



Christopher Bloomstran

Chief Investment Officer, Semper Augustus Investments Group



Cummins Inc.

MOI Global
Best Ideas 2019

January 4, 2019

Christopher P. Bloomstran, CFA
President and Chief Investment Officer

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Cummins Inc.

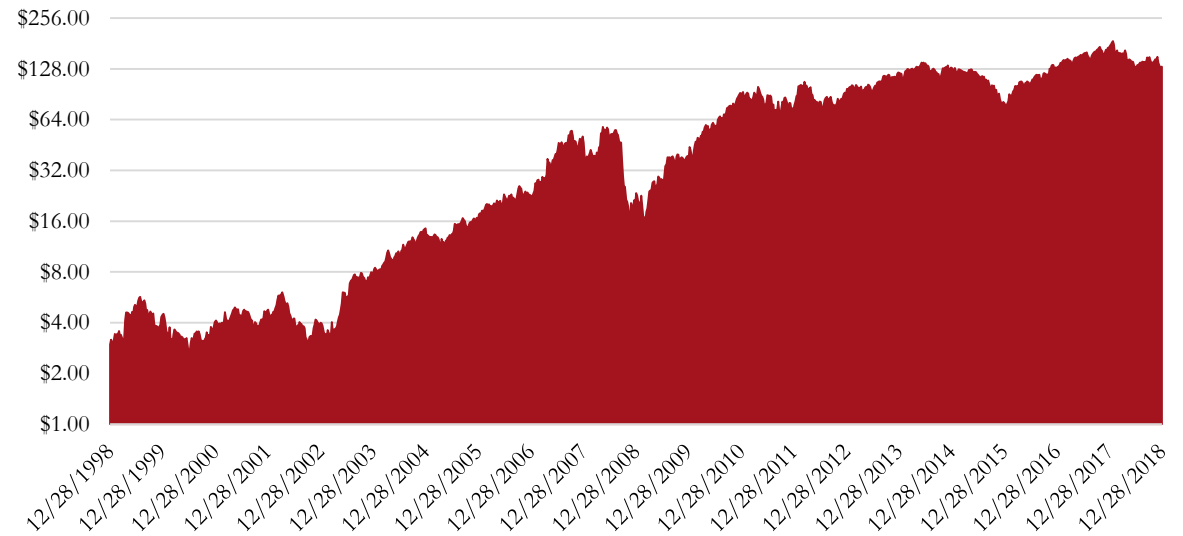
CMI [NYSE] \$133.64 (12/31/18)



- Incorporated: IN
- HQ: Columbus, IN
- Shares Outstanding (fully diluted): 163.3 million
- Float: Insider ownership 1.1m shares; <1%
- Market Cap: \$21.8 billion
- SAI: 2% position at cost; \$141.70
 - 10.2x 2018 EPS
- EPS TTM (09/30/18): \$12.83*; P/E: 10.4x
- EPS FY 2018E: \$13.91; P/E: 9.6x
- Dividend FWD: \$4.56; 3.4%; Payout: ~33%
- Fiscal year ends December 31st

*Adjusted for non-cash TCJA 12/31/17

Historical Stock Price



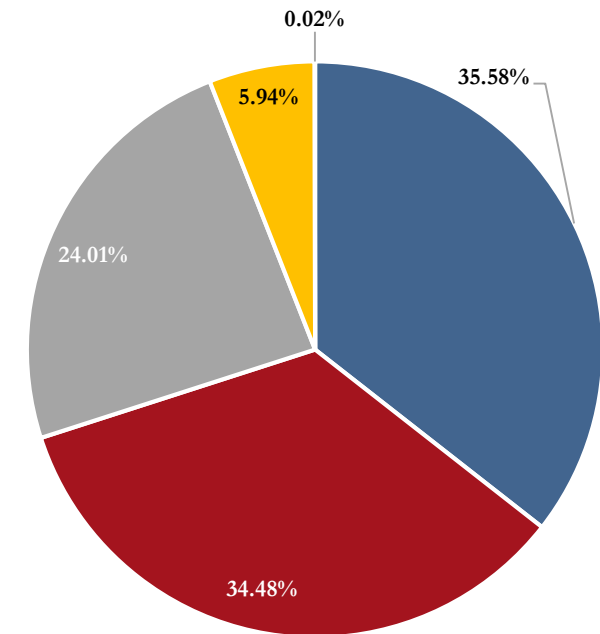
Source: Yahoo Finance

Cummins: Business



- Founded by Clessie Lyle Cummins in 1919 as Cummins Engine Company as one of the first diesel engine manufacturers
 - The diesel engine was invented by German engineer Rudolf Diesel in the late 1800's.
- Designs, manufactures, distributes and services diesel and natural gas engines and engine-related component products, including filtration, aftertreatment, turbochargers, fuel systems, controls systems, air handling systems, transmissions and electric power generation systems
- Customers include PACCAR, Navistar International, Daimler Trucks North America, Volvo Trucks, and Fiat Chrysler
- Network of approximately 500 wholly-owned and independent distributor locations spans across 7,500 dealer locations in more than 190 countries
- 4+ Segments
 - Engine
 - Distribution
 - Components
 - Power Systems
 - Electrified Power

Revenue Segments (9/30/18)



