



Caterpillar Inc. (CAT)

Updated February 4th, 2020 by Eli Inkrot

Key Metrics

| | | | | | |
|-----------------------------|-------|--|-------|----------------------------------|----------|
| Current Price: | \$134 | 5 Year CAGR Estimate: | 9.9% | Market Cap: | \$75.5 B |
| Fair Value Price: | \$130 | 5 Year Growth Estimate: | 8.0% | Ex-Dividend Date: | 01/17/20 |
| % Fair Value: | 103% | 5 Year Valuation Multiple Estimate: | -0.6% | Dividend Payment Date: | 02/20/20 |
| Dividend Yield: | 3.1% | 5 Year Price Target | \$190 | Years Of Dividend Growth: | 26 |
| Dividend Risk Score: | B | Retirement Suitability Score: | B | Last Dividend Increase: | 19.8% |

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 \$75 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 January 31st, 2020 Caterpillar reported Q4 and full year 2020 results for the period ending December 31st, 2019. For the quarter the company reported revenue of \$13.1 billion, representing an -8% decline compared to Q4 2018. Earnings-per-share came in at \$1.97 against \$1.78 previously, while adjusted earnings-per-share equaled \$2.63 compared to \$2.55. For the year revenue totaled \$53.8 billion, a -2% decline from the \$54.7 billion posted in a 2018. Meanwhile, earnings-per-share equaled \$10.74 compared to \$10.26 in the prior year, while adjusted earnings-per-share totaled \$11.06 versus \$11.22 prior, which was in-line with prior guidance.

Caterpillar also updated provided a 2020 outlook, anticipating \$8.50 to \$10.00 in earnings-per-share as continued economic uncertainty pressures sales and weighs on dealer inventories. We have initiated our forecast accordingly.

Growth on a Per-Share Basis

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2025 |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|---------|---------|---------------|----------------|
| EPS | \$4.15 | \$7.81 | \$9.36 | \$5.79 | \$6.37 | \$4.62 | \$3.44 | \$6.88 | \$11.20 | \$11.06 | \$9.25 | \$13.59 |
| DPS | \$1.74 | \$1.82 | \$2.02 | \$2.32 | \$2.70 | \$3.01 | \$3.08 | \$3.11 | \$3.36 | \$3.78 | \$4.12 | \$5.12 |
| Shares¹ | 639 | 648 | 655 | 638 | 606 | 582 | 586 | 598 | 576 | 568 | 565 | 545 |

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.

Things were going well for Caterpillar, but the company has run into headwinds as of late, especially as it relates to global trade uncertainties, and indeed coronavirus uncertainties and the resultant decline in dealer inventories. That being said, mining companies have been 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 can 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. 2018 was a record year for Caterpillar, but 2019 saw a marginal decline. Further, the expectation is for 2020 to be another down year. Collectively, we are slightly cautious over the intermediate term as the cyclical nature of the business weighs in from time to time but are still forecasting 8% annual growth off what will be a much lower base for 2020.

¹ In millions.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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Valuation Analysis

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | Now | 2025 |
|-----------|------|------|------|------|------|------|------|------|------|------|------|------|
| Avg. P/E | 16.6 | 12.4 | 10.0 | 15.1 | 15.8 | 17.1 | 22.8 | 16.4 | 12.9 | 11.7 | 14.4 | 14.0 |
| Avg. Yld. | 2.5% | 1.9% | 2.2% | 2.7% | 2.7% | 3.8% | 3.9% | 2.8% | 2.3% | 2.9% | 3.1% | 2.7% |

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 14 times earnings as a reasonable starting place. With the current valuation just over 14 times earnings, this implies the potential for a small valuation headwind.

Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2025 |
|--------|------|------|------|------|------|------|------|------|------|------|------|------|
| Payout | 42% | 23% | 22% | 40% | 42% | 65% | 90% | 45% | 30% | 34% | 45% | 38% |

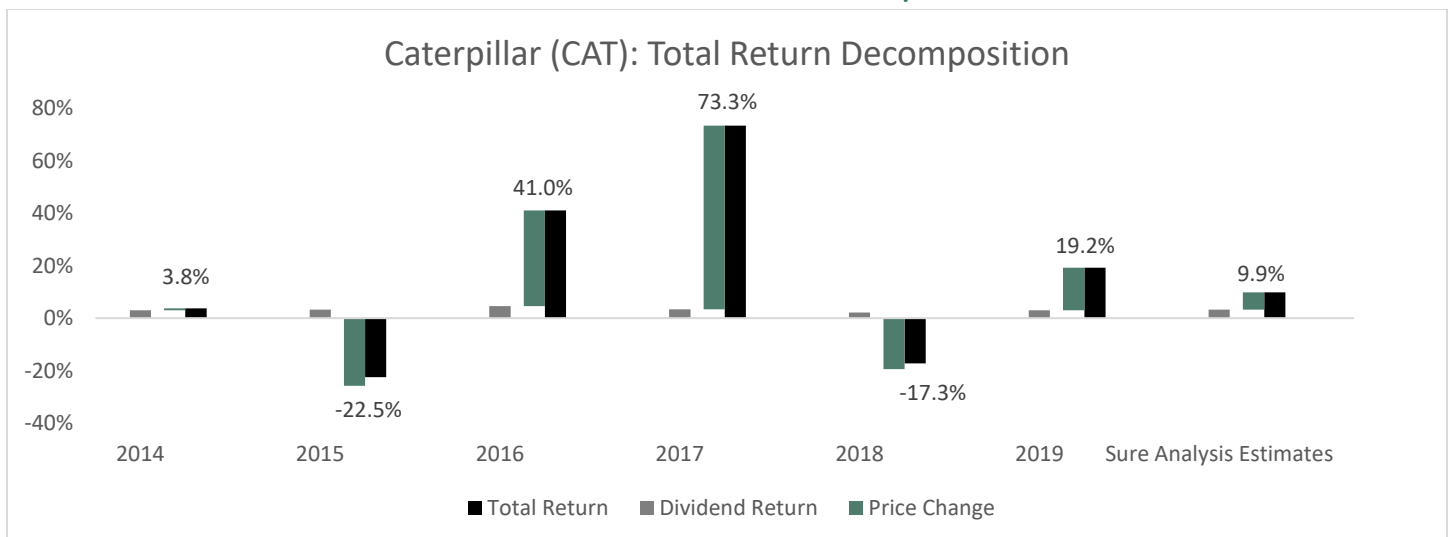
Caterpillar's dividend payout ratio has moved up and down throughout the last couple of years, which is not surprising as the company's profits were quite cyclical. In 2018, the significant increase in Caterpillar's earnings-per-share allowed the payout ratio to decline substantially. Due to the fact 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 marginally since our last report, while earnings expectations have once again declined. Caterpillar is a leader in its industry, with volatile earnings. Total return potential comes in at 9.9% per annum, stemming from 8% growth (off a lower base) and a 3.1% starting dividend yield, offset by a small valuation headwind. While we are cautious on the cyclical nature of the business, Caterpillar continues to earn a buy rating at the current quotation.

