

## Caterpillar Inc. (CAT)

**\$139.72** (As of 02/13/20)

Price Target (6-12 Months): **\$148.00**

Long Term: 6-12 Months

**Zacks Recommendation:**

**Neutral**

(Since: 12/23/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

**Zacks Rank:** (1-5)

**4-Sell**

Zacks Style Scores:

VGM:B

Value: B

Growth: B

Momentum: F

### Summary

Caterpillar's global retail sales dipped for two months in a row in January 2020, thanks to low demand. The company's adjusted EPS guidance for 2020 is \$8.50-\$10.00. The mid-point indicates a decline of 16% from 2019. Low demand and dealers reducing inventory owing to the ongoing global uncertainty, will impact sales. Caterpillar is taking steps to cut production to match demand and focusing on cost control. Infrastructure demand in North America will aid growth in the Construction segment. However, mining customers remain cautious with their spending, which is likely to impact the Resource Industries segment's sales. Nevertheless, investments in expanded offerings and services, and digital initiatives like e-commerce will fuel growth. Given that China is a major market, the coronavirus outbreak remains a concern.

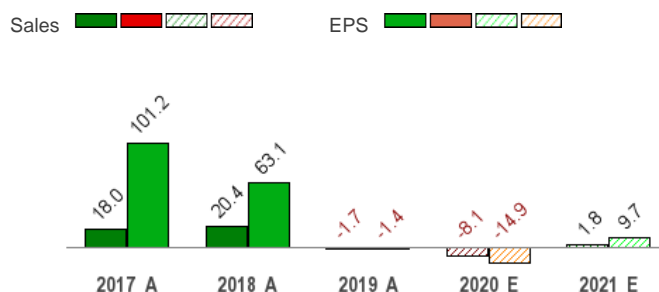
### Price, Consensus & Surprise



### Data Overview

52 Week High-Low	\$150.55 - \$111.75
20 Day Average Volume (sh)	3,187,711
Market Cap	\$77.2 B
YTD Price Change	-5.4%
Beta	1.50
Dividend / Div Yld	\$4.12 / 2.9%
Industry	<a href="#">Manufacturing - Construction and Mining</a>
Zacks Industry Rank	Bottom 4% (244 out of 255)

### Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	11.0%
Last Sales Surprise	-3.3%
EPS F1 Est- 4 week change	-12.3%
Expected Report Date	04/22/2020
Earnings ESP	0.0%
P/E TTM	12.6
P/E F1	14.9
PEG F1	1.2
P/S TTM	1.4

### Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	12,053 E	13,239 E	12,818 E	13,836 E	50,296 E
2020	11,612 E	12,677 E	12,220 E	12,936 E	49,417 E
2019	13,466 A	14,432 A	12,758 A	13,144 A	53,800 A

### EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$2.33 E	\$2.61 E	\$2.81 E	\$2.82 E	\$10.32 E
2020	\$2.01 E	\$2.27 E	\$2.49 E	\$2.49 E	\$9.41 E
2019	\$2.94 A	\$2.83 A	\$2.66 A	\$2.63 A	\$11.06 A

\*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/13/2020. The reports text is as of 02/14/2020.

## Overview

Deerfield, IL-based Caterpillar is the world's leading manufacturer of construction and mining equipment, diesel and natural gas engines and industrial gas turbines. It is also a leading exporter in the United States. The company has six operating segments, of which four are reportable segments.