■ Engine ■ Distribution ■ Components ■ Power Systems ■ Electrified Power

Source: Cummins Q3 2018 Earnings Press Release



Strengths

- Dominant market position in diesel engine manufacturing
- Less economically cyclical than generally perceived
- Management team and capital allocation skills are exceptional

Risks

- Economic slowdown in class 8 trucking market
- Electrified powertrains in heavy duty trucks
- Environmental regulation

Financial Profile

- Great balance sheet
- High core and incremental profitability
- Excellent capital management

Valuation

- Price more than discounts cycle
- Perpetual discount for high ROC business
- Normalize valuation at mid-cycle; discount for disruption

Management and Board

- Tom Linebarger (Chairman and CEO)
- Long-tenured team
- Compensation aligned to shareholder returns



Dominant market position

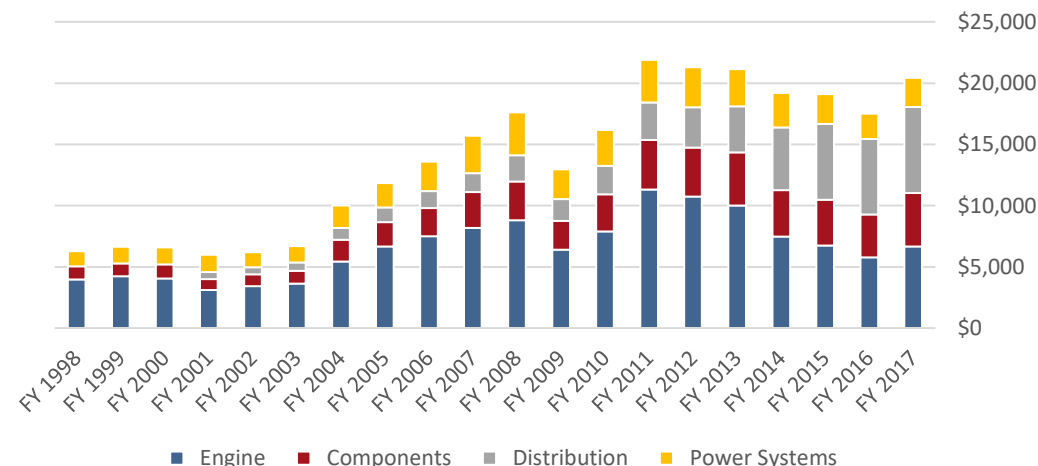
- Supply to OEM on-highway and off-highway truck manufacturers displacement range 2.8 to 15 liters and horsepower ranging from 48 to 715 hp
- International was 54% of sales in 2017
- Long-term supply agreements with customers, stable pricing, jointly engineer better integrated vehicles
 - Scale advantage allows them to leverage global distribution
- Acquired North American distributors
 - Ownership is strategic asset, increase growth and competitive advantage
 - Non-Cummins products distributed
 - Increase adjacent products and services, regional
 - Parts and service opportunity
- Compete well on performance, fuel economy, speed of delivery, quality, customer support and price

Growing global markets

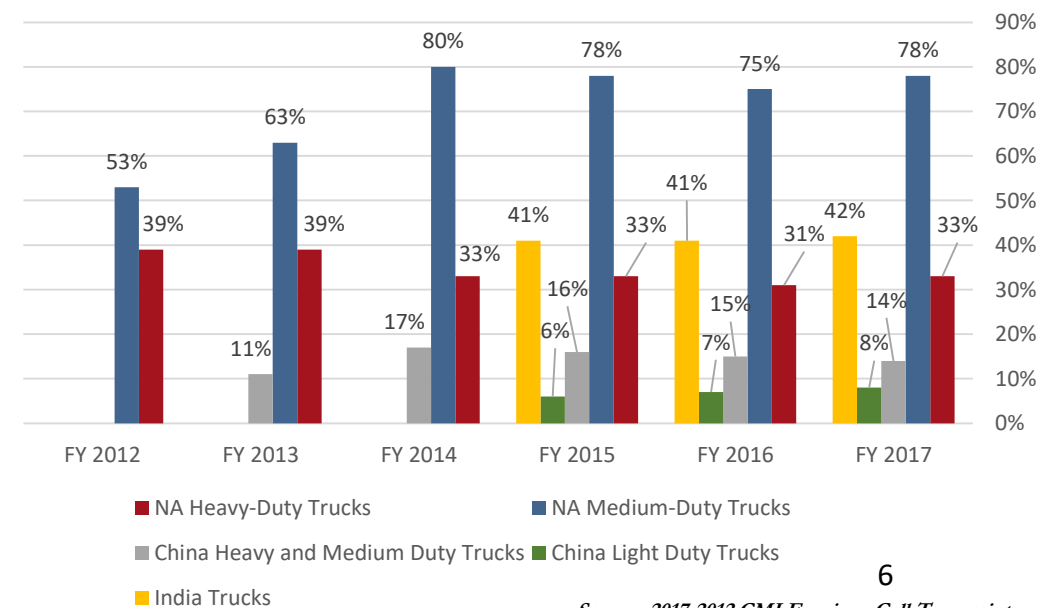
- China LCV market from 1% share in 2012 to 8% in '17
- Expect Chinese truck demand to be 1.15m to 1.2m units for 2018
- Growth in power generation, oil and gas, rail, marine, natural gas
- Strong position in the Indian truck market



