

Cummins Inc

In a tough(er) spot: Downgrade to Underperform

Rating Change: UNDERPERFORM | PO: 225.00 USD | Price: 233.19 USD

Quality operator but expectations feel a bit off vs peers

CMI is a strong operator with a healthy balance sheet & market leadership positions. We downgrade CMI to Underperform from Neutral in conjunction with our YA report. This is more of a relative view given consensus earnings expectations for CMI are a bit higher vs peers: i) consensus forecasts flattish EPS in 2024 vs decline for peers (Exhibit 2) – while there are tailwinds (data centers, cost actions, China truck), we expect NA truck production to fall double-digits in 2024, ii) long-term investment needs (on top of a recent resolution of a regulatory claim) weigh on the FCF profile, and iii) rising caution around the hydrogen ecosystem.

Trucks: Production catches up with weak freight trends

CMI is the largest truck engine OEM. ACT expects NA truck production to fall 20% to 272k units in '24 – closer to normalized levels – following the ramp in production ('21: 264k, +23%, '22 315k, +19%, '23e: 339k, +8%). While the '24 downturn is likely less severe vs prior downturns and we expect a recovery to play out in '25, weak trends are not exactly out of the woods (trucker capex, used equipment values, see Exhibits 5-10).

Strong balance sheet yet heavy investments required

CMI is in a strong financial position (net debt ~0.5x). While we are skeptical on EV adoption rates (positive for CMI's legacy business), CMI is investing heavily in its platform to prepare for rising regulatory environment (Exhibit 15). Additionally, a recent resolution of a regulatory claim (December 22nd) is expected to be a ~\$1.9bn headwind to 1H24 cash flow – a sizeable figure (we note: FCF on a YTD basis in 2023 is ~\$2.1bn).

Rising uncertainty that weighs on hydrogen opportunity

CMI's Accelera unit (i.e., zero emission solutions) is expected to lose \$420-440mn of EBITDA in 2023. CMI targets 'break-even' by '27 with the hydrogen economy as one of the single biggest outgrowth opportunities. BofA's recent hydrogen conference at the end of December [struck a cautious tone](#) (see report) (see overhang on pure plays, Exhibit 3).

Lower PO to \$225 on 12.5x 2024E EPS

We update our estimates and PO to \$225 (\$243), based on 12.5x 2024e EPS (vs 13.5x prior). We believe the headwind to FCF in the 1H and some caution around the hydrogen ecosystem limits valuation upside in the near-term relative to other Machinery peers.

Estimates (Dec) (US\$)	2021A	2022A	2023E	2024E	2025E
EPS	14.56	16.28	19.91	18.00	19.95
GAAP EPS	14.61	17.45	20.28	18.00	19.95
EPS Change (YoY)	21.5%	11.8%	22.3%	-9.6%	10.8%
Consensus EPS (Bloomberg)			19.83	19.52	21.72
DPS	5.60	6.04	6.50	6.83	7.17
Valuation (Dec)					
P/E	16.0x	14.3x	11.7x	13.0x	11.7x
GAAP P/E	16.0x	13.4x	11.5x	13.0x	11.7x
Dividend Yield	2.4%	2.6%	2.8%	2.9%	3.1%
EV / EBITDA*	9.5x	8.4x	6.5x	7.0x	6.5x
Free Cash Flow Yield*	4.6%	3.1%	6.4%	5.4%	7.6%

* For full definitions of *IQmethod*SM measures, see page 8.

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Refer to important disclosures on page 9 to 11. Analyst Certification on page 7. Price Objective Basis/Risk on page 7.

12647983

Timestamp: 19 January 2024 06:00AM EST

19 January 2024

Equity

Key Changes

(US\$)	Previous	Current
Inv. Opinion	B-2-7	B-3-7
Inv. Rating	NEUTRAL	UNDERPERFORM
Price Obj.	243.00	225.00
2023E Rev (m)	33,358.5	33,604.4
2024E Rev (m)	32,027.0	32,369.9
2025E Rev (m)	33,641.5	33,960.8
2023E EPS	19.70	19.91
2025E EPS	21.17	19.95

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Stock Data

Price	233.19 USD
Price Objective	225.00 USD
Date Established	19-Jan-2024
Investment Opinion	B-3-7
52-Week Range	203.18 USD - 265.28 USD
Mkt Val (mn) / Shares Out (mn)	33,230 USD / 142.5
Free Float	98.0%
Average Daily Value (mn)	169.52 USD
BofA Ticker / Exchange	CMI / NYS
Bloomberg / Reuters	CMI US / CMI.N
ROE (2023E)	27.6%
Net Dbt to Eqty (Dec-2022A)	25.5%
ESGMeter TM	High

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"](#).

