

Cummins Inc. (CMI)

\$139.27 (As of 03/09/20)

Price Target (6-12 Months): **\$118.00**

Long Term: 6-12 Months

Zacks Recommendation: Underperform

(Since: 02/16/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:B

Value: C

Growth: B

Momentum: B

Summary

Cummins' reported a dismal record in fourth-quarter 2019, with both earnings and revenues declining year over year. The firm projects year-over-year revenue decline of 8-12% in 2020. The bleak guidance is attributed to lower truck production in North America, Europe, China and India. It anticipates a reduction of 10% in heavy and medium-duty truck demand currently. Decline in demand in off-highway markets, including construction and mining markets, is likely to limit revenues, going forward. It expects orders to remain lukewarm in 2020, with continued weak freight activity resulting in excess capacity and lower used truck market prices. The company is also battling with elevated expenses, owing to rising R&D expenses for product development and high material costs. As such, the stock is viewed as a risky bet.

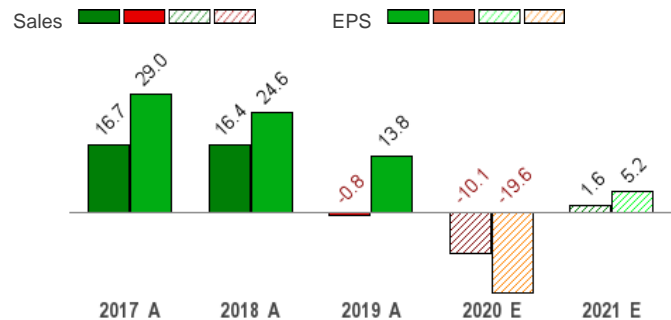
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$186.73 - \$136.57
20 Day Average Volume (sh)	1,457,974
Market Cap	\$21.3 B
YTD Price Change	-22.2%
Beta	1.11
Dividend / Div Yld	\$5.24 / 3.8%
Industry	Automotive - Internal Combustion Engines
Zacks Industry Rank	Bottom 11% (224 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	5.8%
Last Sales Surprise	4.5%
EPS F1 Est- 4 week change	-0.7%
Expected Report Date	05/05/2020
Earnings ESP	0.3%
P/E TTM	9.4
P/E F1	11.5
PEG F1	1.4
P/S TTM	0.9

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	5,298 E	5,713 E	5,575 E	5,756 E	21,543 E
2020	5,051 E	5,399 E	5,274 E	5,493 E	21,194 E
2019	6,004 A	6,221 A	5,768 A	5,578 A	23,571 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$2.79 E	\$3.49 E	\$3.74 E	\$2.90 E	\$12.73 E
2020	\$2.52 E	\$3.10 E	\$3.30 E	\$2.92 E	\$12.10 E
2019	\$4.20 A	\$4.27 A	\$3.83 A	\$2.56 A	\$15.05 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 03/09/2020. The reports text is as of 03/10/2020.

Overview

Cummins Inc. is a leading global designer, manufacturer and distributor of diesel and natural gas engines and powertrain-related component products. Powertrain components include fuel systems, turbochargers, transmissions, batteries and electrified power systems, among others. Headquartered in Columbus, IN, the company offers products to original equipment manufacturers (OEMs), distributors and dealers through a network of roughly 600 company-owned and independent distributor facilities over 7,600 dealer locations in more than 190 countries and territories. Cummins has the following five operating segments:

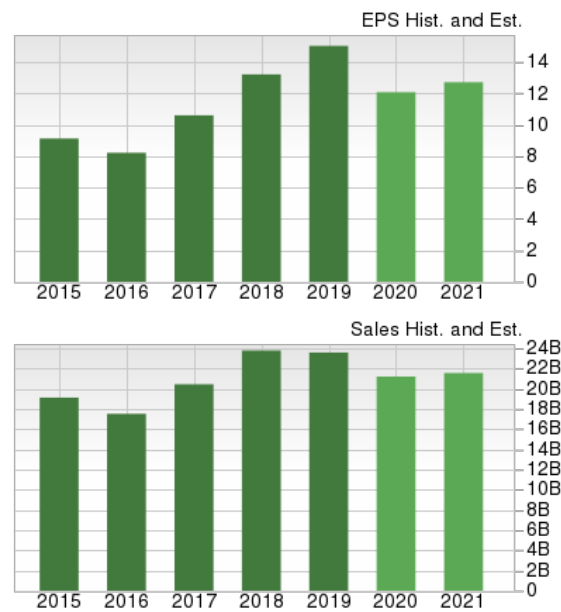
The **Engine** segment (34% of consolidated net sales in 2019) produces diesel and natural gas-based engines for on-highway and industrial markets. The engines are used in heavy and medium-duty trucks, buses, recreational vehicles, and various industrial applications such as construction, mining, agriculture, marine, oil and gas, rail, and defense.

