

Date: **October 22, 2012**

Analyst Name: **Kyle Blore**

CIF Stock Recommendation Report (Fall 2012)

Company Name and Ticker: **Caterpillar Inc. (CAT)**

Section (A) Summary

Recommendation: Do Not Buy Recommended Buy Price: \$69		Target Price: \$85	Stop-Loss Price: \$59
Sector: Industrials	Industry: Farm & Construction Machinery	Market Cap (in Billions): \$54.3	# of Shrs. O/S (in Millions): 653.27
Current Price: \$83.86	52 WK Hi: \$116.95	52 WK Low: \$78.25	EBO Valuation: \$84.70
Morningstar (MS) Fair Value Est.: \$111.00	MS FV Uncertainty: High	MS Consider Buying: \$66.60	MS Consider Selling: \$172.05
EPS (TTM): 8.94	EPS (FY1): 9.41	EPS (FY2): 10.16	MS Star Rating: ★★★★
Next Fiscal Yr. End: December 2012	Last Fiscal Qtr. End: September 2012 Less Than 8 WK: Yes	If Less Than 8 WK, next Earnings Ann. Date: October 22, 2012	Analyst Consensus Recommendation: 2.28
Forward P/E: 8.25	Mean LT Growth: 14.00	PEG: 0.59	Beta: 1.86
% Inst. Ownership: 64.09%	Inst. Ownership- Net Buy: Yes	Short Interest Ratio: 2.339269	Short as % of Float: 3.50%
<u>Ratio Analysis</u>	<u>Company</u>	<u>Industry</u>	<u>Sector</u>
P/E (TTM)	9.30	12.99	22.05
P/S (TTM)	0.82	1.13	1.72
P/B (MRQ)	3.41	1.40	1.17
P/CF (TTM)	6.22	10.84	15.14
Dividend Yield	2.50	2.37	2.20
Total Debt/Equity (MRQ)	246.87	76.91	67.14
Net Profit Margin (TTM)	9.10	6.56	6.04
ROA (TTM)	7.43	4.81	2.89
ROE (TTM)	40.75	12.45	7.14

<p><u>Investment Thesis:</u> Caterpillar experienced very high growth during the boom years just prior to the 2008 financial crisis due to increasing commodity prices that fueled very high growth in infrastructure development and mining. Caterpillar has recently been engaged in aggressive acquisitions financed mostly through debt. At the same time Caterpillar has been decreasing its equity financing which has resulted in an extremely high debt/equity ratio relative to its competitors. Caterpillar's cash flows were negative in 2010 and 2011. Caterpillar's cash declined from \$4.8 billion at the end of 2009 to \$3 billion at the end of 2011 mostly as a result of debt servicing and high capital expenditures. Caterpillar is currently being faced with increasing amounts of competition in Asia from Komatsu and rising Chinese competitors which may hamper its growth in the region if the company does not continue its aggressive acquisitions and expansion plans. Additional growth, however, will require additional debt financing and capital expenditures which will further decrease Caterpillar's available cash. Significantly decreased cash may hamper Caterpillar's ability to finance its debt during another economic downturn.</p>	<p><u>Summary</u></p> <p><u>Company Profile:</u> Caterpillar is based in Illinois, and it is the world's largest manufacturer of heavy machinery and equipment. The company also provides financing for its entire product line, and remanufactures equipment and machinery.</p> <p><u>Fundamental Valuation:</u> Caterpillar's P/E, P/S, and P/CF are low, but its P/B is quite high. The company is also very highly levered which could pose problems during an economic downturn.</p> <p><u>Relative Valuation:</u> Caterpillar is fairly valued relative to some of its competitors such as Deere & Co. when you take into account Caterpillar's forecasted dip in earnings from the previous year.</p> <p><u>Revenue and Earnings Estimates:</u> Caterpillar's revenue and earnings growth is estimated to decline from last year's highs to more stable, long-term growth rates in the low teens or high single digit percentiles.</p> <p><u>Analyst Recommendations:</u> Currently at 2.28 which shows that analysts believe Caterpillar will outperform.</p> <p><u>Institutional Ownership:</u> Institutional Ownership has remained flat over the previous three months.</p> <p><u>Short Interest:</u> Short Interest has increased over 60% in the past year which signals that investor sentiment with respect to Caterpillar has become increasingly negative.</p> <p><u>Stock Price Chart:</u> Caterpillar's stock has been outperformed by most of its close competitors and the S&P 500.</p>
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Section (B) Company Profile (two pages maximum)

