Danaher Corporation DHR [XNYS] | ★★★

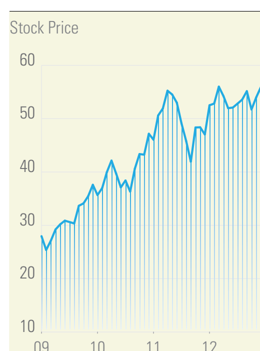
Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Stewardship	Morningstar Credit Rating	Industry
59.99 USD	53.00 USD	31.80 USD	82.15 USD	High	Narrow	Standard	A	Diversified Industrials

Danaher's Third Quarter Below Expectations, Cash Flow Remains Strong

by Daniel Holland
Senior Stock Analyst
Analyst covering this company do not own its stock.

Pricing as of Jan 15, 2013.
Rating as of Jan 15, 2013.

Currency amounts expressed with "$" are in U.S. dollars (USD) unless otherwise denoted.



Analyst Note Oct. 18, 2012

Danaher DHR delivered third-quarter earnings below our expectations. Management's full year guidance trails our own projections for the year. We're lowering our fair value estimate to account for weaker earnings in 2012, and a more modest earnings growth assumption for 2013.

While we are lowering our fair value estimate for Danaher, our long-term thesis stands. Weaker global economic growth was the primary driver behind the quarter's weakness, particularly in Europe, and to a lesser extent in China. Quarterly operating margins were quite resilient, with consolidated margins reaching 18%, as compared to an adjusted 17.6% in the prior year, after accounting for charges related to the Beckman Coulter acquisition.

Our primary concerns for the portfolio reside in the continuing weakness in test and measurement, as capital spending and research and development budgets contract to adjust to a weaker economic environment. We have lowered our 2013 top-line growth assumption to 3%, down from nearly 7%, as we account for slower growth in the in test and measurement, environmental, and industrial technologies segments. To Danaher's credit, cash flow remains quite strong: Trailing twelve months cash flow from operations is nearly $3.4 billion, driven by strong performance at Beckman Coulter.

Thesis Oct. 18, 2012

Danaher has generated double-digit margins and growth through acquisitions and its proprietary business integration system. Its focus on eking out efficiencies and attacking niche markets has helped the firm build a narrow economic moat.

Danaher's path to success involves execution on two basic levels: acquiring companies in attractive markets at reasonable prices and easily integrating them into the larger organization to maximize potential efficiencies. As opposed to going into highly competitive markets, Danaher attacks niche markets and executes on the principles of the Danaher Business System, or DBS, resulting in higher operating margins and stronger cash flows. In addition, Danaher's focus on smaller markets enables it to enjoy economies of scale and helped the company build a narrow moat.

Acquisitions are the company's primary growth engine. This has had an accretive impact on the top line, but it has also caused the balance sheet to become more heavily weighted with goodwill and other intangible assets. Even though operating margins have remained strong, returns on invested capital slid 520 basis points, from 17.0% in 2004 to 12.1% in 2010. This is a combined result of the global recession in 2009 and the prices that Danaher has been paying for acquisitions. Although current returns on invested capital are higher than the firm's cost of capital, we would like to see Danaher slow acquisition spending in order to focus on stabilizing shareholder returns.

Danaher raised its exposure to the test and measurement business with the November 2007 purchase of Tektronix. Tektronix dominates the market for high-precision oscilloscopes used in telecom networking and helps fill out the company's electronic test platform, which already includes specialty test toolmaker Fluke. In addition, Danaher should be able to rely on its medical technology business unit for meaningful internal revenue growth. Thanks to acquisitions like Sybron Dental, a producer of light equipment for the professional dental market, and Leica Microsystems, a maker of high-end microscopes, the medical technology unit now represents nearly 40% of Danaher's total sales base. In early 2011, Danaher completed the acquisition of Beckman Coulter, a leading life sciences and diagnostics firm, for $6.8 billion. While this presents an opportunity for Danaher to push further into the medical equipment end markets, we think this will be a test of DBS and may make more acquisition growth difficult through 2012.