Segment Sales TTM



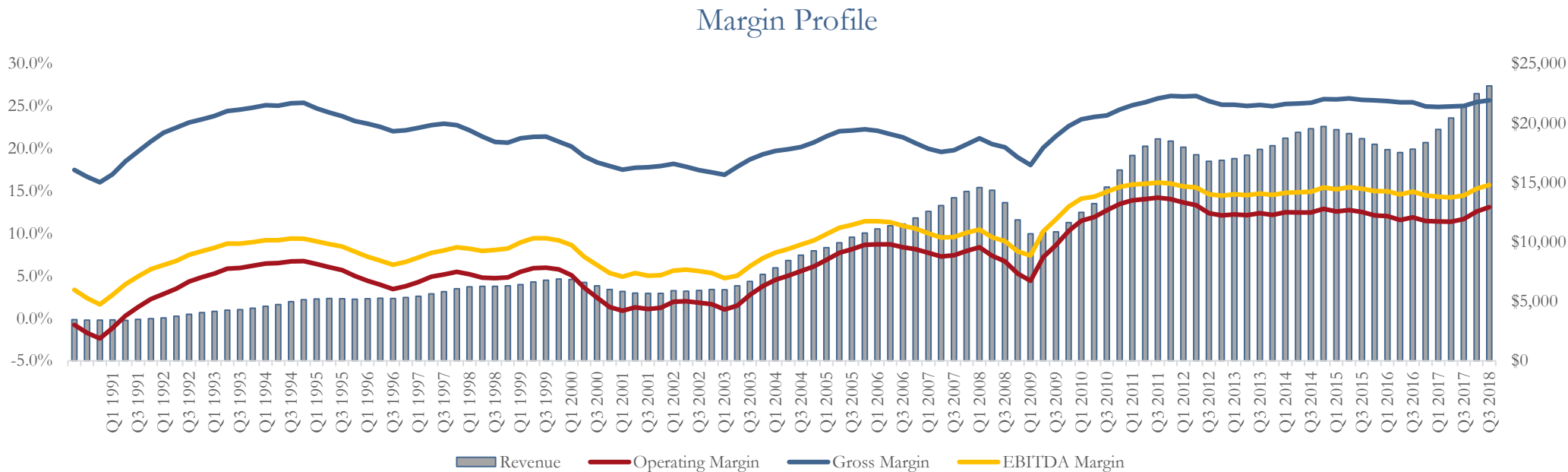
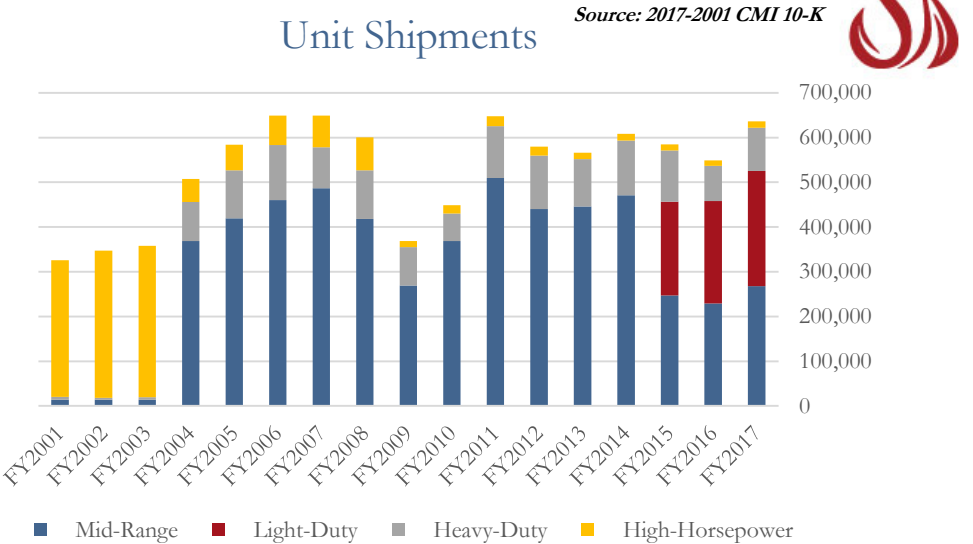
Historical Market Share TTM





Upgrade cycle in Class 8 trucking is driven by emissions regulation

- Regulators consistently require freight companies to upgrade fleets with ever more restrictive emissions standards
- Leading provider of OEM and aftermarket emissions equipment
- Less economically cyclical than most people think
- Current price more than compensates for the likelihood of a recession



