

Caterpillar Inc

CAT fights off the bears: Next leg to the story requires green shoots for 2025

Reiterate Rating: BUY | PO: 363.00 USD | Price: 321.40 USD

Break out earned: margin up, inventory down - impressive

CAT shares broke out to new highs (+1.9% vs SPX -0.3%) on the back of a solid Q4 and guiding flat 2024 outlook. Why is that impressive? Q4 adj EPS of \$5.23, up 35% YoY and 10% ahead of cons included \$900mn inventory de-stock (\$1.4bn from Machines). Construction & Resources expanded margins 180bps & 90bps YoY on 5% sales declines that included a de-stock. CAT reported a record EPS of ~\$21 in FY23 and now believes inventories are broadly rightsized into '24 (note: Komatsu shared similar sentiments).

Too much focus on what can go wrong...what can go right?

There is an overwhelming investor focus on the downside risks (i.e., *what could go wrong?*). Growth is clearly slowing: backlog down, retail sales decelerating, price moderating, inventory drawn down. In our view, this is somewhat expected given the cyclical headwinds over the last year - tightening cycle, weak China, & industrial indicators (ISM) in contraction for 15 months. Begs the question - if CAT is still delivering ~\$21 of EPS in this backdrop - what happens when these headwinds turn?

Tech capex: be careful on 'themes' yet it moves the needle

We are always skeptical of cyclical OEMs attaching to tech 'themes'. That said, data center growth is starting to move the needle - Power Gen sales +29% YoY (now 11% of ME&T) - offers growth as other end markets slow. Last week, Meta guided capex \$30-37bn in '24 (vs \$27bn '23), partly driven by data centers. Another reason this theme catches our attention: CAT's management team - laser focused on FCF - is spending capex for the first time in a decade (\$2-2.5bn in '24) to build capacity to meet growth.

Eyes turn to '25: Next leg requires Copper, China, ISM, Fed

CAT proved its EPS resiliency yet upside requires green shoots to indicate if EPS grows in '25-26. What to watch: i) BofA expects higher copper price in 2H - key for Resources unit that is still below peak, ii) China excavators 40% below vs 2020, ii) ISM typically leads retail sales (exhibit 1) iv) easing cycle leads end user demand (albeit., two year lag).

Buy: CAT raises long-term margin & FCF targets

We update our estimates and raise our PO to \$363 (\$319) based on 16.5x (from 15x prior), as CAT raising its long-term margin and FCF targets warrants a higher multiple, in our view. Reiterate Buy rating as CAT is delivering higher EPS power through cycle.

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	13.84	21.21	22.00	24.00	26.50
GAAP EPS	12.64	20.12	21.24	23.59	26.07
EPS Change (YoY)	28.0%	53.3%	3.7%	9.1%	10.4%
Consensus EPS (Bloomberg)			20.68	21.54	23.41
DPS	4.71	5.10	5.50	5.94	6.42
Valuation (Dec)					
P/E	23.2x	15.2x	14.6x	13.4x	12.1x
GAAP P/E	25.4x	16.0x	15.1x	13.6x	12.3x
Dividend Yield	1.5%	1.6%	1.7%	1.8%	2.0%
EV / EBITDA*	16.4x	11.5x	11.4x	10.8x	10.2x
Free Cash Flow Yield*	3.1%	6.1%	5.5%	5.6%	6.5%

* For full definitions of *IQmethod*SM measures, see page 6.

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Timestamp: 06 February 2024 05:00AM EST

06 February 2024

Equity

Key Changes

(US\$)	Previous	Current
Price Obj.	319.00	363.00
2024E Rev (m)	66,551.5	65,247.0
2025E Rev (m)	70,280.3	68,922.9
2026E Rev (m)	NA	72,778.1
2024E EPS	21.25	22.00
2025E EPS	23.00	24.00
2026E EPS	NA	26.50

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Stock Data

Price	321.40 USD
Price Objective	363.00 USD
Date Established	6-Feb-2024
Investment Opinion	B-1-7
52-Week Range	204.04 USD - 334.87 USD
Mkrt Val (mn) / Shares Out (mn)	164,750 USD / 512.6
Free Float	99.8%
Average Daily Value (mn)	902.37 USD
BofA Ticker / Exchange	CAT / NYS
Bloomberg / Reuters	CAT US / CAT.N
ROE (2024E)	65.5%
Net Dbt to Eqty (Dec-2023A)	22.2%
ESGMeter TM	Medium

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to ["BofA ESGMeter Methodology"](#).

