Cummins Inc. (CMI)

Updated November 6th, 2022 by Nathan Parsh

Key Metrics

Current Price:	$238	**5 Year CAGR Estimate:**	8.5%	**Market Cap:**	$33.6 B
Fair Value Price:	$219	**5 Year Growth Estimate:**	8.0%	**Ex-Dividend Date:**	11/17/22
% Fair Value:	109%	**5 Year Valuation Multiple Estimate:**	-1.7%	**Dividend Payment Date:**	12/01/22
Dividend Yield:	2.6%	**5 Year Price Target**	$321	**Years Of Dividend Growth:**	17
Dividend Risk Score:	B	**Retirement Suitability Score:**	B	**Rating:**	Hold

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 annual revenues), Distribution (26%), Components (24%) and Power Systems (15%). The company also has a small New Power segment, which focuses on electric vehicles. Roughly 60% of its business is done in the U.S. and Canada. The company employs about 60,000 people and serves customers in about 190 countries. Cummins generates ~$26 billion in annual revenues.

On July 12th, 2022, Cummins announced that it was increasing its quarterly dividend 8.3% to $1.57, extending the company's dividend growth streak to 17 years.

On August 3rd, 2022, Cummins completed its $3.7 billion purchase of Meritor, a leading global supplier of drivetrain, mobility, braking, aftermarket, and electric powertrain solutions for commercial vehicle and industrial markets. This purchase should add at least $1.7 billion to revenue through the end of the year.

On November 3rd, 2022, Cummins reported third quarter results for the period ending September 30th, 2022. Revenue grew 22.3% to $7.3 billion, topping estimates by $170 million. Net income of $456 million, or $3.21 per share, compared to $534 million, or $3.69 per share, in the prior year.

Revenues for North America increased 19% while international revenue fell 1%. Again, much of the decrease was due to a slowdown in China, though the decline was lower on a sequential basis for the second consecutive quarter. The Engine segment grew 8% to $2.8 billion, led by strength in on-highway revenue and better demand for aftermarket services. Distribution improved 14% to $2.2 billion, due to higher demand in North America. Revenue for Components increased 10%, as North America gains more than offset weaker demand in China. Power Systems was up 16% to $1.3 billion, due to increased demand from industrial and oil and gas end markets. New Power nearly doubled to $50 million as battery demand has been robust in the North American school bus market.

Leadership maintained much of its outlook for 2022 as well. The company continues to expects revenue growth of 8% for the year, up from 6% previously. Full year EBITDA is now expected to be 15%, down from 15.5% previously. Cummins is now projected to earn $16.81 per share for the year, down from $17.58, $17.44, and $17.72 previously.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	$8.69	$7.91	$9.14	$8.92	$8.23	$10.63	$13.15	$14.48	$12.01	$14.61	***$16.81***	***$24.70***
DPS	$1.80	$2.25	$2.81	$3.51	$4.00	$4.21	$4.44	$4.90	$5.28	$5.60	***$6.28***	***$8.02***
Shares[1]	190	187	182	175	168	166	163	152	149	144	***142***	***140***

Looking at the 2012 to 2021 period, Cummins grew earnings-per-share by an average compound rate of 5.9%. The growth rate has accelerated to nearly 11% over the last five year. Taking into account the long- and medium-term growth rates, we reaffirm our earnings-per-share growth rate of 8% through 2027. 2020 was a difficult one for the company, but Cummins saw a rebound in 2021. That rebound is expected to continue into the current year as well. We

[1] In millions of shares.

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

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believe the company will see a higher than usual growth rate as the global economy recovers from the pandemic. Cummins has also benefited 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.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	11.9	15.3	15.8	14.0	14.1	15.0	11.4	11.0	16.0	14.9	***14.2***	***13.0***
Avg. Yld.	1.7%	1.9%	1.9%	2.8%	3.5%	2.6%	2.9%	3.0%	2.9%	2.6%	***2.6%***	***2.5%***

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. Shares of Cummins have gained $15, or 6.7%, since our August 2nd, 2022 report. Using the current share price and expected earnings-per-share for the year, Cummins trades with a price-to-earnings ratio of 14.2. If shares were to trade at our target multiple by 2027, then valuation would be a 1.7% headwind to total returns over this time period.

