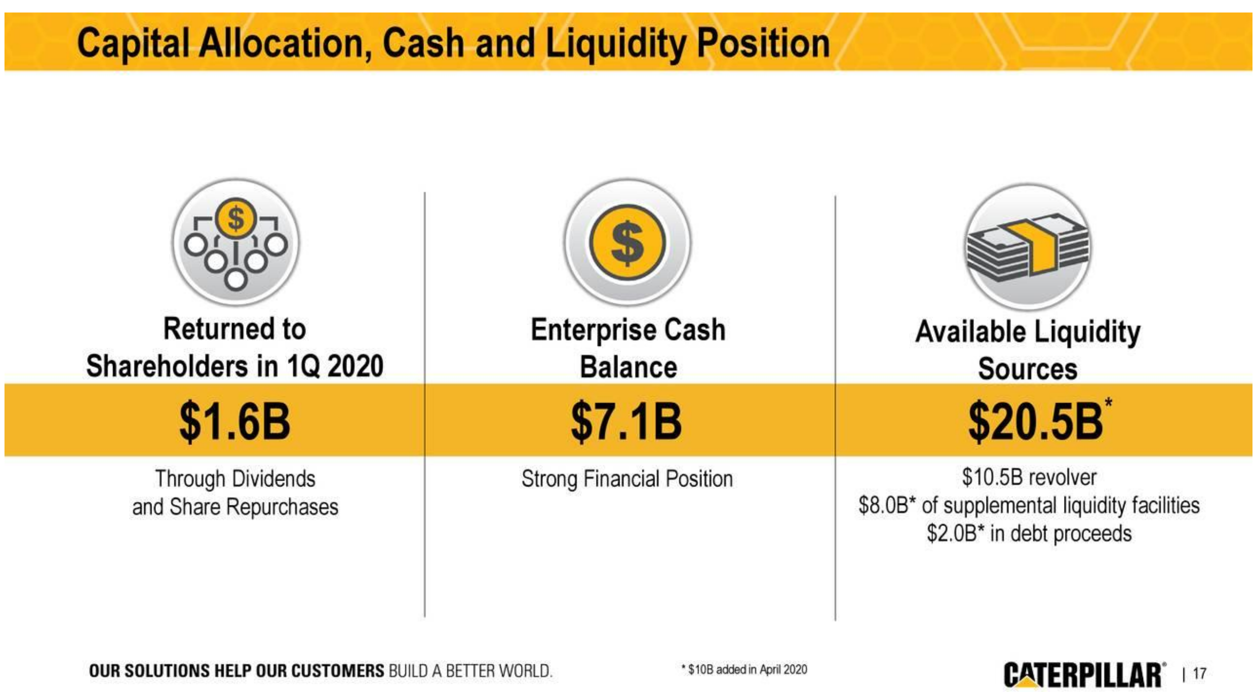
Inside Caterpillar: Last Quarter's Progress.

