

Initiating Coverage:

Caterpillar

Digging Deep: Will Caterpillar Unearth Growth Again?

Key Takeaway: Lower sales and rental fleet loading negatively impacted revenues YoY (-4%) and operating profits YoY (-9%) for Caterpillar. While price realizations have been notably positive across industry segments, decreased sales significantly offset any upside. Fourth quarter revenue forecasts have been slightly lowered following the Q3 2024 earnings call, signaling another underwhelming quarter.

Conflicting Financials: Caterpillar's Construction and Resource Industry segments experienced the brunt of the company's sales and revenue decreases, down 9% and 10%, respectively. However, Energy and Transportation increased YoY sales by 5%, and Financial Products YoY profit gained 21%. While segment performance was mixed, Caterpillar maintained a healthy TTM operating profit margin of 19.5% and a strong TTM operating cash flow of \$3.6 billion. Overall, lower rental fleet loading negatively impacted short-term guidance and sales, but Caterpillar's margins and long-term profitability strategy remain healthy and intact.

Mixed Regional Performance: Caterpillar's largest market, North America, saw revenue weakness in Construction Industries, down 11%, and Resource Industries, down 17%, suggesting a cooling demand in key infrastructure and mining sectors. EMEA and Asia/Pacific regions were additionally weak with sales and revenue declines of 15% and 12%, respectively. That said, Latin America's Construction segment was a bright spot, growing 19%.

Sustainability and Innovation: Sustainability has been the forefront of Caterpillar's business model since 2022. Recently, the company introduced Dynamic Energy Transfer (DET), a fully Caterpillar-developed system that can transfer energy to both diesel-electric and battery-electric large mining trucks while they are working around a mine site. DET provides immediate benefit to miners by lowering operating costs and greenhouse gas emissions, giving Caterpillar a unique competitive advantage while promoting and enabling sustainability goals.

Valuation: We initiate coverage with a \$325 PT.

Consortium Equity Research
Industrials | Manufacturing
December 22nd, 2024

Stock Rating: Underweight

Price Target: \$325

Price: \$366.04

Potential Downside: -11.21%

Ticker(s): \$CAT

Market Cap: \$177b
Shares Outstanding: 483mm
Free Float (%): 99.83%
Dividend Yield: 1.54%

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Peer Comparisons

Comparable Companies

\$mm

Ticker	Mkt Cap	EV	P/E LTM	Revenue LTM	EBITDA LTM
Deere & Company (NYSE:DE)	\$ 124,833	\$ 184,375	17.8x	\$ 51,659	\$ 11,585
PACCAR Inc (NasdaqGS:PCAR)	\$ 62,082	\$ 68,542	13.2x	\$ 34,833	\$ 5,908
Cummins Inc. (NYSE:CMI)	\$ 51,900	\$ 58,869	25.3x	\$ 34,198	\$ 4,592
United Rentals, Inc. (NYSE:URI)	\$ 56,976	\$ 70,912	22.7x	\$ 14,978	\$ 4,542
Caterpillar	\$ 192,884	\$ 226,031	18.5x	\$ 65,664	\$ 15,819

Ticker	LTM EV/EBITDA	Gross Margin	EBITDA Margin	EBIT Margin	1 Yr Rev Growth Rate LF
Deere & Company (NYSE:DE)	15.9x	34.9%	22.4%	18.3%	(15.6%)
PACCAR Inc (NasdaqGS:PCAR)	11.6x	18.5%	17.0%	15.8%	1.9%
Cummins Inc. (NYSE:CMI)	12.8x	24.6%	13.4%	10.4%	2.7%
United Rentals, Inc. (NYSE:URI)	15.6x	41.0%	30.3%	27.5%	7.8%
Caterpillar	14.3x	32.5%	24.1%	20.9%	(1.4%)

