	3.00%	3.25%	3.1%	3.0%	3.1%
Weighted-average assumptions used to determine benefit obligations as of June 30:						
Discount rate	5.25%	6.50%	6.25%	4.7%	4.9%	5.3%
Rate of compensation increase	3.00%	3.25%	3.25%	3.0%	3.1%	3.5%

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 primary objective for the investment of plan assets is to secure participant retirement benefits, while earning a reasonable rate of return. Plan assets are invested consistent with the provisions of prudence and diversification rules of ERISA and with a long-term investment horizon. The expected return on plan assets assumption is determined by reviewing the investment return of the plans for the past ten years and the historical return (since 1926) of an asset mix approximating Emerson's current asset allocation targets and evaluating these returns in relation to expectations of various investment organizations to determine whether long-term future returns are expected to differ significantly from the past. The Company's pension plan asset allocations at June 30, 2007 and 2006, and target weighted-average allocations are as follows:

	U.S. PLANS			NON-U.S. PLANS		
	2006	2007	TARGET	2006	2007	TARGET
Asset category						
Equity securities	68%	67%	65-69%	55%	57%	50-60%
Debt securities	28%	28%	26-30%	36%	36%	30-40%
Other	4%	5%	3-7%	9%	7%	5-10%
	100%	100%	100%	100%	100%	100%

The Company estimates that future benefit payments for the U.S. plans will be as follows: $133 in 2008, $139 in 2009, $146 in 2010, $153 in 2011, $161 in 2012 and $935 in total over the five years 2013 through 2017. Using foreign exchange rates as of September 30, 2007, the Company estimates that future benefit payments for the non-U.S. plans will be as follows: $30 in 2008, $29 in 2009, $32 in 2010, $36 in 2011, $39 in 2012 and $226 in total over the five years 2013 through 2017. In 2008, the Company expects to contribute $50 to $100 to the retirement plans.

(11) Postretirement Plans

The Company sponsors unfunded postretirement benefit plans (primarily health care) for certain U.S. retirees and their dependents. Net postretirement plan expense for the years ended September 30 follows:

	2005	2006	2007
Service cost	$ 6	5	6
Interest cost	27	26	29
Net amortization	21	32	26
Net postretirement	$54	63	61

The reconciliations of the actuarial present value of accumulated postretirement benefit obligations follow:

	2006	2007
Benefit obligation, beginning	$ 502	516
Service cost	5	6
Interest cost	26	29
Actuarial loss (gain)	16	(16)
Benefits paid	(39)	(37)
Acquisitions/divestitures and other	6	3
Benefit obligation, ending	516	501
Unrecognized net loss	(102)	–
Unrecognized prior service benefit	6	–
Postretirement benefit liability recognized in the balance sheet	$ 420	501

Approximately $24 of the $57 of accumulated losses included in accumulated other comprehensive income at September 30, 2007, will be amortized into earnings in 2008. The assumed discount rates used in measuring the obligations as of September 30, 2007, 2006 and 2005, were 6.00 percent, 5.75 percent and 5.25 percent, respectively. The assumed health care cost trend rate for 2008 was 9.5 percent, declining to 5.0 percent in the year 2017. The assumed health care cost trend rate for 2007 was 10.0 percent, declining to 5.0 percent in the year 2016. A one-percentage-point increase or decrease in the assumed health care cost trend rate for each year would increase or decrease the obligation as of September 30, 2007 and the 2007 postretirement plan expense by less than 5 percent. The Company estimates that future benefit payments will be as follows: $44 in 2008, $46 in 2009, $47 in 2010, $54 in 2011, $54 in 2012 and $238 in total over the five years 2013 through 2017.

(12) Contingent Liabilities and Commitments

Emerson is a party to a number of pending legal proceedings and claims, including those involving general and product liability and other matters, several of which claim substantial amounts of damages. The Company accrues for such liabilities when it is probable that future costs (including legal fees and expenses) will be incurred and such costs can be reasonably estimated. Such accruals are based on developments to date, management's estimates of the outcomes of these matters, the Company's experience in contesting, litigating and settling other similar matters, and any related insurance coverage.

Although it is not possible to predict the ultimate outcome of the matters discussed above, historically, the Company has been successful in defending itself against claims and suits that have been brought against it. The Company will continue to defend itself vigorously in all such matters. While the Company believes a material adverse impact is unlikely, given the inherent uncertainty of litigation, a remote possibility exists that a future adverse development could have a material adverse impact on the Company.

