Cummins Inc. (CMI)

Updated April 28th, 2020 by Nathan Parsh

Key Metrics

Current Price:	$161	**5 Year CAGR Estimate:**	7.9%	**Market Cap:**	$23.9 billion
Fair Value Price:	$139	**5 Year Growth Estimate:**	8.0%	**Ex-Dividend Date:**	5/22/20[1]
% Fair Value:	116%	**5 Year Valuation Multiple Estimate:**	-2.9%	**Dividend Payment Date:**	6/5/20[2]
Dividend Yield:	3.3%	**5 Year Price Target**	$205	**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 released first quarter results on 4/28/2020. The company's GAAP earnings-per-share totaled $3.41 for the quarter, which came in $1.18 ahead of estimates, but was a decline of 19% year-over-year. Revenue declined 17% to $5.0 billion, though this was $140 million higher than expected.

Cummins faced headwinds related to the COVID-19 pandemic. All markets faced significant declines due to a lack of demand as stay at home directives limited construction activities. A decrease in North American truck demand also contributed to the decline. U.S. sales were down 16% with international revenues declining 17%. Sales for the Engine segment decreased 19% primarily due to lower demand in truck and construction markets. The Distribution segment experienced a 9% drop in sales due to challenges in all lines of business. North America was particularly weak, with sales decreasing 11%. Sales for Components dropped 19%, led by a 24% decrease in North America. The Power Systems segment had a sales decrease of 18%, mostly due to a 30% decline year-over-year in the industrial business. Cummins removed its guidance for the year due to the uncertainty regarding the COVID-19 pandemic. Analysts expect earnings-per-share of $6.97 for the current year.

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	***$6.97***	***$15.74***
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***

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. Cummins has averaged a return on assets of 10.4% over the last decade. In order to provide a margin of safety, we expect the company to grow earnings at a rate of 8% through 2025 up from our previous estimate of 5%. While the short term will likely be difficult for the company, we believe Cummins will see a higher than usual growth rate as the global economy recovers from the pandemic. 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

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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.

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	***15.0***	***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%***	***3.8%***

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. Using assets of $20 billion, our earnings growth rate and the current share count, we believe that Cummins has earnings power of $10.71. We will use this figure to determine fair value and total returns. Shares of Cummins are flat since our 2/4/2020 update. Using our expectations for earnings power for 2020, the stock trades with a multiple of 15 currently. If shares were to trade at our target multiple by 2025, then valuation would be a 2.9% headwind to total returns over this time period.

Safety, Quality, Competitive Advantage, & Recession Resiliency

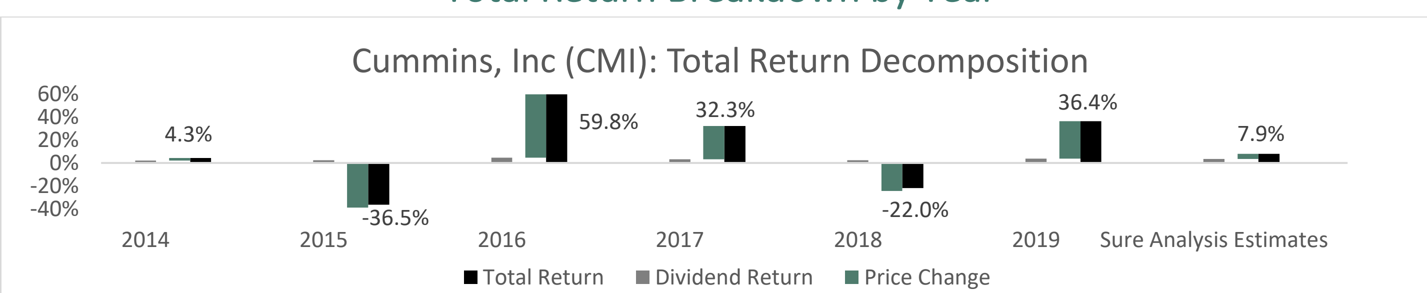
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	17%	15%	21%	28%	31%	39%	49%	40%	34%	33%	***49%***	***42%***

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

Cummins is expected to return a total of 7.9% annually through 2025, down from our prior estimate of 8.7%. COVID-19 has drastically reduced demand for Cummins' products and services. Each segment within the company suffered a decline, with several posting a double-digit decrease. That said, Cummins is well positioned as a leader in its industry and should reap the benefits of a recovery. However, we encourage investors to wait for a pullback before buying shares due to projected returns. We have lowered our 2025 price target $9 to $205 due to estimates for the current year as well as maintain our hold recommendation on Cummins.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	13226	18048	17334	17301	19221	19110	17509	20428	23771	23571
Gross Profit	3168	4589	4416	4280	4861	4947	4458	5100	5737	5980
Gross Margin	24.0%	25.4%	25.5%	24.7%	25.3%	25.9%	25.5%	25.0%	24.1%	25.4%
SG&A Exp.	1487	1837	1808	1817	2095	2092	2099	2429	2437	2454
D&A Exp.	320	325	361	407	455	514	530	583	611	672
Operating Profit	1251	2121	1887	1756	2018	2118	1733	1977	2409	2513
Op. Margin	9.5%	11.8%	10.9%	10.1%	10.5%	11.1%	9.9%	9.7%	10.1%	10.7%
Net Profit	1040	1848	1645	1483	1651	1399	1394	999	2141	2260
Net Margin	7.9%	10.2%	9.5%	8.6%	8.6%	7.3%	8.0%	4.9%	9.0%	9.6%
Free Cash Flow	599	1391	755	1349	1468	1266	1345	1690	1594	2406
Income Tax	477	725	533	531	698	555	474	1371	566	566

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	10402	11668	12548	14728	15764	15134	15011	18075	19062	19737
Cash & Equivalents	1023	1484	1369	2699	2301	1711	1120	1369	1303	1129
Accounts Receivable	1935	2526	2475	2649	2946	2820	3025	3618	3866	3670
Inventories	1977	2141	2221	2381	2866	2707	2675	3166	3759	3486
Goodwill & Int. Ass.	589	566	814	818	822	810	812	2055	2035	2289
Total Liabilities	5406	5837	5574	6858	7671	7384	7837	9911	10803	11272
Accounts Payable	1362	1546	1339	1557	1881	1706	1854	2579	2822	2534
Long-Term Debt	791	783	775	1740	1686	1639	1856	2006	2476	2367
Shareholder's Equity	4670	5492	6603	7510	7749	7406	6875	7259	7348	7507
D/E Ratio	0.17	0.14	0.12	0.23	0.22	0.22	0.27	0.28	0.34	0.32

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	10.8%	16.7%	13.6%	10.9%	10.8%	9.1%	9.2%	6.0%	11.5%	11.6%
Return on Equity	24.6%	36.4%	27.2%	21.0%	21.6%	18.5%	19.5%	14.1%	29.3%	30.4%
ROIC	19.8%	29.8%	22.9%	17.1%	17.0%	14.6%	15.1%	10.4%	20.5%	21.0%
Shares Out.	198	193	190	187	182	175	168	166	163	152
Revenue/Share	67.09	93.22	91.39	92.31	105.0	107.1	103.4	122.1	146.0	151.0
FCF/Share	3.04	7.19	3.98	7.20	8.02	7.10	7.94	10.10	9.79	15.41

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