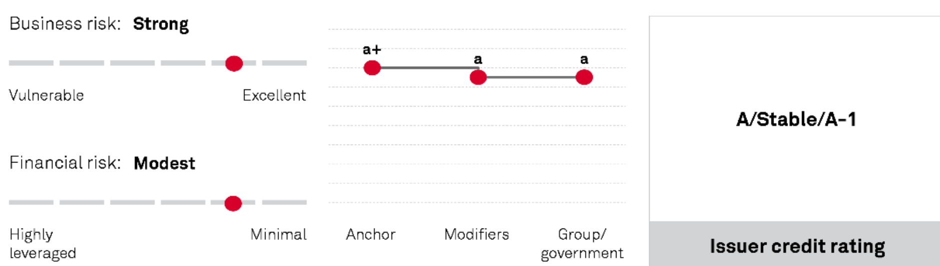
Caterpillar

November 18, 2022

Ratings Score Snapshot



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Credit Highlights

Overview

Key strengths	Key risks
Strong market position as the largest manufacturer of construction and mining equipment globally and a leading provider of diesel and natural gas engines, industrial gas turbines, and diesel-electric locomotives.	Operates in a highly cyclical and competitive industry with deep inventory-correction cycles. We therefore expect manufacturing credit measures will exhibit volatility in correlation with the demand cycle.
Good product, end-market, and geographic diversity, with support from the industry's strongest dealer network.	Financial policy supports large dividends and share repurchases.
Maintains a competitive cost structure that supports good, but variable, operating margins over the business cycle.	

We expect Caterpillar’s operating performance to remain strong through 2023 given the overall favorable demand environment. The company’s operating performance has remained robust in the first nine months of 2022, with Machinery, Energy, and Transportation (ME&T) revenue growth of about 16% over the same period last year, driven by strong growth across all the three primary operating segments, and we expect this momentum to continue in the fourth quarter. In our view, the construction industries segment will continue to benefit from the improving overall demand from non-residential construction activities. While demand for equipment related to residential construction should weaken due to the high interest rate environment, it makes up a smaller proportion of the company's sales. In addition, we expect the resource industries segment will continue to benefit from the high commodity prices, as well as mining companies replacing aging equipment. Longer term, the mining business will benefit from the demand for commodities in order to support the energy transition. In our view, higher oil prices, increased international rail deliveries, and strong demand for power generation associated with data centers will support the Energy & Transportation (E&T) segment’s growth. Furthermore, we expect the recently signed infrastructure bill to provide a further boost to the company and believe it will give the company's customers more confidence when making equipment purchasing decisions. Accordingly, we expect a mid-teen percentage revenue growth rate in 2022, that will be followed by high-single-digit percentage revenue growth in 2023.

Caterpillar’s leading competitive position allows it to push through increased prices in a difficult macroeconomic environment. We expect the company to improve its profitability in 2022 despite the inflationary environment. Through the first nine months of 2022, price realization contributed to over $3.4 billion of $5.7 billion of revenue growth, which more than offset the increase in manufacturing, selling, general and administrative, and research and development costs. The strong dollar caused a $930 million sales headwind, but the impact of greater volumes allowed the company to increase year-to-date operating profit to $6.2 billion from $5.3 billion in the same period the previous year. We believe this is evidence of the company’s strong competitive positioning. We expect its S&P Global Ratings’-adjusted EBITDA margin to grow by 50 to 100 basis points this year, with further improvement the following year.

Caterpillar maintains significant cushion in its credit metrics, which we view as appropriate given the cyclicality of its end markets. The company sells into cyclical end markets, such as residential and non-residential construction, mining, and energy and transportation. Therefore, we believe it is prudent that the company maintain significant cushion in its credit metrics during periods of stronger demand. Caterpillar's S&P Global Ratings-adjusted funds from operations (FFO)-to-debt ratio was 98% for the 12-months ended Sept. 30, 2022, which is well above our 30% downside trigger. In our view, this provides the company with a healthy cushion to withstand any future potential economic downturns. We expect the company's FFO-to-debt ratio to remain significantly over 30% (closer to 100%) over the next 12-24 months, which we view as appropriate for the current rating.

Outlook

The stable outlook reflects our view that Caterpillar will continue performing well over the next 18-24 months and operate with significant cushion in its credit metrics. Specifically, we believe the company will maintain FFO to debt well in excess of 30%, a level that we view as appropriate for the current rating.