Company Summary

Caterpillar, Inc. is a global manufacturer and seller of construction and mining equipment, diesel and natural gas engines, industrial gas turbines, and diesel-electric locomotives. The company also provides financing for its entire product line, remanufactures equipment and machinery, and distributes products from other companies. Caterpillar provides the majority of its equipment to customers in construction, mining, and forestry.

Business Model, Competition, Environment and Strategy

Caterpillar has a large market share in its industry of approximately 33% globally which gives it strong pricing power. Caterpillar has been engaging in aggressive expansion especially internationally. The company has increased its international sales from 50% of its total sales five years ago to 60% of its total sales currently.

Caterpillar is continuing to invest heavily in research and development which has made it a leader in high-tech engine production. In order to retain its large market share and its lead in high-tech engine technology Caterpillar will have to continue its aggressive acquisitions and expansion and high research and development expenditures.

Revenue and Earnings History

REVENUE (in millions of USD)			
Periods	2010	2011	2012
March	8238	12949	15981
June	10409	14230	17374
September	11134	15716	
December	12807	17243	
Total	42588	60138	33355

EARNINGS			
Periods	2010	2011	2012
March	0.36208	1.84238	2.36646
June	1.09274	1.52128	2.53734
September	1.21547	1.71321	
December	1.46756	2.32317	
Total	4.13785	7.40004	4.90380

Section (C) Fundamental Valuation (EBO)

CAT	PARAMETERS	FY1	FY2	Ltg										
	EPS Forecasts	9.41	10.16	14.00%										
	Book value/share (last fye)	13.03												
	Discount Rate	12.12%												
	Dividend Payout Ratio (POR)	20.24%												
	Next Fisc Year end	2012												
	Current Fisc Mth (1 to 12)	9												
	Target ROE (industry avg.)	12.45%												
Year		2012*	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	
	Long-term EPS Growth Rate (Ltg)			0.1400	0.1400	0.1400	0.1400	0.1400						
	Forecasted EPS	9.41	10.16	11.58	13.20	15.05	17.16	19.56						
	Beg. of year BV/Shr	13.030	20.535	28.639	37.877	48.409	60.414	74.101						
	Implied ROE		0.495	0.404	0.349	0.311	0.284	0.264						
ROE	(Beg. ROE, from EPS forecasts)	0.722	0.495	0.404	0.349	0.311	0.284	0.264	0.236	0.208	0.180	0.152	0.125	
Abnormal ROE	(ROE-k)	0.601	0.374	0.283	0.227	0.190	0.163	0.143	0.115	0.087	0.059	0.031	0.003	
growth rate for B	(1-POR)*(ROE-1)	0.000	0.576	0.395	0.323	0.278	0.248	0.227	0.211	0.188	0.166	0.144	0.122	
Compounded growth		1.000	1.576	2.198	2.907	3.715	4.637	5.687	6.884	8.181	9.539	10.911	12.237	
growth* AROE		0.601	0.589	0.623	0.661	0.705	0.755	0.812	0.791	0.712	0.564	0.340	0.040	
required rate (k)		0.121	0.121	0.121	0.121	0.121	0.121	0.121	0.121	0.121	0.121	0.121	0.121	
Compound discount rate		1.121	1.257	1.409	1.580	1.772	1.987	2.227	2.497	2.800	3.139	3.520	3.946	
div. payout rate (k)		0.202												
Add to P/B	PV(growth* AROE)	0.54	0.47	0.44	0.42	0.40	0.38	0.36	0.32	0.25	0.18	0.10	0.01	
Cum P/B		1.54	2.00	2.45	2.86	3.26	3.64	4.01	4.32	4.58	4.76	4.85	4.86	
Add: Perpetuity beyond current yr	(Assume this yr's AROE forever)	4.42	3.86	3.64	3.45	3.28	3.14	3.01	2.61	2.10	1.48	0.80	0.08	
Total P/B	(P/B if we stop est. this period)	5.96	5.87	6.09	6.32	6.54	6.78	7.02	6.94	6.67	6.24	5.65	4.95	
Implied price		84.70	83.42	86.57	89.77	93.03	96.35	99.71	98.60	94.88	88.68	80.34	70.34	
Check:														
Beg. BV/Shr		13.03	20.54	28.64	37.88	48.41	60.41	74.10	89.70	106.60	124.30	142.17	159.45	
Implied EPS		9.41	10.16	11.58	13.20	15.05	17.16	19.56	21.18	22.19	22.41	21.67	19.85	
Implied EPS growth			0.080	0.140	0.140	0.140	0.140	0.140	0.083	0.048	0.010	-0.033	-0.084	

