Cummins Inc. (CMI)

Updated October 30th, 2018 by Nate Parsh

Key Metrics

Current Price:	$134	**5 Year CAGR Estimate:**	18.1%	**Volatility Percentile:**	59.7%
Fair Value Price:	$184	**5 Year Growth Estimate:**	8.0%	**Momentum Percentile:**	10.2%
% Fair Value:	77%	**5 Year Valuation Multiple Estimate:**	6.6%	**Growth Percentile:**	71.7%
Dividend Yield:	3.5%	**5 Year Price Target**	$271	**Valuation Percentile:**	86.2%
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Total Return Percentile:**	89.5%

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 $21 billion in sales in 2017. Today the company employs more 58,000+ people in 160+ countries.

Cummins released 3rd quarter earnings on October 30th. The company earned $4.05 per share, $0.28 above estimates and an increase of 49% year-over-year. Revenue grew 12.3% to $5.94 billion, but $10 million below estimates. This is six consecutive quarters of 12%+ revenue growth for Cummins. North American sales were very impressive in the quarter, growing 17%. International sales, led by India and China, increased 6%. Each division of Cummins saw sales growth as well. The Engine division was up 17% as truck production in North America was strong. The Distribution segment increased revenues 10% due to higher demand for power generation equipment and growth in parts and service. Component sales grew 14% due to higher sales volumes in North America. Sales for Power Systems improved 5% due to increased demand for power generation and oil and gas. Tariffs are expected to cost Cummins just $80 million in 2018, down from the company's previous estimate of $100 million. Charges to upgrade engines produced between 2010-2015 appear to have subsided after costing Cummins more than $360 million in the first half of 2018.

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***
Shares	201.4	201.4	197.8	192.9	189.8	186.7	182.2	175.2	168.2	164	***160***	***156***

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.

The company gave shareholders a 5.6% dividend increase on July 10th. We expect dividends to grow at a rate similar to earnings going forward. The company also issued a new $2 billion share repurchase authorization, which would retire almost 10% of the current market cap.

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	***10.1***	***13.9***
Avg. Yld.	1.2%	1.9%	1.2%	1.3%	1.7%	1.9%	1.9%	2.8%	3.5%	2.7%	***3.5%***	***2.4%***

Shares of Cummins have declined $8, or 5.6%, since our August 9th update. Based off of guidance, the stock currently trades at a price to earnings ratio of 10.1, down from 10.7 previously. 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

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

is 13.9. If the valuation were to return to the average, then Cummins could see 6.6% added to annual returns due to multiple expansion through 2023. Value investors should find Cummins attractive given its low P/E.

Safety, Quality, Competitive Advantage, & Recession Resiliency

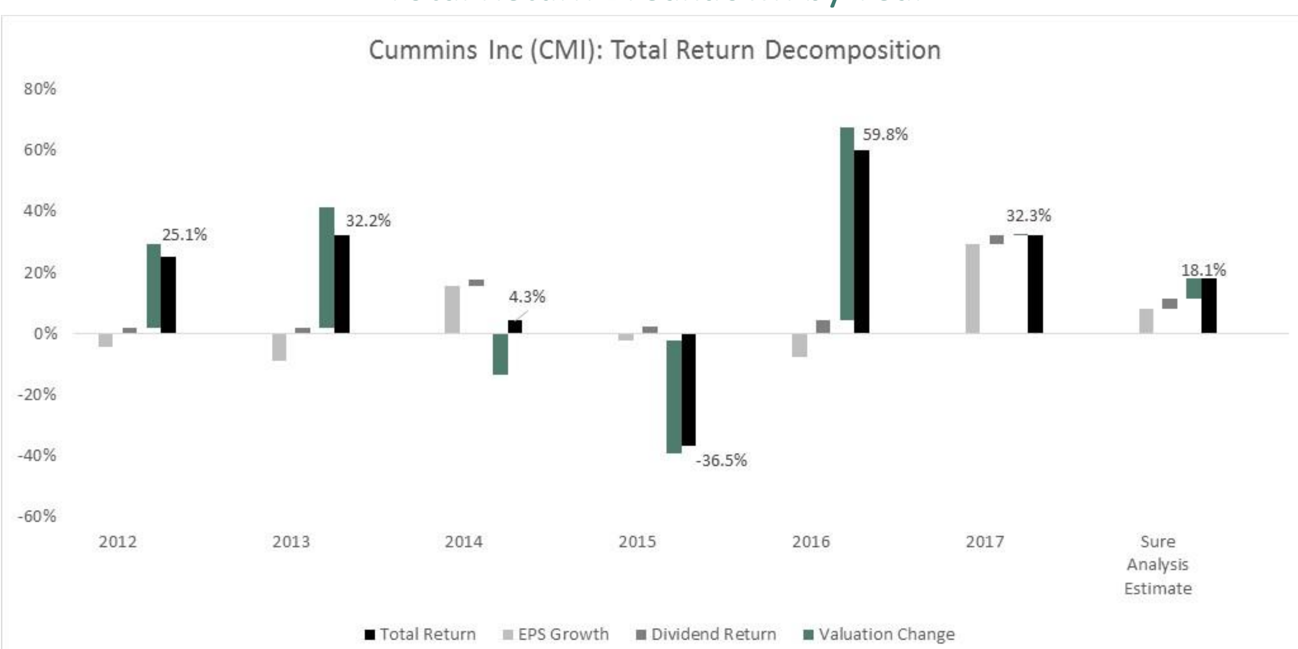
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	34.5%	24.6%	30.5%	39.3%	35.2%	29.1%	30.8%	32.7%	29.7%	28.2%	***28.8%***	***31.4%***
Debt/A	59.2%	54.4%	52%	50%	44.4%	46.6%	48.7%	48.8%	52.2%	54.8%	***54.1%***	***51.1%***
Int. Cov.	50.8	25	87.2	271.5	104.7	154.3	60.9	51	36.3	33.5	***44.3***	***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. 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. 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 3rd quarter earnings, we have raised our estimate for annual total returns through 2023 to 18.1% from 16.5% previously. This total return is a combination of growth (8%), dividends (3.5%) and multiple expansion (6.6%). Cummins had a solid quarter with strong revenue growth in all divisions. North American sales were especially impressive. On top of that, charges for upgraded engines appear to have subsided. Cummins offers one of the highest estimated total annual returns in our coverage universe. We feel that stock is undervalued and provides a sizeable dividend yield. We maintain our 2023 price target of $271 and rate the stock as a buy.

