Cummins Inc. (CMI)

Updated July 30th, 2019 by Nathan Parsh

Key Metrics

Current Price:	$165	**5 Year CAGR Estimate:**	12.4%	**Volatility Percentile:**	48.5%
Fair Value Price:	$202	**5 Year Growth Estimate:**	5.0%	**Momentum Percentile:**	76.2%
% Fair Value:	82%	**5 Year Valuation Multiple Estimate:**	4.2%	**Growth Percentile:**	37.0%
Dividend Yield:	3.2%	**5 Year Price Target**	$257	**Valuation Percentile:**	85.0%
Dividend Risk Score:	B	**Retirement Suitability Score:**	B	**Total Return Percentile:**	75.3%

Overview & Current Events

Cummins, headquartered in Indiana and founded in 1919, 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. Cummins operates in four segments: Engines (35% of 2018 revenue), Distribution (26%), Components (24%) and Power Systems (15%). Roughly 60% of its business is done in the U.S. and Canada. The $26 billion market capitalization company employs more than 60,000 people and serves customers in about 190 countries. Cummins generates nearly $24 billion in annual revenues.

Cummins released second quarter results on 7/30/2019. The company earned $4.27 per share during the quarter, which missed estimates by $0.17, but grew 30% from the previous year. Revenue increased 1.5% to $6.2 billion, though this was $138 million lower than expected. Currency reduced revenues by 2% and EBITDA was 17% of sales.

Cummins' businesses had a mixed second quarter. The Engine segment produced sales of $2.7 billion, matching the previous year's second quarter. On-highway revenues were up 2%, but this was offset by a 7% drop in off-highway revenues. Sales for North America were up 7%, but lower demand in China helped lead to a 15% drop in international sales. The Distribution segment grew 2% to $2 billion. This division saw strong demand for power generation equipment in North America. Sales for the Components segment were down 2% to $1.8 billion. Higher heavy and medium-duty truck production was more than offset by lower demand in Europe, China and India. The Power Systems segment experienced a sales decline of 3%. Weaker demand in North American oil and gas and global mining markets were the primary culprits for lower sales.

Cummins expects 2019 revenue to be flat compared to the previous year. This is at the low end of the company's previous guidance of flat to 4% revenue growth for the year. Cummins continues to expect EBITDA of 16.25% to 16.75% for 2019. We maintain our earnings-per-share estimates of $15.50 for the year.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$2.47	$5.17	$9.07	$8.69	$7.91	$9.14	$8.92	$8.23	$10.63	$13.15	***$15.50***	***$19.78***
DPS	$0.70	$0.88	$1.33	$1.80	$2.25	$2.81	$3.51	$4.00	$4.21	$4.44	***$5.24***	***$6.69***
Shares	201	198	193	190	187	182	175	168	166	163	***157***	***150***

The above table is slightly misleading as it relates to growth, as the data starts at the last recession. Looking at the 2008 to 2018 period, Cummins grew earnings-per-share by an average compound rate of 12.4%, quite an impressive record, although most of the improvement was in the 2010-2011 and 2017-2018 periods. We forecast 5% earnings growth due to increases in revenue and share repurchases.

Cummins has been benefiting from an increase in worldwide emission regulations and fuel efficiency standards. When paired with the company's reliable and superior quality engines, this has afforded the company growth opportunities. This trend is likely to continue, but we believe there is a tipping point whereby the increase in standards starts to be addressed via alternative technologies, such as batteries. In turn, this could slow Cummins' growth profile as the company would either need to invest heavily in new technologies or risk falling behind.

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Cummins increased its dividend 15% to $1.31 for the 9/3/2019 payment. On an annualized basis, the stock has a yield of 3.2%.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	14.8	14.5	11.1	11.9	15.3	15.8	14.0	14.1	14.9	10.2	***10.6***	***13.0***
Avg. Yld.	1.9%	1.2%	1.3%	1.7%	1.9%	1.9%	2.8%	3.5%	2.7%	3.3%	***3.2%***	***2.6%***

Over the past decade, shares of Cummins have traded with an average price-to-earnings ratio of 13 to 14 times earnings. We believe this is a reasonable multiple considering the company's growth prospects paired with a fair amount of cyclicality in earnings. Shares of Cummins are down $2, or 1.2%, since our 4/30/2019 update. Using our expectations for earnings for 2019, the stock trades with a multiple of 10.6 currently. If shares were to trade at our target multiple by 2024, then valuation would be a 4.2% tailwind to total returns over this time period.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	28%	17%	15%	21%	28%	31%	39%	49%	40%	34%	***34%***	***34%***