Cons = consensus OEM = original equipment manufacturer, CMI = Cummins, ACT = third party truck forecasts

iQprofileSM Cummins Inc

iQmethodSM – Bus Performance*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Return on Capital Employed	12.8%	13.6%	15.2%	13.2%	13.4%
Return on Equity	25.7%	26.2%	27.6%	21.1%	20.4%
Operating Margin	11.3%	11.1%	11.7%	11.6%	12.2%
Free Cash Flow	1,522	1,046	2,128	1,794	2,516

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash Realization Ratio	1.1x	0.8x	1.2x	1.2x	1.3x
Asset Replacement Ratio	1.1x	1.2x	1.2x	1.2x	1.2x
Tax Rate	21.1%	22.0%	22.0%	22.5%	22.5%
Net Debt-to-Equity Ratio	12.7%	25.5%	14.0%	5.9%	-3.5%
Interest Cover	24.4x	15.7x	10.3x	9.9x	10.9x

Income Statement Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Sales	24,021	28,074	33,604	32,370	33,961
% Change	21.3%	16.9%	19.7%	-3.7%	4.9%
Gross Profit	5,695	6,739	8,267	7,850	8,504
% Change	16.4%	18.3%	22.7%	-5.0%	8.3%
EBITDA	3,521	3,991	5,150	4,777	5,144
% Change	13.3%	13.3%	29.0%	-7.2%	7.7%
Net Interest & Other Income	27	(110)	(170)	(380)	(380)
Net Income (Adjusted)	2,124	2,317	2,833	2,562	2,839
% Change	19.0%	9.1%	22.3%	-9.6%	10.8%

Free Cash Flow Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Net Income from Cont Operations (GAAP)	2,124	2,317	2,833	2,562	2,839
Depreciation & Amortization	662	784	1,010	1,010	1,010
Change in Working Capital	(548)	(920)	(812)	(597)	(259)
Deferred Taxation Charge	7	(274)	0	0	0
Other Adjustments, Net	11	55	347	19	125
Capital Expenditure	(734)	(916)	(1,250)	(1,200)	(1,200)
Free Cash Flow	1,522	1,046	2,128	1,794	2,516
% Change	-30.6%	-31.3%	103.5%	-15.7%	40.2%
Share / Issue Repurchase	(1,346)	(374)	0	0	0
Cost of Dividends Paid	(809)	(855)	(918)	(964)	(1,013)
Change in Debt	(32)	2,814	0	0	0

Balance Sheet Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash & Equivalents	2,592	2,101	2,964	3,872	5,275
Trade Receivables	3,990	5,202	6,227	5,998	6,293
Other Current Assets	5,727	7,148	8,395	8,126	8,430
Property, Plant & Equipment	4,422	5,521	5,761	5,951	6,141
Other Non-Current Assets	6,979	10,327	11,370	11,914	12,252
Total Assets	23,710	30,299	34,718	35,860	38,391
Short-Term Debt	208	210	210	210	210
Other Current Liabilities	6,876	11,211	13,368	12,893	13,472
Long-Term Debt	3,579	4,498	4,498	4,498	4,498
Other Non-Current Liabilities	3,646	4,155	4,155	4,155	4,155
Total Liabilities	14,309	20,074	22,231	21,756	22,335
Total Equity	9,401	10,225	12,487	14,104	16,056
Total Equity & Liabilities	23,710	30,299	34,718	35,860	38,391

* For full definitions of iQmethodSM measures, see page 8.

Company Sector

Industrial Machinery

Company Description

Cummins is a global leading designer and mfr of diesel and natural gas engines and components for on- and off-highway vehicles and power generation markets. About 57% of consolidated sales are derived from North America, 11% from EMEA/CIS, 8% from Asia Pacific, 10% from China, 6% from Latin America and Mexico, 4% from India, and 4% from Middle East/Africa. About 35% of sales are derived from the Engine segment, 22% from Components, 16% from Power Systems, and 27% from Distribution.

