



# Caterpillar Inc. (CAT)

Updated October 28<sup>th</sup>, 2018 by Jonathan Weber

## Key Metrics

<b>Current Price:</b>	\$115	<b>5 Year CAGR Estimate:</b>	18.4%	<b>Volatility Percentile:</b>	60.5%
<b>Fair Value Price:</b>	\$178	<b>5 Year Growth Estimate:</b>	6.2%	<b>Momentum Percentile:</b>	21.7%
<b>% Fair Value:</b>	65%	<b>5 Year Valuation Multiple Estimate:</b>	9.2%	<b>Growth Percentile:</b>	56.0%
<b>Dividend Yield:</b>	3.0%	<b>5 Year Price Target</b>	\$241	<b>Valuation Percentile:</b>	94.6%
<b>Dividend Risk Score:</b>	C	<b>Retirement Suitability Score:</b>	C	<b>Total Return Percentile:</b>	92.0%

## 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 \$68 billion.

Caterpillar reported its third quarter earnings results on October 23. The company generated revenues of \$13.5 billion during the quarter, an increase of 18.4% year over year. This strong sales performance, coupled with some margin expansion due to operating leverage, allowed Caterpillar to grow its earnings-per-share by 47% year over year, to \$2.86. Caterpillar's management has stated that its guidance for 2018 remains unchanged, the company still expects to generate earnings-per-share of \$11.00 to \$12.00 for fiscal 2018.

## 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>\$11.50</b>	<b>\$15.54</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>\$3.28</b>	<b>\$4.50</b>
<b>Shares</b>	602	625	639	648	655	638	606	582	586	598	<b>585</b>	<b>565</b>

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. 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 much points into the right direction for Caterpillar. Mining companies are expanding their operations, 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 reported record profits for the first nine months. 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 nevertheless.

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

## 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>10.0</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>3.0%</b>	<b>2.5%</b>

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Caterpillar's share price has declined significantly over the last couple of weeks, due to a broad sell-off in equity markets that hits more cyclical companies like Caterpillar to a significant degree. This share price decline has made Caterpillar's valuation decline to a very inexpensive level, which means that Caterpillar's share price will benefit from considerable multiple expansion tailwinds going forward. The company's shares offer an above-average dividend yield of 3.0%.

## 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>28.5%</b>	<b>29.0%</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>