The **Power Generation** segment (15.9%) sells power generators, diesel and natural gas high-horsepower engines, and AC generator or alternator products for internal consumption and external generator set assemblers. The unit is organized in Power Generation, Industrial and Generator Technologies product lines.

The **Components** segment (23%) has five businesses namely, Emission solutions, Turbo technologies, Filtration, Electronics and fuel systems, and Automated transmissions. The systems offered by this unit support the Engine and Power Systems segments of Cummins.

The **Distribution** segment (27%) includes 28 wholly and partially-owned distributorships and 10 joint ventures that offer a varied range of products and services, including Parts, Engines, Power generation and Service. The segment has a diverse customer base, with a global presence.

The **New Power** segment (0.1%) designs, manufactures, sells and supports electrified power systems ranging from fully electric to hybrid. It currently offers the Cummins PowerDrive series of fully electric and hybrid powertrain systems targeting various applications in the Class 4-8 commercial vehicle markets and are developing the Cummins Battery Electric System and the Cummins Hybrid Power Plug-In System for the urban bus market.



Reasons To Sell:

- ▼ With Cummins being the largest independent engine manufacturer in the world, contracting demand for heavy trucks— which is the firm's most significant end market— is likely to mar the company's prospects, going forward. The firm projects year-over-year revenue decline of 8-12% in 2020. The bleak guidance is attributed to lower truck production in North America, Europe, China and India. Decline in demand in off-highway markets — including construction and mining markets — is likely to limit revenues, going forward.
- ▼ Industry truck production declined by 29% in 2019 and the trend is likely to continue in 2020 as well. Cummins currently anticipates a reduction of 10% in heavy and medium-duty truck demand and flat demand in the light-duty truck market in 2020.
- ▼ Industry production for heavy-duty trucks in North America is projected to be 185,000 units in 2020 a 40% decrease year-over-year. The company expects orders to remain weak in 2020 with continued weak freight activity resulting in excess capacity and lower used truck market prices. In the medium-duty truck market, the company anticipates the market size to be 123,000 units, a 20% decrease from 2019 after several years of strong demand. Its engine shipments for pickup trucks in North America are also expected to be down 10% compared to a very strong 2019.
- ▼ Lower demand in global construction markets and soft light duty truck demand in China amid trade tussle and weak economy will dent its revenues in the Chinese markets. In China, the company projects domestic revenues, including joint ventures to be down 7% in 2020. Construction demand of Cummins declined 34% in 2019. Cummins anticipates that construction, mining and oil and gas markets will experience double-digit declines in 2020, which will limit the prospects of the firm. Power generation markets will also decline 5% to 10%.
- ▼ The company is battling with elevated expenses, owing to rising R&D expenses for product development and high material costs. In 2019, the company reported R&D expenses of \$271 million, depicting an increase from the prior year's figure of \$244 million. Further, expenses are expected to increase in the coming quarters for launching on-highway products that comply with emission regulation. Additionally, tariff-related commodity costs and fluctuating foreign currencies will likely hamper Cummins' margins.

Declining demand for heavy trucks — which is Cummins' chief end market — is likely to mar its prospects in both domestic and international regions, going forward.

Risks

- Cummins focuses on introducing innovative products and strategies such as partnerships in order to record high returns. Besides widening the product portfolio, it collaborated with Hyundai Construction and Isuzu Motors in October 2018. The collaboration with Hyundai is to develop an electric powered mini excavator while the one with Isuzu Motors will discover opportunity in the powertrain area. Further, the company partnered with Russia's KAMAZ to supply electrified power solutions for KAMAZ's new line of battery-powered vehicles.
 - Cummins is poised to gain from acquisitions. In sync with its aim to be a leader in electrified power, the company has acquired Hydrogenic Corp. The buyout will likely boost Cummins' ability to innovate hydrogen fuel-cell technologies across commercial markets. The company also announced the acquisition of Efficient Drivetrains, Inc., in July 2018. Earlier in January 2018, the company announced its buyout of the automotive battery business of United Kingdom's Johnson Matthey.
 - Cummins is focused on enhancing the shareholder value by pursuing aggressive share repurchases and increasing dividend payouts. For 2020, the company aimed at returning 75% of full-year operating cash flow to shareholders in forms of dividends and share repurchases. In Feb 2020, the company declared quarterly dividend of \$1.311 per share.
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Last Earnings Report

Cummins Q4 Earnings Surpass Estimates, Down Y/Y

Cummins reported earnings of \$2.56 per share in fourth-quarter 2019, surpassing the Zacks Consensus Estimate of \$2.42. Higher-than-expected contribution from the Components segment led to the outperformance. Segmental EBITDA (including restricting costs) came in at \$189 million, topping the consensus mark of \$181 million.