ME&T = machine, energy & transportation

iQprofileSM Caterpillar Inc

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	19.3%	31.5%	31.1%	30.8%	30.6%
Return on Equity	42.4%	65.9%	65.5%	61.2%	56.7%
Operating Margin	14.9%	20.8%	21.2%	21.1%	21.4%
Free Cash Flow	5,079	10,064	9,089	9,224	10,695

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	0.9x	1.1x	1.1x	1.0x	1.0x
Asset Replacement Ratio	0.9x	1.2x	1.8x	1.5x	1.6x
Tax Rate	24.1%	20.9%	23.0%	23.0%	23.0%
Net Debt-to-Equity Ratio	21.2%	22.2%	22.0%	14.2%	6.7%
Interest Cover	20.5x	26.6x	27.1x	29.1x	31.2x

Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	56,574	63,869	65,247	68,923	72,778
% Change	17.4%	12.9%	2.2%	5.6%	5.6%
Gross Profit	15,218	21,093	21,727	23,055	24,708
% Change	20.1%	38.6%	3.0%	6.1%	7.2%
EBITDA	10,550	14,951	15,203	15,941	16,964
% Change	15.7%	41.7%	1.7%	4.9%	6.4%
Net Interest & Other Income	10	(268)	(510)	(500)	(500)
Net Income (Adjusted)	7,339	10,893	10,933	11,509	12,296
% Change	23.7%	48.4%	0.4%	5.3%	6.8%

Free Cash Flow Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	7,339	10,890	10,933	11,509	12,296
Depreciation & Amortization	1,439	1,361	1,371	1,371	1,371
Change in Working Capital	(2,015)	(11)	(18)	(1,014)	(214)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	(405)	(552)	(750)	(575)	(575)
Capital Expenditure	(1,279)	(1,624)	(2,447)	(2,068)	(2,183)
Free Cash Flow	5,079	10,064	9,089	9,224	10,695
% Change	-16.6%	98.1%	-9.7%	1.5%	16.0%
Share / Issue Repurchase	(4,179)	(4,963)	(6,600)	(5,445)	(6,389)
Cost of Dividends Paid	(2,440)	(2,563)	(2,735)	(2,850)	(2,979)
Change in Debt	(172)	(10)	0	0	0

Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	6,042	6,106	5,860	6,788	8,116
Trade Receivables	3,710	3,971	4,022	4,343	4,985
Other Current Assets	18,758	20,892	21,065	22,674	23,555
Property, Plant & Equipment	8,186	8,694	9,770	10,466	11,279
Other Non-Current Assets	17,133	14,015	14,493	15,143	15,807
Total Assets	53,829	53,678	55,210	59,416	63,742
Short-Term Debt	123	1,044	1,044	1,044	1,044
Other Current Liabilities	19,303	20,028	20,338	21,529	23,126
Long-Term Debt	9,529	8,626	8,626	8,626	8,626
Other Non-Current Liabilities	7,880	7,904	7,904	7,904	7,904
Total Liabilities	36,835	37,602	37,912	39,103	40,700
Total Equity	16,994	16,076	17,299	20,313	23,041
Total Equity & Liabilities	53,829	53,678	55,210	59,416	63,742

* For full definitions of iQmethodSM measures, see page 6.

Company Sector

Construction Machinery

Company Description

Caterpillar (CAT), the largest manufacturer/marketer of construction equipment worldwide, is also a leading manufacturer of engines and turbines for transport, energy, and industrial applications.

Investment Rationale

CAT is a global powerhouse in mining, construction, oil and gas, rail, and power systems equipment. We believe CAT is well positioned with trough earnings notably higher than in prior downturns. As we look to towards the next cycle, CAT's earnings power and multi-year growth prospects are positive: capex is higher following years of underinvestment, older fleets require replacement, and shift in construction spending towards heavy/infrastructure projects.