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Close Competitors	Currency (Mil)	Market Cap	TTM Sales	Oper Income	Net Income
3M Co	USD	67,318	29,606	6,404	4,407
Illinois Tool Works Inc	USD	29,021	18,023	2,885	2,333
Dover Corporation	USD	11,924	8,433	1,289	930
Ametek, Inc.	USD	9,362	3,255	723	441
Snap-on, Inc.	USD	4,679	2,921	502	296

Valuation, Growth and Profitability

We're lowering our fair value estimate to $53 per share from $58 as a result of weaker near-term growth assumptions in light of a slower growth in Europe and China. Our fair value estimate implies a forward price/earnings multiple of 16 times. Danaher's recent acquisition of Beckman Coulter heightens the firm's exposure to life sciences and diagnostics, further dampening the cyclicality of Danaher's earnings. We think DBS could help increase Beckman's operating margin by around two percentage points, giving Danaher overall a better margin profile than it has ever had. Additionally, as customers reinvest in new products and research and development. Even though the company is operating above past midcycle margin levels, we think Danaher can hold on to recent productivity gains and will be able to sustain operating margins above 17%. Recent announcements of proactive restructuring may be a temporary drag on profitability, but should have a payback period of just over a year, and contributing to profitability by 2014. Given the firm's tradition of growth via acquisitions, we forecast average annual revenue growth of 7% during the next five years, down from our previous assumption of 9% average revenue growth, with 3% coming from newly acquired entities. We forecast the firm will reinvest all free cash flow into acquisitions at a price of 2.5 times target sales.

Risk

Many of the end markets that Danaher serves are sensitive to prevailing economic conditions and customer capital expenditure budgets. In addition, more than half of the firm's revenue is generated outside the United States, leaving Danaher exposed to geopolitical risks as well as some currency risk. Because of Danaher's reliance on acquisitions for growth, there is risk of overpayment and integrating acquisitions into the portfolio.

Bulls Say

- Danaher products enjoy great brand presence. For instance, Fluke is the leader in handheld electronic test equipment, and Gilbarco Veeder-Root dominates the retail petroleum dispenser market.
- Before Danaher formed its sixth strategic platform, medical technology, management studied the industry for about three years and says it conducted more than 400 customer interviews.
- Danaher and Cooper Industries announced a joint venture between their tool segments, which will be managed by Danaher, paving the way for the business to be operated as a stand-alone entity.

Bears Say

- About 75% of Danaher's sales growth during the past five years has come from acquisitions. If the well of new acquisition candidates dries up, Danaher's growth rate could slow.
- Other manufacturing companies are catching up with Danaher's processes as former Danaher managers take high-level positions outside the firm. Developing an internal talent pipeline may be difficult.

Financial Overview

Financial Health:Danaher is in fine financial condition. Debt is a manageable 110% of EBITDA, though the recent debt issuance related to the acquisition of Beckman Coulter will likely cause this ratio to deteriorate. The firm's EBITDA comfortably covers interest payments 21.2 times.

Company Overview

Profile: Danaher is a diversified manufacturer, housing more than 40 industrial brands in three segments. The professional instrumentation segment produces electronic, medical, and water-test equipment. The industrial technology segment

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produces precision motors and controls,
product-identification equipment, and other niche products. The tool and component division makes Sears' Craftsman line of hand tools, Matco tools for professional mechanics, and other store-branded tools through a joint venture with Cooper Industries.

Management: Danaher was founded by Steven and Mitchell Rales in the early 1980s. Combined, they own more than 10% of outstanding stock, and both serve as directors on the 10-member board. Steven Rales is chairman, and seven members are independent. Board members and senior management collectively own a significant chunk of the company, indicating strong alignment with minority holders. Lawrence Culp became CEO in 2001, replacing George Sherman, who led the firm's transformation from toolmaker to industrial conglomerate. While we are comforted by the fact the board is in the same boat as minority holders, we would prefer greater transparency in the incentive compensation structure. Executive officers' variable cash compensation is based on growth in earnings per share and undisclosed personal objectives. Equity awards are based on factors such as peer benchmarks, undisclosed contributions to growth, development, and success of the company, individual performance, and level of management. We'd be more comfortable if performance benchmarks were more explicitly stated and if a return on capital measure were mentioned prominently.

In spite of heavy acquisition spending, Danaher has managed to avoid asset impairments, indicating management is able to get what it expects from acquisitions. Shareholders benefit from the steady earnings growth, though the company pays a minimal dividend and rarely repurchases its own shares.

