Cummins Inc. (CMI)

Updated February 7th, 2023 by Nathan Parsh

Key Metrics

Current Price:	$251	**5 Year CAGR Estimate:**	10.5%	**Market Cap:**	$35 B
Fair Value Price:	$256	**5 Year Growth Estimate:**	8.0%	**Ex-Dividend Date:**	02/17/23[1]
% Fair Value:	98%	**5 Year Valuation Multiple Estimate:**	0.4%	**Dividend Payment Date:**	03/03/23[2]
Dividend Yield:	2.5%	**5 Year Price Target**	$377	**Years Of Dividend Growth:**	17
Dividend Risk Score:	A	**Retirement Suitability Score:**	B	**Rating:**	Buy

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 ~$32 billion in annual revenues.

On February 6th, 2023, Cummins reported fourth quarter and full year results for the period ending December 31st, 2022. For the quarter, revenue grew 32.2% to $7.8 billion, beating estimates by $590 million. Adjusted net income of $644 million, or $4.52 per share, compared to $394 million, or $2.73 per share, in the prior year and was in-line with expectations. For the year, revenue grew 17% to $28.1 billion. Excluding the addition of Meritor, revenue was up 9% year-over-year. Adjusted earnings-per-share for the year totaled $15.67 compared to $14.61 in 2021.

For 2022, North America sales grew 18% with international down 2%. Much of the decline in international markets was due to a slowdown in China, but that impact has lessened recently. For the fourth quarter, the Engine segment grew 9% to $2.6 billion, again due to strength in on-highway and aftermarket demand. Distribution was up 13% to $2.3 billion as the North America markets continues to perform well. Revenue for Components totaled $3.1 billion as demand in North America and India was only partially offset by China. Excluding Meritor, revenue grew 13% to $1.9 billion. Power Systems was up 22% to $1.3 billion, due to increased demand from industrial and oil and gas end markets. New Power nearly grew 79% to $61 million as battery demand has been robust in the North American school bus market.

The company provided initial guidance for the year as well. Cummins is expected to grow revenues by 12% to 17%. Cummins is projected to earn $19.72 in 2023.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	$7.91	$9.14	$8.92	$8.23	$10.63	$13.15	$14.48	$12.01	$14.61	$15.67	***$19.72***	***$28.98***
DPS	$2.25	$2.81	$3.51	$4.00	$4.21	$4.44	$4.90	$5.28	$5.60	$6.04	***$6.28***	***$8.02***
Shares[3]	187	182	175	168	166	163	152	149	144	142	***142***	***140***

Looking at the 2013 to 2022 period, Cummins grew earnings-per-share by an average compound rate of 7.9%. The growth rate has accelerated somewhat to 8.4% 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 2028. 2020 was a difficult one for the company, but Cummins saw a rebound in 2021 and 2022. That rebound is expected to continue into the current year as well. We 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

[1] Estimated ex-dividend 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.

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.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	15.3	15.8	14.0	14.1	15.0	11.4	11.0	16.0	14.9	15.5	***12.7***	***13.0***
Avg. Yld.	1.9%	1.9%	2.8%	3.5%	2.6%	2.9%	3.0%	2.9%	2.6%	2.5%	***2.5%***	***2.1%***

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 increased $13, or 5.5%, since our November 6th, 2022 report. Using the current share price and expected earnings-per-share for the year, Cummins trades with a price-to-earnings ratio of 12.7. If shares were to trade at our target multiple by 2028, then valuation would be a 0.4% tailwind to total returns over this time period.