Stock Data

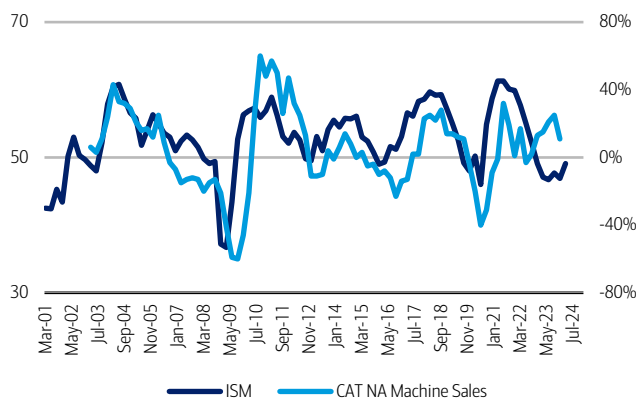
Average Daily Volume 2,807,634

Quarterly Earnings Estimates

	2023	2024
Q1	4.91A	5.11E
Q2	5.55A	5.66E
Q3	5.52A	5.61E
Q4	5.23A	5.62E

Exhibit 1: ISM vs Caterpillar Dealer Sales Machines (North America)

ISM typically leads Machine retail sales

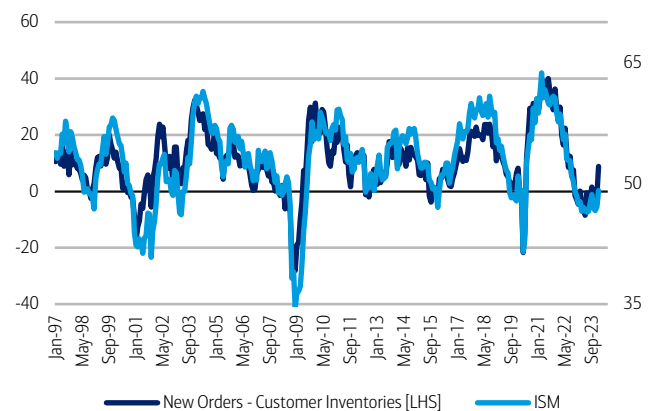


Source: Bloomberg

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Exhibit 2: ISM New Orders less Inventories leads ISM

Underlying data suggests upside for ISM

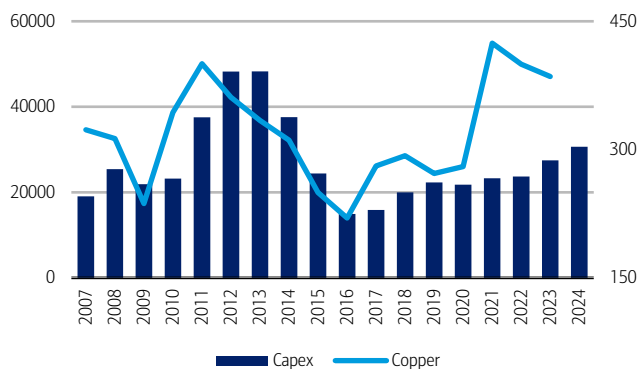


Source: Bloomberg

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Exhibit 3: Big 4 miners capex vs Copper Price

Big 4 miner capex up 12% in 2024 – look for copper for capex in 2025

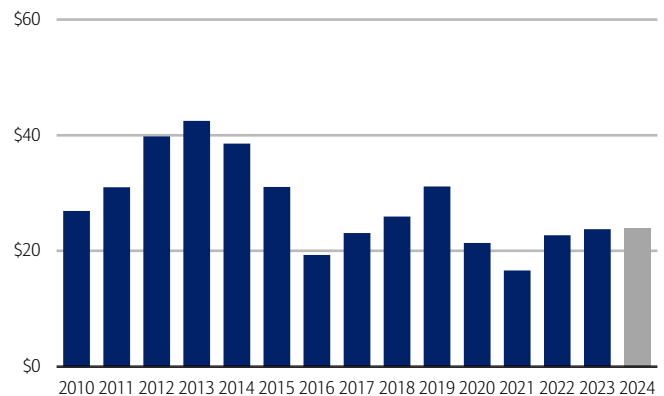


Source: BofA Metals & Mining team (BHP, Rio, Anglo, Glencore), \$bn

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Exhibit 4: Exxon's Capex and Annual Spending Budget (\$bns)