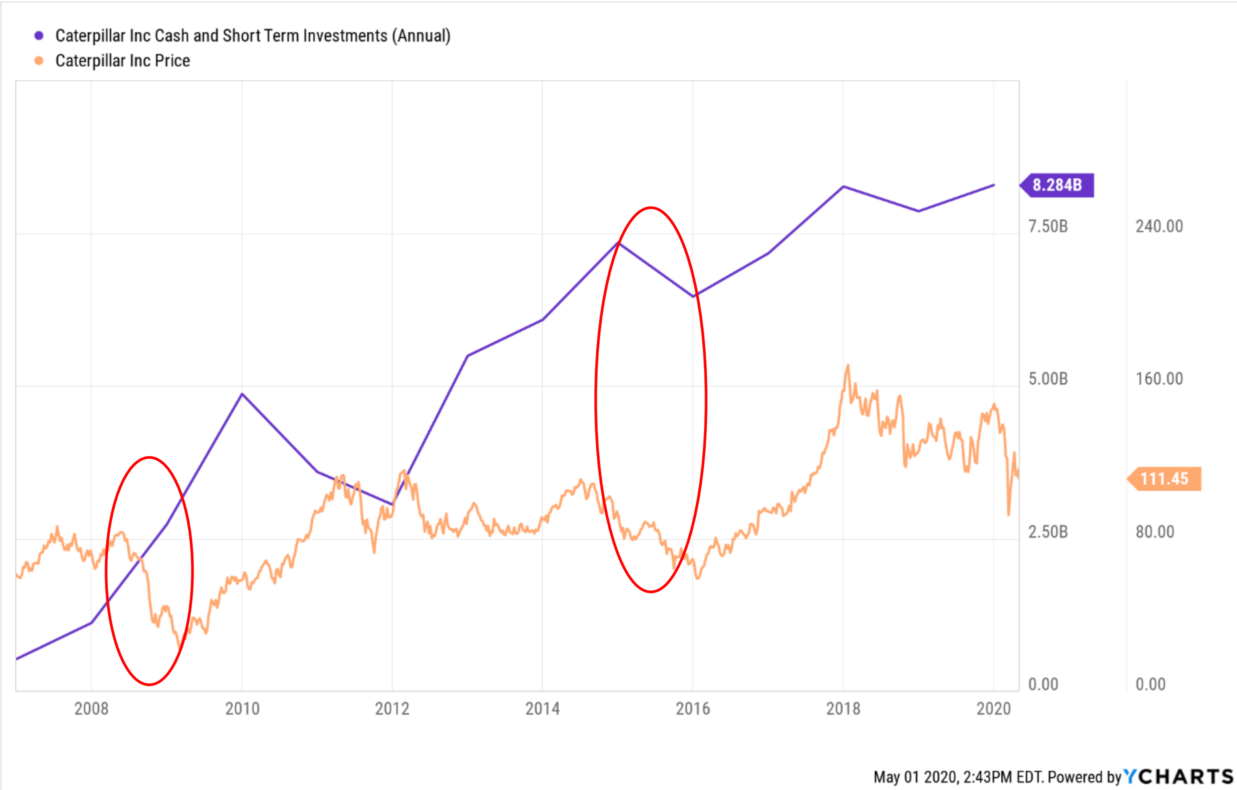
May 1, 2020

Caterpillar entered 2020 already expecting lower demand for its equipment from customers, but the impact of the pandemic lowered that demand even more, resulting in sales 21% lower than a year ago. To illustrate just how much demand "shut off" this quarter, we'll look at Caterpillar's dealer inventory numbers (Caterpillar sells most of its products to dealers, who in turn sell to end users). The first quarter is usually when dealers buy a lot of their equipment to gear up for the spring selling season. This year, dealer inventory grew by $100 million. Last year, dealer inventory grew by $1.3 billion. With so much uncertainty over how long people and businesses are going to be in financial distress, dealers obviously were not willing to buy products as they normally would.

The Virus Shutdown also greatly affected Caterpillar's operations. It temporarily closed 25% of its facilities due to supply chain disruptions or government mandates. Management reduced discretionary spending, cancelled salary increases and bonuses, and is reducing production costs as much as possible to meet the new lower customer demand. However, just as we noted in Texas Instrument's report, CAT is not reducing spending on the main priorities it set in 2017: expanding its offerings and its services. By continuing to invest in these areas, Caterpillar hopes to emerge from this crisis in a better position for long term growth.

This earnings report highlighted the fact that Caterpillar is heading into a steeper downturn. The second quarter is expected to be worse than this past quarter, and there is so much uncertainty about the rest of the year that management did not set forth any year-end guidance. The two most important things a company can do when faced with this situation are to operate as efficiently as possible and have ample cash on hand. Caterpillar made a massive effort after its downturn in 2015 and 2016 to cut costs to the bone, and hasn't increased costs much in the 4 years since then. Even though the company entered this year operating very efficiently, it is looking to reduce costs even further.





In terms of cash, Caterpillar is in the best position it's been in over the last two downturns. The first slide shows the company's financial position and its newly added $10 billion worth of liquidity. The second graph shows Caterpillar's cash position over the last 13 years. The first red circle is the Financial Crisis, which Caterpillar entered with around $1 billion in cash. The next red circle is the 2015 downturn, which it entered with about $7 billion in cash. It entered this downturn with $8.2 billion. Caterpillar has transformed itself into a stronger company over the last 5 years. That work will pay off throughout this crisis.