High	15.91x	41.0%	30.3%	27.5%	7.8%
75th Percentile	15.61x	34.9%	24.1%	20.9%	2.7%
Average	14.05x	30.3%	21.4%	18.6%	-0.9%
Median	14.29x	32.5%	22.4%	18.3%	1.9%
25th Percentile	12.82x	24.6%	17.0%	15.8%	-1.4%
Low	11.60x	18.5%	13.4%	10.4%	-15.6%

CaterpillarValuation

Implied Enterprise Value (25th Percentile)	\$	202,798
Implied Enterprise Value (Median)	\$	226,031
Implied Enterprise Value (75th Percentile)	\$	246,974
Implied Share Price (25th Percentile)		353.2211706
Implied Share Price (Median)	\$	401.34
Implied Share Price (75th Percentile)		444.7206147

Source: S&P NetAdvantage

Company Overview

Company Description: Caterpillar is the leading global manufacturer of construction and mining equipment, engines, industrial turbines, and locomotives. Known for its iconic yellow machinery, CAT operates through four primary business segments: Construction Industries, Resource Industries, Energy and Transportation, and Financial Products. With a robust dealer network across 190 countries and a focus on sustainability and new technology, Caterpillar integrates advanced solutions to enhance efficiency and performance, providing a reliable and well-established product line.

Steady and Diverse: Since its founding in 1925, Caterpillar has dialed in on product dependability and longevity, securing it a wide moat within a highly competitive industry. Operating through one of the largest and most reliable dealer networks ensures that Caterpillar provides exceptional support, service,

and parts all over the globe. Within their massive network, Caterpillar supplies customers with an incredibly diverse range of products and services, allowing for an edge compared to streamlined peers. The company's legacy of reliability and its ability to serve diverse industries solidify its position as a global market leader relative to competition.

AI and New Technology: As the world shifts toward energy efficiency, lowered emissions, and AI integration, Caterpillar has adjusted its business model towards sustainability and technological dominance to reflect the growing trend. Cat Connect, an equipment optimization product, and the Dynamic Energy Transfer (DET) system have been beneficial implementations spurring higher product output and continued energy efficiency. Furthermore, global AI and energy trends have initiated datacenter construction and increased turbine construction. Caterpillar, which already experienced a boost in sales and revenue in their Energy and Transportation Industries segment in Q3 2024 (+5% YoY), continues to benefit from the increase in activity.

Industry Overview

Geopolitical Uncertainty: Potential policy changes following the U.S. and global elections have further enhanced doubt regarding the future business climate. Supply chains, demand, and long-term investments in industrial and manufacturing fields are all fields of potential impact. Changes to tariffs and policy could drive up raw material and component costs while it could also incentivize supply chain restructuring. As elected leaders come into the office, global regulation, tax, policy, and trade will be affected.

High Prices and Lingering Supply Chain Problems: The rate of inflation has diminished, yet manufacturers continue to see high costs. According to the producer price index (PPI), materials and components have somewhat stabilized but still remain highly priced and costly. Furthermore, wages and raw material prices are expected to rise by 2.7% over the next 12 months. This couples with continued global supply chain issues. While they have eased since the COVID-19 pandemic, pressure still remains, and measures of production, like average lead times for production materials, have yet to return to healthy pre-pandemic levels.

Automation and AI: The global integration of automation and AI has been revolutionizing operational efficiency and cost structures throughout the industrial sector. Caterpillar and other top peers have transitioned towards the booming trend and have increased research and development spending in order to stay ahead of competition, cut costs, and drive future revenue. Moreover, as AI themes continue to develop globally, construction and infrastructure spending for datacenters is expected to grow consistently at 10% a year through 2030, and industrial companies, like Caterpillar, are poised for growth.