Guiding flattish spending 2024 – area for upside if commodities come back



Source: Company Filings, BofA Global Research

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Exhibit 5: Industrial End markets in easing cycles: takes some time to work through the system and kickstart demand

Typically, one to two years out of the easing cycle starts to improve metrics

Year	Δ in Fed Funds rate (Bps)	ABI		ISM		Class 8 Trucks	Combines	Private Non-Res Spend	Mining	CAT NA Retail Sales	
		Starting	Ending	Starting	Ending					Starting	Ending
1990	-125			47.4	40.8	-30%	6%		44%		
1991	-300				46.8	3%	-7%		-18%		
1992	-100			46.8	54.2	71%	-16%		15%		
1993	0			54.2	55.6	21%	7%		54%		
1994	250			55.6	56.1	55%	1%	7%	-16%		
1995	0			56.1	46.2	-54%	10%	13%	19%		
1996	-25	53.4	44.6	46.2	55.2	-4%	6%	8%	27%		
1997	25	44.6	51.3	55.2	54.5	110%	8%	9%	5%		
1998	-75	51.3	55.2	54.5	46.8	18%	-4%	11%	-12%		
1999	75	55.2	57.7	46.8	57.8	-33%	-47%	5%	-28%		
2000	100	57.7	53.2	57.8	43.9	-39%	5%	10%	-11%		
2001	-475	53.2	45.6	43.9	45.3	-13%	11%	0%	25%		
2002	-50	45.6	47.8	45.3	51.6	33%	-21%	-13%	-15%		
2003	-25	47.8	50.3	51.6	60.1	19%	-3%	-4%	-3%	-1%	24%
2004	125	50.3	48.1	60.1	57.2	89%	40%	4%	107%	24%	29%

Exhibit 5: Industrial End markets in easing cycles: takes some time to work through the system and kickstart demand

Typically, one to two years out of the easing cycle starts to improve metrics

Year	Δ in Fed Funds	ABI		ISM		Class 8 Trucks	Combines	Private Non-Res Spend	Mining	CAT NA Retail Sales	
2005	200	48.1	50.3	57.2	55.1	-14%	1%	8%	44%	29%	12%
2006	100	50.3	55.4	55.1	51.4	-1%	-7%	16%	7%	12%	-7%
2007	-100	55.4	52.9	51.4	50.1	-44%	13%	24%	15%	-7%	-13%
2008	-400	52.9	34.7	50.1	34.5	-2%	22%	11%	19%	-13%	-21%
2009	0	34.7	44.0	34.5	55.8	-33%	15%	-16%	-32%	-21%	-46%
2010	0	44.0	52.4	55.8	56.6	49%	9%	-23%	26%	-46%	48%
2011	0	52.4	50.5	56.6	53.0	69%	-4%	-2%	49%	48%	51%
2012	0	50.5	51.5	53.0	50.1	-25%	-1%	17%	7%	51%	-11%
2013	0	51.5	49.0	50.1	56.5	17%	8%	4%	-44%	-11%	-1%
2014	0	49.0	52.9	56.5	55.7	42%	-25%	15%	-32%	-1%	0%
2015	25	52.9	51.0	55.7	48.7	-24%	-28%	12%	-17%	0%	-10%
2016	25	51.0	55.1	48.7	54.4	-36%	-21%	7%	-18%	-10%	-14%
2017	75	55.1	52.2	54.4	59.7	59%	9%	2%	91%	-14%	23%
2018	100	52.2	49.8	59.7	54.9	65%	10%	5%	33%	23%	14%
2019	-75	49.8	51.3	54.9	47.9	-63%	-7%	7%	-24%	14%	-4%
2020	-150	51.3	42.1	47.9	60.2	54%	0%	-1%	-37%	-4%	-9%
2021	0	42.1	51.8	60.2	58.6	27%	24%	0%	72%	-9%	1%
2022	425	51.8	48.4	58.6	48.4	-15%	15%	12%	45%	1%	13%
2023	100	48.4	45.3	48.4	47.4	-7%	3%	19%	7%	13%	