The Company enters into indemnification agreements in the ordinary course of business in which the indemnified party is held harmless and is reimbursed for losses incurred from claims by third parties. In connection with divestitures of certain assets or businesses, the Company often provides indemnities to the buyer with respect to certain matters including, for example, environmental liabilities and unidentified tax liabilities related to periods prior to the disposition. Because of the uncertain nature of the indemnities, the maximum liability cannot be quantified. Liabilities for obligations are recorded when probable and when they can be reasonably estimated. Historically, the Company has not made significant payments for these obligations.

At September 30, 2007, there were no known contingent liabilities (including guarantees, pending litigation, taxes and other claims) that management believes will be material in relation to the Company's financial statements, nor were there any material commitments outside the normal course of business.

(13) Income Taxes

Earnings before income taxes consist of the following:

	2005	2006	2007
United States	$1,157	1,518	**1,550**
Non-U.S.	992	1,166	**1,557**
Earnings before income taxes	$2,149	2,684	**3,107**

The principal components of income tax expense follow:

	2005	2006	2007
Current:			
Federal	$ 458	394	**606**
State and local	42	57	**58**
Non-U.S.	272	316	**372**
Deferred:			
Federal	(41)	73	**(4)**
State and local	(7)	8	**(14)**
Non-U.S.	3	(9)	**(47)**
Income tax expense	$ 727	839	**971**

The federal corporate statutory rate is reconciled to the Company's effective income tax rate as follows:

	2005	2006	2007
Federal corporate statutory rate	35.0%	35.0%	**35.0%**
State and local taxes, less federal tax benefit	1.0	1.6	**0.9**
Non-U.S. rate differential	(3.2)	(3.4)	**(4.1)**
Non-U.S. tax holidays	(1.6)	(1.6)	**(1.3)**
Export benefit	(1.1)	(0.8)	**(0.2)**
U.S. manufacturing deduction	–	(0.4)	**(0.4)**
Repatriation - American Jobs Creation Act	3.0	–	**–**
Other	0.7	0.9	**1.4**
Effective income tax rate	33.8%	31.3%	**31.3%**

Non-U.S. tax holidays reduce the tax rate in certain foreign jurisdictions, approximately half of which are expected to expire next year. The American Jobs Creation Act of 2004 (the Act) was signed into law on October 22, 2004. The Act allows the repatriation of foreign earnings at a reduced rate for one year, subject to certain limitations. 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 in 2005. Other, in 2007, includes tax expense of $40 provided for certain earnings of non-U.S. subsidiaries as a result of the Company's intention to repatriate those earnings in 2008.

The principal items that gave rise to deferred income tax assets and liabilities follow:

	2006	2007
Deferred tax assets:		
Accrued liabilities	$ 218	195
Employee compensation and benefits	124	193
Postretirement and postemployment benefits	160	174
NOL and tax credits	254	261
Capital loss benefit	30	47
Other	126	110
Total	$ 912	980
Valuation allowance	$ (183)	(166)
Deferred tax liabilities:		
Intangibles	$ (346)	(413)
Property, plant and equipment	(266)	(244)
Pension	(308)	(121)
Leveraged leases	(110)	(96)
Other	(92)	(105)
Total	$(1,122)	(979)
Net deferred income tax liability	$ (393)	(165)

At September 30, 2007 and 2006, respectively, net current deferred tax assets were $269 and $269, and net noncurrent deferred tax liabilities were $434 and $662. Total income taxes paid were approximately $960, $820 and $600 in 2007, 2006 and 2005, respectively. Approximately half of the $47 capital loss carryforward expires in 2008 and the remainder over five years. The majority of the $261 net operating losses and tax credits can be carried forward indefinitely, while the remainders expire over varying periods. The valuation allowance was reduced $39 as a result of improved profitability of certain Swedish operations partially offset by foreign currency translation. The valuation allowance for deferred tax assets at September 30, 2007, includes $55 related to acquisitions, which would reduce goodwill if the deferred tax assets are ultimately realized.

(14) Stock-Based Compensation

The Company's stock-based compensation plans include stock options and incentive shares.