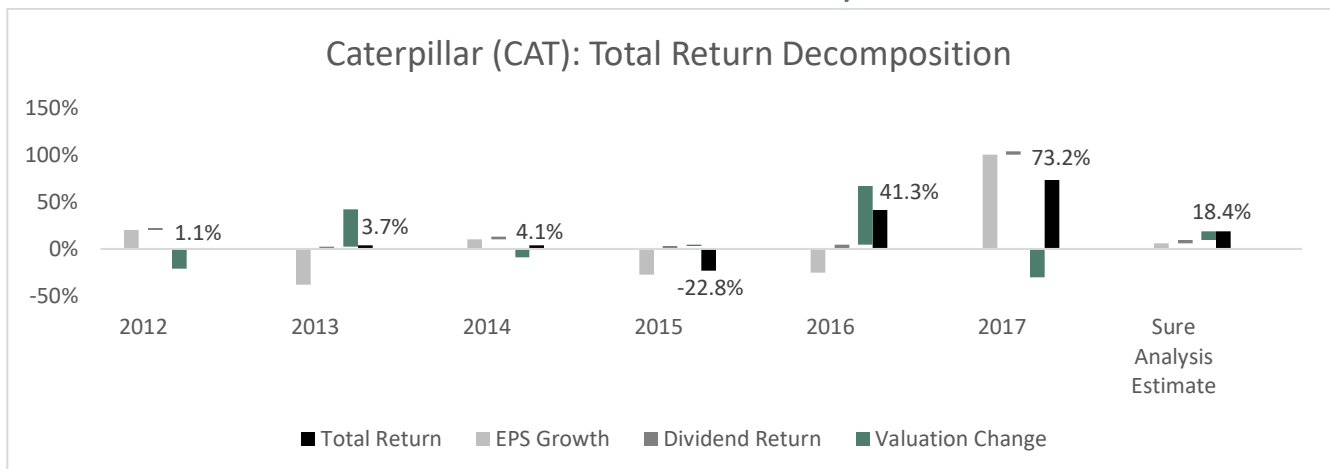
Caterpillar has a highly leveraged balance sheet, but a significant portion of Caterpillar's liabilities belong to the company's financial products business. Caterpillar offers financing solutions and other financial services to its customer, the same way many automobile companies offer banking-related solutions to their customers. \$21 billion of debt belong to these financial products businesses. Adjusted for this, leverage ratios would be significantly lower. Interest coverage looked solid in 2017, and 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 is a market leader in its industry, and the company has a strong presence around the globe. The company's results are cyclical, though, and Caterpillar is vulnerable versus recessions and economic downturns. 2018 will be a record year for Caterpillar. It is likely that Caterpillar's earnings will be even higher a couple of years from now. Due to an inexpensive valuation, coupled with some earnings-per-share growth and an above-average dividend yield, Caterpillar could produce compelling total returns going forward. The company earns a buy recommendation from Sure Dividend at current prices.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Revenue</b>	51324	32396	42588	60138	65875	55656	55184	47011	38537	45462
<b>Gross Profit</b>	12909	8510	11307	15734	18023	14202	13842	12878	9632	13767
<b>Gross Margin</b>	25.2%	26.3%	26.5%	26.2%	27.4%	25.5%	25.1%	27.4%	25.0%	30.3%
<b>SG&amp;A Exp.</b>	4399	3645	4248	5203	5919	5547	6529	4951	4686	5177
<b>D&amp;A Exp.</b>	1980	2336	2296	2527	2813	3087	3163	3046	3034	2877
<b>Operating Profit</b>	6782	3444	3963	7153	9153	5628	3314	3785	1093	4406
<b>Op. Margin</b>	13.2%	10.6%	9.3%	11.9%	13.9%	10.1%	6.0%	8.1%	2.8%	9.7%
<b>Net Profit</b>	3557	895	2700	4928	5681	3789	2452	2512	-67	754
<b>Net Margin</b>	6.9%	2.8%	6.3%	8.2%	8.6%	6.8%	4.4%	5.3%	-0.2%	1.7%
<b>Free Cash Flow</b>	786	4027	2423	3033	108	5745	4678	3438	2708	3366
<b>Income Tax</b>	953	-270	968	1720	2528	1319	692	916	192	3339

## Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Total Assets</b>	67782	60038	64020	81218	88970	84896	84681	78342	74704	76962
<b>Cash &amp; Equivalents</b>	2736	4867	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
<b>Acc. Receivable</b>	N/A	N/A	8494	10057	9706	8413	7737	6695	5981	7436
<b>Inventories</b>	8781	6360	9587	14544	15547	12625	12205	9700	8614	10018
<b>Goodwill &amp; Int.</b>	2772	2734	3419	11448	10958	10552	9770	9436	8369	8311
<b>Total Liabilities</b>	61068	50738	53156	68289	71388	64018	67855	63457	61491	63196
<b>Accounts Payable</b>	4827	2993	5856	8161	6753	6560	6515	5023	4614	6487
<b>Long-Term Debt</b>	35535	31631	28337	34546	40070	37653	39200	37936	36715	34441
<b>Total Equity</b>	6087	8740	10824	12883	17532	20811	16746	14809	13137	13697
<b>D/E Ratio</b>	5.84	3.62	2.62	2.68	2.29	1.81	2.34	2.56	2.79	2.51

## Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Return on Assets</b>	5.7%	1.4%	4.4%	6.8%	6.7%	4.4%	2.9%	3.1%	-0.1%	1.0%
<b>Return on Equity</b>	47.5%	12.1%	27.6%	41.6%	37.4%	19.8%	13.1%	15.9%	-0.5%	5.6%
<b>ROIC</b>	8.9%	2.2%	6.7%	11.4%	10.8%	6.5%	4.3%	4.6%	-0.1%	1.5%
<b>Shares Out.</b>	602	625	639	648	655	638	606	582	586	598
<b>Revenue/Share</b>	81.74	51.75	65.48	90.28	98.38	84.51	87.75	78.18	65.95	75.86
<b>FCF/Share</b>	1.25	6.43	3.73	4.55	0.16	8.72	7.44	5.72	4.63	5.62

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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