Source: 2017-1991 CMI 10-K



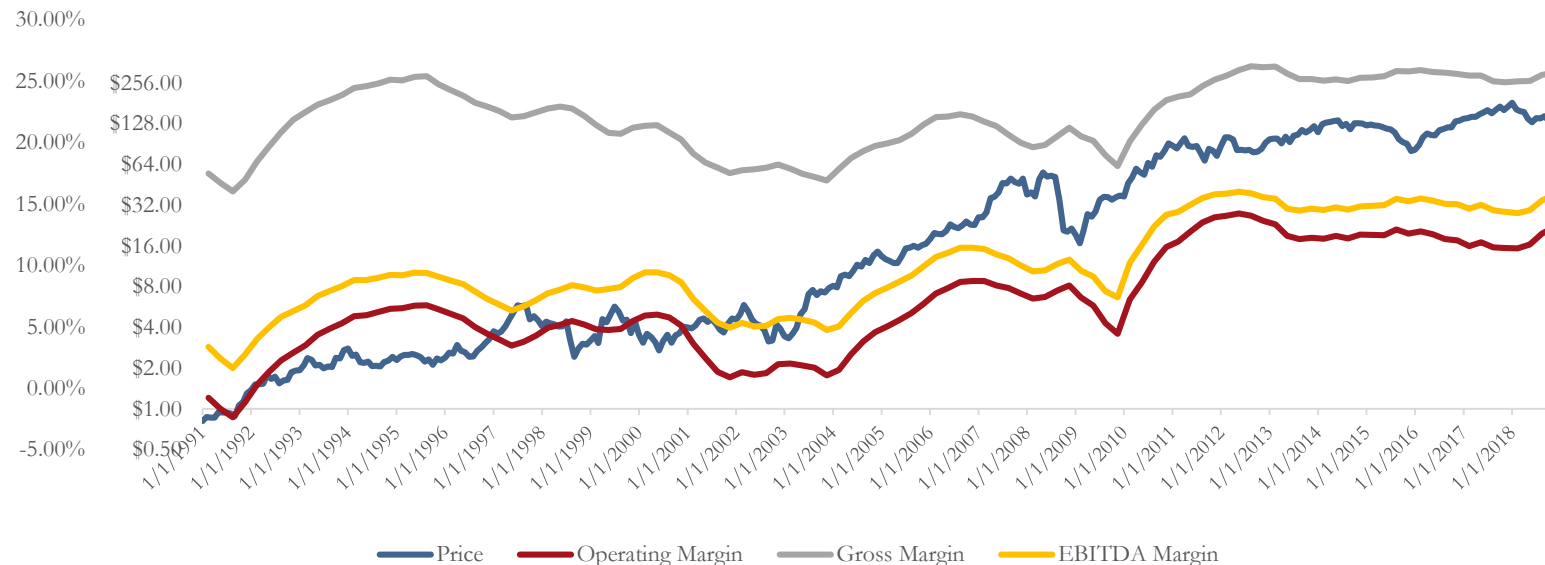
Significant downturn in Class 8 trucking market

- Due to the high operating leverage within the company, a significant slow down in the class 8 trucking market would cause significant margin compression
 - Decremental EBITDA margins of 25%
 - Heavy-duty trucks comprise 34% of revenue in the first 3 quarters of 2018
 - 32% of revenues in 2017

Environmental Regulation

- Governments around the world have started talking about forcing citizens to end the use of diesel engines
 - 2025 diesel ban in Athens, Madrid, Mexico City, Paris
 - 2030 German ban on NEW internal combustion engine
 - China considering ban
 - California CARB phase-out 2040 (status?)
- If governments were to subsidize the charging infrastructure for electric vehicles, it would speed up the switch from diesel to electric significantly

Price Cyclicity



Source: 2017-1991 CMI 10-K



Electrification of powertrains

Strengths

Risks

Financial Profile

Valuation

Management and Board

- The electrification of powertrains in the Class 8 trucking industry presents a long-term risk
 - We do not see this as being viable in the next decade
 - Drivers are allowed up to 11 hours of driving time
 - 10 consecutive hours of time off-duty is needed for this to reset
 - At an average of 60 mph highway speed, this equates to a rough distance of 660 miles per trip
 - Tesla claims to have the farthest battery range of 500 miles for its Class 8 truck that can be recharged in 30 minutes (Most other companies are in the 300 mile range with 90 minute charging times)
 - The charging time is inhibitive to the viability of these trucks as truckers will not want to sit and wait 30-90 minutes for recharging in the middle of their shift
- We recognize the uses of electrified trucks in buses and short haul trucking
 - Cummins electric engines for use in city buses by the end of 2019
- Hybrid trucks seem to be a much greater threat
 - Nikola Motor Company have developed a truck that can travel 800-1200 miles on a single charge
 - Fully electric drivetrain is powered by high-density lithium batteries ⁽¹⁾
 - Electricity is supplied on-the-go by a hydrogen fuel cell⁽¹⁾
 - NMC has 8,000 pre-orders ⁽²⁾
 - The required infrastructure for recharging is the main headwind here.
 - “NMC is building a nationwide fuel network with 364 locations. Construction will start in 2019.” ⁽¹⁾
 - Planning to build the first 2 stations in June of 2019 in Arizona ⁽²⁾
 - 28 additional stations are planned on key routes serving Anheuser-Busch breweries and distribution centers ⁽²⁾
 - Anheuser-Busch has ordered 800 trucks for regional runs between breweries. Should enter service in 2 years. ⁽²⁾

(1):<https://www.overdriveonline.com/new-electric-class-8-truck-1000-hp-1200-mile-range/>

(2):<https://www.trucks.com/2018/11/15/nikola-tops-200-million-fundraising-goal/>



Revenues: \$20.4 billion in 2017; \$23.1 billion TTM from 9/30/18

- \$23.7 B expected midpoint 2018; up 16% y/y
 - Engine backlog strong
 - Mid 2019 may be cycle peak
 - Cycle more environment/regulatory driven
 - 2008 revenues \$14.3B vs. \$13.1b 2007
 - 2009 revs \$10.8B down 25% from peak
 - '09 simultaneous end of upgrade and economy