The bottom line, however, declined from earnings of \$3.63 a share recorded in fourth-quarter 2018. In the reported quarter, net income attributable to the company was \$300 million compared with \$579 million in the prior-year period.

Its revenues declined 8.9% year over year to \$5.57 billion in the reported quarter. However, revenues beat the Zacks Consensus Estimate of \$5.33 billion.

Earnings before interest, taxes, depreciation and amortization (EBITDA) declined to \$563 million (10.1% of sales) from \$682 million (11.2% of sales) recorded in the prior-year quarter.

Segmental Performance

Sales for the Engine segment declined 15.3% year over year to \$2,284 million. The segment's EBITDA (excluding restricting actions) declined to \$277 million (12.1% of sales) from \$393 million (14.6% of sales) a year ago. Decline in global demand in truck and construction markets resulted in lower on-and off-highway revenues.

Sales for the Distribution segment totaled \$2,038 million, down from \$2,050 million recorded in the year-ago period. While revenues from North America remained unchanged year over year, international sales declined 1%. The segment's EBITDA rose to \$164 million (8% of sales) from \$140 million (6.8% of sales) a year ago.

Sales for the Components segment declined 12% from the prior-year quarter to \$1,557 million. The segment's EBITDA was \$209 million (13.4% of sales) compared with the year-ago quarter figure of \$278 million (15.7% of sales). Sales in North America and International markets declined 13% and 11% year over year, respectively.

Sales for the Power Systems segment declined 12% from the year-ago quarter to \$1,054 million. The segment's EBITDA declined to \$55 million (5.2% of sales) in fourth-quarter 2019 from \$123 million (10.3% of sales) in the year-ago period. In addition to lower revenues, the decline in EBITDA is also attributed to a \$15-million charge related to a planned exit of a business in Africa.

Sales for the New Power segment were \$18 million. The segment recorded EBITDA loss of \$50 million.

Financial Position

Cummins' cash and cash equivalents were \$1,129 million as of Dec 31, 2019, down from \$1.3 billion in the corresponding period of 2018. Long-term debt totaled \$1,576 million. Its debt-to-capital ratio stands at 15.6%.

Outlook

For 2020, Cummins now projects revenue decline of 8-12%. The bleak guidance is attributed to lower truck production in North America, India, Brazil, China, India and Europe. Decline in demand in off-highway markets — including construction and mining markets — is likely to limit revenues. EBITDA is now expected to be 14.2-15.2% of sales. Notably, the company anticipates to return 75% of operating cash flow to its shareholders in the form of dividends and share repurchases.

Quarter Ending **12/2019**

Report Date	Feb 04, 2020
Sales Surprise	4.52%
EPS Surprise	5.79%
Quarterly EPS	2.56
Annual EPS (TTM)	14.86

Valuation

Cummins' shares are down 22.2% in the year-to-date period and up 11.9% over the trailing 12-month period. Stocks in the Zacks Automotive – Internal Combustion Engines industry and the Zacks Automotive sector are down 22.2% and 15.4%, in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are down 11.9% and 6.9%, respectively.

The S&P 500 index is down 14.8% and 2.3% in the year-to-date period and over the past year, respectively.

The stock is currently trading at 11.4X forward 12-month earnings, which compares to 11.4X for the Zacks sub-industry, 10.13X for the Zacks sector and 17.01X for the S&P 500 index.

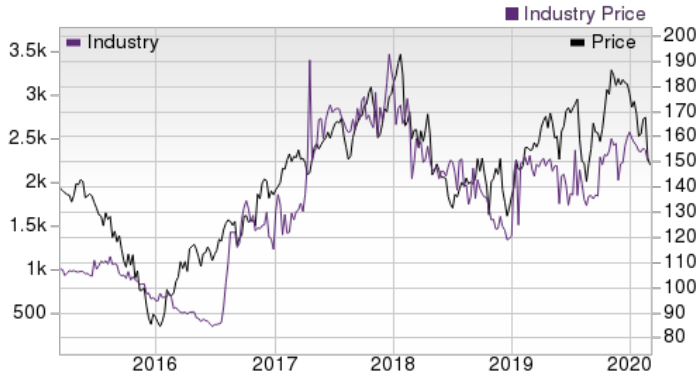
Over the past five years, the stock has traded as high as 18.94X and as low as 8.06X, with a 5-year median of 12.9X. Our Underperform recommendation indicates that the stock will perform worse than the market. Our \$118 price target reflects 9.66X forward 12-month earnings.

