Cummins Inc. (CMI)

Updated February 7th, 2021 by Nathan Parsh

Key Metrics

Current Price:	$230	**5 Year CAGR Estimate:**	7.7%	**Market Cap:**	$34 billion
Fair Value Price:	$205	**5 Year Growth Estimate:**	8.0%	**Ex-Dividend Date:**	02/19/21
% Fair Value:	112%	**5 Year Valuation Multiple Estimate:**	-2.3%	**Dividend Payment Date:**	03/03/21
Dividend Yield:	2.3%	**5 Year Price Target**	$301	**Years Of Dividend Growth:**	15
Dividend Risk Score:	B	**Retirement Suitability Score:**	C	**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 more than $22 billion in annual revenues.

Cummins announced fourth quarter and full year earnings results on 2/4/2021. For the quarter, revenue grew 4.5% to $5.83 billion, which was $650 million more than expected. Net income of $501 million, or $3.36 per share, compared favorably to net income of $390 million, or $2.56 per share, in the prior year. EPS was also $0.54 better than expected. For the year, revenue declined 16% to $19.8 billion. Excluding restructuring charges, earnings-per-share fell 17.1% to $12.01.

COVID-19 was a negative impact on the company for the year, but each segment showed sequential improvements for the second consecutive quarter. The Engine segment returned to growth as sales were higher by 2% to $2.3 billion. Revenues were up 1% and 4% for on-highway and off-highway, respectively. North America was flat, but international sales improved 8% due to continued higher demand in China and India. Distribution declined 2% to $2.0 billion as gains made in power generation were offset by declines in parts and services. International sales were up 8%. Components was higher by 18% to $1.8 billion. North America returned to growth while international surged 40% due to better demand in China and India. Power Systems fell 6% to $989 million due to a double-digit decline in industrial as oil and gas markets remained weak. Cummins expects revenues to grow 8% to 12% in 2021. Each region is expected to grow, expect China, which had a record year in 2020. Analysts expect that the company will earn $13.93 in 2021.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	$9.07	$8.69	$7.91	$9.14	$8.92	$8.23	$10.63	$13.15	$14.48	$12.01	***$13.93***	***$23.17***
DPS	$1.33	$1.80	$2.25	$2.81	$3.51	$4.00	$4.21	$4.44	$4.90	$5.28	***$5.40***	***$6.89***
Shares[1]	193	190	187	182	175	168	166	163	152	149	***149***	***145***

Looking at the 2008 to 2020 period, Cummins grew earnings-per-share by an average compound rate of almost 9%, 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 2026 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

[1] In millions of shares

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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.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	11.1	11.9	15.3	15.8	14.0	14.1	14.9	10.2	11.9	18.9	***14.6***	***13.0***
Avg. Yld.	1.3%	1.7%	1.9%	1.9%	2.8%	3.5%	2.7%	3.3%	2.8%	2.3%	***2.3%***	***2.3%***

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 $22.6 billion, average return on assets over the last decade and the current share count, we believe that Cummins has earnings power of $15.77, up from $14.05 previously. We will use this figure to determine fair value and total returns. Shares of Cummins are higher by $6, or 2.7%, since our 10/27/2020 update. Using our expectations for earnings power for 2021, the stock trades with a multiple of 14.6 currently. If shares were to trade at our target multiple by 2026, then valuation would be a 2.3% headwind to total returns over this time period.