Source: Bloomberg

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Price objective basis & risk

Caterpillar Inc (CAT)

Our \$363 PO on CAT is on based on 16.5x 2024e EPS which is in-line with the long term historical range of 15-17x. While we see some headwinds that are likely to slow growth (higher inventories, capex plateauing, pricing moderating, backlog softening), there are unique macro and business cycle factors that are underpinning stronger cycle over cycle earnings: infrastructure, construction spending mix shifts towards heavy vs light, higher miner free cash flow generation, aging fleets, and data centers.

Downside risks to our PO: 1) widening global coronavirus pandemic that tilts global economy into recession, 2) a greater-than-expected reduction or delay in capital spending among large mining, and oil and gas customers, 3) intensifying pricing pressure in the construction and mining equipment industries, 4) greater than expected dealer destocking, 5) ongoing deterioration in dealer sales growth.

Upside risks: 1) a faster recovery in the global economy, 2) firming earthmoving construction equipment market, 3) stronger-than-expected fleet replacement, 4) continuing recovery in commodity prices, 5) stronger-than-expected demand trends in gas compression, 6) quicker-than-expected resolution to the pandemic.

Analyst Certification

I, Michael Feniger, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Machinery Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	AECOM	ACM	ACM US	Michael Feniger
	Blue Bird Corp	BLBD	BLBD US	Sherif El-Sabbahy
	Caterpillar Inc	CAT	CAT US	Michael Feniger
	CNH Industrial NV	CNHI	CNHI US	Michael Feniger
	Construction Partners Inc.	ROAD	ROAD US	Michael Feniger
	ESAB Corp	ESAB	ESAB US	Sherif El-Sabbahy
	Finning International Inc.	YFTT	FTT CN	Sherif El-Sabbahy
	H&E Equipment Services Inc	HEES	HEES US	Sherif El-Sabbahy
	Knife River Corp	KNF	KNF US	Sherif El-Sabbahy
	Republic Services	RSG	RSG US	Michael Feniger
	Techtronic Industries Co Ltd	TTNDF	669 HK	Michael Feniger
	Techtronic Industries Co Ltd	TTNDY	TTNDY US	Michael Feniger
	United Rentals Inc	URI	URI US	Michael Feniger
	Vulcan Materials	VMC	VMC US	Michael Feniger
	Waste Connections Inc	WCN	WCN US	Michael Feniger
	WillScot Mobile Mini	WSC	WSC US	Sherif El-Sabbahy
NEUTRAL				
	AGCO Corp	AGCO	AGCO US	Michael Feniger
	Deere & Co	DE	DE US	Michael Feniger
	Fluor	FLR	FLR US	Michael Feniger
	GFL Environmental Inc	GFL	GFL US	Michael Feniger
	GFL Environmental Inc	YGFL	GFL CN	Michael Feniger
	Jacobs Eng.	J	J US	Michael Feniger
	Kennametal Inc.	KMT	KMT US	Michael Feniger
	Martin Marietta Materials	MLM	MLM US	Michael Feniger
	NV5 Global Inc.	NVEE	NVEE US	Michael Feniger
	PACCAR Inc	PCAR	PCAR US	Michael Feniger
	RB Global, Inc	RBA	RBA US	Michael Feniger
	Waste Management	WM	WM US	Michael Feniger



US - Machinery Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
UNDERPERFORM				
	Allison Transmission Holdings Inc.	ALSN	ALSN US	Sherif El-Sabbahy
	Casella	CWST	CWST US	Michael Feniger
	Cummins Inc	CMI	CMI US	Michael Feniger
	Herc Holdings Inc	HRI	HRI US	Sherif El-Sabbahy
	IPG Photonics	IPGP	IPGP US	Michael Feniger
	Oshkosh Corp.	OSK	OSK US	Michael Feniger
	Terex Corp.	TEX	TEX US	Michael Feniger
	Timken Company	TKR	TKR US	Michael Feniger

iQmethodSM Measures Definitions**Business Performance**

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization

Shareholders' Equity

Sales

N/A

N/A

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt + Other LT Liabilities

Enterprise Value

Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

iQmethodSM is the set of BofA Global Research standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and validations. The key features of iQmethod are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

