

Cummins Inc

Mixed results: lacks 'torque' until peak investment spend subsides

Reiterate Rating: UNDERPERFORM | PO: 243.00 USD | Price: 251.54 USD

Results a bit messy: guide reflects (captures) weakness

Q4 results were mixed. EBITDA of \$1.23bn (excl, \$2bn cost related to agreement to settle with US regulators) was broadly in line with cons yet we found some elements underwhelming: Engines margin -60bps YoY, Power Systems EBITDA slightly down on 8% revenue gain. Bright spots include Components margin and robust cash flow. 2024 guide - sales down 2-5%, EBITDA margin 14.4-15.4% - slightly softer than consensus (midpoint \$4.9bn, -6% YoY vs \$4.94bn) yet likely fully captures end market headwinds.

Arbs take over: EPS neutral yet cleaner story on other side

CMI shares turned from -2% to finish up 4% (vs SPX +0.2%) around commentary to pare down its Atmus position (80.5%). The positive is that CMI emerges as a 'cleaner' story. That said, we estimate a neutral to slightly dilutive EPS impact as loss of minority interest is offset by lower share count. Note: Atmus multiple trades at a discount to CMI.

Demand: NA slows, China sluggish, Parts = swing factor

2024 end market commentary is in line with expectations: NA heavy duty trucks down 10-15%, China down 5% to up 10% (BofA APAC team sees upside here), mining flattish, power gen up 5-10% (data center growth). In our view, Parts is likely the swing factor in '24 following a soft patch in the 2H (i.e., de-stocking) & a likely a QoQ sequential bump.

Still in peak investment: likely holds back CMI's 'torque'

Engines margin guide of 12.5%-13.5% was weaker than expected. The unit did not reach a new peak margin in the 2021-23 production upcycle – an outlier relative to other OEMs (or in CAT's case – raising its long-term target earlier this week). CMI is investing heavily in its fuel agnostic platform to prepare for regulatory changes. For now, this places CMI in a tricky situation (in our view) relative to pure play OEMs that benefit from stronger on-highway trends (PCAR) or off-highway (CAT). We look to the upcoming investor day in '24 to provide color on margin potential post peak investment phase.

Underperform

We update our estimates post Q4 and raise our PO to \$243 (\$225) based on 13.5x '24E EPS (vs 12.5x), as we believe a higher multiple is warranted given Parts de-stocking likely over. We reiterate Underperform given less 'torque' to margin upside near-term.

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	16.01	19.69	18.00	20.50	23.50
GAAP EPS	17.17	34.23	18.00	20.50	23.50
EPS Change (YoY)	10.0%	23.0%	-8.6%	13.9%	14.6%
Consensus EPS (Bloomberg)			19.49	21.70	24.20
DPS	6.04	6.50	6.88	7.23	7.59
Valuation (Dec)					
P/E	15.7x	12.8x	14.0x	12.3x	10.7x
GAAP P/E	14.6x	7.3x	14.0x	12.3x	10.7x
Dividend Yield	2.4%	2.6%	2.7%	2.9%	3.0%
EV / EBITDA*	9.1x	7.0x	7.4x	6.8x	6.1x
Free Cash Flow Yield*	2.9%	7.7%	3.4%	7.4%	8.3%

* For full definitions of *IQmethod*SM measures, see page 4.

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Timestamp: 07 February 2024 05:00AM EST

07 February 2024

Equity

Key Changes

(US\$)	Previous	Current
Price Obj.	225.00	243.00
2024E Rev (m)	32,369.9	33,044.0
2025E Rev (m)	33,960.8	34,689.8
2026E Rev (m)	NA	37,280.2
2025E EPS	19.95	20.50
2026E EPS	NA	23.50
2024E DPS	6.83	6.88

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Stock Data

Price	251.54 USD
Price Objective	243.00 USD
Date Established	7-Feb-2024
Investment Opinion	B-3-7
52-Week Range	203.18 USD - 265.28 USD
Mkt Val (mn) / Shares Out (mn)	35,945 USD / 142.9
Free Float	99.6%
Average Daily Value (mn)	186.48 USD
BofA Ticker / Exchange	CMI / NYS
Bloomberg / Reuters	CMI US / CMI.N
ROE (2024E)	26.5%
Net Dbt to Eqty (Dec-2023A)	29.3%
ESGMeter TM	High

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OEMs = original equipment manufacturers
PCAR: Paccar
CAT: Caterpillar

iQprofileSM Cummins Inc

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	13.3%	15.7%	14.5%	14.8%	15.2%
Return on Equity	25.7%	31.1%	26.5%	25.4%	24.5%
Operating Margin	11.0%	11.6%	11.7%	12.4%	13.1%
Free Cash Flow	1,046	2,753	1,220	2,663	2,992

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	0.9x	1.4x	1.0x	1.3x	1.3x
Asset Replacement Ratio	1.2x	1.2x	1.2x	1.1x	1.1x
Tax Rate	22.3%	23.4%	24.0%	24.0%	24.0%
Net Debt-to-Equity Ratio	25.5%	29.3%	22.5%	7.7%	-4.5%
Interest Cover	15.5x	10.5x	10.7x	12.3x	13.9x

Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	28,074	34,065	33,044	34,690	37,280
% Change	16.9%	21.3%	-3.0%	5.0%	7.5%
Gross Profit	6,700	8,375	8,261	8,742	9,544
% Change	17.6%	25.0%	-1.4%	5.8%	9.2%
EBITDA	3,991	5,195	4,912	5,344	5,918
% Change	13.3%	30.2%	-5.4%	8.8%	10.7%
Net Interest & Other Income	(110)	(135)	(360)	(350)	(350)
Net Income (Adjusted)	2,278	2,810	2,568	2,926	3,353
% Change	7.3%	23.3%	-8.6%	13.9%	14.6%

Free Cash Flow Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	2,278	2,810	2,568	2,926	3,353
Depreciation & Amortization	784	1,016	1,045	1,045	1,045
Change in Working Capital	(920)	2,950	(1,209)	(234)	(370)
Deferred Taxation Charge	(274)	0	0	0	0
Other Adjustments, Net	94	(2,810)	65	126	164
Capital Expenditure	(916)	(1,213)	(1,250)	(1,200)	(1,200)
Free Cash Flow	1,046	2,753	1,220	2,663	2,992
% Change	-31.3%	163.2%	-55.7%	118.3%	12.4%
Share / Issue Repurchase	(374)	0	0	0	0
Cost of Dividends Paid	(855)	(921)	(975)	(1,024)	(1,075)
Change in Debt	2,814	(1,054)	0	0	0

Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	2,101	2,179	2,477	4,029	5,809
Trade Receivables	5,202	5,583	5,416	5,685	6,110
Other Current Assets	7,148	7,436	7,178	7,492	7,993
Property, Plant & Equipment	5,521	6,249	6,454	6,609	6,764
Other Non-Current Assets	10,327	10,558	11,721	12,054	12,580
Total Assets	30,299	32,005	33,246	35,870	39,255
Short-Term Debt	210	280	280	280	280
Other Current Liabilities	11,211	12,623	12,206	12,802	13,745
Long-Term Debt	4,498	4,802	4,802	4,802	4,802
Other Non-Current Liabilities	4,155	4,396	4,396	4,396	4,396
Total Liabilities	20,074	22,101	21,684	22,280	23,223
Total Equity	10,225	9,904	11,562	13,590	16,032
Total Equity & Liabilities	30,299	32,005	33,246	35,870	39,255

* For full definitions of iQmethodSM measures, see page 4.

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 741,344

Quarterly Earnings Estimates

	2023	2024
Q1	5.65A	5.70E
Q2	5.18A	4.99E
Q3	4.73A	4.23E
Q4	4.14A	3.08E

Price objective basis & risk

Cummins Inc (CMI)

Our 12-month price objective of \$243 is based on 13.5x 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
	RB Global, Inc	RBA	RBA US	Michael Feniger



US - Machinery Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	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

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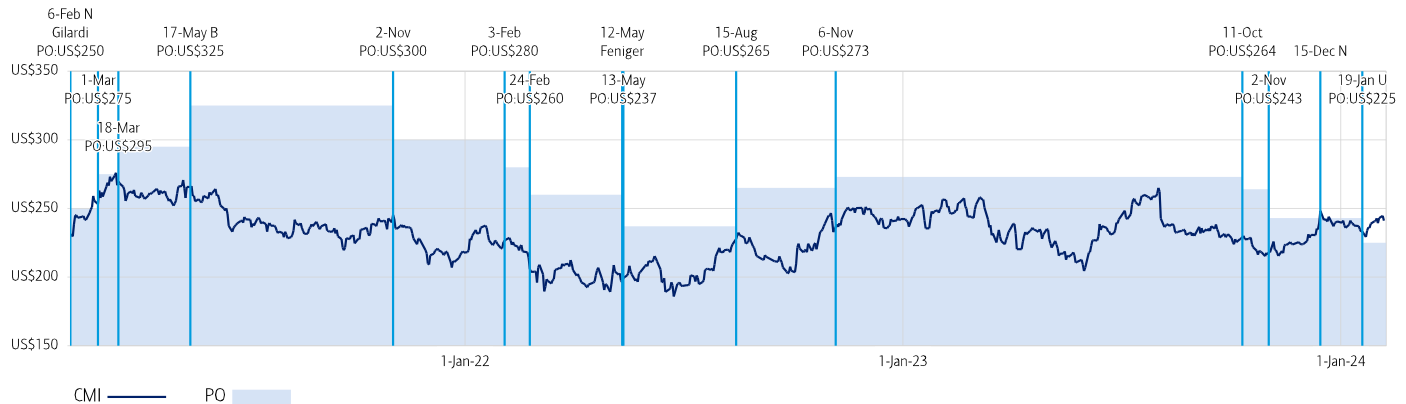
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Cummins Inc (CMI) Price Chart



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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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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