Total Return Breakdown by Year



Click here to rate and review this research report. Your feedback is important to us.

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

Cummins Inc. (CMI)

Updated October 30th, 2018 by Nate Parsh

Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	14342	10800	13226	18048	17334	17301	19221	19110	17509	20428
Gross Profit	2940	2169	3168	4589	4416	4280	4861	4947	4452	5090
Gross Margin	20.5%	20.1%	24.0%	25.4%	25.5%	24.7%	25.3%	25.9%	25.4%	24.9%
SG&A Exp.	1450	1239	1487	1837	1808	1817	2095	2092	2046	2390
D&A Exp.	314	326	320	325	361	407	455	514	530	583
Operating Profit	1068	568	1251	2144	1870	1740	1995	2103	1781	1997
Op. Margin	7.4%	5.3%	9.5%	11.9%	10.8%	10.1%	10.4%	11.0%	10.2%	9.8%
Net Profit	755	428	1040	1848	1645	1483	1651	1399	1394	999
Net Margin	5.3%	4.0%	7.9%	10.2%	9.5%	8.6%	8.6%	7.3%	8.0%	4.9%
Free Cash Flow	362	792	599	1391	755	1349	1468	1266	1345	1690
Income Tax	360	156	477	725	533	531	698	555	474	1371

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	8519	8816	10402	11668	12548	14728	15764	15134	15011	18075
Cash & Equivalents	426	930	1023	1484	1369	2699	2301	1711	1120	1369
Accounts Receivable	1551	1730	1935	2252	2235	2362	2744	2640	2803	3311
Inventories	1783	1341	1977	2141	2221	2381	2866	2707	2675	3166
Goodwill & Int. Ass.	585	592	589	566	814	818	822	810	812	2055
Total Liabilities	5039	4796	5406	5837	5574	6858	7671	7384	7837	9911
Accounts Payable	1009	957	1362	1546	1339	1557	1881	1706	1854	2579
Long-Term Debt	698	674	791	783	775	1740	1686	1639	1856	2006
Shareholder's Equity	3230	3773	4670	5492	6603	7510	7749	7406	6875	7259
D/E Ratio	0.22	0.18	0.17	0.14	0.12	0.23	0.22	0.22	0.27	0.28

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	9.0%	4.9%	10.8%	16.7%	13.6%	10.9%	10.8%	9.1%	9.2%	6.0%
Return on Equity	22.7%	12.2%	24.6%	36.4%	27.2%	21.0%	21.6%	18.5%	19.5%	14.1%
ROIC	17.7%	9.6%	19.8%	29.8%	22.9%	17.1%	17.0%	14.6%	15.1%	10.4%
Shares Out.	201.4	201.4	197.8	192.9	189.8	186.7	182.2	175.2	168.2	164
Revenue/Share	72.98	54.63	67.09	93.22	91.39	92.31	104.99	107.11	103.40	122.13
FCF/Share	1.84	4.01	3.04	7.19	3.98	7.20	8.02	7.10	7.94	10.10

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