Safety, Quality, Competitive Advantage, & Recession Resiliency

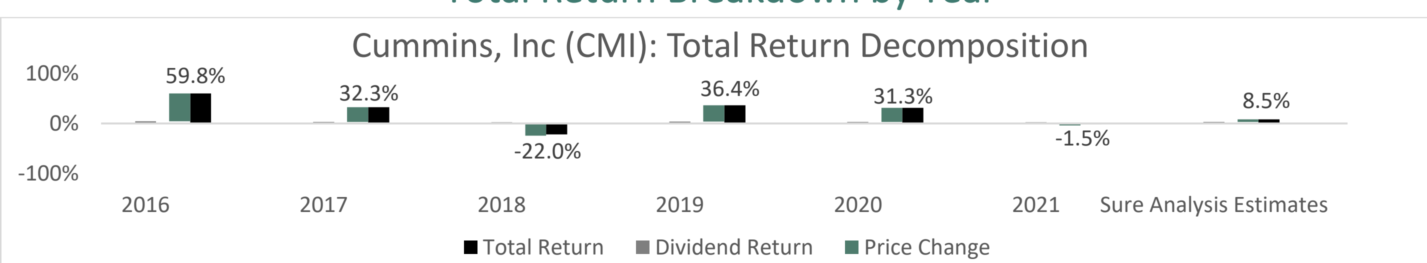
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	21%	28%	31%	39%	49%	40%	34%	33%	44%	38%	***37%***	***32%***

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 8.5% annually through 2027, down from our prior estimate of 10.8%. Our projected return consists of an 8% earnings growth rate and a starting yield of 2.6%, offset by a small headwind from multiple compression. Cummins once again saw strong growth in most areas of its business and the slowdown in China is becoming less of a headwind. That said, we have lowered our 2027 price target $15 to $321 due to revised earnings estimates for the year and now view shares of Cummins as a hold due to projected returns.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	17334	17301	19221	19110	17509	20428	23771	23571	19811	24021
Gross Profit	4,416	4,280	4,861	4,947	4,458	5,100	5,737	5,980	4,894	5,695
Gross Margin	25.5%	24.7%	25.3%	25.9%	25.5%	25.0%	24.1%	25.4%	24.7%	23.7%
SG&A Exp.	1,808	1,817	2,095	2,092	2,099	2,429	2,437	2,454	2,125	2,374
D&A Exp.	361	407	455	514	530	583	611	672	673	
Operating Profit	1,887	1,756	2,018	2,118	1,733	1,977	2,392	2,513	1,847	2,200
Op. Margin	10.9%	10.1%	10.5%	11.1%	9.9%	9.7%	10.1%	10.7%	9.3%	9.2%
Net Profit	1,645	1,483	1,651	1,399	1,394	999	2,141	2,260	1,789	2,131
Net Margin	9.5%	8.6%	8.6%	7.3%	8.0%	4.9%	9.0%	9.6%	9.0%	8.9%
Free Cash Flow	755	1,349	1,468	1,266	1,345	1,690	1,594	2,406	2,147	1,470
Income Tax	533	531	698	555	474	1,371	566	566	527	587

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	12548	14728	15764	15134	15011	18075	19062	19737	22624	23710
Cash & Equivalents	1,369	2,699	2,301	1,711	1,120	1,369	1,303	1,129	3,401	2,592
Accounts Receivable	2,475	2,649	2,946	2,820	3,025	3,618	3,866	3,387	3,440	3,990
Inventories	2,221	2,381	2,866	2,707	2,675	3,166	3,759	3,486	3,425	4,355
Goodwill & Int. Ass.	814	818	822	810	812	2,055	2,035	2,289	2,256	2,187
Total Liabilities	5,574	6,858	7,671	7,384	7,837	9,911	10,803	11,272	13,635	14,309
Accounts Payable	1,339	1,557	1,881	1,706	1,854	2,579	2,822	2,534	2,820	3,021
Long-Term Debt	775	1,740	1,686	1,639	1,856	2,006	2,476	2,367	4,164	4,159
Shareholder's Equity	6,603	7,510	7,749	7,406	6,875	7,259	7,348	7,507	8,062	8,474
LTD/E Ratio	0.12	0.23	0.22	0.22	0.27	0.28	0.34	0.32	0.52	0.49

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	13.6%	10.9%	10.8%	9.1%	9.2%	6.0%	11.5%	11.6%	8.4%	9.2%
Return on Equity	27.2%	21.0%	21.6%	18.5%	19.5%	14.1%	29.3%	30.4%	23.0%	25.8%
ROIC	22.9%	17.1%	17.0%	14.6%	15.1%	10.4%	20.5%	21.0%	14.9%	16.0%
Shares Out.	190	187	182	175	168	166	163	152	149	144
Revenue/Share	91.39	92.31	104.99	107.11	103.40	122.10	146.01	151.00	132.96	164.64
FCF/Share	3.98	7.20	8.02	7.10	7.94	10.10	9.79	15.41	14.41	10.08

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