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Analyst Notes

Bain Capital Purchases Cooper's and Danaher's Apex Tool Joint Venture Oct. 10, 2012

Bain Capital is buying the Apex Tool joint venture of Danaher DHR and Cooper Industries CBE for $1.6 billion, valuing the business at 12 times 2011 earnings or 1.1 times 2011 sales. While we ultimately think the business may be worth a bit more than the actual transaction value, this purchase closes one of the loose ends that remained after the announced purchase of Cooper by Eaton ETN. We expect proceeds from the sale to offset acquisition costs for Eaton; in the case of Danaher, we anticipate this capital will be redeployed for future acquisitions. Our long-term thesis for all companies remains unchanged, and we maintain our fair value estimates.

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Danaher Corporation(USD) DHR

Last Close $	Sales $Mil	Mkt Cap $Mil	Industry	Currency
$59.59	$18,002	$41,277	Diversified Industrials	USD

Danaher Corporation designs, manufactures and markets professional, medical, industrial and consumer products.

Morningstar Rating	Fair Value Uncertainty	Fair Value	Economic Moat	Style	Sector
★★★ As of 01-14-2013	High	$53.00	Narrow	Large Growth	

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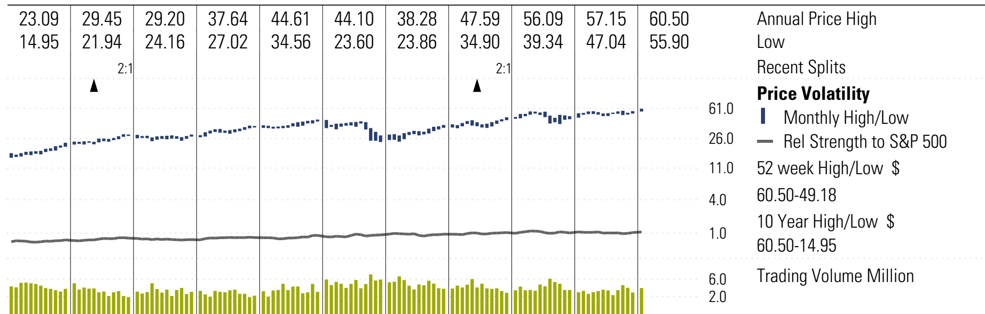
Website: http://www.danaher.com

2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	YTD	
23.09	29.45	29.20	37.64	44.61	44.10	38.28	47.59	56.09	57.15	60.50	Annual Price High
14.95	21.94	24.16	27.02	34.56	23.60	23.86	34.90	39.34	47.04	55.90	Low
	2:1						2:1				Recent Splits



Growth Rates Compound Annual

Grade: C	1 Yr	3 Yr	5 Yr	10 Yr
Revenue %	28.2	8.2	10.9	15.6
Operating Income %	27.7	11.9	11.5	18.0
Earnings/Share %	9.5	11.9	9.8	18.6
Dividends %	12.5	14.5	17.6	16.2
Book Value/Share %	17.7	17.0	17.9	20.2
Stock Total Return	18.2	15.8	8.5	13.9
+/- Industry	0.8	4.3	7.0	6.3
+/- Market	1.5	4.8	5.5	7.0

Profitability Analysis

Grade: C	Current	5 Yr Avg	Ind	Mkt
Return on Equity %	13.2	14.1	15.4	20.7
Return on Assets %	7.5	7.9	4.1	8.5
Revenue/Employee $K	305.1	249.2	—	1090.4
Fixed Asset Turns	8.5	10.7	4.0	7.0
Inventory Turns	4.6	5.6*	5.3	13.4
Gross Margin %	51.1	48.3	38.6	43.8
Operating Margin %	17.1	15.4	16.3	19.3
Net Margin %	13.0	12.2	8.8	13.3
Free Cash Flow/Rev %	16.6	14.1	9.5	12.0
R&D/Rev %	6.3	5.9	1.6	—

Financial Position (USD)

Grade: A	12-11 $Mil	09-12 $Mil
Cash	537	1541
Inventories	1781	1882
Receivables	3050	2985
Current Assets	6272	6908
Fixed Assets	2101	2063
Intangibles	20315	21161
Total Assets	29949	31585
Payables	1422	1493
Short-Term Debt	98	55
Current Liabilities	4172	3935
Long-Term Debt	5207	4659
Total Liabilities	13045	12699
Total Equity	16905	18886

