Caterpillar Inc. (CAT)

Updated April 28th, 2020 by Eli Inkrot

Key Metrics

Current Price:	$116	**5 Year CAGR Estimate:**	10.2%	**Market Cap:**	$64.7 B
Fair Value Price:	$112	**5 Year Growth Estimate:**	8.0%	**Ex-Dividend Date:**	04/17/20
% Fair Value:	103%	**5 Year Valuation Multiple Estimate:**	-0.6%	**Dividend Payment Date:**	05/20/20
Dividend Yield:	3.6%	**5 Year Price Target**	$165	**Years Of Dividend Growth:**	26
Dividend Risk Score:	C	**Retirement Suitability Score:**	C	**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 $65 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 28th, 2020 Caterpillar reported Q1 2020 results for the period ending March 31st, 2020 For the quarter the company reported revenue of $10.6 billion, representing a -21% decline compared to Q1 2019. This result was due to lower sales volume driven by lower end-user demand and the impact from changes in dealer inventories. Earnings-per-share equaled $1.98 compared to $3.25 in the prior year quarter, as the COVID-19 crisis began to influence results. Caterpillar ended the first quarter with $7.1 billion of cash and $10.5 billion of available global credit facilities.

Previously Caterpillar provided a 2020 outlook, anticipating $8.50 to $10.00 in EPS. However, the company has withdrawn this guidance amid the ongoing crisis and expects results to be impacted for the remainder of the year.

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	***$5.00***	***$11.75***
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***
Shares[1]	639	648	655	638	606	582	586	598	576	568	***560***	***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.

Things were going well for Caterpillar, but the company has run into numerous headwinds as of late. Global trade uncertainties have now taken a back seat to the coronavirus crisis, as demand will be seriously impacted in the short-term. Furthermore, even if consumer demand comes back, dealers may be more cautious with their inventories moving forward. Results will be volatile in the short-term.

We expect earnings to be down significantly this year, but we are more optimistic over the long-term. For forecasting purposes, we are using $8 per share in underlying earnings power – based on $50 billion in sales and a 9% margin. In addition, we are keeping our 8% intermediate-term growth rate intact, but this implies a much lower earnings figure coming off a lower base. This reflects both some caution with regard to the cyclical nature of the business and Caterpillar's ability to bounce back when demand returns.

[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	12.0	***14.4***	***14.0***
Avg. Yld.	2.5%	1.9%	2.2%	2.7%	2.7%	3.8%	3.9%	2.8%	2.3%	2.8%	***3.6%***	***3.1%***

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 power, 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%	***52%***	***44%***

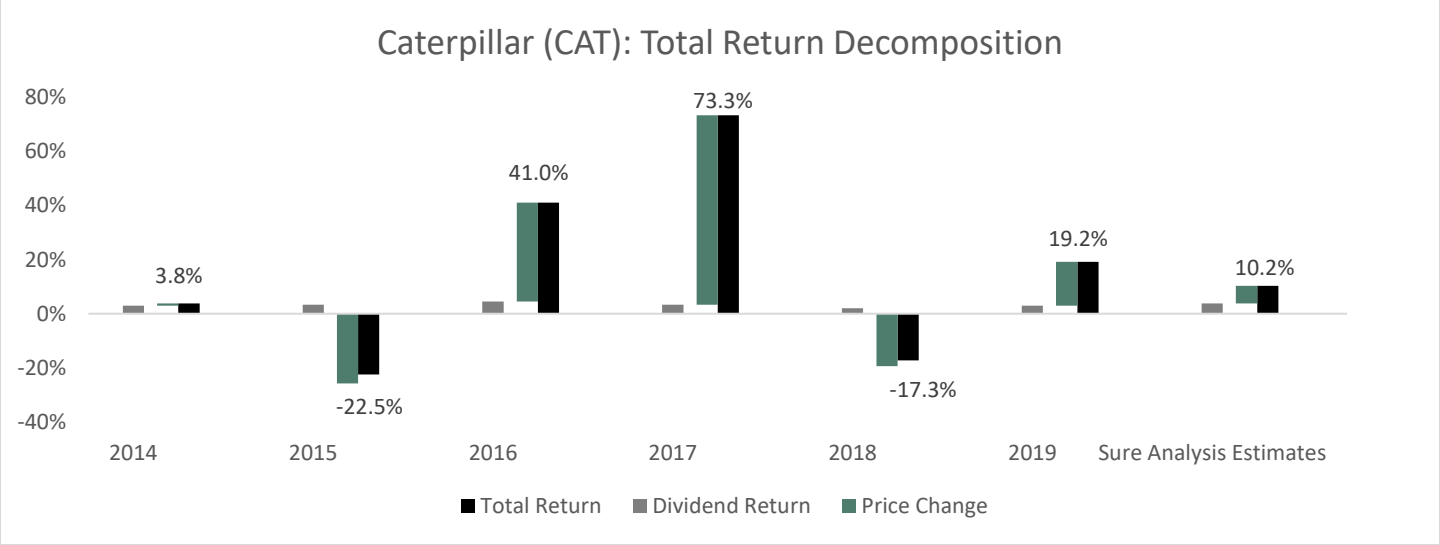
Caterpillar's dividend payout ratio has moved up and down throughout the last couple of years, which is not surprising as the company's profits were quite cyclical. In 2018, the significant increase in Caterpillar's earnings-per-share allowed the payout ratio to decline substantially. Due to the fact that the payout ratio rose above 100% during the last financial crisis, we view the dividend as 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. We expect significantly lower results this time around as well.

Final Thoughts & Recommendation

Shares are down -13% since our last report, with earnings expectations once again reduced as well. Caterpillar is a leader in its industry, with volatile earnings. Total return potential comes in at 10.2% per annum, stemming from 8% growth (off a lower base) and a 3.6% starting dividend yield, offset by a small valuation headwind. We are cautious on the cyclical nature of the business, especially today, and Caterpillar earns a hold rating.

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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