STOCK OPTIONS

The Company's Stock Option Plans permit key officers and employees to purchase common stock at specified prices. Options are granted at 100 percent of the market value of the Company's common stock on the date of grant, generally vest one-third each year and expire ten years from the date of grant. Compensation cost is recognized over the vesting period based on the number of options expected to vest. At September 30, 2007, approximately 15.1 million options remained available for grant under these plans.

Changes in shares subject to option during the year ended September 30, 2007, follow:

(SHARES IN THOUSANDS)	AVERAGE EXERCISE PRICE PER SHARE	SHARES	TOTAL INTRINSIC VALUE OF AWARDS	AVERAGE REMAINING CONTRACTUAL LIFE
Beginning of year	$28.64	15,807		
Options granted	$43.09	930		
Options exercised	$27.34	(2,882)		
Options canceled	$35.73	(185)		
End of year	$29.80	13,670	$321	5.0
Exercisable at year-end	$27.87	10,729	$272	4.1

The weighted-average grant-date fair value per share of options granted was $9.31, $8.80 and $6.39 for 2007, 2006 and 2005, respectively. The total intrinsic value of options exercised was $53, $74 and $26 in 2007, 2006 and 2005, respectively. Cash received from option exercises under share option plans was $60, $89 and $50 and the actual tax benefit realized for the tax deductions from option exercises was $14, $6 and $4 for 2007, 2006 and 2005, respectively.

The fair value of each award is estimated on the grant date using the Black-Scholes option-pricing model. Weighted-average assumptions used in the Black-Scholes valuations for 2007, 2006 and 2005 are as follows: risk-free interest rate based on the U.S. Treasury yield of 4.6 percent, 4.4 percent and 3.5 percent; dividend yield of 2.4 percent, 2.4 percent and 2.5 percent; and expected volatility based on historical volatility of 20 percent, 23 percent and 24 percent for 2007, 2006 and 2005, respectively. The expected life of an option is based on historical experience and expected exercise patterns in the future. Expected lives were 6 years, 6 years and 5 years for 2007, 2006 and 2005, respectively.

INCENTIVE SHARES

The Company's Incentive Shares Plans include performance share awards, which involve the distribution of common stock to key management personnel subject to certain conditions and restrictions. Performance share distributions are made primarily in shares of common stock of the Company and partially in cash. Compensation cost is recognized over the service period based on the number of awards expected to be ultimately earned. Performance share awards are accounted for as liabilities in accordance with Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment." Compensation expense is adjusted at the end of each period to reflect the change in the fair value of the awards.

As of September 30, 2007, 9,510,872 performance shares were outstanding, which are contingent upon accomplishing the Company's performance objective and the performance of services by the employees. The objective for 4,651,172 performance shares (awarded primarily in 2004) was met at the end of 2007, of which 2,790,707 awards will be issued in early 2008 and 1,860,465 awards remain contingent upon one additional year of service by the employees. The remaining 4,859,700 performance shares (awarded in 2007) are contingent upon achieving the Company's performance objective through 2010 and the performance of services by the employees.

The Company's Incentive Shares Plans also include restricted stock awards, which involve the distribution of the Company's common stock to key management personnel subject to service periods ranging from three to ten years. The fair value of these awards is determined by the market price of the Company's stock at the date of grant. Compensation cost is recognized over the applicable service period. In 2007, 115,000 shares of restricted stock vested as a result of the fulfillment of the applicable service periods and were distributed to participants as follows: 75,435 issued in shares and 39,565 withheld for income taxes. As of September 30, 2007, there were 2,132,554 shares of restricted stock awards outstanding.

Changes in awards outstanding but not yet earned under the Incentive Shares Plans during the year ended September 30, 2007, follow:

(SHARES IN THOUSANDS)	SHARES	AVERAGE GRANT DATE FAIR VALUE PER SHARE
Beginning of year	6,797	$31.23
Granted	5,180	$42.00
Earned/vested	(115)	$23.83
Canceled	(219)	$38.36
End of year	11,643	$35.99

The total fair value of shares earned/vested was $5, $123 and $5 under the Incentive Shares Plans of which $2, $55 and $2 was paid in cash, primarily for tax withholding, in 2007, 2006 and 2005, respectively. As of September 30, 2007, approximately 16.3 million shares remained available for award under the Incentive Shares Plans.