Inputs (provide below input values used in your analysis)

EPS forecasts (FY1 & FY2): **9.41% & 10.16%**

Long-term growth rate: **14%**

Book value /share (along with book value and number of shares outstanding):

Book value: **\$8,515M**

of shares outstanding: **653.27M**

Book value / share: **\$13.03**

Dividend payout ratio: **20.24%**

Next fiscal year end: **December 2012**

Current fiscal month: **September**

Target ROE: **12.45%**

Output

Above normal growth period chosen: **2015**

EBO valuation (Implied price from the spreadsheet): **\$89.77**

Section (E) Revenue and Earnings Estimates

HISTORICAL SURPRISES

Sales and Profit Figures in US Dollar (USD)
Earnings and Dividend Figures in US Dollar (USD)

Estimates vs Actual	Estimate	Actual	Difference	Surprise %
SALES (in millions)				
Quarter Ending Jun-12	17,110.00	17,374.00	263.99	1.54
Quarter Ending Mar-12	16,221.10	15,981.00	240.08	-1.48
Quarter Ending Dec-11	16,052.00	17,243.00	1,190.97	7.42
Quarter Ending Sep-11	15,034.90	15,716.00	681.07	4.53
Quarter Ending Jun-11	13,544.70	14,230.00	685.31	5.06
Earnings (per share)				
Quarter Ending Jun-12	2.28	2.54	0.26	11.32
Quarter Ending Mar-12	2.13	2.37	0.24	11.43
Quarter Ending Dec-11	1.73	2.32	0.59	34.05
Quarter Ending Sep-11	1.54	1.71	0.17	10.86
Quarter Ending Jun-11	1.75	1.72	0.03	-1.48

Caterpillar has positively surprised the market every quarter for the last five quarters with exceptions being in sales during the quarter ending Mar-12 and in earnings during the quarter ending Jun-11. Earnings surprises were much greater than sales surprises. The stock did not consistently respond to these surprises which implies that the surprises were typically already priced in.

CONSENSUS ESTIMATES ANALYSIS

Sales and Profit Figures in US Dollar (USD)

Earnings and Dividend Figures in US Dollar (USD)

	# of Estimates	Mean	High	Low	1 Year Ago
SALES (in millions)					
Quarter Ending Dec-12	14	17,820.90	18,897.00	16,253.00	17,675.10
Quarter Ending Mar-13	8	16,554.60	17,532.00	15,798.00	16,973.50
Year Ending Dec-12	18	67,759.60	69,769.00	64,587.70	65,490.80
Year Ending Dec-13	18	70,861.80	76,288.00	62,560.30	72,310.60
Earnings (per share)					
Quarter Ending Dec-12	22	2.31	2.61	2.02	2.30
Quarter Ending Mar-13	9	2.31	2.56	1.97	2.34
Year Ending Dec-12	26	9.41	9.80	8.76	8.75
Year Ending Dec-13	26	9.97	11.05	8.64	10.19
LT Growth Rate (%)	2	14.00	20.00	8.00	24.27

Sales Estimates	
Year	Difference from Mean
Year Ending Dec-12	High: 3.0% Low: -4.9%
Year Ending Dec-13	High: 7.7% Low: -13.3%
Earnings Estimates	
Year Ending Dec-12	High: 4.0% Low: -7.4%
Year Ending Dec-13	High: 9.8% Low: -15.4%

There are only two analysts who provided long term growth estimates relative to the 18 analysts who provided sales estimates and the 26 analysts who provided earnings estimates.