Investment Rationale

Cummins is a well-managed, high quality market leader with strong technology and scale advantages. CMI is in a strong financial position yet is investing heavily in its platform to prepare for a rising regulatory environment. While we see some tailwinds into 2024 (data centers, off-highway, cost reduction initiatives), we see some uncertainty around truck production levels (likely double digit decline in North America) and caution on the hydrogen ecosystem.

Stock Data

Average Daily Volume 726,974

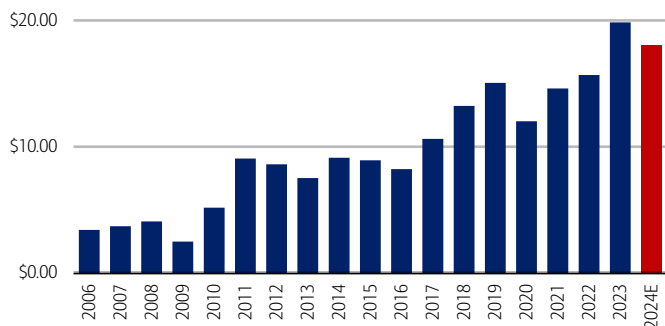
Quarterly Earnings Estimates

	2022	2023
Q1	4.04A	5.65A
Q2	4.77A	5.18A
Q3	3.30A	4.73A
Q4	4.16A	4.34E

Key charts

Exhibit 1: Cummins Adj EPS (BofA est for 2024)

We expect Cummins adj EPS to be down in 2024

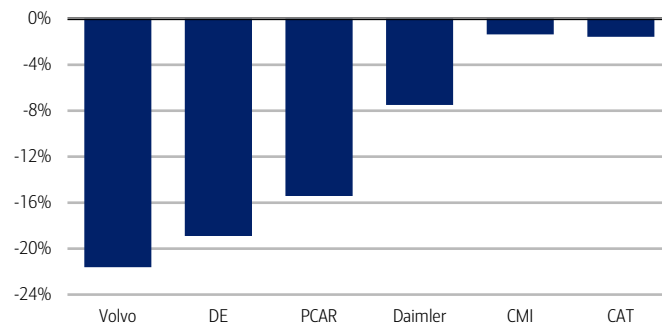


Source: Company Filings

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Exhibit 2: 2024 Adj EPS Growth YoY (Consensus)

Consensus forecasts ~2% EPS decline next year, more modest than other machinery and truck OEMs

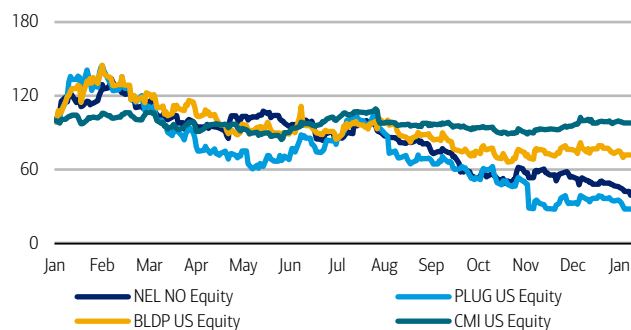


Source: Bloomberg

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Exhibit 3: Hydrogen (PLUG, NEL, BLDP) vs CMI stock returns

Hydrogen peers have underperformed vs CMI in 2023, particularly in recent weeks on concerns around regulatory framework

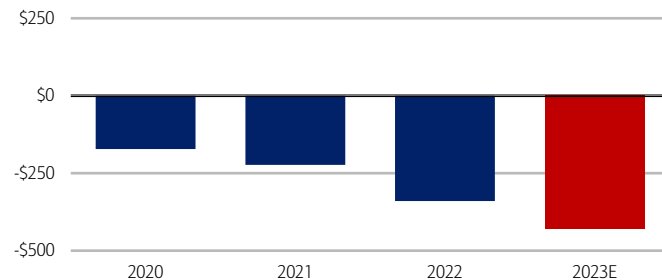


Source: Bloomberg

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Exhibit 4: Accelerera EBITDA (in mn)