Downside scenario

We could lower the rating if Caterpillar's operations were pressured to the extent that its FFO-to-debt ratio declined to less than 30% or if cash flow generation weakened significantly. This could occur if the company's end markets weakened or if it incurred sizable cash outflows. We could also consider a downgrade if the credit quality of the company's captive finance unit deteriorated, as indicated by higher debt-to-equity and net loss ratios or if Caterpillar aggressively pursued share buybacks or debt-funded acquisitions that stretched credit measures.

Upside scenario

We could raise the rating if Caterpillar's management adopted more conservative financial policies that allowed the company to maintain an FFO-to-debt ratio of well over 30%--even through industry downturns and while undertaking discretionary share repurchases and acquisitions. This is unlikely in the next one to two years given the cyclical nature of the company's end markets and our expectations for the company's capital allocation priorities.

Our Base-Case Scenario

Assumptions

- Global GDP growth of 3.2% in 2022 and 2.7% in 2023.
- U.S. real GDP growth of 1.6% in 2022 and 0.2% in 2023.
- Asia-Pacific real GDP growth of 3.8% in 2022 and 4.5% in 2023.
- Eurozone real GDP growth of 3.1% in 2022 and 0.3% in 2023.
- U.S. real equipment investment to grow by 6.8% in 2022 and decline by 0.8% in 2023.
- U.S. real residential investment to decline by 9.9% in 2022 and 10.4% in 2023.
- A Brent oil price of $90 per barrel (bbl) in 2022 and $75 per barrel (bbl) 2023. We expect a Henry Hub natural gas price of $5.75 per million Btu (mmBtu) for 2022 and $4.25 per mmBtu in 2023.
- Revenue increases in the mid-teen percentage area in 2022 due to the combined impact of strong demand in all the three primary operating segments and realization of price increases, followed by high-single-digit growth in 2023.
- S&P Global Ratings'-adjusted EBITDA margin grow by 50-100 basis points in 2022 with further improvement in 2023.
- Industrial capital expenditure of $1.1 billion-$1.4 billion annually.
- About $4 billion-$5 billion of share repurchases and $2.5 billion in dividends in 2022, increasing in 2023. Over the long term, we forecast the company will deploy substantially all of its ME&T free cash flow toward share repurchases and a growing dividend.
- We assume bolt-on acquisition activity of up to $500 million annually from 2023 onward but have not currently incorporated any larger acquisitions into our forecast.

Key metrics

Caterpillar Inc.--Key Metrics*

Mil. $	2020a	2021a	2022e	2023f	2024f
Revenue	39,022	48,188	55,500-56,000	60,000	62,000-64,000
EBITDA	6,401	8,272	9,800-10,000	11,000	11,500-12,000
EBITDA margin (%)	16.4	17.2	17.7-18.0	18.0-19.0	18.0-19.0
Funds from operations (FFO)	4,719	6,221	7,500	8,250-8,500	9,000
Free operating cash flow (FOCF)	3,415	5,883	5,000-5,500	6,00-6,500	6,000-6,500
Dividends	2,243	2,332	2,500	2,600	2,650
Debt/EBITDA (x)	1.2	0.5	0.5-1.0	<1	<1
FFO/debt (%)	59.6	137.0	100-120	>100	>100

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast.

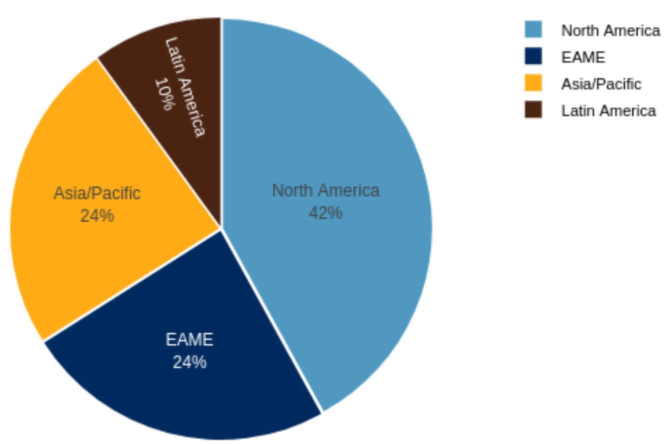
Caterpillar is shifting toward more consistent share repurchase activity and intends to return substantially all of its ME&T free cash flow to shareholders over time. Caterpillar repurchased $3.3 billion in shares in the first nine months of 2022, and we believe the company will continue to repurchase shares throughout the remainder of the year. In addition, the company announced an 8% dividend increase in the second quarter of 2022. We expect the company will continue to raise its annual dividend and consistently repurchase shares, at a minimum to offset dilution.