**Machinery, Energy & Transportation (ME&T)** (Accounted for approximately 94% of total revenues in fiscal 2019) includes -

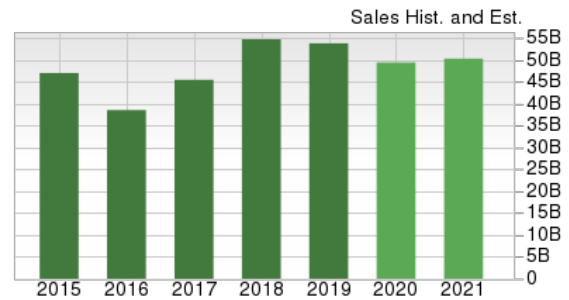
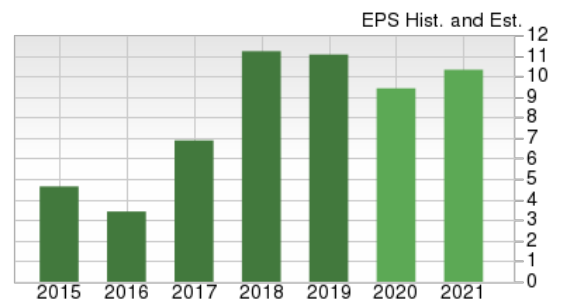
**Construction Industries** (38%) – The segment manufactures machinery utilized in infrastructure, forestry and building construction. The majority of machine sales are generated from traditional construction applications (road, heavy, and general), and the balance from quarry and aggregates, industrial and waste, agriculture and landscaping, and forestry applications. The segment's wide product portfolio is divided into earthmoving, excavation and building construction categories.

**Resource Industries** (18%) – The segment caters to customers using machinery in mining, quarry and aggregates, heavy construction, waste and material handling applications. Resource Industries also develops and sells technology products and services to provide customers fleet management systems, equipment management analytics and autonomous machine capabilities. Products in the segment fall under three broad categories - surface mining, underground mining and material handling, which include support equipment for mining, construction, and quarry and aggregate applications.

**Energy & Transportation** (45%) – This segment supports customers in oil and gas, power generation, marine, rail and industrial applications. The segment offers a range of prime motive power products including reciprocating engines, turbines, locomotives and related parts.

**All Other Segments** (1%) – These segments primarily comprise activities such as the re-manufacturing of CAT engines and components and re-manufacturing services for other companies as well as product management, development, manufacturing, marketing and product support.

**Financial Products Segment** (6%) – Cat Financial provides retail and wholesale financing alternatives for Caterpillar products to customers and dealers globally.



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## Reasons To Buy:

- ▲ Caterpillar continues to monitor end-user demand, commercial shipments, dealer inventory, orders and backlog and plans to adjust production levels accordingly. The company has been successful in reducing the lead times, which allow dealers to maintain lower levels of inventory. Further, shorter lead times enable both the company and dealers to adapt quickly to changing market conditions. The company is also making every effort to reduce production to match dealer demand and will proactively increase production once order levels improve.
- ▲ For the Construction Industries segment, stable spending on infrastructure in North America is likely to drive revenues. Improvement in commodity prices is likely to support capital investment in the mining sector going forward. Quoting activity for mining equipment remains positive, which will drive the Resource Industries segment. Capital spend will increase for both equipment replacement cycles and expansions. In the Energy & Transportation segment, power generation and transportation are likely to improve.
- ▲ Caterpillar's cash and liquidity position remains strong with the company ending 2019 with cash and short-term investments of \$8.3 billion. In 2019, the company repurchased \$4 billion of its common stock and paid out dividends of \$2.1 billion. In total, the company returned \$6.2 billion to its shareholders or about 115% of its free cash flow in 2019. Over the course of 2019, Caterpillar reduced quarterly average shares outstanding by about 9%. Backed by its significant improvement in financial performance over the last two years, Caterpillar's board of directors authorized a 20% increase in quarterly cash dividend to \$1.03 per share in May. In each of the following four years, Caterpillar anticipates increasing the dividend by at least a high single-digit percentage. Moreover, the company intends to utilize the remaining ME&T free cash flow to repurchase shares on a more consistent basis.
- ▲ In September 2015, Caterpillar set out with significant restructuring and cost reduction initiative, which has now been substantially completed. The plan will likely lower annual operating costs by about \$1.5 billion. Caterpillar is focused on developing a more competitive and flexible cost structure and controlling discretionary spending. Caterpillar expects to double ME&T services sales to \$28 billion by 2026 and deliver higher adjusted operating margins through cycles of three to six percentage points above historical performance.
- ▲ Caterpillar continues to focus on customers and on the future by continuing to invest in digital capabilities, connecting assets and jobsites along with developing the next generation of more productive and efficient products. The company plans to fund initiatives that drive long-term profitable growth focused on areas of expanded offerings and services and digital initiatives like e-commerce. In its GC line, the company has launched six new models in 2019 including excavators, articulated trucks, motor graders, wheel loaders and paving products and has plans to roll out five additional GC models this year. In 2019, Caterpillar achieved its target of connecting 1 million assets by year-end and boasts the largest fleets of connected assets in the industries it serves. Notably, connected products, such as CAT and non-CAT assets, provide rich data, including operating hours, location and product health, enabling customers to better manage and plan their maintenance.