Margins

- Gross margins normalize at 25.5% full cycle
 - Was 24% in 2016 when sales fell 8%
- EBITDA normalized at 15%
 - Goal is to manage decremental EBITDA margin to 25%
- EBIT margin normalizes to 13.5%
- EBT is 13.2%
- NI is 10.2%

*Uses net debt; net debt include operating lease expense capitalized at \$1.075B

**ROANA = EBIT/Avg Net Assets; 10-year average

*** ROIC = NOPAT / Average total capital; 10-year avg; Invested capital defined using total debt, not net debt

Profitability

ROE	30.8%
ROC (net)*	26.7%
ROANA**	28%
ROIC***	21%



Balance Sheet Summary Figures

Millions of USD (9/30/18)

Cash	\$1,404
Total Assets	\$18,992
Total Debt*	\$2,465
Operating Leases (SAI Capitalized)	\$1,075
Interest Expense pre-tax	\$118
Rent Expense pre-tax	\$215
CMI Shareholder's Equity	\$7,191
Non-Controlling Interest	\$869
Inventory	\$3,831
Goodwill	\$1,110
Other Intangibles, net	\$950
PP&E, gross	\$8,079
Accumulated Depreciation	\$4,209
PP&E, net	\$3,870

Source: CMI Q3 2018 10Q



Summary of Financial Data

(Millions of USD)

Strengths

Risks

Financial
Profile

Valuation

Management and
Board

Statement of Income Data

	9/30/2018 TTM	12/31/2017	12/31/2016	12/31/2015	12/31/2014	12/31/2013
Net Sales	23,121	20,428	17,509	19,110	19,221	17,301
Cost of Goods Sold	17,188	15,330	13,057	14,163	14,360	12,973
Gross Profit	5,933	5,098	4,452	4,947	4,861	4,328
SG&A	2,427	2,419	2,046	2,092	2,089	1,865
R&D	865	753	636	735	750	713
Other Operating Income	441	397	255	392	374	353
Operating Profit	3,024	2,323	2,025	2,436	2,396	2,103
Interest Expense	73	63	46	40	41	14
Other (Income) Expense	(70)	(91)	(45)	(9)	(110)	(32)
Income Before Income Tax	2,639	2,365	474	555	698	531
Income Tax Expense	594	594	688	616	603	545
Net Income*	2,065	1,776	1,456	1,470	1,736	1,588
EPS-Basic	\$12.39	\$10.51	\$8.26	\$7.84	\$9.04	\$7.94
EPS-Diluted	\$12.35	\$10.49	\$8.24	\$7.84	\$9.02	\$7.91
Dividends per Share	\$4.38	\$4.21	\$4.00	\$3.51	\$2.81	\$2.25

Statement of Cash Flows Data

Net Cash Provided by (Used in)						
Operating Activities	2,194	2,277	1,943	2,059	2,266	2,089
Investing Activities	(785)	(1,052)	(917)	(918)	(1,413)	(566)
Financing Activities	(1,434)	(1,074)	(1,417)	(1,644)	(1,343)	52
Total Capital Expenditures	(642)	(477)	(580)	(799)	(798)	(740)
Depreciation	476	471	438	424	356	321
Amortization	130	112	92	90	99	86

Supplemental Data

Cash Dividends	718	701	676	624	513	420
Net Share Repurchases	939	451	778	908	670	381
Acquisition Expenditures	132	662	93	117	436	147



Summary of Financial Data

(Millions of USD)

Balance Sheet Summary Data	9/30/2018 TTM	12/31/2017	12/31/2016	12/31/2015	12/31/2014	12/31/2013	12/31/2012
Cash	1,407	1,567	1,380	1,811	2,394	2,849	1,616
Receivables	3,670	3,311	2,803	2,640	2,744	2,362	2,235
Inventories	3,831	3,166	2,675	2,707	2,866	2,381	2,221
Other	955	884	849	789	1,051	1,047	1,095
Current Assets	9,863	8,928	7,707	7,947	9,055	8,639	7,167
PP&E	3,870	3,927	3,800	3,745	3,686	3,156	2,724
Goodwill	1,110	1,082	480	482	479	461	445
Other Intangibles	950	973	332	328	343	357	369
Prepaid Pension Costs	1,022	1,043	731	735	637	514	182
Investments in Affiliates	1,255	1,156	946	975	981	931	897
Misc LT Assets	922	966	1,015	922	583	670	675
Non-current Assets	9,129	9,147	7,304	7,187	6,709	6,089	5,381
Total Assets	18,992	18,075	15,011	15,134	15,764	14,728	12,548
Payables	5,014	4,759	3,569	3,337	3,511	3,015	2,841
Short-term Debt	902	418	288	63	109	68	77
Other	500	500	468	403	401	285	218
Current Liabilities	6,416	5,677	4,325	3,803	4,021	3,368	3,136
Long-term Debt	1,563	1,588	1,568	1,576	1,577	1,672	698
Other	2,953	2,646	1,944	2,005	2,073	1,818	1,740
Non-current Liabilities	4,516	4,234	3,512	3,581	3,650	3,490	2,438
Total Liabilities	10,932	9,911	7,837	7,384	7,671	6,858	5,574
Common Stock	556	556	556	556	556	556	556
Additional Paid in Capital	1,595	1,654	1,597	1,622	1,583	1,543	1,502
Treasury Stock	5,674	4,905	4,489	3,735	2,844	2,195	1,830
Retained Earnings	12,519	11,464	11,040	10,322	9,545	8,406	7,343
Other Equity	-1,805	-1,510	-1,829	-1,359	-1,091	-800	-968
Cummins Shareholder Equity	7,191	7,259	6,875	7,406	7,749	7,510	6,603
Minority/Non Controlling Interest	869	905	299	344	344	360	371
Equity	8,060	8,164	7,174	7,750	8,093	7,870	6,974