Caterpillar's strong backlog bodes well for 2023 demand. Although S&P Global economists project a dismal macroeconomic outlook in 2023, we think several factors will support demand for Caterpillar's products. Since falling to $12.9 billion in the second quarter of 2020, Caterpillar's backlog has grown by about 130% to $30 billion. We expect about $24.3 billion of that amount to be fulfilled over the next 12 months, providing a good line of sight into its revenue. Furthermore, the infrastructure bill in the U.S. and low dealer inventory levels should also keep demand healthy.

Company Description

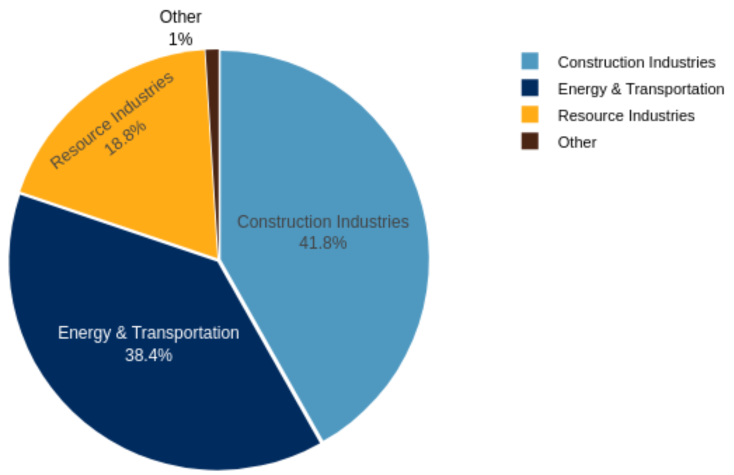
Caterpillar manufactures and sells construction and mining equipment; off-highway diesel and natural gas engines; industrial gas turbines; and diesel-electric locomotives for construction, resource, and energy and transportation industries. Founded in 1925, the company is headquartered in Irving, Tx. The company principally operates through its three primary segments: Construction Industries, Resource Industries, and Energy & Transportation. It also provides financing and related services through its Financial Products segment.

Caterpillar Inc. 2021 Revenue By Geography



Source: Company Filings, S&P Global Ratings

Caterpillar Inc. 2021 Revenue By Segment



Source: S&P Global Ratings, Company Filings

Peer Comparison

- Japan-based Komatsu is the world's second-largest manufacturer of construction and mining machinery after U.S.-based Caterpillar. Like Caterpillar, Komatsu has a sufficient financial cushion relative to the rating.
- U.S.-based Deere & Co. is the largest global agricultural equipment manufacturer and a major player in the North American construction market. Both Caterpillar and Deere both have significant headroom to rating thresholds currently.
- CNH Industrial N.V. (CNHI) is the second-largest agricultural equipment manufacturer and also has a mid-tier position in the construction equipment, truck, and powertrain markets. Compared with Caterpillar, CNHI is smaller and has lower profitability.
- U.S.-based Cummins manufactures diesel and natural gas engines and competes with Caterpillar's Energy & Transportation segment. Both companies are exposed to cyclical markets yet posted strong operating performance during 2021.

Peer Comparisons

Caterpillar Inc.--Peer Comparisons

	Caterpillar Inc.	Deere & Co.	CNH Industrial N.V.	Cummins Inc.
Foreign currency issuer credit rating	A/Stable/A-1	A/Stable/A-1	BBB/Stable/A-2	A+/Stable/A-1
Local currency issuer credit rating	A/Stable/A-1	A/Stable/A-1	BBB/Stable/A-2	A+/Stable/A-1
Period	Annual	Annual	Annual	Annual
Period ending	2021-12-31	2021-10-31	2021-12-31	2021-12-31
Mil.	$	$	$	$
Revenue	48,188	40,441	31,622	24,021
EBITDA	8,272	7,958	4,062	3,417