Valuation Analysis

	Current	5 Yr Avg	Ind	Mkt
Price/Earnings	19.0	17.8	17.6	15.0
Forward P/E	14.2	—	—	13.1
Price/Cash Flow	12.3	12.7	11.1	9.2
Price/Free Cash Flow	14.2	14.4	18.1	75.1
Dividend Yield %	0.2	0.2	2.3	2.3
Price/Book	2.2	2.0	2.6	2.1
Price/Sales	2.4	2.1	1.4	2.5
PEG Ratio	1.6	—	—	1.7

*3Yr Avg data is displayed in place of 5 Yr Avg

Stock Performance

2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	YTD	Stock Performance
40.3	24.8	-2.7	30.0	21.3	-35.3	33.1	25.7	-0.1	19.0	6.6	Total Return %
11.6	13.9	-7.6	14.2	15.8	1.7	6.6	10.6	-2.2	3.0	3.4	+/- Market
3.2	8.1	-5.3	16.9	5.7	9.8	8.1	1.8	4.4	-1.1	3.7	+/- Industry
0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	Dividend Yield %
14089	17718	17186	22297	27928	18093	24270	30961	32286	38721	41277	Market Cap $Mil

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	TTM	Financials (USD)
4577	5294	6889	7871	9466	11026	12697	11185	12550	16091	18002	Revenue $Mil
39.0	40.4	42.0	43.3	44.3	45.7	46.8	47.2	51.0	50.8	51.1	Gross Margin %
-44	-49	-47	-30	-71	1741	1869	1542	2050	2617	3081	Oper Income $Mil
15.3	16.0	16.0	15.9	15.9	15.8	14.7	13.8	16.3	16.3	17.1	Operating Margin %
290	537	746	898	1122	1370	1318	1152	1793	2172	2333	Net Income $Mil
0.70	0.84	1.15	1.38	1.74	1.86	1.98	1.73	2.64	2.77	3.27	Earnings Per Share $
0.02	0.03	0.03	0.04	0.04	0.06	0.06	0.07	0.08	0.09	0.10	Dividends $
634	646	655	656	651	659	672	671	683	701	714	Shares Mil
4.94	5.94	7.48	8.24	10.79	14.27	15.34	18.02	20.89	24.63	27.26	Book Value Per Share $
710	862	1033	1204	1547	1646	1859	1801	2084	2626	3443	Oper Cash Flow $Mil
-65	-80	-116	-120	-136	-162	-194	-189	-191	-334	-453	Cap Spending $Mil
645	781	917	1084	1411	1484	1665	1612	1893	2292	2989	Free Cash Flow $Mil

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	TTM	Profitability
5.4	8.3	9.7	10.2	10.2	9.0	7.5	6.2	8.6	8.3	7.5	Return on Assets %
11.1	16.1	18.1	18.5	19.1	17.4	14.0	10.7	14.2	14.2	13.2	Return on Equity %
0.84	0.82	0.90	0.89	0.86	0.73	0.73	0.60	0.60	0.62	0.58	Asset Turnover
6.3	10.1	10.8	11.4	11.9	12.4	10.4	10.3	14.3	13.5	13.0	Net Margin %
2.0	1.9	1.8	1.8	1.9	1.9	1.8	1.7	1.6	1.8	1.7	Financial Leverage

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	09-12	Financial Health (USD)
1197	1284	926	858	2423	3396	2553	2889	2784	5207	4659	Long-Term Debt $Mil
3010	3647	4620	5080	6645	9086	9809	11630	13711	16905	18886	Total Equity $Mil
0.40	0.35	0.20	0.17	0.36	0.37	0.26	0.25	0.20	0.31	0.25	Debt/Equity
1122	1562	716	676	977	1150	1442	2460	2745	2100	2973	Working Capital $Mil

2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	TTM	Valuation
27.3	24.9	20.2	20.8	23.6	14.3	21.7	17.9	17.0	17.9	19.0	Price/Earnings
0.0	0.0	—	—	0.0	0.0	0.0	0.0	—	0.0	1.3	P/E vs. Market
2.8	2.7	2.3	2.5	2.6	1.5	2.3	2.4	2.0	2.2	2.4	Price/Sales
3.9	3.8	3.4	3.4	3.1	1.8	2.1	2.3	1.9	2.1	2.2	Price/Book
17.3	18.2	15.2	15.2	17.6	10.2	14.0	15.5	12.5	11.6	12.3	Price/Cash Flow

