# Cummins Inc. (CMI)

*Updated October 27th, 2020 by Nathan Parsh*

## Key Metrics

| | | | | | |
|---|---|---|---|---|---|
| **Current Price:** | $224 | **5 Year CAGR Estimate:** | 6.0% | **Market Cap:** | $32.8 billion |
| **Fair Value Price:** | $183 | **5 Year Growth Estimate:** | 8.0% | **Ex-Dividend Date:** | 11/19/20 |
| **% Fair Value:** | 123% | **5 Year Valuation Multiple Estimate:** | -4.0% | **Dividend Payment Date:** | 12/3/20 |
| **Dividend Yield:** | 2.4% | **5 Year Price Target** | $268 | **Years Of Dividend Growth:** | 15 |
| **Dividend Risk Score:** | C | **Retirement Suitability Score:** | D | **Last Dividend Increase:** | 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 company employs more than 60,000 people and serves customers in about 190 countries. Cummins generates over $19 billion in annual revenues.

Cummins reported third quarter earnings results on 10/27/2020. The company's GAAP earnings-per-share of $3.36 was 13.4% lower than the previous year, but topped estimates by $0.88. Revenue was down 11.3% to $5.1 billion, but was $620 million better than expected.

COVID-19 once again weighed on results, but was not nearly as impactful as with the second quarter. Revenue for each segment fell year-over-year, but was higher on a sequential basis. Engine sales were down 13% to $2.1 billion as an 18% decline in North America more than offset an 8% gain in international markets. China sales were especially strong. Distribution declined 14% to $1.7 billion as demand was lower in each business. Sales for Components was down 7% to $1.5 billion. North America sales were lower by 24%, but international sales were up considerably due to strength in China and India. Power Systems decreased 13% to $981 million due to headwinds in the mining and oil and gas end markets. The company did not offer guidance for the year, but expects results to be similar to the third quarter. Analysts now expect earnings-per-share of $9.70 for 2020, up from the previous estimates of $7.57.

## 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 | ***$9.70*** | ***$20.64*** |
| DPS | $0.88 | $1.33 | $1.80 | $2.25 | $2.81 | $3.51 | $4.00 | $4.21 | $4.44 | $4.90 | ***$5.40*** | ***$6.89*** |
| Shares[1] | 198 | 193 | 190 | 187 | 182 | 175 | 168 | 166 | 163 | 152 | ***149*** | ***145*** |

Looking at the 2008 to 2019 period, Cummins grew earnings-per-share by an average compound rate of more than 12%, quite an impressive record, although most of the improvement was in the 2010-2011 and 2017-2019 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 Cummins' growth profile as the company would either need to invest heavily in new technologies or risk falling behind. Cummins last increased its dividend 3% to $1.35 for the 12/3/2020 payment.

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[1] In millions of shares

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## 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 | ***15.9*** | ***13.0*** |
| Avg. Yld. | 1.2% | 1.3% | 1.7% | 1.9% | 1.9% | 2.8% | 3.5% | 2.7% | 3.3% | 2.8% | ***2.4%*** | ***2.6%*** |

Over the past decade, shares of Cummins have traded with an average price-to-earnings ratio of slightly more than 13. 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 $21.6 billion, average return on assets over the last decade and the current share count, we believe that Cummins has earnings power of $14.05, up from $10.81 previously. We will use this figure to determine fair value and total returns. Shares of Cummins are higher by $25, or 12.6%, since our 7/28/2020 update. Using our expectations for earnings power for 2020, the stock trades with a multiple of 15.9 currently. If shares were to trade at our target multiple by 2025, then valuation would be a 4.0% headwind to total returns over this time period.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

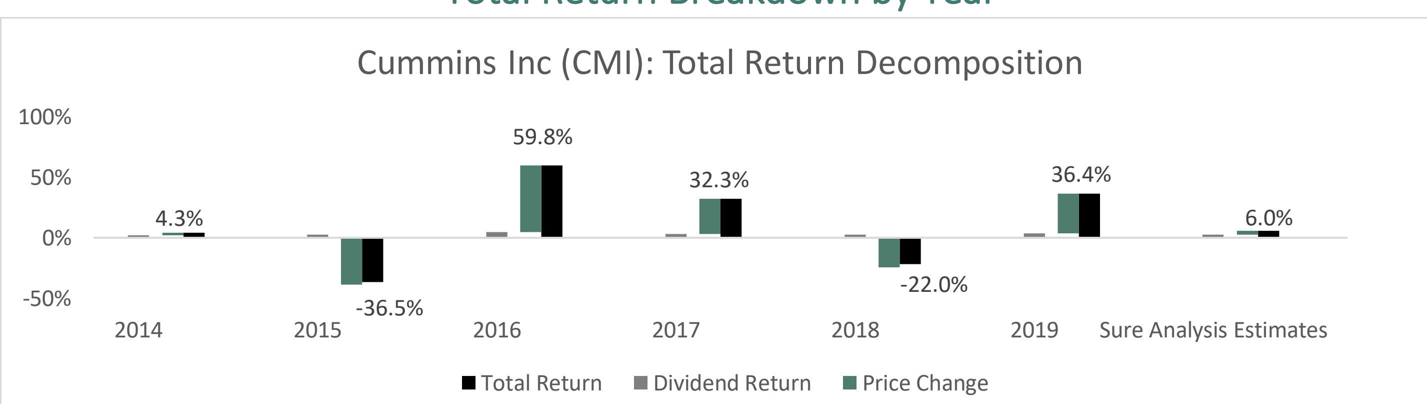
| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2025 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Payout | 17% | 15% | 21% | 28% | 31% | 39% | 49% | 40% | 34% | 33% | ***38%*** | ***33%*** |

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 recover 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 now projected to return a total of 6% annually through 2025, up from our prior estimate of 3.5%. The COVID-19 pandemic led to lower demand for all business segments, but this was far less pronounced than in the previous quarter. Still, the pandemic will have a material impact on the company's year-over-year EPS results, but we feel that Cummins would have considerably higher earnings power under more normalized conditions. We maintain our hold rating on the stock due to projected returns, but have raised our 2025 price target $44 to $268 due to an increase in earnings power estimates.

## 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 | 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.*