Investment Theses

Construction Market Challenges: North America currently leads Caterpillar's business model, providing 54% of sales globally. Within this, the Construction Industries segment is the largest. As previously stated, sales in this U.S. sector fell 11% YoY, but more problems arise heading into Q4 2024 and throughout 2025. Weak housing starts, mortgage rates steadily over 6%, continued weakness in commercial property

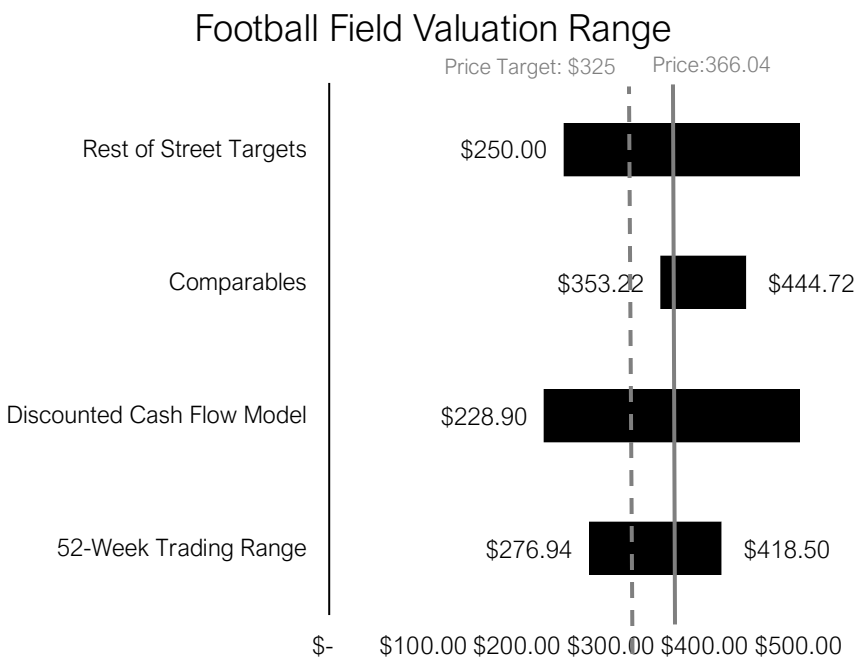
values (-13.5% since mid-2022), and ongoing softness in billings at architecture firms, a leading indicator of construction activity, have contributed to a slowdown in construction spending and lower future expectations. Additionally, already high material prices are expected to rise steadily through 2025. As Caterpillar experiences tough headwinds in a valuable business segment, we expect plateaued, if not continued, lower sales and tighter profitability margins.

U.S. Infrastructure Deal: The \$1.2 trillion infrastructure deal in the U.S., while not new, is set to be a key catalyst and driver for the company's construction equipment purchases within their top business segment. Notably poor infrastructure conditions have promoted large-scale refurbishing efforts, and the majority of projects funded by the bill, initiated in late 2021, are only starting to break ground now in 2024 and 2025. We expect to see consistent cash flow from this deal as Caterpillar is heavily exposed to U.S. infrastructure and as the bulk of projects begin to physically launch.

Energy and Power Generation: Energy and transportation were another highlight for Caterpillar in Q3 2024 (+21% profit YoY) and are expected to continue growth as power generation markets, like data centers, and capital spending on oil and gas become common themes. Construction, infrastructure, and energy spending tied to these power generation and AI trends make Caterpillar a potential derivative play for its heavy exposure. However, even with expected upsides in energy, strong headwinds and uncertainty exist across multiple segments for the vastly diverse company.

Price Target & Valuation

Our analysis gives \$CAT a price target of \$325 and an underweight rating.



Potential Downsides to Our Rating

Timely Revenue Recovery: If Caterpillar is able to better handle negative sales factors that are currently impacting major business segments, like higher costs and an unrecovered supply chain, a boost in stock price is very possible. The company has already lowered future guidance and revenue expectations for the next quarter and year; thus, any unexpected sales boost in the near future would be surprising.