Quarterly Results (USD)

Revenue $Mil	Dec	Mar	Jun	Sep
Most Recent	4716.0	4316.0	4553.0	4415.0
Previous	3231.0	3292.0	3635.0	4445.0
Rev Growth %	**Dec**	**Mar**	**Jun**	**Sep**
Most Recent	45.9	31.1	25.2	-0.7
Previous	3.2	9.5	13.0	43.7
Earnings Per Share $	**Dec**	**Mar**	**Jun**	**Sep**
Most Recent	0.77	0.73	0.84	0.77
Previous	0.69	0.61	0.65	0.74

Close Competitors

	Mkt Cap $Mil	Rev $Mil	P/E	ROE%
3M Co	67173	29606	15.5	25.5
Illinois Tool Works Inc	29142	18023	15.4	23.2

Major Fund Holders

	% of shares
T. Rowe Price Growth Stock	1.88
Fidelity Contrafund	1.74
MainStay Large Cap Growth A	1.34

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MORNINGSTAR®

Morningstar's Approach to Rating Stocks

Our Key Investing Concepts
- Economic Moat™ Rating
- Discounted Cash Flow
- Discount Rate
- Fair Value
- Uncertainty
- Margin of Safety
- Consider Buying/Consider Selling
- Stewardship Grades

At Morningstar, we evaluate stocks as pieces of a business, not as pieces of paper. We think that purchasing shares of superior businesses at discounts to their intrinsic value and allowing them to compound their value over long periods of time is the surest way to create wealth in the stock market.

We rate stocks 1 through 5 stars, with 5 the best and 1 the worst. Our star rating is based on our analyst's estimate of how much a company's business is worth per share. Our analysts arrive at this "fair value estimate" by forecasting how much excess cash--or "free cash flow"--the firm will generate in the future, and then adjusting the total for timing and risk. Cash generated next year is worth more than cash generated several years down the road, and cash from a stable and consistently profitable business is worth more than cash from a cyclical or unsteady business.

Stocks trading at meaningful discounts to our fair value estimates will receive high star ratings. For high-quality businesses, we require a smaller discount than for mediocre ones, for a simple reason: We have more confidence in our cash-flow forecasts for strong companies, and thus in our value estimates. If a stock's market price is significantly above our fair value estimate, it will receive a low star rating, no matter how wonderful we think the business is. Even the best company is a bad deal if an investor overpays for its shares.

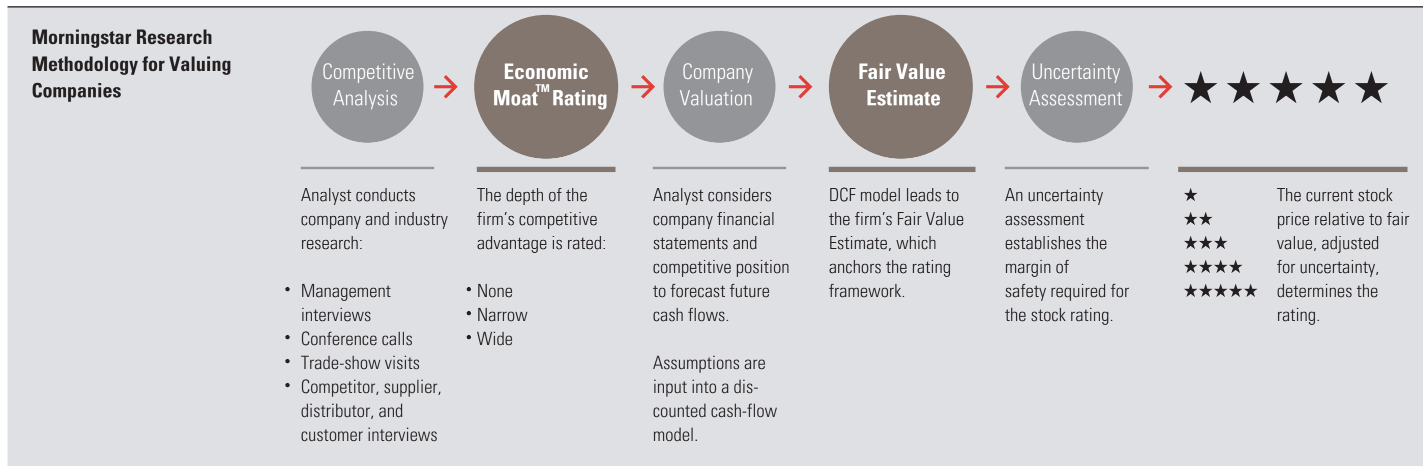
Our fair value estimates don't change very often, but market prices do. So, a stock may gain or lose stars based just on movement in the share price. If we think a stock's fair value is $50, and the shares decline to $40 without much change in the value of the business, the star rating will go up. Our estimate of what the business is worth hasn't changed, but the shares are more attractive as an investment at $40 than they were at $50.

