

Caterpillar Inc. (CAT)

\$100.20 (As of 03/17/20)

Price Target (6-12 Months): **\$106.00**

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:C

Value: B

Growth: C

Momentum: F

Summary

Caterpillar's global retail sales declined for three months in a row in February 2020, thanks to low demand. The company's earnings per share 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. The coronavirus outbreak and low oil prices will weigh on its performance this year. Nevertheless, investments in expanded offerings and services, and digital initiatives like e-commerce will fuel growth.

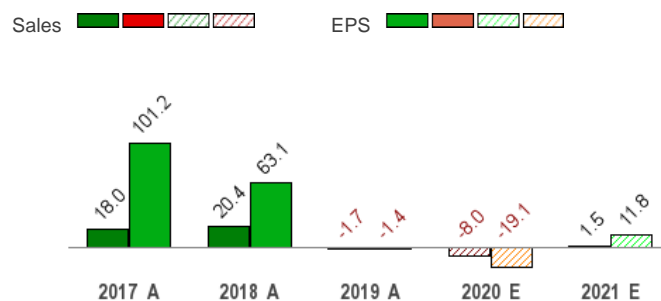
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$150.55 - \$87.50
20 Day Average Volume (sh)	6,297,530
Market Cap	\$55.1 B
YTD Price Change	-32.2%
Beta	1.44
Dividend / Div Yld	\$4.12 / 4.1%
Industry	<u>Manufacturing - Construction and Mining</u>
Zacks Industry Rank	Bottom 9% (231 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	11.0%
Last Sales Surprise	-3.3%
EPS F1 Est- 4 week change	-4.2%
Expected Report Date	04/28/2020
Earnings ESP	-4.3%
P/E TTM	9.1
P/E F1	11.2
PEG F1	0.9
P/S TTM	1.0

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	11,925 E	12,978 E	12,457 E	13,590 E	50,256 E
2020	11,594 E	12,594 E	12,106 E	12,858 E	49,494 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	\$2.11 E	\$2.41 E	\$2.61 E	\$2.73 E	\$10.01 E
2020	\$1.96 E	\$2.22 E	\$2.46 E	\$2.46 E	\$8.95 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 03/17/2020. The reports text is as of 03/18/2020.

Overview

Caterpillar, known for its iconic yellow machines, is the largest global manufacturer of construction and mining equipment. Given that it serves a gamut of sectors - infrastructure, construction, mining, oil & gas and transportation, the company is considered a bellwether of the global economy.

Since 1925, Caterpillar's product portfolio has evolved and currently boasts 20 brands and generated revenues of \$53.8 billion in 2019. It has more than 4 million of products with an extensive dealer network of 165 dealers spanning 191 countries. Caterpillar started using telematics in the 1990's and reached its target of 1 million connected assets in 2019. The combination of innovation, cutting-edge technology, coupled with the formidable reputation, sets Caterpillar apart from its peers.

While a weak manufacturing sector, trade woes impacted Caterpillar's stock price lately, it is the 95th-largest company in the S&P 500 Index with a market capitalization of \$55.1 billion. Caterpillar holds the 44th position in Fortune's "World's most admired companies" and 16th in the Dow Jones Industrial Average, with 2.95% weight of the index.

The Deerfield, IL-based company has six operating segments. **Machinery, Energy & Transportation (ME&T)** (94% of total revenues in 2019) includes

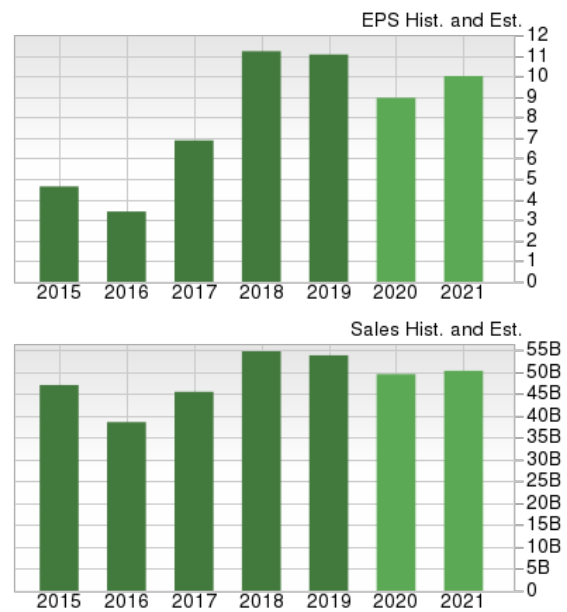
Construction Industries (38%) manufactures machinery utilized in infrastructure, forestry and building construction.