Caterpillar Inc.--Peer Comparisons

Funds from operations (FFO)	6,221	5,916	3,583	2,770
Interest	501	316	249	126
Cash interest paid	478	315	170	126
Operating cash flow (OCF)	6,822	5,867	3,084	2,413
Capital expenditure	939	842	1,433	784
Free operating cash flow (FOCF)	5,883	5,025	1,651	1,629
Discretionary cash flow (DCF)	883	1,447	1,463	(610)
Consolidated cash and short-term investments	10,218	8,745	6,006	3,187
Gross available cash	10,218	8,745	5,306	3,187
Debt	4,541	3,569	1,476	2,142
Equity	12,076	12,520	3,899	9,401
EBITDA margin (%)	17.2	19.7	12.8	14.2
Return on capital (%)	37.9	42.8	40.5	24.9
EBITDA interest coverage (x)	16.5	25.2	16.3	27.2
FFO cash interest coverage (x)	14.0	19.8	22.1	23.0
Debt/EBITDA (x)	0.5	0.4	0.4	0.6
FFO/debt (%)	137.0	165.8	242.7	129.3
OCF/debt (%)	150.2	164.4	208.9	112.7
FOCF/debt (%)	129.5	140.8	111.9	76.1
DCF/debt (%)	19.5	40.6	99.1	(28.5)

Note: All figures are adjusted by S&P Global Ratings.

Business Risk

Caterpillar remains the world's largest construction and mining equipment manufacturer, with a broad product line and a global footprint that is well balanced between mature and higher-growth markets. In addition to its excellent scope and market position, Caterpillar enjoys several competitive advantages, including its premium products and brand, strong technical capabilities, the industry's strongest dealer network, and its ability to provide financing to its customers. Still, Caterpillar's competitors include well-established manufacturers (such as Cummins Inc. and General Electric Co. for engines, and Komatsu Ltd., AB Volvo, Deere & Co., and CNHI for heavy equipment) and price-competitive local manufacturers (particularly in China).

The company remains exposed to highly cyclical end markets and to dealer inventory-correction cycles. In addition, Caterpillar's operating leverage has remained high because of a high degree of vertical integration and its ongoing fixed-capital requirements. However, Caterpillar is focusing on increasing its services business, including expanded digital capabilities, which over time could partially mitigate volatility and help achieve more stable profit margin performance through the cycle.

Financial Risk

We expect the company's FFO-to-debt ratio to increase and remain above 100% in 2022 and 2023 because of top-line and margin expansion, with additional support from a leaner cost structure following past restructuring actions, which should provide strong cushion in credit metrics. We believe the prolonged supply chain issues could limit incremental margin growth and result in some degree of foregone revenue, but that the company will manage well in the face of these headwinds.

Caterpillar's captive finance business has a high-quality portfolio of assets, with portfolio losses (net of recoveries) of about 0.5% (10-year average) and leverage of less than 7x as of Sept. 30, 2022 (both figures are as calculated by S&P Global Ratings), which continues to support our view of Caterpillar's consolidated financial risk.

We assess Caterpillar's captive-finance modifier by considering the captive's non-credit- and non-liquidity-related risks. We believe these risks on aggregate are neutral to the rating. The captive has some exposure to residual value through its operating lease assets, but we expect lease assets--at about 10% as of Sept. 30, 2022 (as calculated by S&P Global Ratings)--will continue to account for well below 30% of the total portfolio. Similarly, we believe its exposure to dealers does not constitute a meaningful borrower concentration.

We revised our 'a+' anchor score on Caterpillar down by one notch because we do not believe the company has articulated a financial policy that supports a rating higher than 'A'. The company has historically engaged in significant share repurchases. Although we expect the company would curtail such outflows during a downturn, future shareholder returns and acquisitions could exceed our base case forecast.

Debt maturities

- 2023: $82 million
- 2024: $999 million
- 2025: $0
- 2026: $0
- 2027: $0
- Thereafter: $8.586 billion