Accelerera is expected to lose between \$440mn and \$420mn in 2023 – CMI is targeting break even by 2027. Hydrogen is a big part of the Accelerera story

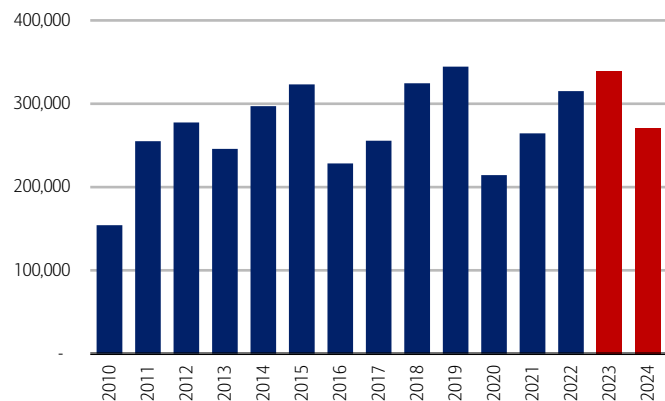


Source: Company Filings

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Exhibit 5: CL8 Truck Production

ACT expects truck production to decline 20% YoY in 2024

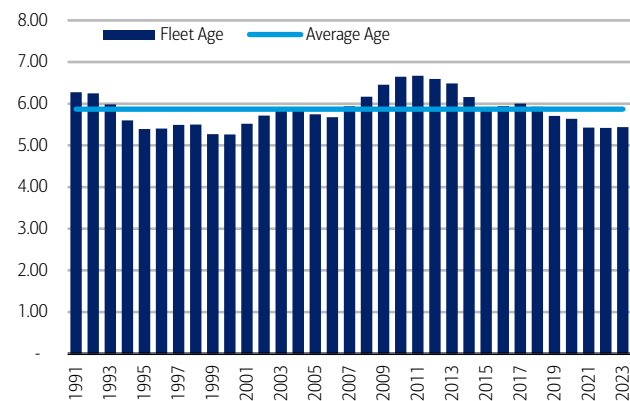


Source: ACT

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Exhibit 6: NA CL8 Average Truck Fleet Age

NA CL8 Truck fleet is normalizing after years of robust orders/production

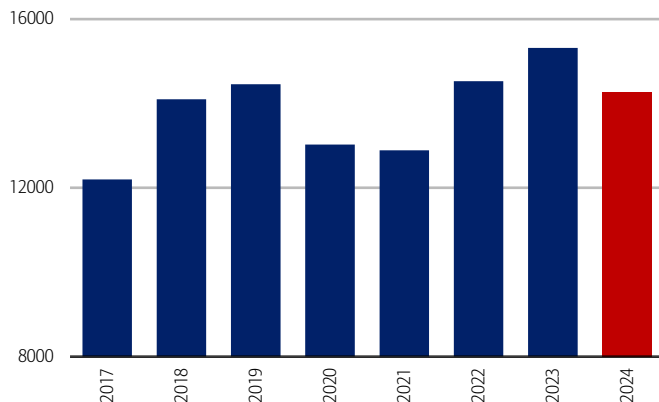


Source: ACT

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Exhibit 7: Trucker Capex

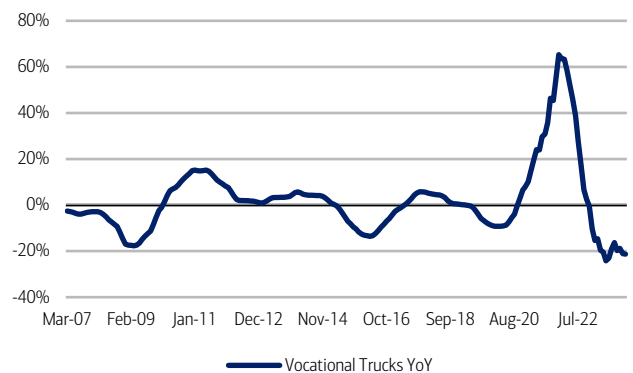
Trucker capex is expected to be down in 2024



