



Caterpillar Inc. (CAT)

Updated April 24th, 2019 by Eli Inkrot

Key Metrics

Current Price:	\$138	5 Year CAGR Estimate:	13.3%	Volatility Percentile:	62.4%
Fair Value Price:	\$184	5 Year Growth Estimate:	5.0%	Momentum Percentile:	25.9%
% Fair Value:	75%	5 Year Valuation Multiple Estimate:	5.8%	Growth Percentile:	35.9%
Dividend Yield:	2.5%	5 Year Price Target	\$235	Valuation Percentile:	93.4%
Dividend Risk Score:	A	Retirement Suitability Score:	B	Total Return Percentile:	84.0%

Overview & Current Events

Founded in 1925 and headquartered in Peoria, Illinois, Caterpillar is the world's leading manufacturer of construction and mining equipment, diesel and natural gas engines, industrial gas turbines and diesel-electric locomotives. The \$80 billion market cap company operates in three primary segments: Construction Industries, Resource Industries and Energy & Transportation, along with ancillary financing and related services through its Financial Products segment.

On April 24th, 2019 Caterpillar reported Q1 2019 results for the period ending March 31st, 2019. For the quarter the company reported revenue of \$13.5 billion, representing a 5% increase compared to the prior year's quarter. This growth in Caterpillar's top line was driven by an 18% increase in Resource Industries, while Construction Industries and Energy & Transportation saw 3% and flat year-over-year growth, respectively. Earnings-per-share came in at a record \$3.25, representing a 19% increase compared to the \$2.74 posted in Q1 2018; however, \$0.31 of that improvement can from a discrete tax benefit.

Caterpillar also updated its 2019 outlook. Expectations for the business are unchanged; however, as a result of the \$0.31 tax benefit, the company revised its earnings-per-share outlook to a range of \$12.06 to \$13.06 (from \$11.75 to \$12.75 previously). We have kept our estimate for earnings at the midpoint of prior guidance, as the tax item is not reoccurring.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	\$1.43	\$4.15	\$7.81	\$9.36	\$5.79	\$6.37	\$4.62	\$3.44	\$6.88	\$11.18	\$12.25	\$15.65
DPS	\$1.68	\$1.74	\$1.82	\$2.02	\$2.32	\$2.70	\$3.01	\$3.08	\$3.11	\$3.28	\$3.52	\$4.70
Shares	625	639	648	655	638	606	582	586	598	597	580	560

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.

Currently things are going well 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. 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. Last year was a record year for Caterpillar, and indeed it looks like 2019 will be even better. However, we are more cautious over the intermediate-term as the cyclical nature of the business weighs in from time to time and forecast 5.0% annual growth.

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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	29.4	16.6	12.4	10.0	15.1	15.8	17.1	22.8	16.4	12.9	11.3	15.0
Avg. Yld.	4.0%	2.5%	1.9%	2.2%	2.7%	2.7%	3.8%	3.9%	2.8%	2.3%	2.6%	2.0%

Since 2010 shares of Caterpillar have traded hands with an average P/E ratio of about 15 times earnings. However, keep in mind that this includes periods such as 2016 when earnings collapsed, while the share price held up much better. Still, given the company's growth prospects and overall quality, we view 15 times earnings as a reasonable starting place. With the current valuation closer to 11 times earnings, this implies the potential for a significant valuation tailwind.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	117%	42%	23%	22%	40%	42%	65%	90%	45%	29%	29%	30%

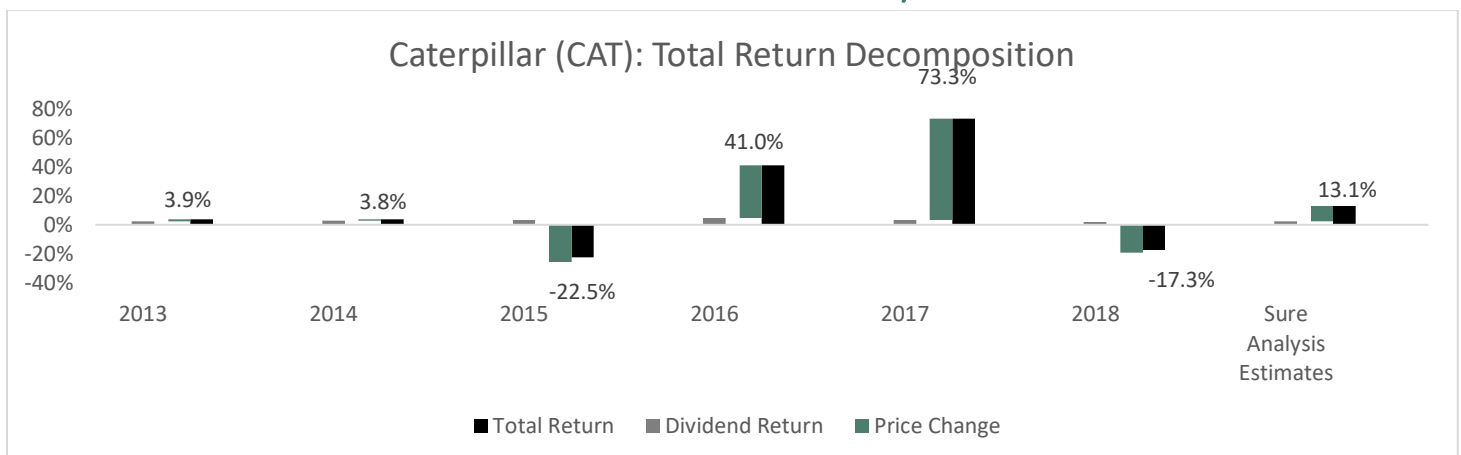
Caterpillar's dividend payout ratio has moved up and down throughout the last couple of years, which is not surprising as the company's profits were quite cyclical. Last year, the significant increase in Caterpillar's earnings-per-share allowed the payout ratio to decline substantially. Due to the fact that the payout ratio rose above 100% during the last financial crisis, we view the dividend is somewhat risky, even though Caterpillar did not cut its dividend during this time.