Oil and AI Spur Demand: Construction and Resouce business segments have hurt Caterpillar’s profitability as of late, but spending in the Energy sector was incredibly promising. If U.S. and global trends continue heavily towards AI and sustainability, a leading innovator, Caterpillar, is positioned to capture market share and demand. Additionally, increased capital spending towards oil and gas has helped maintain Caterpillars overall sales this year. If Construction and Resouce Industry segments can somewhat return to normal and spending in Oil/Gas and AI investments continue to grow, Caterpillar could see notable growth.

Our Price Target: **\$325**

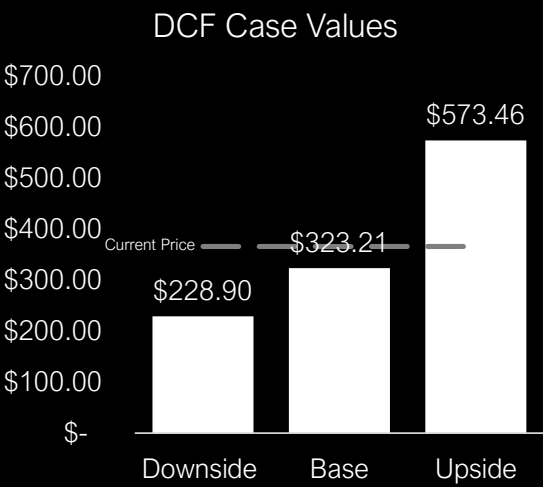
Our price target is based on the negative effect of higher material prices, lower demand across dominant Construction and Resource Industry segments, and worsening global performance.

Our Upside Case: **\$575**

Our upside case is based on the normalization and continued rise of infrastructure spending through the U.S. Infrastructure Deal, continued and robust growth in power generation through wind turbines, oil and gas, data centers, and AI trends, and a healthy, wide moat that should support and improve global growth and assist in capturing supplemental market share.