Financial summary

Period ending Dec. 31	2017	2018	2019	2020	2021
Display currency (mil.)	$	$	$	$	$
Revenues	42,676.0	51,822.0	50,755.0	39,022.0	48,188.0
EBITDA	6,885.0	10,548.0	10,189.0	6,401.0	8,272.0
Funds from operations (FFO)	5,149.6	8,802.0	8,130.9	4,719.1	6,221.2
Interest expense	584.4	447.3	433.7	526.5	500.6
Cash interest paid	538.4	409.3	315.7	512.5	477.6
Operating cash flow (OCF)	5,105.6	6,428.7	5,476.3	4,256.5	6,822.4
Capital expenditure	698.0	1,016.0	972.0	841.0	939.0
Free operating cash flow (FOCF)	4,407.6	5,412.7	4,504.3	3,415.5	5,883.4
Discretionary cash flow (DCF)	2,576.6	(336.3)	(1,674.7)	42.5	883.4
Consolidated cash and short-term investments	8,261.0	7,857.0	8,284.0	9,352.0	10,218.0
Gross available cash	8,261.0	7,857.0	8,284.0	9,352.0	10,218.0
Debt	7,643.0	7,162.1	6,927.9	7,913.4	4,541.5
Common equity	9,657.2	10,455.4	10,369.0	10,548.1	12,075.7
EBITDA margin (%)	16.1	20.4	20.1	16.4	17.2
Return on capital (%)	26.0	47.9	48.0	24.3	37.9
EBITDA interest coverage (x)	11.8	23.6	23.5	12.2	16.5
FFO cash interest coverage (x)	10.6	22.5	26.8	10.2	14.0
Debt/EBITDA (x)	1.1	0.7	0.7	1.2	0.5
FFO/debt (%)	67.4	122.9	117.4	59.6	137.0
OCF/debt (%)	66.8	89.8	79.0	53.8	150.2
FOCF/debt (%)	57.7	75.6	65.0	43.2	129.5
DCF/debt (%)	33.7	(4.7)	(24.2)	0.5	19.5

Note: All figures are adjusted by S&P Global Ratings.

Reconciliation Of Caterpillar Inc. Reported Amounts With S&P Global Adjusted Amounts (Mil. $)

	Debt	Shareholder Equity	Revenue	EBITDA	Operating income	Interest expense	S&PGR adjusted EBITDA	Operating cash flow	Dividends	Capital expenditure
Financial year	Dec-31-2021									
Company reported amounts	37,789	16,484	50,971	9,622	7,333	943	8,272	7,198	2,332	1,207
Cash taxes paid	-	-	-	-	-	-	(1,759)	-	-	-
Cash interest paid	-	-	-	-	-	-	(920)	-	-	-
Lease liabilities	642	-	-	-	-	-	-	-	-	-
Operating leases	-	-	-	214	13	13	(13)	201	-	-
Postretirement benefit obligations/ deferred compensation	3,285	-	-	-	-	-	-	-	-	-
Accessible cash and liquid investments	(9,544)	-	-	-	-	-	-	-	-	-
Share-based compensation expense	-	-	-	200	-	-	-	-	-	-
Captive finance operations	(27,814)	(4,257)	(2,783)	(1,764)	(962)	(455)	641	(1,420)	-	(268)
Nonoperating income (expense)	-	-	-	-	322	-	-	-	-	-
Noncontrolling/ minority interest	-	32	-	-	-	-	-	-	-	-
Debt: Guarantees	183	-	-	-	-	-	-	-	-	-
Equity: other	-	(183)	-	-	-	-	-	-	-	-
D&A: Impairment charges/ (reversals)	-	-	-	-	(63)	-	-	-	-	-
OCF: other	-	-	-	-	-	-	-	843	-	-
Total adjustments	(33,248)	(4,408)	(2,783)	(1,350)	(690)	(442)	(2,051)	(376)	-	(268)

Reconciliation Of Caterpillar Inc. Reported Amounts With S&P Global Adjusted Amounts (Mil. $)

	Debt	Shareholder Equity	Revenue	EBITDA	Operating income	Interest expense	S&PGR adjusted EBITDA	Operating cash flow	Dividends	Capital expenditure
S&P Global Ratings adjusted	**Debt**	**Equity**	**Revenue**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from Operations**	**Operating cash flow**	**Dividends**	**Capital expenditure**
	4,541	12,076	48,188	8,272	6,643	501	6,221	6,822	2,332	939

Liquidity

We expect Caterpillar will maintain strong liquidity over the next 24 months. We estimate ME&T's liquidity sources will exceed its uses by more than 1.5x and believe its net sources will remain positive even if its forecast EBITDA declines by 30%. Qualitative liquidity factors, which include Caterpillar's well-established and solid relationships with its banks and high standing in the credit markets, also support the liquidity assessment of strong. The captive's funding and liquidity are neutral to our overall liquidity assessment for Caterpillar. We expect the captive to maintain globally diversified funding sources and good access to the financial markets.

Principal liquidity sources

- Over $6 billion of ME&T cash balances and liquid investments as of Sept. 30, 2022;
- About $7.5 billion-$8.5 billion in annual FFO over the next 24 months; and
- $2.92 billion in availability under credit facilities that are available to the industrial operations, as of Sept. 30, 2022.