Caterpillar will gain from cost control efforts and proactively managing production. Launch of new products, investment in expanded offerings and digital capabilities will also drive growth.

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## Reasons To Sell:

- ▼ For 2020, Caterpillar expects adjusted earnings per share guidance between \$8.50 and \$10.00. The mid-point of the guidance indicates a fall of 16% from the adjusted earnings per share of \$11.06 reported in 2019. The company anticipates dealers to continue to reduce inventories by about \$1 billion to \$1.5 billion, due to the ongoing global economic uncertainty. End user demand is expected to decline by about 4% to 9% compared to 2019. These factors will impact revenues for the fiscal. Moreover, while commodity prices are generally supportive of reinvestment, mining customers remained disciplined with their capital expenditures due to economic uncertainty that will impact the company's sales. SG&A and R&D spending will continue to escalate due to investments in growth areas including services and expanded offerings. This will put Caterpillar's operating margin under pressure.
- ▼ At the end of 2019, Caterpillar's order backlog was at \$13.7 billion, a sequential decline of \$900 million. Order backlog decreased across the three primary segments by about \$2.9 billion since the end of 2018. This decline reflects dealers' expectations for lower demand from end markets quarter and their desire to reduce inventory levels. This does not bode well for first-quarter 2020 top line. Caterpillar's global retail sales for the three-month period ended January 2020, declined 7% following a decrease of 5% reported in December 2019. The company had last witnessed negative sales growth in 2017. The company has reported average growth rate of 4.4%, on average, during 2019 period, reflecting a sharp decline from the 2018 figure of 23.5%.
- ▼ The U.S.-China trade tensions and waning global demand seems to have taken its toll on the U.S manufacturing sector, which in turn is impacting Caterpillar's performance. Industrial production declined 0.3% in December following a 0.8% growth in November and 0.5% fall in October. Overall, for the fourth quarter, total industrial production declined at an annual rate of 0.5%. Further, per the Institute for Supply Management's latest report, the U.S Purchasing Managers' Index (PMI) was 47.2% in December 2019 — the fifth month of contraction in the sector. Even though the index has climbed to 50.9 in January, it remains to be seen whether this recovery will stay.
- ▼ In the Construction Industries segment, Latin America will continue on its recovery path, but demand will remain relatively low. Though demand remains steady in EMEA, political and economic uncertainties remain. Continued pressure from competitive pricing in China remains a headwind. Given that China represents about 10% to 15% of the construction industry segment's sales and about 5% to 10% of total Caterpillar sales and revenues, it will be a drag on the company's results. The coronavirus outbreak in China remains an overhang. In Energy & Transportation, the company expects modestly lower overall demand. Demand is also expected to be weak in oil and gas on account of oil price volatility and capital discipline at customers end.

Caterpillar's results will bear the brunt of inventory reduction at its dealers and low demand due to the global economic uncertainty. The coronavirus outbreak in China remains a concern.

