



Caterpillar (CAT)

Updated July 30th, 2018 by Jonathan Weber

Key Metrics

Current Price: \$144	5 Year CAGR Estimate: 13.0%	Volatility Percentile: 62.6%
Fair Value Price: \$179	5 Year Growth Estimate: 6.2%	Momentum Percentile: 77.0%
% Fair Value: 80%	5 Year Valuation Multiple Estimate: 4.4%	Valuation Percentile: 90.3%
Dividend Yield: 2.4%	5 Year Price Target: \$241	Total Return Percentile: 85.2%

Overview & Current Events

Caterpillar manufactures and sells construction and mining equipment as well as products in 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 \$85 billion.

Caterpillar announced its second quarter results on July 30. The company earned \$2.97 during Q2, a massive increase of 99% year over year. This strong pace of earnings growth was driven by a 24% revenue increase, positive operating leverage, lower taxes and a lower share count. Its earnings per share guidance for 2018 was raised to \$11.00 - \$12.00.

Caterpillar has also announced a new \$10 billion share repurchase program during its Q2 earnings call.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	\$5.71	\$1.43	\$4.15	\$7.81	\$9.36	\$5.79	\$6.37	\$4.62	\$3.44	\$6.88	\$11.50	\$15.54
DPS	\$1.62	\$1.68	\$1.74	\$1.82	\$2.02	\$2.32	\$2.70	\$3.01	\$3.08	\$3.11	\$3.28	\$4.50

Caterpillar's customers, primarily mining companies & construction companies, operate in cyclical industries. During good times they are inclined to expand their operations and to upgrade their equipment in order to make operations more efficient, to save on fuel costs, etc. During weak times 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, which is clearly visible in the above table. During the last financial crisis profits experienced a tremendous decline, and during 2015-2016, when commodity prices were relatively low, Caterpillar's sales and profits declined significantly as well.

Right now everything points in the right direction for Caterpillar. 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.

These cost savings 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 its rising cash flows Caterpillar will continue to reduce its share count, which results in a boost to the company's earnings per share growth rate.

2018 will be a new record year for Caterpillar: The company has not only started with record H1 profits, Caterpillar has also guided for adjusted earnings per share of around \$11.50 during 2018. We expect the profit growth rate to normalize beyond 2018, but sales growth and share buybacks will lead to solid growth over the coming five years.

Caterpillar's most recent dividend increase, by 10%, was somewhat higher than the long-term average of 7%.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	11.4	29.4	16.6	12.4	10.0	15.1	15.8	17.1	22.8	16.4	12.5	15.5
Avg. Yld.	2.5%	4.0%	2.5%	1.9%	2.2%	2.7%	2.7%	3.8%	3.9%	2.8%	2.4%	2.5%

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

Caterpillar's average price-to-earnings ratio as well as the median price-to-earnings ratio over the last decade are in the mid-teens. Shares of the company are currently trading at a discount to the fair valuation. Multiple normalization over the coming years should boost Caterpillar's total returns. After the most recent dividend increase Caterpillar's dividend yield is 2.4% right now.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	19.0%	14.2%	19.1%	20.4%	21.1%	17.6%	17.1%	17.2%	13.8%	18.7%	20.0%	22.0%
Debt/A	90.0%	84.5%	83.1%	84.1%	80.0%	75.4%	80.2%	81.1%	82.3%	82.1%	81.0%	80.0%
Int. Cov.	4.5	1.5	4.0	6.5	7.5	5.3	3.8	4.1	1.1	4.5	5.5	6.0
Payout	28.4%	117%	41.9%	23.3%	21.6%	40.1%	42.4%	65.2%	89.5%	45.2%	28.5%	29.0%
Std. Dev.	47.3%	65.9%	29.2%	37.6%	29.5%	16.8%	20.9%	20.5%	24.9%	15.3%	19.0%	22.0%