Source: Company Filings (includes: J.B. Hunt, Werner, Arcbest, Knight-Swift, FedEx, UPS)
BofA GLOBAL RESEARCH

Exhibit 8: Used Vocational Trucks YoY

Used truck prices have been falling

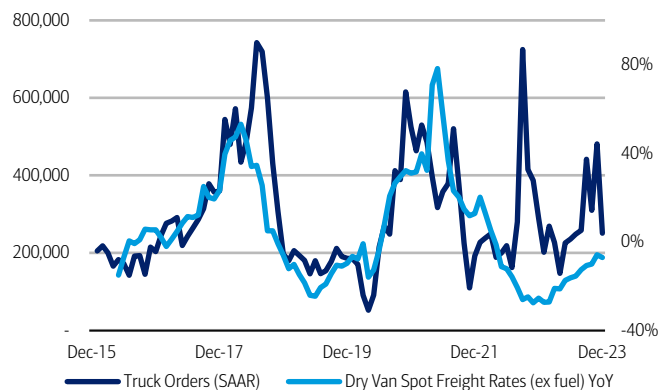


Source: RB Global

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Exhibit 9: Heavy Duty truck orders (SAAR) vs Spot Freight Rates YoY

Order rates running ahead of spot freight rates

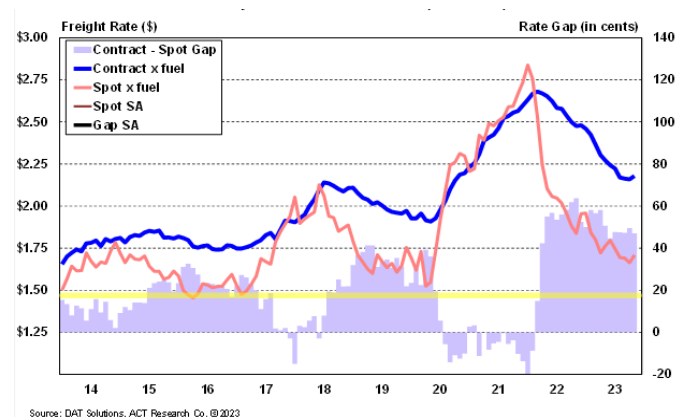


Source: Bloomberg, ACT

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Exhibit 10: DAT Trendlines Spot Rates: Aggregate Revenue per Mile

Spot rates have been trending down with a wide spread vs contract

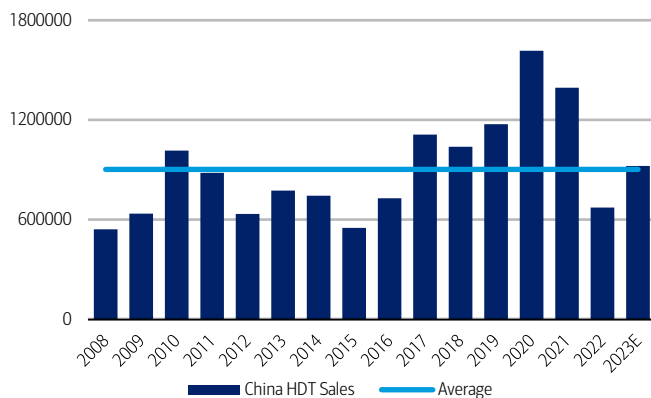


Source: ACT

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Exhibit 11: China Heavy Duty Truck Sales (units)

HDT Truck sales recovered in 2023, no longer at very depressed levels

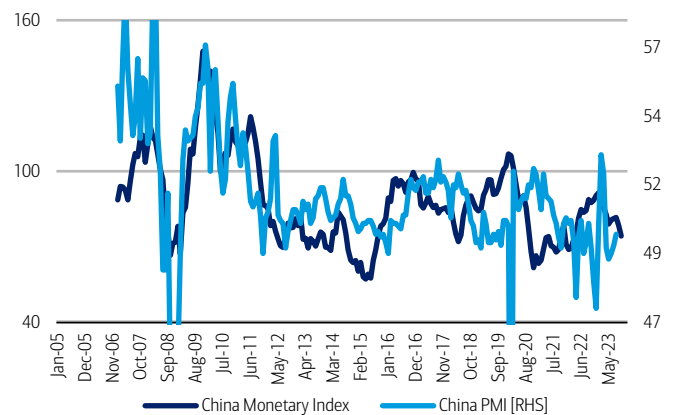


Source: CVWorld, BofA Global Research

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Exhibit 12: China Monetary Index vs China PMI

