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HEARD ON THE STREET

Caterpillar Investors May Be Hungry for Returns

The company's disappointing quarter could be the start of a long haul if the global economy worsens

Caterpillar's revenue slid 5.6% year over year in the latest quarter. **PHOTO:** EVA HAMBACH/AGENCE FRANCE-PRESSE/GETTY IMAGES

By Lauren Silva Laughlin

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Caterpillar CAT **1.23%** ▲ investors are ignoring a rocky road.

The industrial-equipment company reported a drop in both revenue and earnings and cut its outlook as the global economy takes its toll on clients that use its heavy equipment for the mining and construction sectors.

The market's reaction has been surprisingly sanguine, though. Caterpillar has proven sensitive during past cycles to global growth wobbles, but Wednesday's news, like headlines in the past several months, have had a relatively muted impact on its shares. The stock is up nearly 12% over the past year, slightly outpacing the S&P 500.

Shareholders are being far too optimistic. Caterpillar unloads its products to dealers who then sell them to end users. While demand at the end of its supply chain increased in the latest quarter, dealers worked to trim inventory. Their hesitation to replace sold goods reflects a cautious outlook from those nearest to future buyers. It contributed to sending Caterpillar's revenue down 5.6% from the same quarter last year.

The company's biggest sales decline was in its resource industries group, which fell 12% from a year earlier. The division, which includes sales to the thermal-coal business, could continue to suffer from secular and cyclical issues. Other cracks are showing: Asia in particular was weak, with sales in its construction industries unit, which sells equipment for infrastructure building, falling by nearly one-third.

Recently the International Monetary Fund lowered its global economic growth outlook for the year. The company's outlook reflects uncertainty, too: After previously guiding earnings toward the lower end of a per-share range of $12.06 to $13.06, Caterpillar now anticipates $10.90 to $11.40. The company expects that dealers will continue to reduce inventories more than expected "due to uncertainty in the global economic environment," according to Chief Executive Jim Umpleby.

Earnings are still expected to be higher than last year, which could be one reason shareholders have thrown caution to the wind. But the company is highly cyclical, and past slumps have been more painful. The stock fell more than 70% between May 2008 and March 2009. The shares shed around half of their value during an earlier period of commodity-price softness and Chinese growth concerns between mid-2014 and early 2016. Chinese economic growth recently touched a three-decade low.

Caterpillar's investors are hanging onto whatever shred of optimism they can find. They may find they are digging in too deep.

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