Qualitatively, Caterpillar is one of the largest 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, Caterpillar's business can be hit hard. This was illustrated during the last recession, when earnings-per-share declined by 75% between 2008 and 2009.

Final Thoughts & Recommendation

Shares are up 11% since our last update, while earnings came in more or less as expected. Caterpillar is a leader in its industry, posting a record year in 2018, and 2019 should be even better. We believe that Caterpillar's earnings growth will slow down to 5%, but when we add in the stock's considerable potential for multiple expansion, adding the prospect for 5.8% yearly improvement, as well as the company's solid 2.5% dividend yield, the 13.3% total return outlook still looks promising. For those that are not afraid of the cyclical, Caterpillar earns a buy recommendation at current prices.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	32396	42588	60138	65875	55656	55184	47011	38537	45462	54722
Gross Profit	8510	11307	15734	18023	14202	13842	12878	9897	13556	17003
Gross Margin	26.3%	26.5%	26.2%	27.4%	25.5%	25.1%	27.4%	25.7%	29.8%	31.1%
SG&A Exp.	3645	4248	5203	5919	5547	6529	4951	4383	4999	5478
D&A Exp.	2336	2296	2527	2813	3087	3163	3046	3034	2877	2766
Operating Profit	3444	3963	7153	9153	5628	3314	3785	1757	4460	8293
Op. Margin	10.6%	9.3%	11.9%	13.9%	10.1%	6.0%	8.1%	4.6%	9.8%	15.2%
Net Profit	895	2700	4928	5681	3789	2452	2512	-67	754	6147
Net Margin	2.8%	6.3%	8.2%	8.6%	6.8%	4.4%	5.3%	-0.2%	1.7%	11.2%
Free Cash Flow	4027	2423	3033	108	5745	4678	3438	2711	3370	3642
Income Tax	-270	968	1720	2528	1319	692	916	192	3339	1698

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	60038	64020	81218	88970	84896	84681	78342	74704	76962	78509
Acc. Receivable	N/A	16792	17725	18566	17176	16764	15686	14503	16193	17452
Inventories	6360	9587	14544	15547	12625	12205	9700	8614	10018	11529
Goodwill & Int.	2734	3419	11448	10958	10552	9770	9436	8369	8311	8114
Total Liabilities	50738	53156	68289	71388	64018	67855	63457	61491	63196	64429
Accounts Payable	2993	5856	8161	6753	6560	6515	5023	4614	6487	7051
Long-Term Debt	31631	28337	34546	40070	37653	39200	37936	36715	34441	36097
Total Equity	8740	10824	12883	17532	20811	16746	14809	13137	13697	14039
D/E Ratio	3.62	2.62	2.68	2.29	1.81	2.34	2.56	2.79	2.51	2.57

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	1.4%	4.4%	6.8%	6.7%	4.4%	2.9%	3.1%	-0.1%	1.0%	7.9%
Return on Equity	12.1%	27.6%	41.6%	37.4%	19.8%	13.1%	15.9%	-0.5%	5.6%	44.3%
ROIC	2.2%	6.7%	11.4%	10.8%	6.5%	4.3%	4.6%	-0.1%	1.5%	12.5%
Shares Out.	625	639	648	655	638	606	582	586	598	597
Revenue/Share	51.75	65.48	90.28	98.38	84.51	87.75	78.18	65.95	75.86	91.29
FCF/Share	6.43	3.73	4.55	0.16	8.72	7.44	5.72	4.64	5.62	6.08

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

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