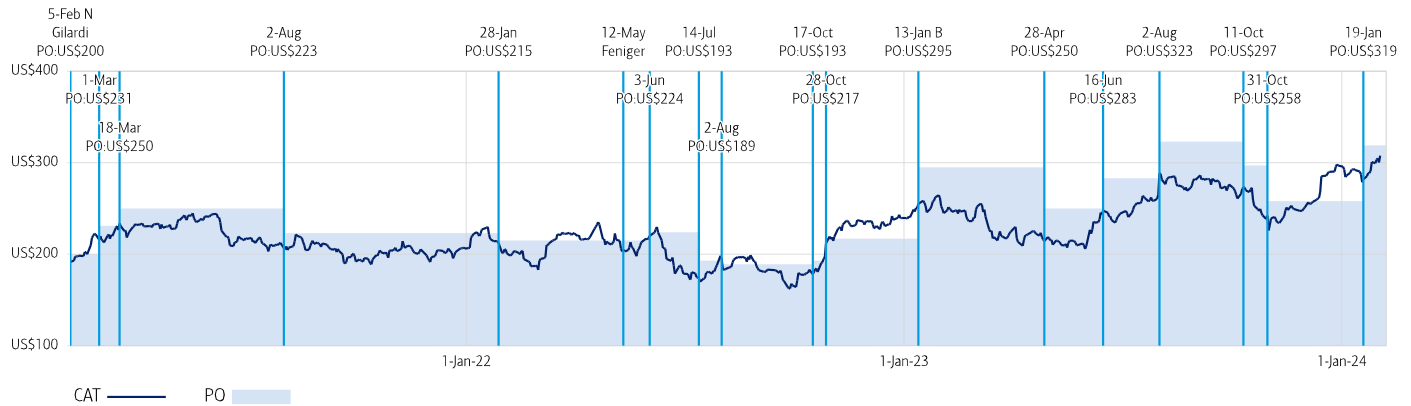
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Disclosures

Important Disclosures

Caterpillar Inc (CAT) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Machinery/Diversified Manufacturing Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	27	42.19%	Buy	8	29.63%
Hold	17	26.56%	Hold	8	47.06%
Sell	20	31.25%	Sell	8	40.00%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

FUNDAMENTAL EQUITY OPINION KEY: Opinions include a Volatility Risk Rating, an Investment Rating and an Income Rating. **VOLATILITY RISK RATINGS**, indicators of potential price fluctuation, are: A - Low, B - Medium and C - High. **INVESTMENT RATINGS** reflect the analyst's assessment of both a stock's absolute total return potential as well as its attractiveness for investment relative to other stocks within its Coverage Cluster (defined below). Our investment ratings are: 1 - Buy stocks are expected to have a total return of at least 10% and are the most attractive stocks in the coverage cluster; 2 - Neutral stocks are expected to remain flat or increase in value and are less attractive than Buy rated stocks and 3 - Underperform stocks are the least attractive stocks in a coverage cluster. An investment rating of 6 (No Rating) indicates that a stock is no longer trading on the basis of fundamentals. Analysts assign investment ratings considering, among other things, the 0-12 month total return expectation for a stock and the firm's guidelines for ratings dispersions (shown in the table below). The current price objective for a stock should be referenced to better understand the total return expectation at any given time. The price objective reflects the analyst's view of the potential price appreciation (depreciation).

Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

INCOME RATINGS, indicators of potential cash dividends, are: 7 - same/higher (dividend considered to be secure), 8 - same/lower (dividend not considered to be secure) and 9 - pays no cash dividend. **Coverage Cluster** is comprised of stocks covered by a single analyst or two or more analysts sharing a common industry, sector, region or other classification(s). A stock's coverage cluster is included in the most recent BofA Global Research report referencing the stock.

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