CONSENSUS ESTIMATES TREND

Sales and Profit Figures in US Dollar (USD)
Earnings and Dividend Figures in US Dollar (USD)

	Current	1 Week Ago	1 Month Ago	2 Month Ago	1 Year Ago
SALES (in millions)					
Quarter Ending Dec-12	17,820.90	17,820.90	18,489.50	18,489.50	17,675.10
Quarter Ending Mar-13	16,554.60	16,554.60	16,693.90	16,693.90	16,973.50
Year Ending Dec-12	67,759.60	67,759.60	68,765.20	68,825.40	65,490.80
Year Ending Dec-13	70,861.80	70,861.80	73,267.70	73,276.90	72,310.60
Earnings (per share)					
Quarter Ending Dec-12	2.31	2.31	2.44	2.44	2.30
Quarter Ending Mar-13	2.31	2.31	2.36	2.37	2.34
Year Ending Dec-12	9.41	9.42	9.62	9.61	8.75
Year Ending Dec-13	9.97	10.05	10.50	10.52	10.19

Analysts' consensus estimates for sales have been trending downwards, and there consensus estimates for earnings have also trended downwards. Both sales and earnings consensus estimates are trending downward at similar rates.

ESTIMATES REVISIONS SUMMARY

	Last Week		Last 4 Weeks	
Number Of Revisions:	Up	Down	Up	Down
Revenue				
Quarter Ending Dec-12	0	0	0	7
Quarter Ending Mar-13	0	0	0	2
Year Ending Dec-12	0	0	0	11
Year Ending Dec-13	0	0	0	11
Earnings				
Quarter Ending Dec-12	0	1	0	12
Quarter Ending Mar-13	0	0	1	1
Year Ending Dec-12	0	1	0	14
Year Ending Dec-13	0	2	0	14

There are significantly more downward revisions for both sales and earnings. The majority of these revisions have been in the last four weeks, but not many have occurred during the last week. These downward revisions are most likely attributable to the growing short-term macro-economic uncertainty combined with uncertainty concerning Caterpillar's recent acquisitions and international growth prospects, particularly in Asia.

Section (F) Analysts' Recommendations

ANALYST RECOMMENDATIONS AND REVISIONS

1-5 Linear Scale	Current	1 Month Ago	2 Month Ago	3 Month Ago
(1) BUY	4	5	5	9
(2) OUTPERFORM	10	10	9	9
(3) HOLD	11	9	9	5
(4) UNDERPERFORM	0	0	0	0
(5) SELL	0	0	0	0
No Opinion	0	0	0	0
Mean Rating	2.28	2.17	2.17	1.83

Caterpillar's current mean rating is 2.28 (outperform) which has decreased from 1.83 three months ago. Many analysts appear to have changed their "buy" recommendation to a "hold" recommendation. The "buy" recommendations have decreased from 9 to 4 whereas the "hold" recommendations have increased from 5 to 11. This trend will most likely continue.

Section (G) Institutional Ownership

CAT					
Ownership Activity	# of Holders	% Beg. Holders	Shares	% Shares	
Shares Outstanding			653,055,555	100.00%	
# of Holders/Tot Shares Held	1,433	100.00%	418,543,305	64.09%	
# New Positions	22	1.54%			
# Closed Positions	22	1.54%			
# Increased Positions	133	9.28%			
# Decreased Positions	118	8.23%			
Beg. Total Inst. Positions	1,433	100.00%	418,543,290	64.09%	
# Net Buyers/3 Mo. Net Chg	15	52.99%	15	0.00%	
Ownership Information	% Outstanding				
Top 10 Institutions % Ownership	28.40%				
Mutual Fund % Ownership	1.22%				
Float %	99.91%				
> 5% Ownership					
Holder Name	% Outstanding	Report Date			
State Street Global Advisors (US)	11.1	6/30/2012			

There has been no noteworthy increase or decrease in shares held by institutions. Over 60% of Caterpillar stock is held by institutions which signifies a strong institutional interest in the stock. There is only one institutional investor which holds more than 5% of the stock. Overall, the institutional ownership mirrors growing analyst sentiment that Caterpillar is not a stock to buy, but rather it is best to hold for the time being.

