The Outlook: Jan. 31, 2017

Caterpillar endures endless pain. The wait will be worth it.

Caterpillar, King of Cycles: 10 Years of Operating Cash Flow and Stock Price

Last week we admired Freeport-McMoRan's stiff upper lip, and extraordinary management performance, through more than a year of being cornered by tigers. Caterpillar's very experienced management team is cut from the same cloth, and has faced those tigers for a solid 3 years by now.

The 10-year chart above captures the nature of CAT as an operating company: always cyclical, and the cycles are like Mt. Everest and the Marianas Trench, not the gently rolling hills around Peoria. Caterpillar's global sales of heavy equipment peaked at $65 billion in 2012 . . . and ended 2016 at $38 billion, which is a 42% decline. To say "that hurts" would be the gold medal of understatements. CAT's team has been through this a lot, though. CEO Jim Umpleby and his team—and Doug Oberhelman, before Mr. Umpleby—have shown outstanding speed and effectiveness in cutting costs and production to safeguard the company for a better future. $2 billion in operating costs have been cut in about 15 months, 30 factories closed or combined with others, 16,000 employees let go. Harsh measures indeed . . . and the only actions in the world which guarantee that the company will prosper again, and grow again in sales, earnings and employees.

As Outlook has remarked before, the stock market is a thing of variety and changes. Sometimes its "judgement" is too silly for words. Sometimes its judgment is experienced and perfectly sensible. The orange line, above, is CAT's operating cash flow, which is something like the gasoline that runs its business engine. It's very easy to see that the market's judgment looked pretty sensible in 2009, as the stock began rocketing up well before CAT's sales and earnings proved they would recover from the 2008 Calamity. And again, at the very beginning of 2016—as nothing but dismal news was coming from Caterpillar's monthly sales figures—the market poured cash into CAT long before any sign of a renewed flow of that gas into Caterpillar's engine. In fact, there is still no sign of improvement—but CAT has risen 67% since early 2016.

The $64 Question, now, is: "Is this the market's good judgment; or is this the market at its silliest?"

Here's Outlook's answer. The global industrial equipment cycle will turn, as it always does. Probability 100%, or as close to that as anything ever gets. Free markets fix themselves, and the mining, energy and construction markets are doing that (though taking their painful, sweet time about it.) So CAT's sales will turn up, and its operating earnings, especially, will turn up like Mt. Everest . . . precisely because Mr. Umpleby and team have cut $2 billion from operating costs. Well before Caterpillar's sales return to their 2012 levels, CAT's profits will have shot past those levels. That's the nature of well-run manufacturing companies, operating in cyclical industries. The market's display of "sensible judgment" since early 2016 may give way to panic before the cycle's upturn has made itself perfectly clear—that's always the nature of the market—but earnings are going to rocket up, and the stock price is very likely to end the next up-cycle much higher than today. So, as usual, we'll hang on, congratulating the market when it's sensible, ignoring it when it's silly. Patient investors make very good money that way.

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