## Last Earnings Report

### Caterpillar Q4 Earnings Beat Estimates on Cost Control

Caterpillar reported fourth-quarter 2019 adjusted earnings per share of \$2.63, which surpassed the Zacks Consensus Estimate of \$2.37 by a margin of 11%. The figure increased 3% from the prior-year quarter's adjusted earnings per share of \$2.55. The company's commitment toward strong cost control helped mitigate the impact of weak demand, and drove earnings.

Despite delivering better-than-expected earnings in the quarter, Caterpillar's shares fell 0.28% in pre-market trading thanks to a tepid 2020 guidance.

Including one-time items, Caterpillar's earnings per share came in at \$1.97 in fourth-quarter 2019 compared with \$1.78 in the prior-year quarter.

Quarter Ending **12/2019**

Report Date	Jan 31, 2020
Sales Surprise	-3.26%
EPS Surprise	10.97%
Quarterly EPS	2.63
Annual EPS (TTM)	11.06

### Revenues Lag Estimates on Low Demand

The company's fourth-quarter revenues declined 8% year over year to \$13.1 billion, missing the Zacks Consensus Estimate of \$13.6 billion. Sales were impacted by lower sales volumes as dealers reduced their inventories by \$700 million in the reported quarter. Demand was also weak in Construction Industries and Resource Industries.

The company witnessed decline in sales across the board. Sales in Latin America fell 15% followed by a decline of 13% in North America. Meanwhile, sales in EAME were down 5% while sales in Asia Pacific remained flat.

### Margins Gain on Lower Costs & Expenses

In fourth-quarter 2019, cost of sales decreased 9% year over year to \$9.1 billion. Manufacturing costs were down due to lower period manufacturing and material costs, partially offset by higher warranty expense. Period manufacturing costs declined owing to lower short-term incentive compensation and favorable impact of restructuring and cost-reduction actions.

Gross profit contracted 7.5% to \$4 billion on lower sales. Gross margin was 30.6% in the reported quarter, up marginally from 30.4% in the prior-year quarter.

Selling, general and administrative (SG&A) expenses decreased 12% to around \$1.3 billion. Research and development (R&D) expenses declined 17% to \$386 million from the prior-year quarter figure of \$466 million. Operating profit in the quarter was \$1.85 billion, down 2% from the prior-year quarter. Benefits from lower SG&A and R&D expense were offset by lower sales volume. Operating margin was 14.1% in the reported quarter, up 100 basis points from the prior-year quarter.

### Weak Demand Weighs on Segment Performances

Machinery and Energy & Transportation (ME&T) sales declined 9% year over year to \$12.8 billion. Construction Industries sales dropped 12% year over year to \$5 billion on account of lower sales volume owing to changes in dealer inventories.

Sales at Resource Industries declined 14% year over year to \$2.4 billion due to lower sales volume. This can be attributed to changes in dealer inventories and lower end-user demand. Sales of Energy & Transportation segment in the quarter was at \$5.95 billion, a decline of 5% from the prior-year quarter due to lower inter-segment engine sales and unfavorable currency impacts.

The ME&T segment reported operating profit of \$1.75 billion, a decline of 8% from the year-ago quarter. The Resource Industries segment's operating profit slumped 35% year over year to \$261 million in fourth-quarter 2019. Construction Industries segment's profit witnessed a year-over-year decrease of 22% to \$659 million. The Energy & Transportation segment, operating profit improved 8% year over year to \$1.17 billion.

Financial Products' revenues went up 4% to \$846 million from the prior-year quarter. Financial Products' profits were \$210 million in the reported quarter, a significant improvement of 624% from \$29 million in the prior-year quarter. This was due to lower provisions for credit losses related to the Cat Power Finance portfolio compared with year-ago quarter.