China still not easing yet, with a sluggish industrial activity (PMI)



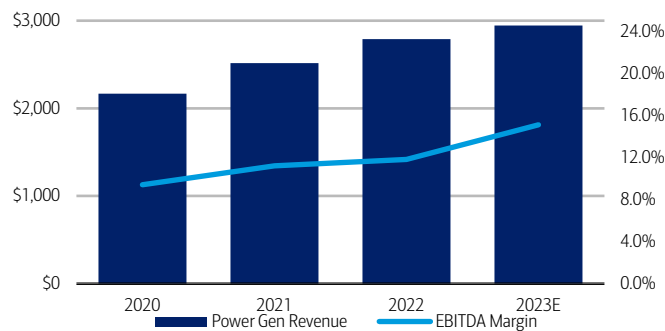
Source: Bloomberg

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Exhibit 13: Cummins Power Gen Revenue – bright spot

Cummins Power Gen has been increasing each year – bright spot

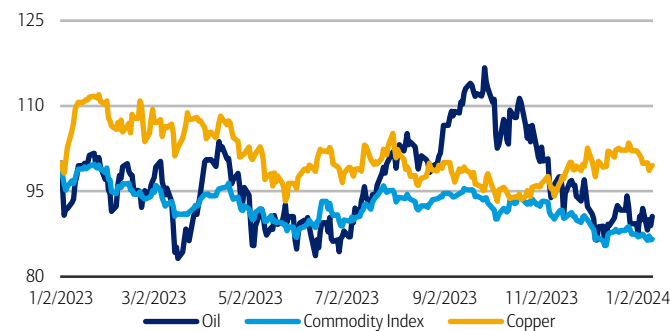


Source: Company Filings

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Exhibit 14: Oil vs Gas vs Copper Prices YTD

Key commodities have rolled over – monitoring for off highway demand

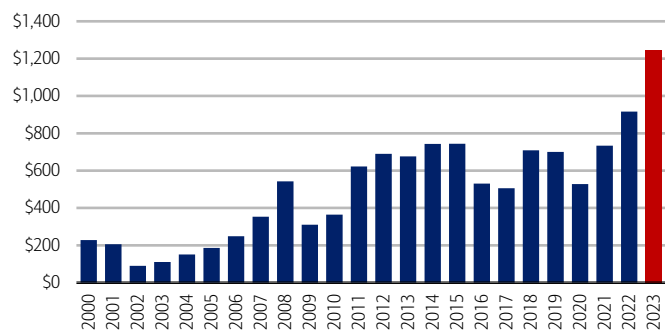


Source: Bloomberg

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Exhibit 15: Cummins Capex – significant investments for the energy transition and new emissions platforms

Cummins expects to spend \$1.2 to \$1.3bn in Capex in 2023

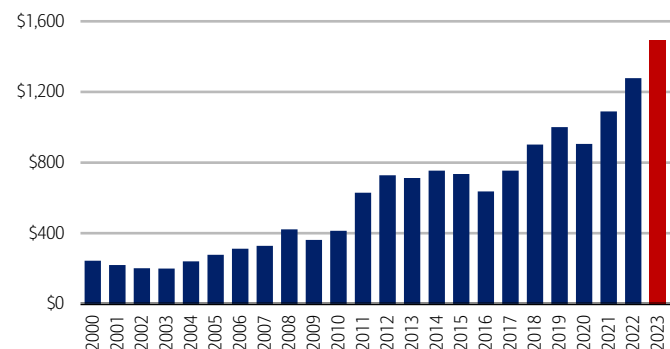


Source: Company Filings

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Exhibit 16: Cummins R&D Expense – significant investments for the energy transition and new emissions platforms