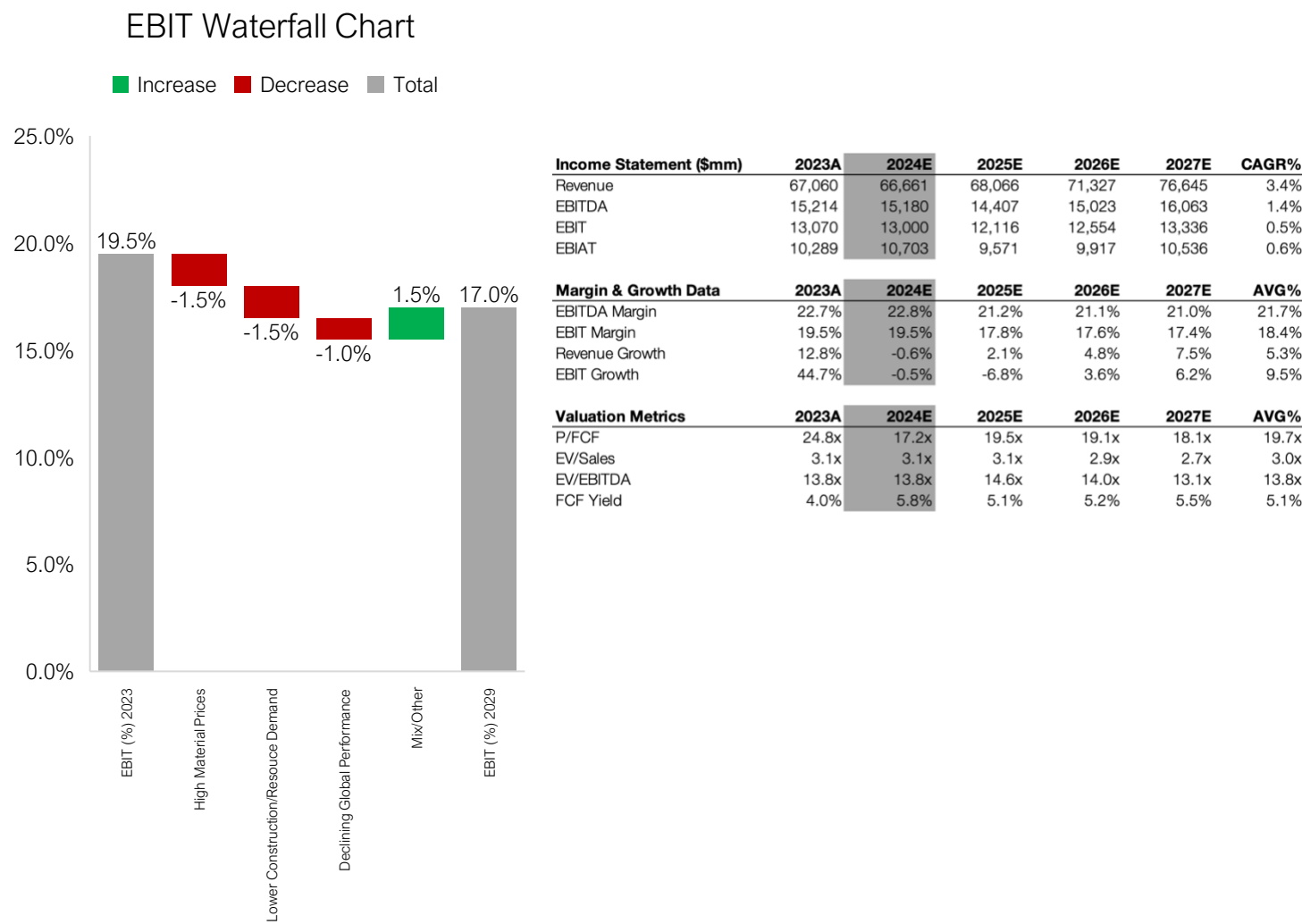
Our Downside Case: **\$230**

Our downside case is structured on a Caterpillar that is burdened by higher material prices with the inability to effectively increase selling price, and a highly competitive domestic and global market that continues to negatively impact sales and take market share control.



Global Market Execution: Caterpillar's global performance was concerning in many major areas overseas. While there were very positive regions, like Latin America, overall global performance was slow. China, an area of focus for Caterpillar, saw underwhelming and weakened numbers due to a highly competitive market and an economic slowdown. If Caterpillar's global demand improved overseas, it is likely to uplift market sentiment towards the company.

Projections



About \$CAT

Caterpillar Inc. (\$CAT), founded in 1925 and headquartered in Irving, Texas, is a leading global manufacturer of heavy equipment and engines. The company operates across several key segments, including Construction Industries, Resource Industries, Energy & Transportation, and Financial Products. Caterpillar's primary business involves designing and producing machinery for construction, mining, and energy sectors, while also offering financial services through its subsidiary. Its key purposes are to drive

sustainability in infrastructure development and to provide equipment solutions that enhance productivity and efficiency for its customers worldwide.

Disclosures & Ratings

Consortium Equity Research does not hold any professional relationships with any reported equities. **Overweight** means the analyst team believes the stock price will outperform the coverage industry (TMT, Healthcare, Industrial, Consumer, FIG, E&S) in the next 6-12 months. **Equal Weight** means the team expects performance in line with the industry. **Underweight** means the team expects underperformance relative to the industry.