### Cash Position

For 2019, ME&T operating cash flow was \$4.9 billion. The company made a \$1.5 billion discretionary pension contribution financed from proceeds of a debt issuance during the year. During 2019, the company repurchased \$4 billion of its common stock and paid out dividends worth \$2.1 billion. Caterpillar ended 2019 with cash and short-term investments of \$8.3 billion, up from \$7.9 billion at 2018 end.

### Backlog Declines

At the end of fourth-quarter 2019, Caterpillar's backlog was at \$13.7 billion, a sequential decline of \$900 million.

### 2019 Results

Caterpillar reported adjusted earnings per share of \$11.06 in 2019, down 1% from the prior-year reported figure of \$11.22. However, the bottom line beat the Zacks Consensus Estimate of \$10.83 and management guidance of \$10.59-\$11.09. Including one-time items, earnings came in at \$10.74, up 5% from \$10.26 in 2018.

Sales dipped 2% year over year to around \$53.8 billion from the prior-year figure of \$54.7 billion. The top line surpassed the Zacks Consensus Estimate of \$51.7 billion.

### 2020 Guidance

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For 2020, Caterpillar expects adjusted earnings per share guidance between \$8.50 and \$10.00. The mid-point of the guidance indicates a fall of 16% from the adjusted earnings per share of \$11.06.

The company anticipates dealers will continue to reduce inventories due to the ongoing global economic uncertainty. Caterpillar continues to monitor end-user demand and has been successful in reducing the lead times. Shorter lead times enable both the company and its dealers to adapt quickly to changing market conditions. Moreover, Caterpillar's continued focus on strategic investments, cost cutting measures, growing services and expanding offerings will deliver long-term profitable growth.

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## Recent News

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### Valuation

Caterpillar's shares have gone up 2.6% over the trailing 12-month period. Stocks in the Zacks Manufacturing – Construction and Mining industry and the Zacks Industrial Products sector are up 1.4% and 9.2%, respectively, over the past year.

The S&P 500 Index has gained 21.0% in the past year.

The stock is currently trading at 14.77x forward 12-month earnings, which compares with 14.42x for the Zacks sub-industry, 18.57x for the Zacks sector and 19.40x for the S&P 500 Index.

Over the past five years, the stock has traded as high as 32.58x and as low as 8.88x, with a 5-year median of 17.21x.

Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$148 price target reflects 15.65x forward 12-month earnings.

The table below shows summary valuation data for CAT:

Valuation Multiples - CAT					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	14.77	14.67	18.57	19.4
	5-Year High	32.58	30.83	19.89	19.4
	5-Year Low	8.88	9.47	12.6	15.18
	5-Year Median	17.21	16.78	16.62	17.47
P/S F12M	Current	1.56	1.28	2.82	3.58
	5-Year High	2.13	1.64	2.82	3.58
	5-Year Low	0.79	0.71	1.51	2.54
	5-Year Median	1.35	1.13	1.98	3
EV/EBITDA TTM	Current	8.71	7.55	16.84	11.36
	5-Year High	14.14	12.79	17.42	12.85
	5-Year Low	6.78	6.05	10.96	8.47
	5-Year Median	9.5	8.67	14.69	10.7

As of 02/13/2020

## Industry Analysis Zacks Industry Rank: Bottom 4% (244 out of 255)



## Top Peers

Arcosa, Inc. (ACA)	Neutral
H&E Equipment Services, Inc. (HEES)	Neutral
Komatsu Ltd. (KMTUY)	Neutral
The Manitowoc Company, Inc. (MTW)	Neutral
Terex Corporation (TEX)	Neutral
Astec Industries, Inc. (ASTE)	Underperform
CNH Industrial N.V. (CNHI)	Underperform
Deere & Company (DE)	Underperform

