Cummins Inc. (CMI)

Updated February 4th, 2020 by Nathan Parsh

Key Metrics

Current Price:	$161	**5 Year CAGR Estimate:**	8.7%	**Market Cap:**	$24.7 billion
Fair Value Price:	$168	**5 Year Growth Estimate:**	5.0%	**Ex-Dividend Date:**	2/21/20[1]
% Fair Value:	96%	**5 Year Valuation Multiple Estimate:**	0.8%	**Dividend Payment Date:**	3/7/20[2]
Dividend Yield:	3.3%	**5 Year Price Target**	$214	**Years Of Dividend Growth:**	14
Dividend Risk Score:	B	**Retirement Suitability Score:**	B	**Last Dividend Increase:**	15%

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 company employs more than 60,000 people and serves customers in about 190 countries. Cummins generates over $21 billion in annual revenues.

Cummins reported fourth quarter and full-year results on 2/4/2020. The company earned $2.56 per share during the quarter, which topped estimates by $0.10, but was a decline of more than 26% from the prior year. Revenue decreased 8.5% to $5.6 billion, but topped estimates by $190 million. For the year, adjusted earnings-per-share increased 13.4% to $14.91 while revenue was lower by 0.8% to $23.6 billion. Currency reduced revenues by 1% in the quarter.

As with the prior quarter, decreased demand for trucks and construction equipment worldwide was responsible for most of the earnings and revenue declines. U.S. sales in the fourth quarter were down 8% while international was lower by 10%. The Engine segment had a 15% decline in revenues 15% as on-highway revenues were down 13% and off-highway revenues were lower by 22%. Distribution revenues declined 1% as higher power generation shipments was offset by decreased demand in oil and gas construction. Components sales were lower by 12% due to weaker global truck demand. Power Systems were lower by 12% as power generation was down 11% and industrial dropped 14%. Cummins expects the medium and heavy-duty truck market in the U.S. to be down 20% and 40%, respectively. China truck demand is seen as dropping by 10%. Analysts expect Cummins to earn $12.89 per share in 2020, which would be a 13.5% decline from the previous year. Shares were lower by 1.2% following the earnings release.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$5.17	$9.07	$8.69	$7.91	$9.14	$8.92	$8.23	$10.63	$13.15	$14.91	***$12.89***	***$16.45***
DPS	$0.88	$1.33	$1.80	$2.25	$2.81	$3.51	$4.00	$4.21	$4.44	$4.90	***$5.24***	***$6.69***
Shares[3]	198	193	190	187	182	175	168	166	163	152	***150***	***145***

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

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[1] Estimated date

[2] Estimated dividend payment date

[3] In millions of shares

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

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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. Cummins increased its dividend 15% to $1.31 for the 9/3/2019 payment. On an annualized basis, the stock has a yield of 3.3%.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	14.5	11.1	11.9	15.3	15.8	14.0	14.1	14.9	10.2	11.9	***12.5***	***13.0***
Avg. Yld.	1.2%	1.3%	1.7%	1.9%	1.9%	2.8%	3.5%	2.7%	3.3%	2.8%	***3.3%***	***3.1%***

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 $16, or 9%, since our 10/29/2019 update. Using our expectations for earnings for 2020, the stock trades with a multiple of 12.5 currently. If shares were to trade at our target multiple by 2024, then valuation would be a 0.8% tailwind to total returns over this time period.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	17%	15%	21%	28%	31%	39%	49%	40%	34%	33%	***41%***	***41%***

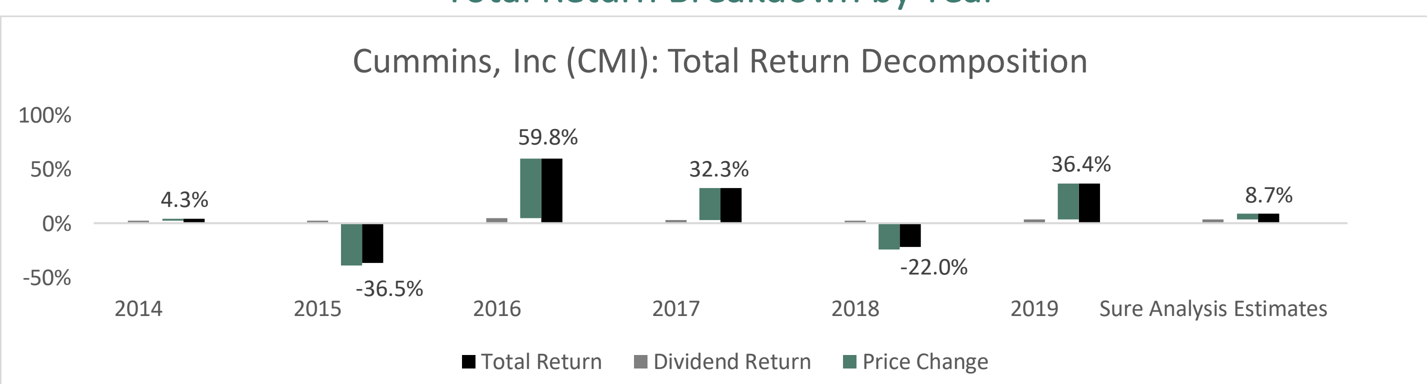
During the last recession Cummins posted earnings-per-share of $4.08, $2.47, $5.17 and $9.07 during the 2008 through 2011 stretch. Meanwhile, the dividend kept increasing during this time. We view this a microcosm of the business at large. That is, in lesser economic times earnings are likely to falter, 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 earnings results, we expect Cummins to return a total of 8.7% annually through 2025, down from our prior estimate of 10.2%. The company saw lower sales in every segment as global truck demand continues to slow. Cummins expects that this slowing will continue into 2020 as well. While we find the stock's yield attractive, we feel investors should require a higher margin of safety before buying shares of the company. We have lowered our 2025 price target $43 to $214 due to consensus estimates for 2020, and rate the stock a hold.

Total Return Breakdown by Year



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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.