Appendix

Caterpillar

Discounted Cash Flow

Active Case: 2 Base

Current Share Price \$366.04

DCF Analysis (\$mm)											
	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024	FY2025	FY2026	FY2027	FY2028	FY2029
	12/31/2019	12/31/2020	12/31/2021	12/31/2022	12/31/2023	12/31/2024	12/31/2025	12/31/2026	12/31/2027	12/31/2028	12/31/2029
Stub						0.02	0.02	0.02	0.02	0.02	0.02
Discount Period						0.01	0.52	1.52	2.52	3.52	4.52
Revenue	53,800.00	41,748.00	50,971.00	59,427.00	67,060.00	66,660.64	68,066.35	71,326.82	76,644.98	84,397.77	95,181.08
Revenue Growth	0%	-22%	22%	17%	13%	-1%	2%	5%	7%	10%	13%
Revenue Breakdown 1	50,755.00	39,022.00	48,188.00	56,574.00	63,869.00	63,230.31	64,368.46	67,329.40	72,311.78	79,687.58	90,046.97
Revenue Breakdown 2	3,045.00	2,726.00	2,783.00	2,853.00	3,191.00	3,430.33	3,697.89	3,997.42	4,333.20	4,710.19	5,134.11
Other Revenue	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
EBIT	8,030.00	4,400.00	8,610.00	9,030.00	13,070.00	13,000.00	12,115.81	12,553.52	13,336.23	14,516.42	16,180.78
EBIT Margin	15%	11%	17%	15%	19%	20%	18%	18%	17%	17%	17%
Tax Expense	1,746.00	1,006.00	1,742.00	2,067.00	2,781.00	2,297.00	2,544.32	2,636.24	2,800.61	3,048.45	3,397.96
Effective Tax Rate	22%	23%	20%	23%	21%	18%	21%	21%	21%	21%	21%
NOPAT	6,284.00	3,394.00	6,868.00	6,963.00	10,289.00	10,703.00	9,571.49	9,917.28	10,535.62	11,467.97	12,782.82
D&A	2,577.00	2,432.00	2,352.00	2,219.00	2,144.00	2,180.00	2,291.27	2,469.46	2,727.12	3,083.94	3,569.29
Capex	2,669.00	2,115.00	2,472.00	2,599.00	3,092.00	2,494.00	2,581.80	2,742.38	2,986.50	3,332.25	3,807.24
Changes in NWC	-	1,175.00	(139.00)	(1,354.00)	(33.00)	80.00	201.48	336.67	496.66	695.44	951.81
UFCF	#VALUE!	2,454.00	4,257.00	3,010.00	7,164.00	10,309.00	9,079.48	9,307.70	9,779.58	10,524.22	11,593.06
PV of FCF						10,298.79	8,704.70	8,234.59	7,984.10	7,928.71	8,059.66

Weighted Average Cost of Capital (\$mm)	
Market Risk Premium	4.24%
Beta	1.11
Risk Free Rate	4.52%
Cost of Equity	7.82%
Weighted Average Cost of Debt	4.50%
Tax Rate	21.00%
Cost of Debt	0.55%
Total Equity	\$176,725
Total Debt	\$32,262
Equity/Total Capitalization	84.56%
Debt/Total Capitalization	15.44%
WACC	8.37%

Terminal Value	
Perpetuity Growth Method	
2029 FCF	\$11,593
Growth	3.00%
Terminal Value	\$ 216,042
PV of Terminal Value	150195.8883
PV of Projection Period	\$51,211
PV of Terminal Value	\$150,196
Implied TEV	\$201,406
(-) Debt	\$37,900
(+) Cash	\$5,638
Implied Equity Value	\$169,144
Basic Shares Outstanding	483
Implied Share Price	350.3387916
Upside/Downside	-4%

Implied BF EV/EBIT	15.49280342
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Terminal Value	
Exit Multiple Method	
2029 EBIT	\$16,181
N/A Exit Multiple	0x
Terminal Value	\$0
PV of Terminal Value	0
PV of Projection Period	\$51,211
PV of Terminal Value	\$0
Implied TEV	\$51,211
(-) Debt	\$37,900
(+) Cash	\$5,638
Implied Equity Value	\$18,949
Diluted Shares Outstanding	483
Implied Share Price	\$39.25
Upside/Downside	-89%

Implied PGR	#DIV/0!
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Blended Share Price	
Perpetuity Growth Method	100%
Exit Multiple Method	0%
Blended Share Price	\$350.34
Upside/Downside	-0.042894789