Cummins has been investing more in R&D



Source: Company Filings

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Exhibit 17: Cummins fwd P/E

CMI 12-month forward PE is approach mid cycle territory near 12-14x

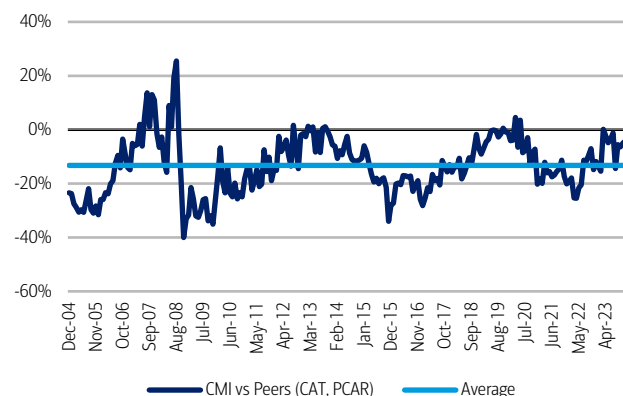


Source: Company Filings, Bloomberg

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Exhibit 18: CMI vs Average (CAT, PCAR) P/E

CMI's valuation discount to peers (CAT + PCAR) has narrowed in recent weeks



Source: Company Filings, Bloomberg

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Price objective basis & risk

Cummins Inc (CMI)

Our 12-month price objective of \$225 is based on 12.5x 2024E EPS, which is near the middle of the historical range (8-19x) and in line with other truck-related Machinery peers. We do not believe the high end of the range is appropriate given economic uncertainty, likely downturn in the truck market, and funding needs for the New Power segment. That said, we do not believe the low end of the range is appropriate given tailwinds around data centers, infrastructure, power generation, and market share gain opportunities. Historically, Cummins has traded at a low to mid-teens PE through the cycle.

Downside risks to our PO include a hard landing for the China or North American heavy duty truck market, faster than expected BEV penetration without a commensurate number of offsetting wins from Cummins, failure of the hydrogen story to ever truly materialize.

Upside risks are a sustained recovery in the NA heavy duty truck cycle, positive developments in the Cummins hydrogen story, stronger-than-expected resilience in China truck, rising government incentives for renewables driving impetus for new emission regulation and/or a large, accretive acquisition.

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



US - Machinery Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	RB Global, Inc	RBA	RBA US	Michael Feniger
	Waste Management	WM	WM US	Michael Feniger
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

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

EV / EBITDA

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

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

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

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

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.

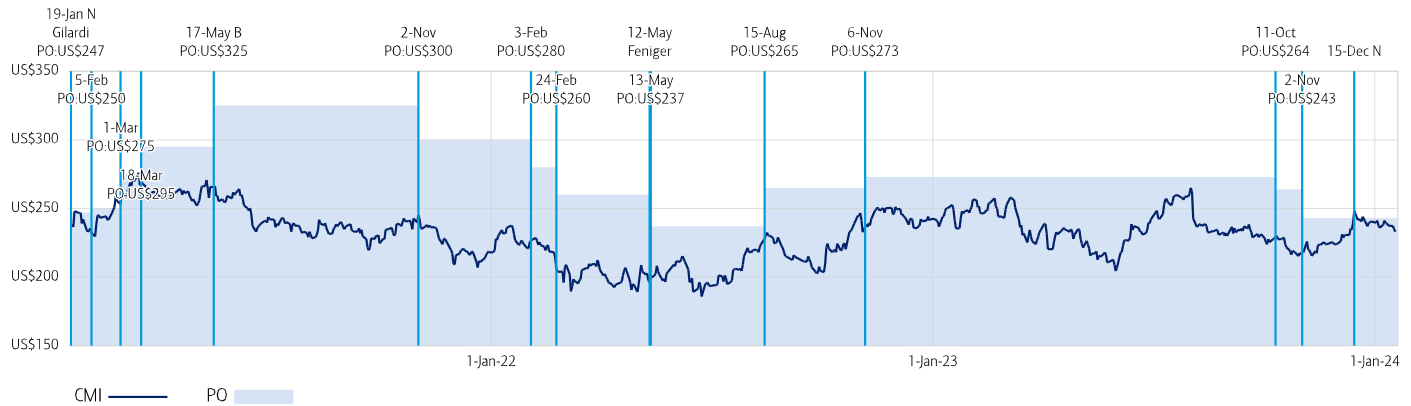
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Disclosures

Important Disclosures

Cummins Inc (CMI) 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.

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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.

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