



# Caterpillar (CAT)

Updated May 2<sup>nd</sup>, 2018 by Jonathan Weber

## Key Metrics

<b>Current Price:</b> \$144	<b>5 Year CAGR Estimate:</b> 11.4%	<b>Quality Percentile:</b> N/A
<b>Fair Value Price:</b> \$167	<b>5 Year Growth Estimate:</b> 6.2%	<b>Momentum Percentile:</b> N/A
<b>% Fair Value:</b> 86%	<b>5 Year Valuation Multiple Estimate:</b> 3.0%	<b>Total Return Percentile:</b> N/A
<b>Dividend Yield:</b> 2.2%	<b>5 Year Price Target</b> \$226	<b>Valuation Percentile:</b>

## Overview & Current Events

Caterpillar manufactures and sells construction and mining equipment as well as products from several other categories, including diesel engines and industrial gas turbines. Caterpillar was founded in 1925, is headquartered in Peoria, Illinois and is currently valued at \$86 billion.

Caterpillar's most recent quarterly results were announced at the end of April. The company earned \$2.82 per share, an increase of more than 100% from the previous year's Q1 level of \$1.28 and a new record profit for a first quarter. Caterpillar also was able to increase its revenues by 31% during Q1 of 2018, driven by strong growth rates in construction industries (+39% yoy), resource industries (+28% yoy) and energy & transportation (+27% yoy).

## Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>EPS</b>	\$5.71	\$1.43	\$4.15	\$7.81	\$9.36	\$5.79	\$6.37	\$4.62	\$3.44	\$6.88	<b>\$10.75</b>	<b>\$14.55</b>
<b>DPS</b>	\$1.62	\$1.68	\$1.74	\$1.82	\$2.02	\$2.32	\$2.70	\$3.01	\$3.08	\$3.11	<b>\$3.16</b>	<b>\$4.50</b>

Caterpillar's customers (mining companies, construction companies, etc.) are operating in cyclical industries. During good times they are inclined to expand their operations and to upgrade their equipment (e.g. in order to make operations more efficient, to save on fuel costs, etc.), which drives sales of Caterpillar's products. During weak times for the industries Caterpillar's customers are active in they are less likely to expand their operations and they will defer the purchase of new equipment, which means lower sales for Caterpillar. Caterpillar's business therefore is relatively cyclical as well, which is clearly visible in the above table. During the last financial crisis profits took a big hit, and during 2015-2016, when commodity prices were relatively low (which meant mining companies had to cut back on purchases), Caterpillar's sales and profits declined significantly as well.

Right now everything points in the right direction for Caterpillar, though. Commodity prices are rising, which means higher sales for mining equipment, and at the same time the construction industry is doing well in key markets such as the US and China. On top of that Caterpillar will benefit from cost-cutting measures that were employed over the last couple of years during the cyclical downturn, as those lower costs will boost Caterpillar's profit margins going forward. Caterpillar also has bought back about ten percent of its shares over the last five years, with rising cash flows and rising profits Caterpillar will likely continue to reduce its share count going forward, which results in a boost to the company's earnings-per-share growth rate.

2018 will in all likelihood be a new record year for Caterpillar: The company has not only started with record Q1 profits, Caterpillar has also guided for adjusted earnings per share of \$10.25 to \$11.25 during 2018.

Caterpillar's dividend has grown consistently at a 6.9% annual growth rate over the last decade. Dividend growth can easily continue at a meaningful pace thanks to a low payout ratio and considerable earnings growth going forward.

## Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
<b>Avg. P/E</b>	11.4	29.4	16.6	12.4	10.0	15.1	15.8	17.1	22.8	16.4	<b>13.4</b>	<b>15.5</b>
<b>Avg. Yld.</b>	2.5%	4.0%	2.5%	1.9%	2.2%	2.7%	2.7%	3.8%	3.9%	2.8%	<b>2.2%</b>	<b>2.5%</b>

Caterpillar's average P/E ratio as well as the median P/E ratio over the last decade are in the mid-teens, thus shares of the company are currently a little less expensive than they usually are. The relatively low P/E ratio can be attributed to the explosive earnings growth Caterpillar will experience during 2018, share price declines were not a factor (shares prices went up substantially through 2017).

Caterpillar's dividend yield is higher than the broad market's 1.9% dividend yield, but compared to the historic range the dividend yield has been in, shares offer relatively low income right now. Caterpillar could easily raise its dividend aggressively over the coming years, but has so far not made any such moves.

### Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>GP/A</b>	19.0%	14.2%	19.1%	20.4%	21.1%	17.6%	17.1%	17.2%	13.8%	18.7%	<b>20.0%</b>	<b>22.0%</b>
<b>Debt/A</b>	90.0%	84.5%	83.1%	84.1%	80.0%	75.4%	80.2%	81.1%	82.3%	82.1%	<b>81.0%</b>	<b>80.0%</b>
<b>Int. Cov.</b>	4.5	1.5	4.0	6.5	7.5	5.3	3.8	4.1	1.1	4.5	<b>5.5</b>	<b>6.0</b>
<b>Payout</b>	28.4%	117%	41.9%	23.3%	21.6%	40.1%	42.4%	65.2%	89.5%	45.2%	<b>29.4%</b>	<b>30.9%</b>
<b>Std. Dev.</b>	47.3%	65.9%	29.2%	37.6%	29.5%	16.8%	20.9%	20.5%	24.9%	15.3%	<b>19.0%</b>	<b>22.0%</b>

Caterpillar has a highly leveraged balance sheet, but a significant portion of Caterpillar's liabilities belong to the company's financial products business. Caterpillar offers financing solutions and other financial services to its customer (the same way many automobile companies offer banking-related solutions to their customers). \$21 billion of debt belong to these financial products businesses, adjusted for that leverage ratios would be significantly lower. Interest coverage looked solid in 2017, and with profits rising significantly during 2018. The Interest coverage ratio will likely improve further in the coming years.

Caterpillar is one of the biggest players in the markets it addresses, with a brand that is well-known and recognized around the globe. The fact that Caterpillar has a global presence and is selling its products to several industries (construction, mining, etc.) makes it less dependent on any single market. During global economic downturns (such as during the last financial crisis) Caterpillar is hit hard (its profits declined by 75% from 2008 to 2009). This is not a recession resistant stock.

### Final Thoughts & Recommendation

In the coming years many macro tailwinds will be beneficial for Caterpillar. Resource industries are experiencing a cyclical upturn, commodity prices are rising, and construction activities are at a strong level in key markets such as the US and China. This will allow for solid growth, which, combined with an inexpensive valuation and the dividend, should lead to compelling total returns going forward.

### Total Return Breakdown by Year