Safety, Quality, Competitive Advantage, & Recession Resiliency

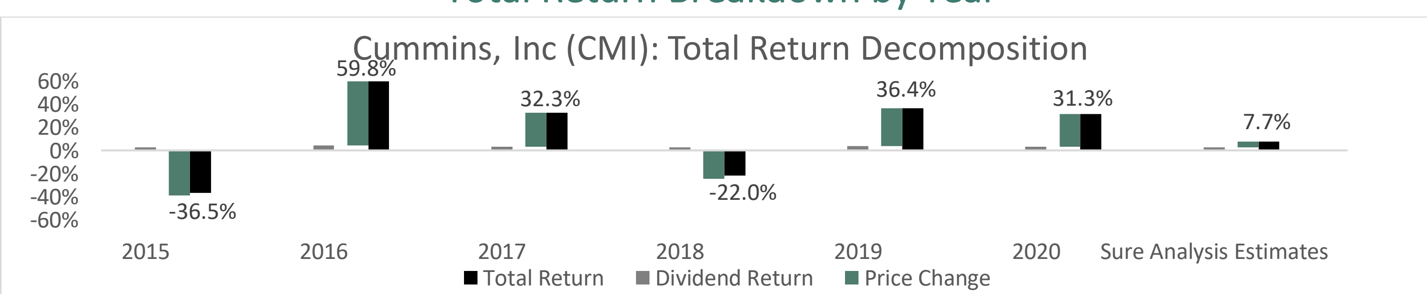
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	15%	21%	28%	31%	39%	49%	40%	34%	33%	44%	***34%***	***30%***

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 7.7% annually through 2026, up from our prior estimate of 6%. Our projected return consists of 8% earnings growth rate and a starting yield of 2.3% offset by a modest headwind from multiple compression. COVID-19 impacted annual results, but each business showed sequential improvement in the most recent quarter. International demand, particularly in China and India, was very strong even as North America continues to show weakness. We have raised our five-year price target $33 to $301, but have a hold rating on Cummins due to projected returns.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	18048	17334	17301	19221	19110	17509	20428	23771	23571	19811
Gross Profit	4589	4416	4280	4861	4947	4458	5100	5737	5980	4894
Gross Margin	25.4%	25.5%	24.7%	25.3%	25.9%	25.5%	25.0%	24.1%	25.4%	24.7%
SG&A Exp.	1837	1808	1817	2095	2092	2099	2429	2437	2454	2125
D&A Exp.	325	361	407	455	514	530	583	611	672	
Operating Profit	2121	1887	1756	2018	2118	1733	1977	2409	2513	1817
Op. Margin	11.8%	10.9%	10.1%	10.5%	11.1%	9.9%	9.7%	10.1%	10.7%	9.2%
Net Profit	1848	1645	1483	1651	1399	1394	999	2141	2260	1789
Net Margin	10.2%	9.5%	8.6%	8.6%	7.3%	8.0%	4.9%	9.0%	9.6%	9.0%
Free Cash Flow	1391	755	1349	1468	1266	1345	1690	1594	2406	2147
Income Tax	725	533	531	698	555	474	1371	566	566	527

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	11668	12548	14728	15764	15134	15011	18075	19062	19737	22624
Cash & Equivalents	1484	1369	2699	2301	1711	1120	1369	1303	1129	3401
Accounts Receivable	2252	2475	2649	2946	2820	3025	3618	3866	3670	3820
Inventories	2141	2221	2381	2866	2707	2675	3166	3759	3486	3425
Goodwill & Int. Ass.	566	814	818	822	810	812	2055	2035	2289	2256
Total Liabilities	5837	5574	6858	7671	7384	7837	9911	10803	11272	13635
Accounts Payable	1546	1339	1557	1881	1706	1854	2579	2822	2534	2820
Long-Term Debt	783	775	1740	1686	1639	1856	2006	2476	2367	4164
Shareholder's Equity	5492	6603	7510	7749	7406	6875	7259	7348	7507	8062
D/E Ratio	0.14	0.12	0.23	0.22	0.22	0.27	0.28	0.34	0.32	0.52

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	16.7%	13.6%	10.9%	10.8%	9.1%	9.2%	6.0%	11.5%	11.6%	8.4%
Return on Equity	36.4%	27.2%	21.0%	21.6%	18.5%	19.5%	14.1%	29.3%	30.4%	23.0%
ROIC	29.8%	22.9%	17.1%	17.0%	14.6%	15.1%	10.4%	20.5%	21.0%	14.9%
Shares Out.	193	190	187	182	175	168	166	163	152	149
Revenue/Share	93.22	91.39	92.31	105	107	103	122	146	151	133
FCF/Share	7.19	3.98	7.20	8.02	7.10	7.94	10.10	9.79	15.41	14.41

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