Total Return Breakdown by Year



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Income Statement Metrics

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Revenue | 42588 | 60138 | 65875 | 55656 | 55184 | 47011 | 38537 | 45462 | 54722 | 53800 |
| Gross Profit | 11307 | 15734 | 18023 | 14202 | 13842 | 12878 | 9897 | 13556 | 17003 | 16416 |
| Gross Margin | 26.5% | 26.2% | 27.4% | 25.5% | 25.1% | 27.4% | 25.7% | 29.8% | 31.1% | 30.5% |
| SG&A Exp. | 4248 | 5203 | 5919 | 5547 | 6529 | 4951 | 4383 | 4999 | 5478 | 5162 |
| D&A Exp. | 2296 | 2527 | 2813 | 3087 | 3163 | 3046 | 3034 | 2877 | 2766 | 2577 |
| Operating Profit | 3963 | 7153 | 9153 | 5628 | 3314 | 3785 | 1757 | 4460 | 8293 | 8290 |
| Op. Margin | 9.3% | 11.9% | 13.9% | 10.1% | 6.0% | 8.1% | 4.6% | 9.8% | 15.2% | 15.4% |
| Net Profit | 2700 | 4928 | 5681 | 3789 | 2452 | 2512 | -67 | 754 | 6147 | 6093 |
| Net Margin | 6.3% | 8.2% | 8.6% | 6.8% | 4.4% | 5.3% | -0.2% | 1.7% | 11.2% | 11.3% |
| Free Cash Flow | 2423 | 3033 | 108 | 5745 | 4678 | 3438 | 2711 | 3370 | 3642 | 4243 |
| Income Tax | 968 | 1720 | 2528 | 1319 | 692 | 916 | 192 | 3339 | 1698 | 1746 |

Balance Sheet Metrics

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|-------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Total Assets | 64020 | 81218 | 88970 | 84896 | 84681 | 78342 | 74704 | 76962 | 78509 | 78453 |
| Acc. Receivable | 16792 | 17725 | 18566 | 17176 | 16764 | 15686 | 14503 | 16193 | 17452 | |
| Inventories | 9587 | 14544 | 15547 | 12625 | 12205 | 9700 | 8614 | 10018 | 11529 | 17904 |
| Goodwill & Int. | 3419 | 11448 | 10958 | 10552 | 9770 | 9436 | 8369 | 8311 | 8114 | 11266 |
| Total Liabilities | 53156 | 68289 | 71388 | 64018 | 67855 | 63457 | 61491 | 63196 | 64429 | 7761 |
| Accounts Payable | 5856 | 8161 | 6753 | 6560 | 6515 | 5023 | 4614 | 6487 | 7051 | 63824 |
| Long-Term Debt | 28337 | 34546 | 40070 | 37653 | 39200 | 37936 | 36715 | 34441 | 36097 | 5957 |
| Total Equity | 10824 | 12883 | 17532 | 20811 | 16746 | 14809 | 13137 | 13697 | 14039 | 37657 |
| D/E Ratio | 2.62 | 2.68 | 2.29 | 1.81 | 2.34 | 2.56 | 2.79 | 2.51 | 2.57 | 14588 |

Profitability & Per Share Metrics

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Return on Assets | 4.4% | 6.8% | 6.7% | 4.4% | 2.9% | 3.1% | -0.1% | 1.0% | 7.9% | 7.8% |
| Return on Equity | 27.6% | 41.6% | 37.4% | 19.8% | 13.1% | 15.9% | -0.5% | 5.6% | 44.3% | 42.6% |
| ROIC | 6.7% | 11.4% | 10.8% | 6.5% | 4.3% | 4.6% | -0.1% | 1.5% | 12.5% | 11.9% |
| Shares Out. | 639 | 648 | 655 | 638 | 606 | 582 | 586 | 598 | 597 | 568 |
| Revenue/Share | 65.48 | 90.28 | 98.38 | 84.51 | 87.75 | 78.18 | 65.95 | 75.86 | 91.29 | 94.80 |
| FCF/Share | 3.73 | 4.55 | 0.16 | 8.72 | 7.44 | 5.72 | 4.64 | 5.62 | 6.08 | 7.48 |

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

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