Principal liquidity uses

- An estimated $1.1 billion-$1.3 billion in annual capital spending over the next 24 months,
- Dividend of $2.5 billion-$2.7 billion annually,
- Sizable intrayear peak working capital needs,
- Share repurchases, and
- Modest debt maturities over the next 24 months.

Covenant Analysis

Requirements

Caterpillar's credit facilities require it to maintain a consolidated net worth above $9 billion. Caterpillar Financial is required to maintain a covenant leverage ratio of no greater than 10 to 1 and a covenant interest coverage ratio of no less than 1.15 to 1.

Compliance expectations

We expect Caterpillar and Caterpillar Financial will continue to comply with the covenant requirements over the next 24 months. We estimate Caterpillar's consolidated debt will remain more than 15% below its covenant net worth limit. As of Sept. 30, 2022, the company had a consolidated net worth under the credit facility of $15.69 billion. At the same time, Caterpillar Financial had a covenant interest coverage ratio of 2.59x and a six-month covenant leverage ratio of 7.03x.

Environmental, Social, And Governance

ESG Credit Indicators

E-1	**E-2**	E-3	E-4	E-5	S-1	**S-2**	S-3	S-4	S-5	G-1	**G-2**	G-3	G-4	G-5

ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumerical 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicators: Definition And Applications," published Oct. 13, 2021.

ESG factors are an overall neutral consideration in our credit rating analysis of Caterpillar Inc. The company manufactures construction and mining equipment, off-highway diesel and natural gas engines, industrial gas turbines, and diesel-electric locomotives and is therefore exposed to regulations regarding exhaust emissions and environmental sustainability. The company's end markets, particularly mining, also face increasingly stringent environmental standards globally. We believe, however, that Caterpillar is mitigating these risks by funding significant research and development and capital expenditures to improve the energy efficiency of its products and reduce the environmental impact of its manufacturing plants.

Group Influence

We view Caterpillar Financial as a core subsidiary of Caterpillar, given its integral importance to the parent (financial services are a key offering that facilitates the sale of Caterpillar's equipment), our view that it is highly unlikely to be sold, and its strong long-term support from Caterpillar management under both good and stressful conditions. The parent has a support agreement with Caterpillar Financial that requires Caterpillar to remain the sole owner of Caterpillar Financial and may, under certain circumstances, require Caterpillar to make payments to Caterpillar Financial if Caterpillar Financial fails to maintain certain financial ratios.

Issue Ratings--Subordination Risk Analysis

Capital structure

Caterpillar's capital structure (not including debt issued by captive finance subsidiaries) consists primarily of senior unsecured debt issued at the parent level. There is no material secured debt.

Analytical conclusions

We rate Caterpillar's unsecured debt the same as the 'A' issuer credit rating because the issuer has sufficiently low leverage, as demonstrated by its overall modest financial risk profile. This limits the risk of subordination for lenders of unsecured debt.

We rate Caterpillar Financial's and its subsidiaries' (Caterpillar International Finance Designated Activity Co., Caterpillar Financial Australia Ltd., Caterpillar Financial Services Ltd., and Caterpillar Finance Kabushiki Kaisha) unsecured debt at the same level as the issuer credit rating on Caterpillar Financial.

Rating Component Scores

Foreign currency issuer credit rating	**A/Stable/A-1**
Local currency issuer credit rating	**A/Stable/A-1**
Business risk	**Strong**
Country risk	Intermediate
Industry risk	Intermediate
Competitive position	Strong
Financial risk	**Modest**
Cash flow/leverage	Modest
Anchor	**a+**
Diversification/portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Negative (-1 notch)
Liquidity	Strong (no impact)
Management and governance	Satisfactory (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile	**a**

Related Criteria

- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology: The Impact Of Captive Finance Operations On Nonfinancial Corporate Issuers, Dec. 14, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
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- ARCHIVE | General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings Detail (as of November 18, 2022)*

Caterpillar Inc.	
Issuer Credit Rating	A/Stable/A-1

Ratings Detail (as of November 18, 2022)*

Commercial Paper	
Local Currency	A-1
Senior Unsecured	A
Issuer Credit Ratings History	
26-Oct-2017	A/Stable/A-1
21-Nov-2016	A/Negative/A-1
26-Apr-2010	A/Stable/A-1
Related Entities	
Caterpillar Financial Services Corp.	
Issuer Credit Rating	A/Stable/A-1
Commercial Paper	
Local Currency	A-1
Senior Unsecured	A
Senior Unsecured	A/A-1

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings credit ratings on the global scale are comparable across countries. S&P Global Ratings credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.