Industry Comparison Industry: Manufacturing - Construction And Mining				Industry Peers		
	CAT Neutral	X Industry	S&P 500	CNHI Underperform	DE Underperform	KMTUY Neutral
<b>VGM Score</b>	<b>B</b>	-	-	<b>D</b>	<b>B</b>	<b>A</b>
Market Cap	77.22 B	1.56 B	24.56 B	12.89 B	53.76 B	20.44 B
# of Analysts	11	3.5	13	6	10	1
Dividend Yield	2.95%	1.75%	1.78%	0.00%	1.78%	3.87%
<b>Value Score</b>	<b>B</b>	-	-	<b>B</b>	<b>C</b>	<b>A</b>
Cash/Price	0.11	0.11	0.04	0.33	0.08	0.07
EV/EBITDA	8.23	4.96	14.00	9.29	10.50	4.80
PEG Ratio	1.22	1.60	2.10	NA	4.04	NA
Price/Book (P/B)	5.28	1.43	3.31	2.11	4.71	1.14
Price/Cash Flow (P/CF)	8.72	6.57	13.68	7.06	10.33	5.65
P/E (F1)	14.62	13.44	19.23	11.85	18.08	12.01
Price/Sales (P/S)	1.44	0.79	2.69	0.46	1.37	0.88
Earnings Yield	6.73%	7.52%	5.20%	8.40%	5.53%	8.33%
Debt/Equity	1.80	0.55	0.71	4.06	2.65	0.24
Cash Flow (\$/share)	16.03	3.95	6.92	1.35	16.53	3.72
<b>Growth Score</b>	<b>B</b>	-	-	<b>F</b>	<b>B</b>	<b>B</b>
Hist. EPS Growth (3-5 yrs)	27.28%	10.20%	10.85%	23.49%	12.82%	NA
Proj. EPS Growth (F1/F0)	-14.89%	-20.55%	7.17%	-4.37%	-5.00%	-29.15%
Curr. Cash Flow Growth	-6.65%	17.91%	8.56%	-24.64%	4.09%	17.91%
Hist. Cash Flow Growth (3-5 yrs)	4.31%	7.61%	8.36%	2.13%	3.09%	7.61%
Current Ratio	1.47	1.68	1.23	6.03	2.04	1.68
Debt/Capital	64.24%	35.34%	42.91%	80.26%	72.60%	19.07%
Net Margin	11.32%	4.63%	11.81%	5.06%	8.29%	8.18%
Return on Equity	41.85%	19.63%	16.86%	19.87%	27.11%	11.31%
Sales/Assets	0.68	0.91	0.54	0.60	0.54	0.70
Proj. Sales Growth (F1/F0)	-8.15%	-2.75%	3.85%	-1.28%	-7.50%	0.00%
<b>Momentum Score</b>	<b>F</b>	-	-	<b>D</b>	<b>C</b>	<b>A</b>
Daily Price Chg	0.09%	0.00%	0.00%	-1.96%	-0.62%	-1.31%
1 Week Price Chg	1.54%	1.14%	2.47%	-1.06%	5.59%	-2.80%
4 Week Price Chg	-5.51%	-5.40%	0.56%	-13.77%	-2.68%	-12.23%
12 Week Price Chg	-2.54%	-2.35%	6.96%	-11.93%	-2.99%	-10.82%
52 Week Price Chg	5.35%	0.13%	16.68%	-9.76%	5.13%	-13.59%
20 Day Average Volume	3,187,711	317,293	2,020,569	1,912,043	1,430,563	429,403
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	-7.66%	0.00%	0.00%
(F1) EPS Est 4 week change	-12.30%	-4.45%	-0.05%	-7.51%	0.00%	-0.57%
(F1) EPS Est 12 week change	-13.52%	-4.98%	-0.17%	-9.88%	-14.94%	-0.57%
(Q1) EPS Est Mthly Chg	-22.39%	-15.24%	-0.24%	-40.00%	0.00%	NA



## Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	<b>B</b>
Growth Score	<b>B</b>
Momentum Score	<b>F</b>
VGM Score	<b>B</b>

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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