Source: 2017-2013 CMI 10-K & Q3 2018 10Q

*Adjusted for non-cash TCJA 9/30/18 TTM and 12/31/17



Capital Management

Dividends

- ~33% payout ratio

Share Repurchases

- Consistent repurchases over the years
 - The stock has never gotten extremely expensive
 - No significant leverage to finance buybacks

Date	Share Repurchase	Cost
2018 (9mo.)	5.3m shares @ \$147.65	\$0.78 billion
2017	2.9m shares @ 155.81	\$0.45 billion
2016	7.3m shares @ 106.48	\$0.78 billion
2015	7.2m shares @ 124.3	\$0.9 billion

Capital Expenditures

- Maintenance
- Capacity
- Environmental

Date	Capital Expenditures in millions of USD	D&A in millions of USD	R&D in millions of USD
9/30/2018 TTM	\$642	\$606	\$865
12/31/2017	\$506	\$583	\$753
12/31/2016	\$531	\$530	\$363
12/31/2015	\$744	\$514	\$735

Acquisitions

- Bolt-on
- Mostly partnerships and JV's

R&D

- 3-4% of sales
- Environmental
- Technology





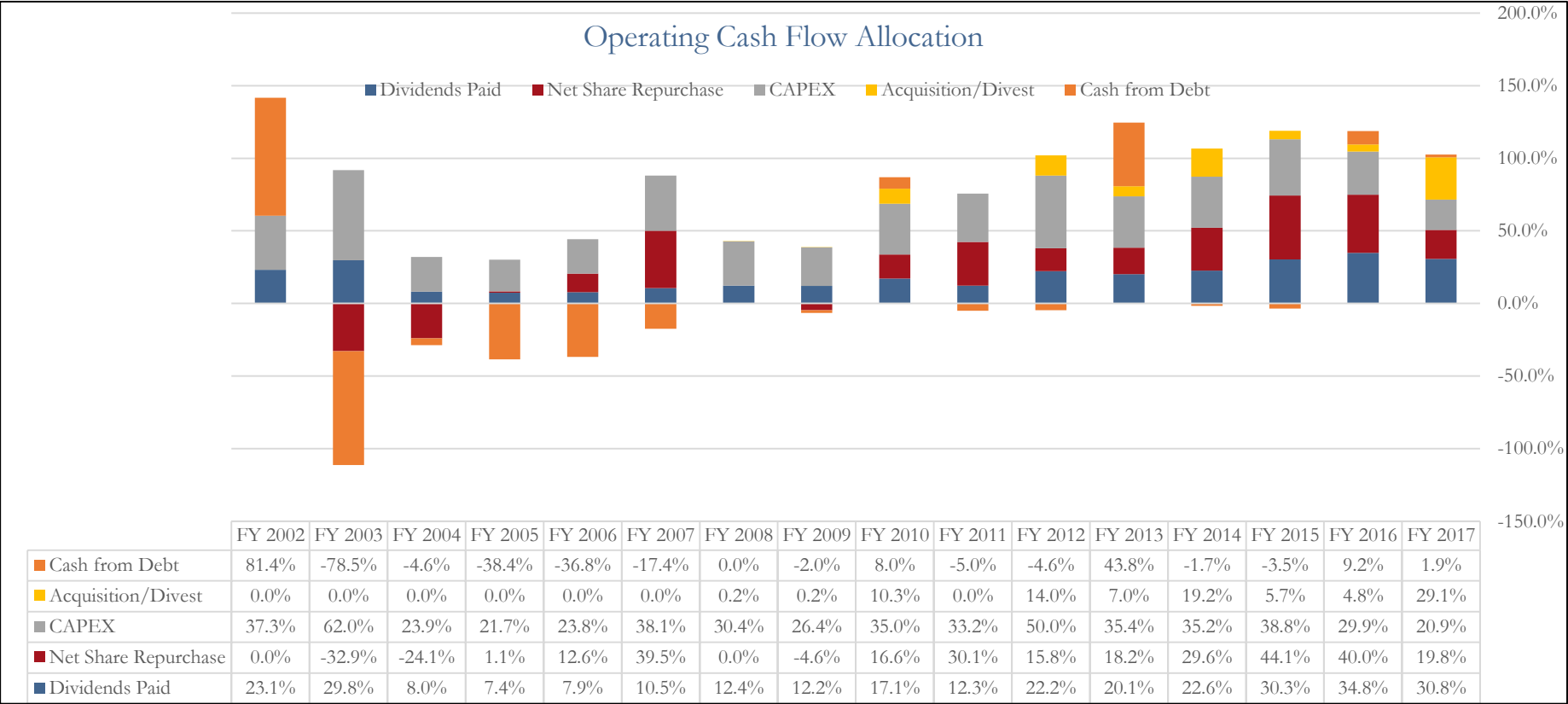
Capital Management



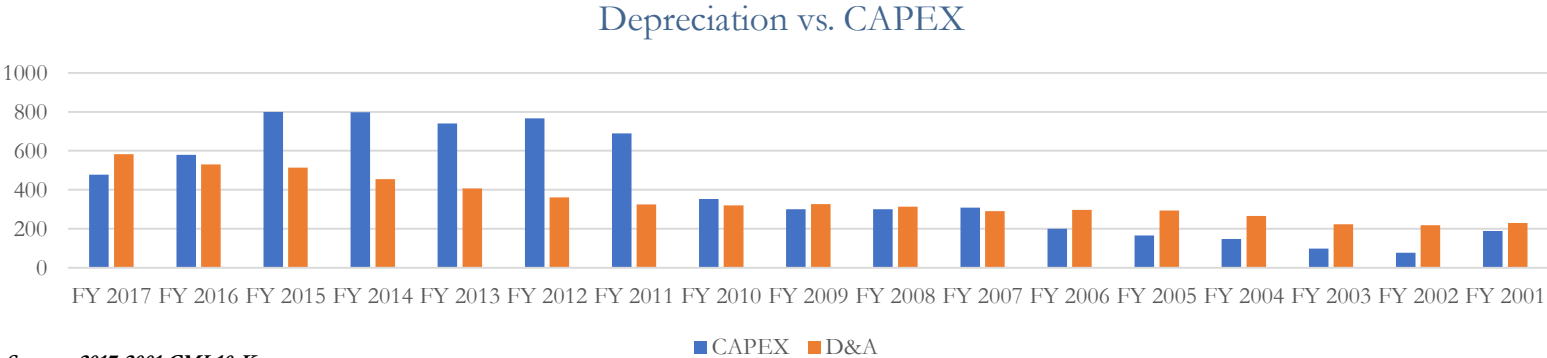
Date	Acquisition	Interest Acquired	Price in Millions of USD	Net Sales in Millions of USD
2017	Brammo Inc.	100%	\$68	\$4
2017	Eaton Cummins Automated Transmission	50%	\$600	N/A
2016	Wuxi Cummins Turbo Technologies	45%	\$86	\$0
2016	Cummins Pacific	50%	\$99	\$391
2016	Cummins Northeast	35%	\$12	\$0
2015	Cummins Crosspoint	50%	\$65	\$258
2015	Cummins Atlantic	51%	\$49	\$245
2015	Cummins Central Power	20%	\$8	\$0
2014	Cummins Bridgeway	54%	\$77	\$331
2014	Cummins Npower	50%	\$73	\$374
2014	Cummins Power South	50%	\$35	\$239
2014	Cummins Eastern Canada	50%	\$62	\$228
2014	Cummins Power Systems	30%	\$14	\$0
2014	Cummins Southern Plains	50%	\$92	\$433
2014	Cummins Mid-South	62%	\$118	\$368
2013	Cummins Western Canada	35%	\$32	\$0
2013	Cummins Rocky Mountain	67%	\$136	\$384
2013	Cummins Northwest	20%	\$4	\$137
2013	Cummins Northwest	50%	\$18	\$137