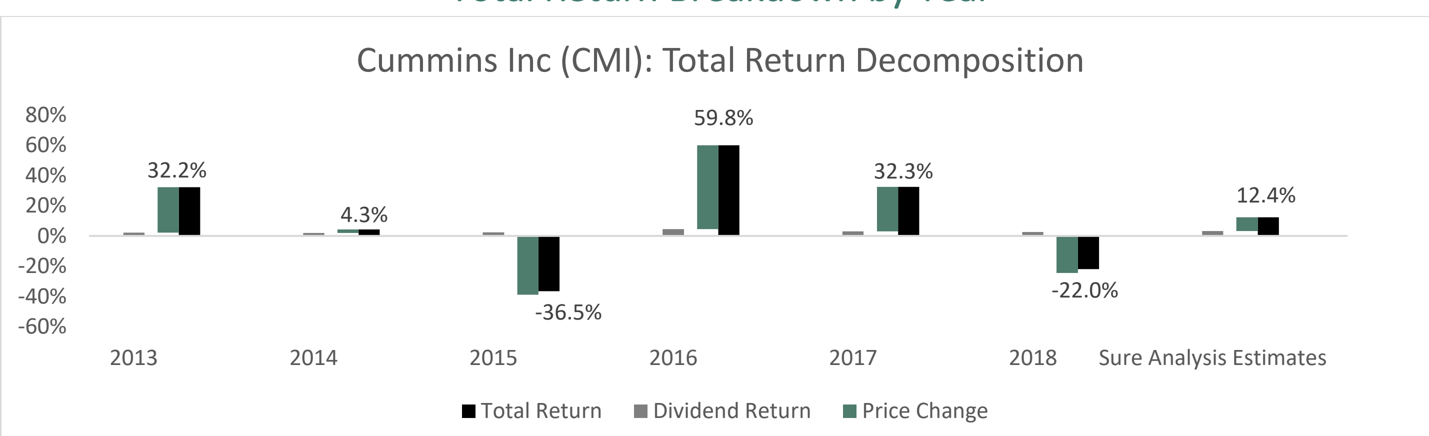
During the last recession Cummins posted earnings-per-share of $4.08, $2.47, $5.17 and $9.07 during the 2008 through 2011 stretch. Meanwhile, the dividend kept increasing during this time. We view this a microcosm of the business at large. That is, in lesser economic times earnings are likely to falter, but the company has the ability to recovery quickly, and the dividend payout ratio is low enough to keep the payment steady.

Cummins maintains a competitive advantage in its strong brand name, stemming from reliability and superior quality. In turn, the company maintains a large share of the heavy-duty engine market. Two main risks stick out: a high reliance on a few customers, namely PACCAR, Daimler, Chrysler and Navistar, which could turn to manufacturing in-house, and the potential for new technologies to disrupt or require increased investment.

Final Thoughts & Recommendation

Following second quarter results, we now estimate that Cummins can offer a total annual return of 12.4% through 2024, up from 11.6% previously. Cummins saw some weakness in certain parts of its business, though North America was strong in most segments. International markets were a headwind due to a strong U.S. dollar. Despite this, Cummins has a strong reputation, an above market average yield and a low valuation. Investors with a long term horizon could do well owning shares of the company. We reiterate our buy recommendation for Cummins and our 2024 price target of $257.

Total Return Breakdown by Year



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

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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	10800	13226	18048	17334	17301	19221	19110	17509	20428	23771
Gross Profit	2169	3168	4589	4416	4280	4861	4947	4452	5090	5737
Gross Margin	20.1%	24.0%	25.4%	25.5%	24.7%	25.3%	25.9%	25.4%	24.9%	24.1%
SG&A Exp.	1239	1487	1837	1808	1817	2095	2092	2046	2390	2437
D&A Exp.	326	320	325	361	407	455	514	530	583	
Operating Profit	568	1251	2144	1870	1740	1995	2103	1781	1997	2392
Op. Margin	5.3%	9.5%	11.9%	10.8%	10.1%	10.4%	11.0%	10.2%	9.8%	10.1%
Net Profit	428	1040	1848	1645	1483	1651	1399	1394	999	2141
Net Margin	4.0%	7.9%	10.2%	9.5%	8.6%	8.6%	7.3%	8.0%	4.9%	9.0%
Free Cash Flow	792	599	1391	755	1349	1468	1266	1345	1690	1594
Income Tax	156	477	725	533	531	698	555	474	1371	566

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	8816	10402	11668	12548	14728	15764	15134	15011	18075	19062
Cash & Equivalents	930	1023	1484	1369	2699	2301	1711	1120	1369	1303
Accounts Receivable	1730	1935	2252	2235	2362	2744	2640	2803	3311	3866
Inventories	1341	1977	2141	2221	2381	2866	2707	2675	3166	3759
Goodwill & Int. Ass.	592	589	566	814	818	822	810	812	2055	2035
Total Liabilities	4796	5406	5837	5574	6858	7671	7384	7837	9911	10803
Accounts Payable	957	1362	1546	1339	1557	1881	1706	1854	2579	2822
Long-Term Debt	674	791	783	775	1740	1686	1639	1856	2006	2476
Shareholder's Equity	3773	4670	5492	6603	7510	7749	7406	6875	7259	7348
D/E Ratio	0.18	0.17	0.14	0.12	0.23	0.22	0.22	0.27	0.28	0.34

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	4.9%	10.8%	16.7%	13.6%	10.9%	10.8%	9.1%	9.2%	6.0%	11.5%
Return on Equity	12.2%	24.6%	36.4%	27.2%	21.0%	21.6%	18.5%	19.5%	14.1%	29.3%
ROIC	9.6%	19.8%	29.8%	22.9%	17.1%	17.0%	14.6%	15.1%	10.4%	20.5%
Shares Out.	201	198	193	190	187	182	175	168	166	163
Revenue/Share	54.63	67.09	93.22	91.39	92.31	104.99	107.11	103.40	122.13	146.01
FCF/Share	4.01	3.04	7.19	3.98	7.20	8.02	7.10	7.94	10.10	9.79

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