Section (H) Short Interest (two pages)

Settlement Date	Short Interest	Avg Daily Share Volume	Days To Cover
9/28/2012	20,069,013	8,579,180	2.339269
9/14/2012	19,095,342	7,991,152	2.389561
8/31/2012	19,019,431	6,078,145	3.129151
8/15/2012	20,435,467	6,584,821	3.103420
7/31/2012	19,900,310	8,645,640	2.301774
7/13/2012	20,425,156	7,697,629	2.653435
6/29/2012	18,145,406	7,255,998	2.500746
6/15/2012	16,324,594	7,451,187	2.190872
5/31/2012	16,587,694	7,807,625	2.124551
5/15/2012	12,362,687	6,540,481	1.890180
4/30/2012	11,695,396	6,423,334	1.820767
4/13/2012	12,306,186	6,465,780	1.903279
3/30/2012	12,444,597	6,740,455	1.846255
3/15/2012	12,888,317	7,279,058	1.770602
2/29/2012	12,701,692	5,281,043	2.405148
2/15/2012	13,428,315	6,422,816	2.090721
1/31/2012	14,838,079	8,630,976	1.719166
1/13/2012	18,396,416	7,806,507	2.356549
12/30/2011	15,533,457	5,796,735	2.679691
12/15/2011	16,600,401	8,042,334	2.064127
11/30/2011	15,488,022	7,982,243	1.940310
11/15/2011	15,348,902	9,195,497	1.669176
10/31/2011	15,191,236	11,108,301	1.367557
10/14/2011	17,257,737	11,893,089	1.451073