2012	Cummins Central Power	45%	\$26	\$209



Capital Management



Source: 2017-2001 CMI 10-K



Source: 2017-2001 CMI 10-K

Capital Management



Strengths

Common Sized

Income Statement

	09/30/2018 TTM	12/31/2017	12/31/2016	12/31/2015	12/31/2014	12/31/2013	12/31/2012	12/31/2011	12/31/2010
Revenue	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Gross Margin	25.7	25.0	25.4	25.9	25.3	25.0	26.2	25.4	23.7
SG&A	10.5	11.8	11.7	10.9	10.9	10.8	11.0	10.2	11.2
R&D	3.7	3.7	3.6	3.8	3.9	4.1	4.2	3.5	3.1
Other Operating Expense	-0.1	-0.2	0.3	-0.4	0.0	0.0	-0.1	0.0	0.1
Operating Income	13.1	11.4	11.6	12.7	12.5	12.2	13.3	14.0	11.9
Interest Expense	0.3	0.3	0.3	0.2	0.2	0.1	0.0	0.1	0.1
Pre-tax Income	11.4	11.6	11.0	10.6	12.7	12.2	13.1	14.8	12.2
Income Tax*	2.6	2.9	2.7	2.9	3.6	3.1	3.1	4.0	3.6
Net Income*	8.8	8.7	8.0	7.3	8.6	8.6	9.5	10.2	7.9

Supplemental

Capital Expenditures	2.8%	2.3%	3.3%	4.2%	4.2%	4.3%	4.4%	3.8%	2.7%
Dividends	3.1	3.4	3.9	3.3	2.7	2.4	2.0	1.4	1.3
Share Repurchases	4.1	2.2	4.4	4.8	3.5	2.2	1.4	3.5	1.3
Acquisitions	0.6	3.2	0.5	0.6	2.3	0.8	1.2	0.0	0.8

Financial
Profile

Valuation

Management and
Board



Valuation

- 12/31/18 price: \$133.64/share
 - \$21.8 billion market cap
- 10.3x TTM \$12.83
- 9.5x expected 2018 EPS of \$13.91
 - Strong fundamentals in the Class 8 and medium-duty truck markets
 - 15x 20% decline is $\$11.13 \times 15 = \166 per share
 - 15x 30% decline is $\$9.74 \times 15 = \146 per share
- Economically a business that earns mid 20's on equity and 20 plus on capital with prospects for organic growth
 - Should trade for closer to 20x mid-cycle earnings
 - Call mid cycle \$1.8 billion in net income; \$36B market cap; \$220 per share; 65% upside
 - Shave 25% for industry disruption and failure to completely adjust
 - 15 x \$1.8B = \$27B market cap; \$165 per share; 24% upside