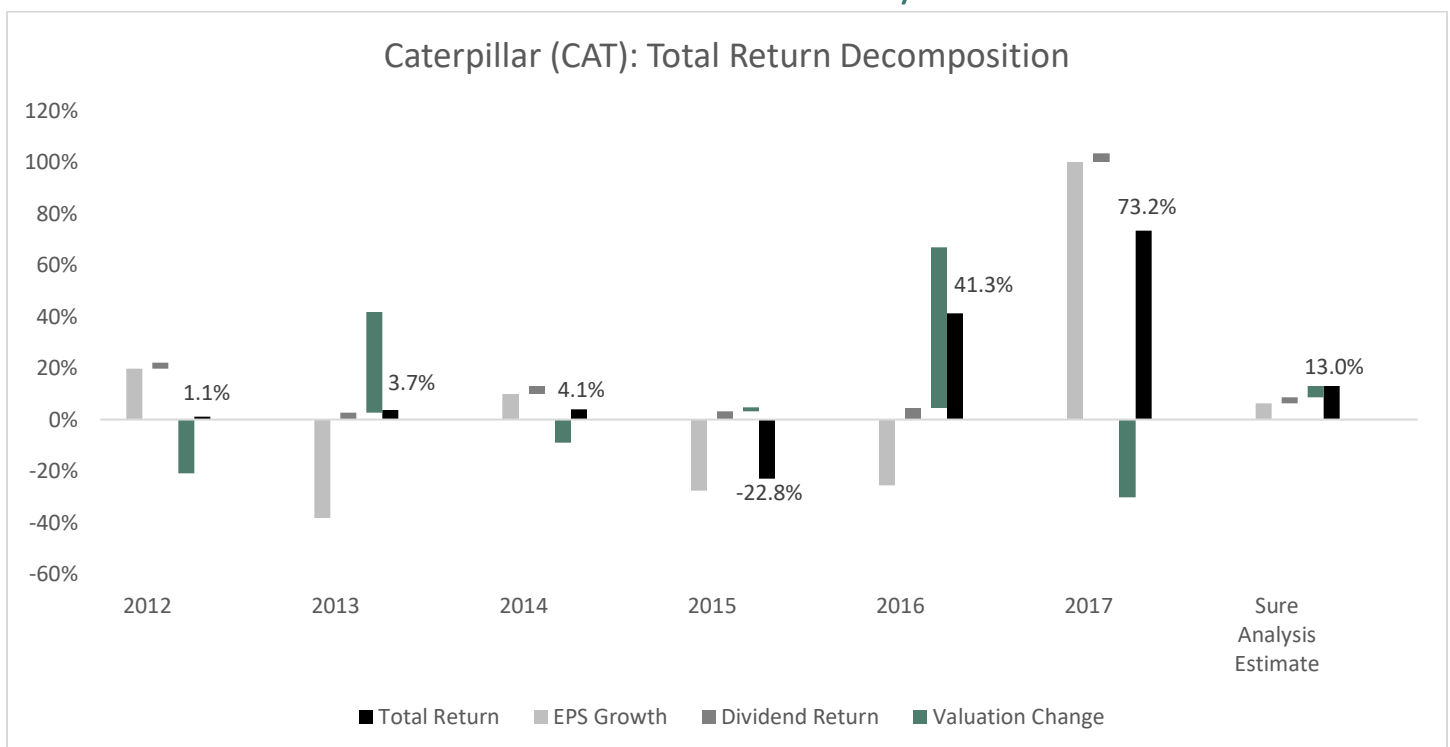
Caterpillar has a highly leveraged balance sheet, but a significant portion of Caterpillar's liabilities belong to the company's financial products business. Caterpillar offers financing solutions and other financial services to its customer, the same way many automobile companies offer banking-related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

Qualitatively, 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's business is hit hard. Caterpillar is not a recession resistant stock.

Final Thoughts & Recommendation

Caterpillar will profit from a cyclical upturn in resource industries, while also benefiting from strong construction activity in several of its key markets. Through a combination of sales growth and share repurchases Caterpillar should be able to deliver solid earnings growth over the coming years. Its total returns will also be boosted by multiple expansion and, to a lesser degree, its dividend payments. These factors help Caterpillar to earn a buy recommendation today.

Total Return Breakdown by Year



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