Cummins Inc (CMI)

Updated May 3rd, 2018 by Nathan Parsh

Key Metrics

Current Price:	$153	**5 Year CAGR Estimate:**	12%	**Quality Percentile:**	N/A
Fair Value Price:	$162	**5 Year Growth Estimate:**	8.0%	**Momentum Percentile:**	N/A
% Fair Value:	94%	**5 Year Valuation Multiple Estimate:**	1.2%	**Total Return Percentile:**	N/A
Dividend Yield:	2.8%	**5 Year Price Target**	$239	**Valuation Percentile:**	N/A

Overview & Current Events

Cummins designs, manufactures, distributes and services engines for heavy, medium and light-duty trucks. The company's products include diesel and natural gas engines as well as hybrid and electric platforms. The company was founded in 1919 and has a current market cap of more than $26 billion. Cummins had more than $20 billion in sales in 2017. Today the company employs more than 58,000 people in more than 160 countries.

Cummins reported 1st quarter 2018 earnings on 5/1/2018. The company earned an adjusted $3.30 per share, $0.38 above estimates. Revenue grew 22% year over year to $5.6 billion, $420 million above estimates. Each segment of the company saw growth in the quarter. Engine was up 21%, Distribution up 13%, Components up 30% and Power Systems up 22%. U.S sales were up 22% and international sales climbed 20%. U.S., Europe and China all demonstrated strong demand for engines, parts and services.

Not included in the EPS adjustment was an initial $187 million charge to upgrade engines after some pre-2013 systems failed emissions tests in 2017. This upgrade now includes some engines produced between 2010-2015. The company said there could be up to an additional $400 million if the California Air Resources Board and the EPA do not accept the company's proposed solutions. Shares fell as much as 7% before ultimately closing down a little more than 4%.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$4.08	$2.47	$5.17	$9.07	$8.69	$7.91	$9.14	$8.92	$8.23	$10.63	***$11.70***	***$17.19***
DPS	$0.60	$0.70	$0.88	$1.33	$1.80	$2.25	$2.81	$3.51	$4.00	$4.21	***$4.32***	***$6.35***

Cummins suffered a step decline during the last recession as earnings dropped almost 40% in 2009. The company's earnings recovered by 2010, but Cummins has seen up and down swings in EPS several times in the last decade. Even with this Cummins has averaged 10% earnings growth since 2008. Because Cummins experienced much of its earnings growth at the beginning of this decade and only recently returned to growth, we estimate that the company can grow earnings by 8% per year through 2023. Our 5-year price target is $239.

Cummins was able to increase its dividend during the last recession. The company has averaged annual increase of more than 25% over the past decade. The company gave shareholders a 5.4% increase on 7/11/2017. Applying the earnings growth rate to the current dividend, investors can expect shares of Cummins could produce $6.35 in income by 2023.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	12.5	14.8	14.5	11.1	11.9	15.3	15.8	14	14.1	14.9	***13.1***	***13.9***
Avg. Yld.	1.2%	1.9%	1.2%	1.3%	1.7%	1.9%	1.9%	2.8%	3.5%	2.7%	***2.8%***	***2.7%***

Unlike many companies, shares of Cummins have never become overly expensive in the current bull market. The average price-to-earnings multiple over the past decade is less than 14. Investors seem to be wary of paying up for shares of Cummins given its somewhat unpredictable EPS performance. After the recent decline due to earnings results, the company's forward multiple is just 13.1. If the valuation were to return to the average, then Cummins could see 1.2% of multiple expansion through 2023. Value investors could find Cummins attractive given its low P/E.

It wasn't until recently that Cummins offered an attractive dividend yield. The current yield of 2.8% is above that of the S&P 500, but slightly below that of the 10-Year Treasury Bond. This type of yield could attractive income orientated investors.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	34.5%	24.6%	30.5%	39.3%	35.2%	29.1%	30.8%	32.7%	29.7%	28.2%	***28.8%***	***31.4%***
Debt/A	59.2%	54.4%	52%	50%	44.4%	46.6%	48.7%	48.8%	52.2%	54.8%	***54.1%***	***51.1%***
Int. Cov.	50.8	25	87.2	271.5	104.7	154.3	60.9	51	36.3	33.5	***44.3***	***87.5***
Payout	14.7%	28.3%	17%	14.7%	20.7%	28.4%	30.7%	39.3%	48.6%	39.6%	***36.9%***	***36.9%***
Std. Dev.	73.1%	53.8%	27.3%	33.2%	37.2%	17.9%	21.7%	15.5%	21.4%	17.2%	***20.2%***	***31.8%***

Cummins saw a sharp drop in earnings during the last recession and inconsistent growth throughout the past decade. Even so, the company has shown a relatively high growth rate. The company's profitability is fairly consistent and its debt levels manageable.

Cummins dividend payout ratio is projected to be below 40% in future years. This low payout ratio allows the company room to continue to increase its dividend even if earnings suffer a decline. Cummins is a shareholder friendly company. Cash flow for 2017 was more than 2.5 times that of 2008's figure, which has allowed for dividend growth and a share count reduction of almost 18% since 2008. This type of cash flow and low payout ratio should give investors confidence that the company will continue to raise payments to shareholders even in the event of adverse economic conditions.

Final Thoughts & Recommendation

Shares of Cummins are expected to return 12% annually through 2023. This total return is a combination of growth (8%), dividends (2.8%) and multiple expansion (1.2%). Engine upgrades could be a short term drag on the company. Cummins still expects to see top and bottom line growth this year even with the capital it will have to spend to bring engines into compliance with various environmental agencies. Prior to this share price decline, Cummins offered attractive growth and income potential. Investors buying today can acquire shares at a further discount.

Total Return Breakdown by Year