The table below shows summary valuation data for CMI:

Valuation Multiples - CMI					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	11.4	11.4	10.13	17.01
	5-Year High	18.94	18.3	11.75	19.34
	5-Year Low	8.06	8.58	8.23	15.18
	5-Year Median	12.9	12.4	9.93	17.42
EV/EBITDA TTM	Current	6.68	6.68	9.88	11.04
	5-Year High	11.26	11.26	11.35	12.87
	5-Year Low	4.76	4.76	7.05	8.49
	5-Year Median	7.47	7.47	9.36	10.79
P/S F12M	Current	1	1	0.61	3.14
	5-Year High	1.53	1.49	0.76	3.44
	5-Year Low	0.81	0.85	0.5	2.54
	5-Year Median	1.15	1.14	0.62	3.01

As of 03/09/2020

Industry Analysis Zacks Industry Rank: Bottom 11% (224 out of 253)



Top Peers

BorgWarner Inc. (BWA)	Neutral
Caterpillar Inc. (CAT)	Neutral
Daimler AG (DDAIF)	Neutral
Deere & Company (DE)	Neutral
Navistar International Corporation (NAV)	Neutral
PACCAR Inc. (PCAR)	Neutral
AB Volvo (VLVLY)	Neutral
Tenneco Inc. (TEN)	Underperform

Industry Comparison Industry: Automotive - Internal Combustion Engines				Industry Peers		
	CMI Underperform	X Industry	S&P 500	BWA Neutral	CAT Neutral	DDAIF Neutral
VGM Score	B	-	-	C	A	A
Market Cap	21.34 B	7.33 B	19.13 B	5.38 B	57.25 B	36.43 B
# of Analysts	10	9	13	9	10	3
Dividend Yield	3.77%	0.89%	2.26%	2.61%	3.96%	0.00%
Value Score	C	-	-	A	B	A
Cash/Price	0.06	0.06	0.05	0.14	0.12	0.75
EV/EBITDA	5.93	0.70	11.99	3.54	6.51	5.52
PEG Ratio	1.46	1.44	1.68	0.93	1.15	1.85
Price/Book (P/B)	2.52	2.01	2.64	1.11	3.91	0.52
Price/Cash Flow (P/CF)	7.06	6.54	10.70	4.16	6.46	2.22
P/E (F1)	11.74	10.73	15.44	6.52	11.14	6.06
Price/Sales (P/S)	0.91	0.91	2.05	0.53	1.06	0.19
Earnings Yield	8.69%	9.37%	6.47%	15.32%	8.97%	16.51%
Debt/Equity	0.19	0.19	0.70	0.35	1.80	1.58
Cash Flow (\$/share)	19.73	1.20	7.01	6.26	16.10	15.32
Growth Score	B	-	-	C	C	A
Hist. EPS Growth (3-5 yrs)	15.86%	15.86%	10.85%	9.76%	27.28%	-1.19%
Proj. EPS Growth (F1/F0)	-19.63%	-7.06%	6.25%	-3.28%	-15.54%	-34.31%
Curr. Cash Flow Growth	9.29%	12.50%	6.09%	-5.66%	-6.65%	-10.36%
Hist. Cash Flow Growth (3-5 yrs)	7.28%	14.75%	8.52%	3.79%	4.31%	1.70%
Current Ratio	1.50	1.19	1.24	1.65	1.47	1.22
Debt/Capital	15.70%	24.36%	42.57%	25.68%	64.24%	61.31%
Net Margin	9.59%	9.59%	11.69%	7.34%	11.32%	1.38%
Return on Equity	26.49%	26.49%	16.74%	18.68%	41.85%	10.82%
Sales/Assets	1.18	1.18	0.54	1.01	0.68	0.58
Proj. Sales Growth (F1/F0)	-10.08%	0.00%	3.76%	-1.60%	-8.15%	-2.36%
Momentum Score	B	-	-	D	A	D
Daily Price Chg	-6.28%	-2.26%	-7.65%	-9.77%	-14.28%	-14.15%
1 Week Price Chg	-1.78%	-3.56%	-0.67%	-8.64%	-2.28%	-3.34%
4 Week Price Chg	-14.15%	-9.46%	-19.26%	-21.73%	-22.52%	-27.80%
12 Week Price Chg	-23.40%	8.24%	-17.26%	-40.98%	-28.41%	-39.89%
52 Week Price Chg	-11.88%	4.21%	-6.83%	-32.57%	-21.82%	-40.47%
20 Day Average Volume	1,457,974	80,576	2,684,709	4,311,159	4,530,353	92,984
(F1) EPS Est 1 week change	0.00%	5.47%	0.00%	-0.69%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.66%	11.96%	-0.06%	-0.47%	-0.03%	-6.59%
(F1) EPS Est 12 week change	-7.40%	8.59%	-0.46%	-3.52%	-13.47%	-13.09%
(Q1) EPS Est Mthly Chg	-2.49%	-2.49%	-0.40%	-7.01%	-0.06%	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	C
Growth Score	B
Momentum Score	B
VGM Score	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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