Compensation cost for the Stock Option and Incentive Shares Plans was $185, $81 and $100, for 2007, 2006 and 2005, respectively. The higher compensation expense in 2007 reflects the increase in the Company's stock price and incentive shares awarded in 2007 as discussed above. Total income tax benefit recognized in the income statement for these compensation arrangements during 2007, 2006 and 2005 were $55, $22 and $33, respectively. As of September 30, 2007, there was $249 of total unrecognized compensation cost related to nonvested awards granted under these plans, which is expected to be recognized over a weighted-average period of 2.6 years.

In addition to the Stock Option and Incentive Shares Plans, the Company issued 22,230 shares of restricted stock in 2007 under the Restricted Stock Plan for Non-Management Directors and 0.4 million shares remained available for issuance as of September 30, 2007.

(15) Common Stock

At September 30, 2007, 55,060,407 shares of common stock were reserved, primarily for issuance under the Company's stock-based compensation plans. During 2007, 18,876,800 treasury shares were acquired and 2,617,078 treasury shares were issued.

Approximately 1.2 million preferred shares are reserved for issuance under a Preferred Stock Purchase Rights Plan. Under certain conditions involving the acquisition of or an offer for 20 percent or more of the Company's common stock, all holders of Rights, except an acquiring entity, would be entitled (i) to purchase, at an exercise price of $260, common stock of the Company or an acquiring entity with a value twice the exercise price, or (ii) at the option of the Board, to exchange each Right for one share of common stock. The Rights remain in existence until November 1, 2008, unless earlier redeemed (at one-half cent per Right), exercised or exchanged under the terms of the plan.

(16) Business Segment Information

The Company designs and supplies product technology and delivers engineering services in a wide range of industrial, commercial and consumer markets around the world. The divisions of the Company are organized primarily by the nature of the products and services provided. The Process Management segment includes systems and software, measurement and analytical instrumentation, valves, actuators and regulators, and services and solutions for automated industrial processes. The Industrial Automation segment includes industrial motors and drives, power transmission equipment, alternators, materials joining and precision cleaning, fluid power and control, and electrical distribution equipment. The Network Power segment consists of power systems, including power conditioning and uninterruptible power supplies, embedded power supplies, precision cooling systems, electrical switching equipment, and site monitoring systems. The Climate Technologies segment consists of compressors, temperature sensors and controls, thermostats, flow controls, and remote monitoring services. The Appliance and Tools segment includes general and special purpose motors and controls, appliances and appliance components, plumbing tools, and storage products.

The primary income measure used for assessing performance and making operating decisions is earnings before interest and income taxes. Intersegment sales approximate market prices. Accounting method differences between segment reporting and the consolidated financial statements include primarily management fees allocated to segments based on a percentage of sales and the accounting for pension and other retirement plans. Gains and losses from divestitures of businesses are included in Corporate and other. Corporate assets include primarily cash and equivalents, pensions, investments, and certain fixed assets.

Summarized information about the Company's operations by business segment and by geographic area follows:

BUSINESS SEGMENTS

(See Notes 3, 4, 5 and 6)

	SALES			EARNINGS			TOTAL ASSETS		
	2005	2006	2007	2005	2006	2007	2005	2006	2007
Process Management	$ 4,200	4,875	5,699	671	878	1,066	3,894	4,146	4,902
Industrial Automation	3,242	3,767	4,269	464	569	665	2,698	2,941	3,141
Network Power	3,317	4,350	5,150	373	484	645	3,379	4,436	4,758
Climate Technologies	3,041	3,424	3,614	453	523	538	1,956	2,129	2,156
Appliance and Tools	4,008	4,313	4,447	534	550	578	2,526	2,670	2,630
	17,808	20,729	23,179	2,495	3,004	3,492	14,453	16,322	17,587
Differences in accounting methods				145	176	210			
Corporate and other (a)				(282)	(289)	(367)	2,774	2,350	2,093
Sales eliminations / Interest	(503)	(596)	(607)	(209)	(207)	(228)			
Total	$17,305	20,133	22,572	2,149	2,684	3,107	17,227	18,672	19,680

(a) Corporate and other increased from 2006 to 2007 primarily because of higher incentive compensation cost (see Note 14).