Resource Industries (18%) caters to customers using machinery in mining, quarry and aggregates, heavy construction, waste and material handling applications.

Energy & Transportation (45%) supports customers in oil and gas, power generation, marine, rail and industrial applications.

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

Financial Products Segment (6%) or Cat Financial provides retail and wholesale financing alternatives for Caterpillar products.



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.

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 recorded a decline of 11% in the three-month period ended February 2020 — levels last witnessed in December 2016 — thanks to weak performance across all regions and segments. This marks the third consecutive month that Caterpillar's global retail sales have been in the negative territory.
- ▼ The U.S.-China trade tensions and waning global demand has taken its toll on the U.S manufacturing sector, and Caterpillar isn't immune to the trend. Industrial production declined 0.3% in January following a dip of 0.5% in fourth-quarter 2019. Further, the U.S Purchasing Managers' Index (PMI) as per the Institute for Supply Management remained below 50 (indicating contraction) for five months in a row till December. Although the index has climbed to 50.9 in January followed by 50.1 in February, it remains to be seen whether this recovery will sustain considering the closures due to the coronavirus outbreak, which is spreading across the United States as well.
- ▼ 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

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.

Recent News

Caterpillar February Retail Sales Plunges 11% - Mar 12, 2020

Caterpillar's global retail sales recorded a decline of 11% in the three-month period ended February 2020, weighed down by weak performance across all regions and segments. With this performance, its global retail sales have been in the negative territory for three months in a row.

Analyzing the February Numbers

In February, Asia Pacific fared the worst with a decline of 17%. Sales in North America fell 12% while both EAME and Latin America both were down 4%.

The Resource Industries segment's sales declined 7% in February – the fourth consecutive month of negative growth. Sales in North America and Latin America plunged 17% followed by a 9% decline in sales in EAME. Asia Pacific was the only bright spot, delivering sales growth of 20%.

Sales in the Construction Industries segment were down 11% — the third consecutive month of decline. Asia Pacific disappointed with the worst decline of 28% in sales. Sales in North America, Latin America and EAME were down 9%, 4% and 2%, respectively.

Sales in the Energy & Transportation segment declined 4%. The segment has been contracting for five consecutive months. The Transportation fared the worst with a decline of 13% in sales. Sales in the Power Generation sector, Oil and Gas and Industrial sectors were down 5%, 3% and 1%, respectively.

Valuation

Caterpillar's shares have gone down 25.3% over the trailing 12-month period. Stocks in the Zacks Manufacturing – Construction and Mining industry and the Zacks Industrial Products sector are down 27.1% and 24.7%, respectively, over the past year.

The S&P 500 Index has declined 16.5% in the past year.

The stock is currently trading at 10.92x forward 12-month earnings, which compares with 10.80x for the Zacks sub-industry, 13.19x for the Zacks sector and 14.79x for the S&P 500 Index.

Over the past five years, the stock has traded as high as 28.53x and as low as 10.58x, with a 5-year median of 17.77x.

Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$106 price target reflects 11.55x 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	10.92	10.8	13.19	14.79
	5-Year High	28.53	30.83	19.96	19.34
	5-Year Low	10.58	9.47	12.57	14.79
	5-Year Median	17.77	16.7	16.48	17.42
P/S F12M	Current	1.11	0.9	1.96	2.71
	5-Year High	2.13	1.64	2.72	3.43
	5-Year Low	0.79	0.71	1.52	2.54
	5-Year Median	1.36	1.13	1.99	3
EV/EBITDA TTM	Current	7.14	6.29	12.71	9.35
	5-Year High	14.28	12.92	17.38	12.88
	5-Year Low	6.66	5.97	10.72	8.31
	5-Year Median	9.46	8.6	14.76	10.78

