Cummins Inc (CMI)

Updated August 9th, 2018 by Nathan Parsh

Key Metrics

Current Price:	$142	**5 Year CAGR Estimate:**	16.5%	**Volatility Percentile:**	66.3%
Fair Value Price:	$184	**5 Year Growth Estimate:**	8.0%	**Momentum Percentile:**	14.8%
% Fair Value:	77%	**5 Year Valuation Multiple Estimate:**	5.4%	**Valuation Percentile:**	93.5%
Dividend Yield:	3.1%	**5 Year Price Target**	$271	**Total Return Percentile:**	94.1%

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 capitalization of more than $36 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 2nd quarter earnings on July 31st. The company earned $3.29 per share, $0.34 below estimates, but an increase of 30% year over year. Revenue grew 20.7% to $6.13 billion, $320 million higher than expected. This is four consecutive quarters of 20%+ revenue growth for Cummins.

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	***$13.28***	***$19.51***
DPS	$0.60	$0.70	$0.88	$1.33	$1.80	$2.25	$2.81	$3.51	$4.00	$4.21	***$4.44***	***$6.52***

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. We estimate that the company can grow earnings by 8% per year through 2023.

All four of Cummins' divisions showed strong growth in the quarter. Engine was up 17% with North American sales growing 12% and international revenues up 32% on higher demand for trucks engines as well market share gains. Growth in North America was robust for the Power System Segment as revenues increased 30% due to higher demand for oil & gas markets. This division overall had 23% growth. After accounting for 2nd quarter results, Cummins is now expected to earn $13.28 per share in 2018, up from $11.70 previously. Demand for all size trucks is expected to show strength this year. Cummins forecasts that Heavy Duty and Medium Duty trucks will be up 29% and 13% respectively worldwide. While demand for trucks is expected to drop 1% in China, management sees growth in units of 20% and 15% for Brazil and India. Included in the company's results was a $181 million charge related to upgrading engines produced between 2010-2015. The company took a $187 million charge in the 1st quarter. Including this quarter's charge, there could be as much as $400 million in charges that Cummins will be forced to spend to upgrade engines.

The company gave shareholders a 5.6% increase on July 10th. We expect dividends to grow at a rate similar to earnings going forward. Cummins announced on August 8th that it was accelerating its stock buyback and repurchasing $500 million worth of shares at the current market price.

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	***10.7***	***13.9***
Avg. Yld.	1.2%	1.9%	1.2%	1.3%	1.7%	1.9%	1.9%	2.8%	3.5%	2.7%	***3.1%***	***2.4%***

Shares of Cummins have declined $11, or 7.7%, since our May 3rd update. Based off of updated guidance, the stock currently trades at a price to earnings ratio of 10.7. Unlike many companies, shares of Cummins have never become

Disclosure: This analyst has a long position in the security discussed in this research report

overly expensive in the current bull market. The average price-to-earnings multiple over the past decade is than 13.9. If the valuation were to return to the average, then Cummins could see 5.4% added to annual returns due to multiple expansion through 2023. Value investors should find Cummins attractive given its low P/E.

It was not until recently that Cummins offered an attractive dividend yield. The current yield of 3.1% is based upon expected dividend payments for 2018. The yield 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

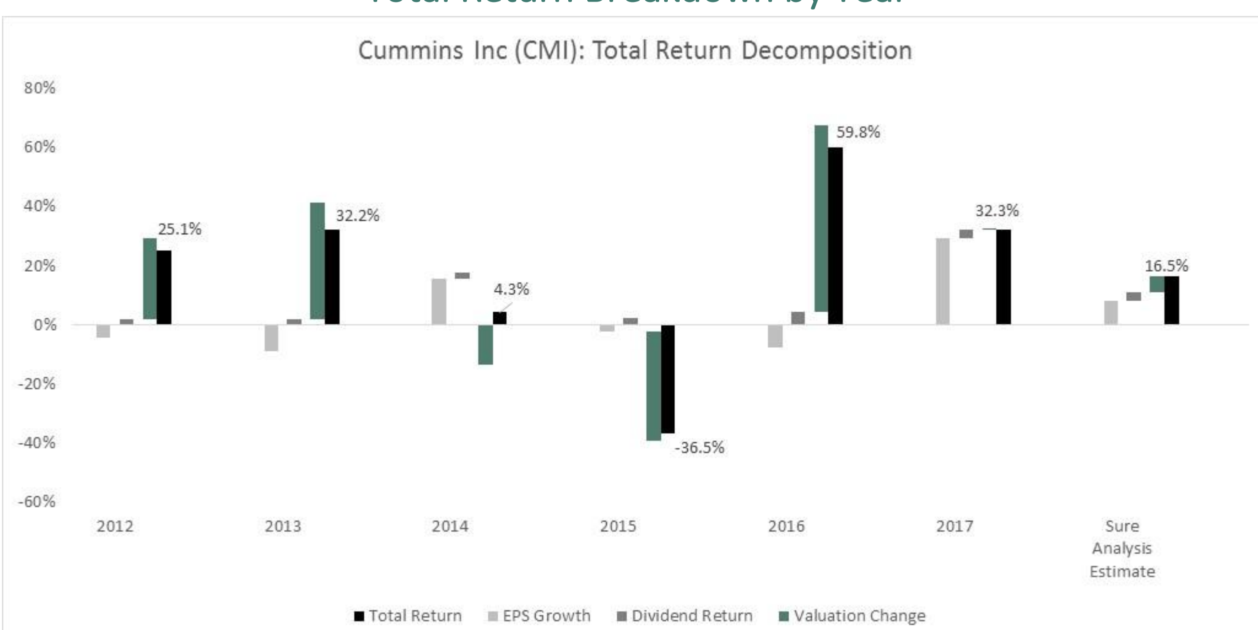
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	34.5%	24.6%	30.5%	39.3%	35.2%	29.1%	30.8%	32.7%	29.7%	28.2%	***28.8%***	***31.4%***
Debt/A	59.2%	54.4%	52%	50%	44.4%	46.6%	48.7%	48.8%	52.2%	54.8%	***54.1%***	***51.1%***
Int. Cov.	50.8	25	87.2	271.5	104.7	154.3	60.9	51	36.3	33.5	***44.3***	***87.5***
Payout	14.7%	28.3%	17%	14.7%	20.7%	28.4%	30.7%	39.3%	48.6%	39.6%	***33.4%***	***33.4%***
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 are 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

After 2nd quarter earnings, we have raised our estimate for annual total returns through 2023 to 16.5% from 12% previously. This total return is a combination of growth (8%), dividends (3.1%) and multiple expansion (5.4%). The stock has declined in recent months due to the charges related to upgrades to engines, but we feel that the selloff is overdone. We feel that Cummins offers a very good value at current levels and encourage investors looking for industrial exposure to purchase the stock. Due to increase in expected EPS for the year, we have increased our 2023 price target $32 to $271.

Total Return Breakdown by Year



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