Safety, Quality, Competitive Advantage, & Recession Resiliency

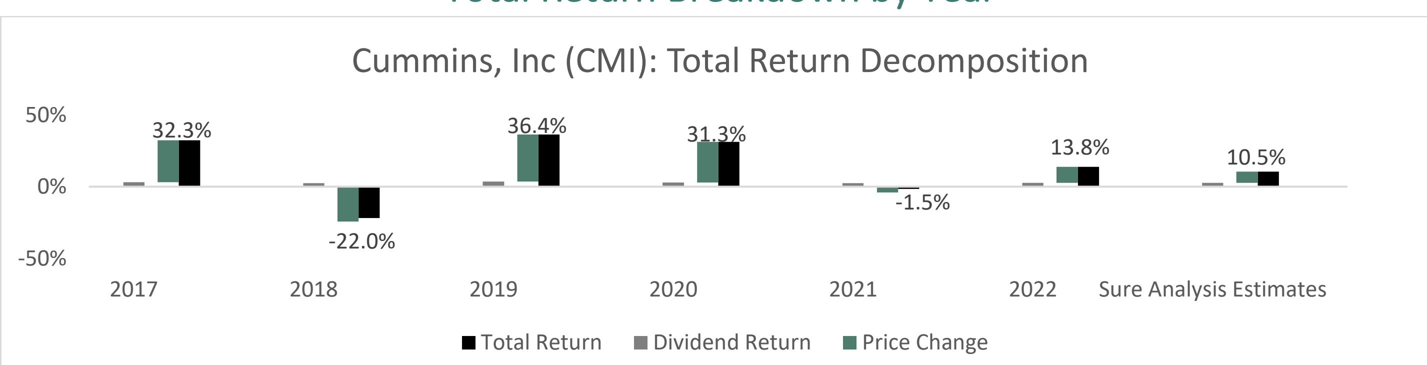
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	28%	31%	39%	49%	40%	34%	33%	44%	38%	39%	***32%***	***28%***

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 10.5% annually through 2028, up from our prior estimate of 8.5%. Our projected return consists of an 8% earnings growth rate, a starting yield of 2.5%, and a small contribution from multiple expansion. Cummins once again saw strong growth in most areas of its business and the slowdown in China is becoming less of a headwind. We have raised our 2028 price target $56 to $377 due to earnings estimates for the year. Cummins now earns a buy recommendation due to projected returns.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	17301	19221	19110	17509	20428	23771	23571	19811	24021	28074
Gross Profit	4,280	4,861	4,947	4,458	5,100	5,737	5,980	4,894	5,695	6,719
Gross Margin	24.7%	25.3%	25.9%	25.5%	25.0%	24.1%	25.4%	24.7%	23.7%	23.9%
SG&A Exp.	1,817	2,095	2,092	2,099	2,429	2,437	2,454	2,125	2,374	2,687
D&A Exp.	407	455	514	530	583	611	672	673	662	
Operating Profit	1,756	2,018	2,118	1,733	1,977	2,392	2,513	1,847	2,200	2,580
Op. Margin	10.1%	10.5%	11.1%	9.9%	9.7%	10.1%	10.7%	9.3%	9.2%	9.2%
Net Profit	1,483	1,651	1,399	1,394	999	2,141	2,260	1,789	2,131	2,151
Net Margin	8.6%	8.6%	7.3%	8.0%	4.9%	9.0%	9.6%	9.0%	8.9%	7.7%
Free Cash Flow	1,349	1,468	1,266	1,345	1,690	1,594	2,406	2,147	1,470	1,046
Income Tax	531	698	555	474	1,371	566	566	527	587	636

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	14728	15764	15134	15011	18075	19062	19737	22624	23710	30299
Cash & Equivalents	2,699	2,301	1,711	1,120	1,369	1,303	1,129	3,401	2,592	2,101
Accounts Receivable	2,649	2,946	2,820	3,025	3,618	3,866	3,387	3,440	3,990	5,202
Inventories	2,381	2,866	2,707	2,675	3,166	3,759	3,486	3,425	4,355	5,603
Goodwill & Int. Ass.	818	822	810	812	2,055	2,035	2,289	2,256	2,187	5,030
Total Liabilities	6,858	7,671	7,384	7,837	9,911	10,803	11,272	13,635	14,309	20,074
Accounts Payable	1,557	1,881	1,706	1,854	2,579	2,822	2,534	2,820	3,021	4,252
Long-Term Debt	1,740	1,686	1,639	1,856	2,006	2,476	2,367	4,164	4,159	7,855
Shareholder’s Equity	7,510	7,749	7,406	6,875	7,259	7,348	7,507	8,062	8,474	8,975
LTD/E Ratio	0.23	0.22	0.22	0.27	0.28	0.34	0.32	0.52	0.49	0.88

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	10.9%	10.8%	9.1%	9.2%	6.0%	11.5%	11.6%	8.4%	9.2%	8.0%
Return on Equity	21.0%	21.6%	18.5%	19.5%	14.1%	29.3%	30.4%	23.0%	25.8%	24.7%
ROIC	17.1%	17.0%	14.6%	15.1%	10.4%	20.5%	21.0%	14.9%	16.0%	13.6%
Shares Out.	187	182	175	168	166	163	152	149	144	142
Revenue/Share	92.31	104.99	107.11	103.40	122.10	146.01	151.00	132.96	164.64	197.29
FCF/Share	7.20	8.02	7.10	7.94	10.10	9.79	15.41	14.41	10.08	7.35

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