As of 03/17/2020

Industry Analysis Zacks Industry Rank: Bottom 9% (231 out of 253)



Top Peers

Arcosa, Inc. (ACA)	Neutral
CNH Industrial N.V. (CNHI)	Neutral
Deere & Company (DE)	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

Industry Comparison Industry: Manufacturing - Construction And Mining				Industry Peers		
	CAT Neutral	X Industry	S&P 500	CNHI Neutral	DE Neutral	KMTUY Neutral
VGM Score	C	-	-	A	F	B
Market Cap	55.12 B	1.13 B	17.72 B	8.78 B	39.74 B	14.59 B
# of Analysts	10	4.5	13	6	10	1
Dividend Yield	4.11%	2.90%	2.51%	0.00%	2.40%	5.42%
Value Score	B	-	-	A	D	B
Cash/Price	0.15	0.15	0.06	0.57	0.10	0.10
EV/EBITDA	6.32	3.74	10.97	8.75	8.72	3.53
PEG Ratio	0.93	1.61	1.54	NA	2.67	NA
Price/Book (P/B)	3.77	1.02	2.39	1.44	3.33	0.84
Price/Cash Flow (P/CF)	6.22	4.09	9.36	3.68	7.67	4.03
P/E (F1)	11.20	8.62	13.98	8.09	13.35	8.62
Price/Sales (P/S)	1.02	0.45	1.87	0.31	1.02	0.63
Earnings Yield	8.93%	11.60%	7.13%	12.31%	7.49%	11.60%
Debt/Equity	1.80	0.54	0.70	4.06	2.55	0.23
Cash Flow (\$/share)	16.10	4.07	7.01	1.77	16.53	3.72
Growth Score	C	-	-	C	F	C
Hist. EPS Growth (3-5 yrs)	27.28%	16.36%	10.85%	23.49%	16.20%	16.93%
Proj. EPS Growth (F1/F0)	-19.04%	-17.31%	5.38%	-4.37%	-4.50%	-29.55%
Curr. Cash Flow Growth	-6.65%	17.91%	6.15%	-1.24%	4.09%	17.91%
Hist. Cash Flow Growth (3-5 yrs)	4.31%	7.61%	8.55%	2.82%	3.09%	7.61%
Current Ratio	1.47	1.64	1.24	5.81	2.12	1.64
Debt/Capital	64.24%	34.88%	42.57%	80.26%	71.88%	18.93%
Net Margin	11.32%	4.51%	11.57%	5.06%	8.41%	8.18%
Return on Equity	41.85%	19.11%	16.74%	19.87%	26.92%	11.05%
Sales/Assets	0.68	0.91	0.54	0.60	0.53	0.69
Proj. Sales Growth (F1/F0)	-8.00%	-1.37%	3.33%	-1.28%	-7.32%	0.00%
Momentum Score	F	-	-	C	C	C
Daily Price Chg	7.27%	1.92%	5.62%	0.46%	5.55%	-3.23%
1 Week Price Chg	-17.93%	-14.88%	-11.01%	-16.26%	-15.29%	-14.63%
4 Week Price Chg	-26.64%	-28.50%	-28.54%	-31.44%	-23.81%	-28.33%
12 Week Price Chg	-32.06%	-36.36%	-25.74%	-41.39%	-27.39%	-38.14%
52 Week Price Chg	-25.31%	-32.23%	-18.88%	-40.31%	-21.28%	-37.95%
20 Day Average Volume	6,297,530	339,021	3,651,283	4,229,273	2,708,882	256,887
(F1) EPS Est 1 week change	-4.14%	0.00%	0.00%	0.00%	-1.42%	0.00%
(F1) EPS Est 4 week change	-4.17%	-4.48%	-0.58%	0.00%	0.53%	-0.57%
(F1) EPS Est 12 week change	-16.42%	-18.37%	-1.18%	-8.41%	0.09%	-1.14%
(Q1) EPS Est Mthly Chg	-2.54%	-27.27%	-0.77%	1.59%	-10.25%	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
Growth Score	C
Momentum Score	F
VGM Score	C

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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