Current Multiples

2018 P/E	9.6x
E/P	10.4%
P/S	0.9x
P/B	4.0x
EV/EBIT	7.1x
Div. Yield	3.5%
Payout	~33%



Chairman and CEO: Thomas Linebarger

- CEO 2012; President and COO 2008-2011
 - Compensation performance metrics are exactly what we want as shareholders
 - Took the recent warranty charge against their compensation performance metrics
 - Conservative accounting
- Stock Ownership
 - 375,712 shares worth \$50.12m
 - 275,510 of these are vested stock options (at 12/31/17)
- Total compensation: \$11.9m
- Base Salary: \$1.375m
- Target Cash Bonus: \$1.856m
 - 135% participation rate and payout factor of 2.0 equals a \$3.712m bonus award
 - Performance metrics: ROANA using EBIT
 - 12.92% threshold
 - 21.53% target
 - 25.83% maximum

- Target Long-term Incentive: \$6.8m for 2017-2019 period
 - Performance cash (34%), ROE, 3-year term
 - Performance shares (33%), ROE, 3 year term
 - Stock options (33%), Share price appreciation, 3-year cliff vesting
 - 10-year term
 - Actual ROE of 18.12% for 2015-2017 period equals a payout factor of 0.7
 - Threshold of 12.31%
 - Target of 20.52%
 - Maximum of 23.71%
 - 2017 LTI comp was \$6.8m
 - 4.22 to 1 ratio of stock options to performance shares





Named Executives

- **N. Thomas Linebarger:** Chairman and CEO
 - Total Compensation: \$11.9m
- **Patrick J. Ward:** VP and CFO
 - Total Compensation: \$5.4m
- **Richard J. Freeland:** President and COO
 - Total Compensation: \$5.9m
- **Livingston L. Satterthwaite:** VP and President-Distribution Business
 - Total Compensation: \$3.5m
- **Marya M. Rose:** Vice President and Chief Administrative Office
 - Total Compensation: \$4.1m
- **Srikanth Padmanabhan:** President of Engine Business

Board of Directors

- **N. Thomas Linebarger:** Chairman and Chief Executive Officer, Cummins Inc.
- **Richard J. Freeland:** President and Chief Operating Officer, Cummins Inc.
- **Robert J. Bernhard:** Vice President for Research and Professor in the Department of Aerospace and Mechanical Engineering, University of Notre Dame
- **Dr. Franklin R. Chang Diaz:** Founder, Chairman and Chief Executive Officer, Ad Astra Rocket Company
- **Bruno V. Di Leo Allen:** Senior Vice President, International Business Machines Corporation
- **Stephen B. Dobbs:** Former Senior Group President of Industrial and Infrastructure Group of Fluor Corporation
- **Robert K. Herdman:** Managing Director, Kalorama Partners LLC
- **Alexis M. Herman:** Chairman and Chief Executive Officer, New Ventures, LLC
- **Thomas J. Lynch:** Chairman, TE Connectivity Ltd.
- **William I. Miller:** President, The Wallace Foundation
- **Georgia R. Nelson:** President and Chief Executive Officer, PTI Resources, LLC
- **Karen H. Quintos:** Chief Customer Officer, Dell Technologies Inc.





Summary

- Major player in the Class 8 trucking market
 - More attractive than OEMs
 - More durable margins
 - Proactively investing in electrification
 - Viability in buses and short-haul trucks
 - Global growth
- Low to mid 20s full cycle returns on capital business with an entrenched market position
 - Should trade at a 20x multiple
 - Cyclical worries and that of disruption have depressed share prices
 - Much less economically cyclical than most believe
 - Trading at 9.6x 2018 earnings
 - 10.4% earnings yield
 - 25% discount to conservative intrinsic value



Biography

Christopher P. Bloomstran, CFA, is the President and Chief Investment Officer of Semper Augustus Investments Group LLC. Chris has more than 25 years of professional investment experience with a value-driven approach to fundamental equity and industry research. At Semper Augustus, Chris directs all aspects of the firm's research and portfolio management effort. Semper Augustus is a fundamental, value-driven investor managing concentrated equity portfolios of well-run, well-capitalized businesses with share prices trading below conservative appraisals of intrinsic value.

Prior to forming Semper Augustus in 1998 – in the midst of the stock market and technology bubble – Chris was a Vice President and Portfolio Manager at UMB Investment Advisors. While at UMB Investment Advisors, he managed the Trust Investment offices in St. Louis and Denver and managed the Scout Balanced Fund from the fund's inception until 1998, when he left to found Semper Augustus.

Chris received his Bachelor of Science in Business Administration with an emphasis in Finance from the University of Colorado at Boulder, where he also played football. He served as President of the Board of Directors for the CFA Society of St. Louis from 2006-2007 and as a Director on the Board since 2001. Chris has judged the local CFA Institute Global Investment Challenge for many years and has been honored to judge the Regional and the Global Finals. He earned his Chartered Financial Analyst (CFA) designation in 1994.



Contact Us...

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