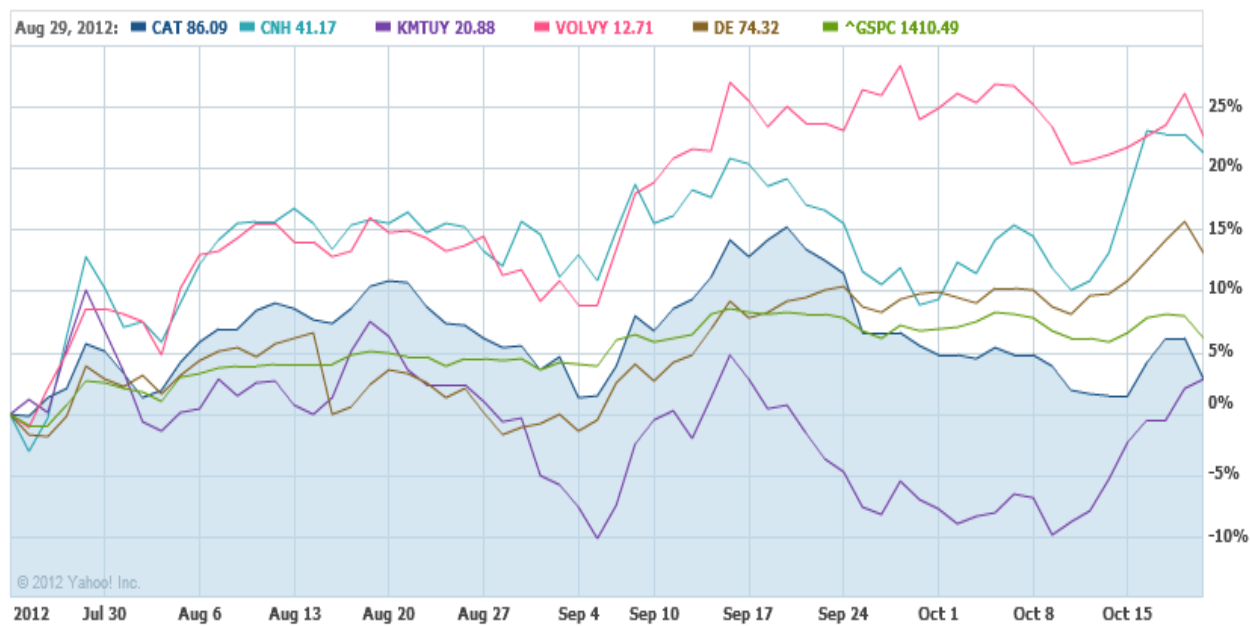


Avg Vol (3 month)	Avg Vol (10 day)	Shares Outstanding	Float
7,435,640	7,194,320	653.27M	651.80M
Shares Short (Most recent date)	Short Ratio (Most recent date)	Short % of Float (Most recent date)	Shares Short (2 weeks prior)
20.07	2.50	3.50%	19.10M

Short interest for Caterpillar has increased by 62% over the past year. Short interest for Caterpillar's competitors has also increased significantly over the same time period. This shows that investor sentiment regarding this industry is increasingly bearish.

Section (I) Stock Charts

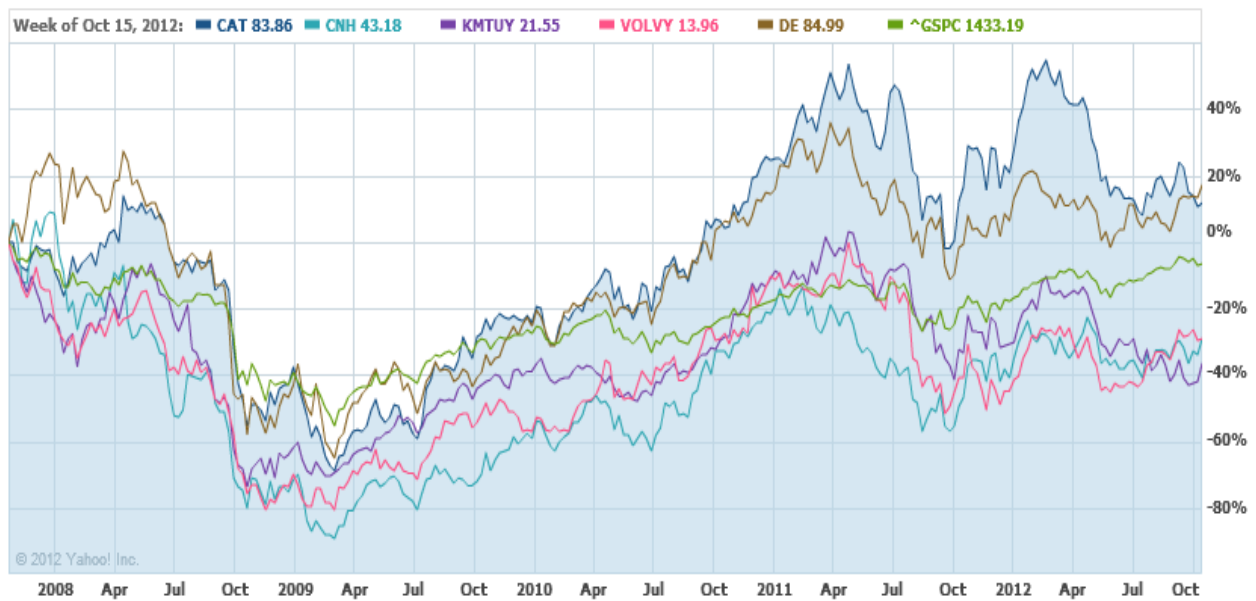
A three months price chart



A one year price chart



A five year price chart



Over the past year Caterpillar has underperformed the S&P 500 by about 20%, however, over the last five cumulative years the company has actually outperformed the S&P 500 by about 20%. Caterpillar's stock has done well against its competitors over the longer five year period, but it hasn't done well with respect to its competition over one year or three month.

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