

Caterpillar Inc

Dealer down under provides some insights

Maintain Rating: BUY | PO: 363.00 USD | Price: 341.52 USD

BofA hosts call with Seven Group Holdings – takeaways

We cohosted a call last night (along with BofA's Shaurya Visen) with Seven Group Holdings' (SVW) Ryan Stokes (MD & CEO) & Richard Richards (CFO). SVW is a diversified operating group based in Australia with market leading businesses across Industrial Services, Energy, and Media. BofA's Shaurya Visen sees SVW business as being driven by Boral's ability to drive margins higher as well as sanguine outlook for WesTrac & Coates. SVW's 5 core business lines and operating structure is rather unique. Relevant for our coverage, we note that WesTrac is the sole CAT dealer in Western Australia and New South Wales.

1) Servicing high quality, low cost mines across Australia

In our view, we did not sense any notable concern over the recent volatility in the iron ore price. We note, WesTrac reported strong demand in its customers despite an underwhelming China recovery story in FY23. According to SVW, WesTrac's demand is more driven by volumes and exports of iron ore (which continues to rise) at AU mines where operating costs remain far lower than the price today. That said, if there is a more substantial pull back in commodity prices closer to break-even levels, the sense is customers will likely pivot to focus on efficiency and drive existing machines harder.

2) EV story likely takes longer....and that's not a bad thing

SVW highlights the complexity around battery electric mining trucks. The idea of exchanging an engine for a battery in a mining truck sounds good in practice yet is much more complicated regarding mining productivity across the entire fleet. In our view, it sounds like this is a much longer-term trend. As a result, this likely supports a higher level of rebuild activity. SVW cited a record period of rebuild activity and this is likely extended as a result of the aged machines and the push out in EV transition on the fleet.

3) CAT's large engines – demand pulled in a few directions

A key takeaway from CAT's earnings season: CAT's management team – laser focused on FCF – spending capex for the first time in a decade (\$2-2.5bn in '24) to build capacity on engines to meeting demand. We came away from our SVW call with more confidence that CAT clearly has visibility into this investment given the continued tightness and demand in this area. While the US theme around data centers is well known, SVW also requires large engines to support its customers – mining trucks run 70k hours a year. We maintain Buy-rating on CAT as E&T segment is an underappreciated tailwind to the story.

4) Inventory commentary around parts

SVW cited the tightness is in large engines and parts business, yet there are signs of improvement (particularly in parts). This remains consistent with prior comments across the space. SVW increased inventory – as cited on its recent results – to support customers in this period of stable demand and strong rebuild activity. We sense that Westrac feels parts inventory is now at the appropriate and sustainable level. As a result, incremental inventory build is likely less of a driver going forward.

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Timestamp: 14 March 2024 05:30AM EDT

14 March 2024

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Stock Data

Price	341.52 USD
Price Objective	363.00 USD
Date Established	6-Feb-2024
Investment Opinion	B-1-7
52-Week Range	204.04 USD - 344.50 USD
Mkt Val (mn) / Shares Out (mn)	175,063 USD / 512.6
Free Float	99.8%
Average Daily Value (mn)	822.79 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™	Medium

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E&T = Energy & transportation

EV = electric vehicle

SVW = Seven Group Holdings

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.

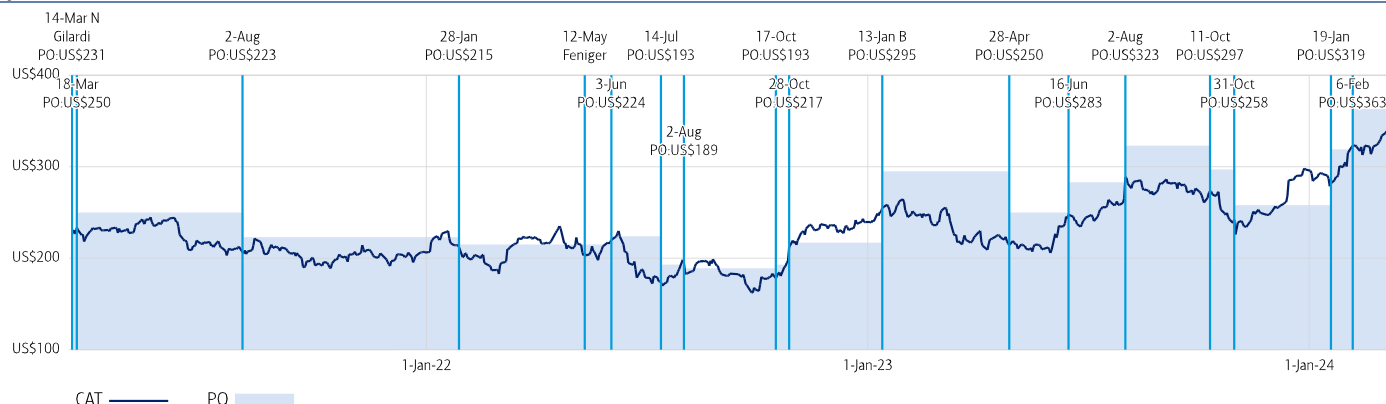
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Caterpillar Inc (CAT) Price Chart



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

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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)

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Sell	807	22.84%	Sell	383	47.46%

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