	Intersegment Sales			Depreciation and Amortization Expense			Capital Expenditures		
	2005	2006	2007	2005	2006	2007	2005	2006	2007
Process Management	$ 2	3	4	125	128	148	89	101	125
Industrial Automation	19	21	28	95	100	104	68	87	107
Network Power	9	10	10	76	98	115	55	103	111
Climate Technologies	37	43	48	118	127	132	148	148	160
Appliance and Tools	436	519	517	134	137	140	136	149	131
Corporate and other				14	17	17	22	13	47
Total	$503	596	607	562	607	656	518	601	681

GEOGRAPHIC

	Sales by Destination			Property, Plant and Equipment		
	2005	2006	2007	2005	2006	2007
United States	$ 9,126	10,588	10,930	1,919	1,963	1,998
Europe	3,890	4,334	5,199	511	583	680
Asia	2,370	2,920	3,678	343	419	484
Latin America	670	857	1,012	149	177	197
Other regions	1,249	1,434	1,753	81	78	72
Total	$17,305	20,133	22,572	3,003	3,220	3,431

(17) Other Financial Data

Items reported in earnings during the years ended September 30 include the following:

	2005	2006	2007
Depreciation	$472	500	525
Research and development	$303	356	397
Rent expense	$241	263	300

The Company leases facilities, transportation and office equipment and various other items under operating lease agreements. The minimum annual rentals under noncancelable long-term leases, exclusive of maintenance, taxes, insurance and other operating costs, will approximate $163 in 2008, $118 in 2009, $77 in 2010, $56 in 2011 and $42 in 2012.

Other assets, other are summarized as follows:

	2006	2007
Pension plans	$1,037	649
Intellectual property and customer relationships	470	544
Capitalized software	163	171
Equity and other investments	171	103
Leveraged leases	109	100
Other	159	205
Total	$2,109	1,772

Items reported in accrued expenses include the following:

	2006	2007
Employee compensation	$ 518	563
Product warranty	$ 206	197

Other liabilities are summarized as follows:

	2006	2007
Deferred income taxes	$ 724	519
Postretirement plans, excluding current portion	371	451
Retirement plans	253	296
Minority interest	176	191
Other	492	533
Total	$2,016	1,990

(18) Quarterly Financial Information (Unaudited)

	FIRST QUARTER		SECOND QUARTER		THIRD QUARTER		FOURTH QUARTER		FISCAL YEAR	
	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007
Net sales	$ 4,548	5,051	4,852	5,513	5,217	5,874	5,516	6,134	20,133	22,572
Gross profit	$ 1,593	1,795	1,734	1,952	1,856	2,105	1,985	2,259	7,168	8,111
Net earnings	$ 399	445	434	494	486	574	526	623	1,845	2,136
Earnings per common share:										
Basic	$ 0.49	0.56	0.53	0.62	0.59	0.72	0.65	0.79	2.26	2.69
Diluted	$ 0.48	0.55	0.52	0.61	0.59	0.72	0.65	0.78	2.24	2.66
Dividends per common share	$0.2225	0.2625	0.2225	0.2625	0.2225	0.2625	0.2225	0.2625	0.89	1.05
Common stock prices:										
High	$ 38.70	44.52	42.84	45.80	43.74	49.11	42.03	53.37	43.74	53.37
Low	$ 33.97	41.11	37.54	42.11	39.31	41.85	38.08	45.42	33.97	41.11

All per share data reflect the 2007 two-for-one stock split.

See Notes 3 and 4 for information regarding the Company's acquisition and divestiture activities and non-recurring items.

Emerson Electric Co. common stock (symbol EMR) is listed on the New York Stock Exchange and the Chicago Stock Exchange.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Emerson Electric Co.:

We have audited the accompanying consolidated balance sheets of Emerson Electric Co. and subsidiaries as of September 30, 2007 and 2006, and the related consolidated statements of earnings, stockholders' equity, and cash flows for each of the years in the three-year period ended September 30, 2007. We also have audited Emerson Electric Co.'s internal control over financial reporting as of September 30, 2007, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Emerson Electric Co.'s management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Emerson Electric Co. and subsidiaries as of September 30, 2007 and 2006, and the results of their operations and their cash flows for each of the years in the three-year period ended September 30, 2007, in conformity with U.S. generally accepted accounting principles. Also in our opinion, Emerson Electric Co. maintained, in all material respects, effective internal control over financial reporting as of September 30, 2007, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

As discussed in note 1 to the consolidated financial statements, effective September 30, 2007, the Company adopted the provisions of Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106, and 132(R).*

KPMG LLP

St. Louis, Missouri
November 15, 2007