Because we focus on the long-term value of businesses, rather than short-term movements in stock prices, at times we may appear out of step with the overall stock market. When stocks are high, relatively few will receive our highest rating of 5 stars. But when the market tumbles, many more will likely garner 5 stars. Although you might expect to see more 5-star stocks as the market rises, we find assets more attractive when they're cheap.

We calculate our star ratings nightly after the markets close, and issue them the following business day, which is why the rating date on our reports will always be the previous business day. We update the text of our reports as new information becomes available, usually about once or twice per quarter. That is why you'll see two dates on every Morningstar stock report. Of course, we monitor market events and all of our stocks every business day, so our ratings always reflect our analyst's current opinion.

Economic Moat™ Rating

The Economic Moat™ Rating is our assessment of a firm's ability to earn returns consistently above its cost of capital in the future, usually by virtue of some competitive advantage. Competition tends to drive down such



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economic profits, but companies that can earn them for an extended time by creating a competitive advantage possess an Economic Moat. We see these companies as superior investments.

Discounted Cash Flow
This is a method for valuing companies that involves projecting the amount of cash a business will generate in the future, subtracting the amount of cash that the company will need to reinvest in its business, and using the result to calculate the worth of the firm. We use this technique to value nearly all of the companies we cover.

Discount Rate
We use this number to adjust the value of our forecasted cash flows for the risk that they may not materialize. For a profitable company in a steady line of business, we'll use a lower discount rate, also known as "cost of capital," than for a firm in a cyclical business with fierce competition, since there's less risk clouding the firm's future.

Fair Value
This is the output of our discounted cash-flow valuation models, and is our per-share estimate of a company's intrinsic worth. We adjust our fair values for off-balance sheet liabilities or assets that a firm might have--for example, we deduct from a company's fair value if it has issued a lot of stock options or has an under-funded pension plan. Our fair value estimate differs from a "target price" in two ways. First, it's an estimate of what the business is worth, whereas a price target typically reflects what other investors may pay for the stock. Second, it's a long-term estimate, whereas price targets generally focus on the next two to 12 months.

Uncertainty
To generate the Morningstar Uncertainty Rating, analysts consider factors such as sales predictability, operating leverage, and financial leverage. Analysts then classify their ability to bound the fair value estimate for the stock into one of several uncertainty levels: Low, Medium, High, Very High, or Extreme. The greater the level of uncertainty, the greater the discount to fair value required before a stock can earn 5 stars, and the greater the premium to fair value before a stock earns a 1-star rating.

Margin of Safety
This is the discount to fair value we would require before recommending a stock. We think it's always prudent to buy stocks for less than they're worth.The margin of safety is like an insurance policy that protects investors from bad news or overly optimistic fair value estimates. We require larger margins of safety for less predictable stocks, and smaller margins of safety for more predictable stocks.

Consider Buying/Consider Selling
The consider buying price is the price at which a stock would be rated 5 stars, and thus the point at which we would consider the stock an extremely attractive purchase. Conversely, consider selling is the price at which a stock would have a 1 star rating, at which point we'd consider the stock overvalued, with low expected returns relative to its risk.

Stewardship Grades
Our corporate Stewardship Rating represents our assessment of management's stewardship of shareholder capital, with particular emphasis on capital allocation decisions. Analysts consider companies' investment strategy and valuation, financial leverage, dividend and share buyback policies, execution, compensation, related party transactions, and accounting practices. Corporate governance practices are only considered if they've had a demonstrated impact on shareholder value. Analysts assign one of three ratings: "Exemplary," "Standard," and "Poor." Analysts judge stewardship from an equity holder's perspective. Ratings are determined on an absolute basis. Most companies will receive a Standard rating, and this is the default rating in the absence of evidence that managers have made exceptionally strong or poor capital allocation decisions.

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