

Cummins – An Oversold And Undervalued Dividend Stock

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By Robert Hauver

The market has fallen out of love with stalwart Industrial dividend stock Cummins, (CMI), sending its shares down over 16% in May. Lowered guidance from fellow equipment maker Joy Global, (JOY), has also helped to depress CMI's shares this week. JOY cut its guidance approx. 3.4 to 4.5%, down to a \$7.15 to \$7.45 range, and trimmed its revenue guidance by approx. 1.8%, based on weaker mining equipment demand from US coal miners.

Here's the anomaly and the opportunity: JOY's coal mining equipment business is slowing in the US because of the ongoing natural gas boom, which is causing utility and other power users to switch from more expensive, dirtier coal, to cheaper, cleaner natural gas. BUT, as the biggest natural gas and hybrid bus engine manufacturer in the US market, **Cummins will gain from this shift from coal to natural gas**, as more fleet owners switch to these natural gas and hybrid engines.

Huge firms, like Waste Mgt., Walmart, UPS, and Ryder, are converting their fleets to capitalize on the fuel savings, which is substantial: the natgas engines cost approx. \$30,000 more, but, the fuel cost savings is about \$27,000/year. It's a no-brainer for these firms, which stand to save millions by switching. Indeed, Cummins estimates that its heavy-duty truck sales will grow 29% in 2012. The natgas engine story is compelling overseas also – The Wall St. Journal recently reported that annual overseas growth has been 42% over the past decade in the Asia-Pacific region.

So, Wall Street is handing out a buying opportunity for Cummins, by incorrectly discounting its stock along with JOY and other Industrials. Here's a look at CMI's slow stochastic chart, which shows that it's below the oversold 20 line. This is also supported by its Relative Strength of 29.06, which is under the 30 threshold.:



In addition to being oversold, CMI is also undervalued on a PEG basis, for 2012 and 2013 earnings growth, and is toward the low end of its 5-year P/E range:

Ticker	P/E (Trailing 12 months)	5-Year P/E Range	EPS growth 2011	Estimated EPS Growth 2012	PEG: 2012	Estimated EPS Growth 2013	PEG: 2013
CMI	9.27	6.96 to 21.18	81.00%	11.41%	0.81	12.22%	0.76
Industry Avg. P/E:	12.86	CMI EPS:	2011: \$9.55	2012: \$10.64		2013: \$11.94	

How to play it: Given the overall gloom of the market, the most conservative way to profit from CMI is by selling cash secured puts below CMI's share price. Fortunately, CMI has high options yields, so you can achieve a break-even that's very close to its 52-week low. (There are more details on this and over 30 high yield Cash Secured Puts trades in our [Cash Secured Puts Table](#).)

CMI 6/1/12 PRICE PER SHARE	DIVIDEND PER SHARE \$ EX-DATES BEFORE PUT EXPIRATION	ANNUAL'D DIVIDEND YIELD %	PUT OPTION EXPIRATION MONTH & STRIKE PRICE	PUT BID PREMIUM	ANNUAL'D PUT YIELD	100% CASH RESERVE AMOUNT	BREAK-EVEN PRICE	52-WEEK LOW
\$94.18	\$0.80	1.54%	DEC. 2012 \$92.50	\$11.60	22.77%	\$9,250.00	\$80.90	\$79.53

Conversely, buying CMI and selling covered calls above its share price will also produce a high yield. This covered call trade is listed with over 30 other high yield options trades in our [Covered Calls Table](#)):

CMI 6/1/12 PRICE PER SHARE	DIVIDEND PER SHARE \$ PAID PRIOR TO CALL EXPIRATION	ANNUAL'D DIVIDEND YIELD %	CALL OPTION EXPIRATION MONTH & STRIKE PRICE	CALL BID PREMIUM	ANNUAL'D CALL YIELD	TOTAL ANN'D STATIC YIELD	POTENTIAL ASSIGNED YIELD	ANNUAL'D TOTAL POTENTIAL YIELD
\$94.18	\$0.80	1.54%	DEC. 2012 \$95.00	\$11.10	21.40%	22.17%	1.58%	23.75%

Dividends: Although it still isn't a high dividend stock, Cummins really cranked up its dividend yield and payout in 2011, jumping from \$.26/quarter, to \$.40/quarter, a 54% increase.

Ticker	Dividend Yield	Dividend Payout Ratio	Quarterly Dividend	Next Ex-Dividend Date approx.
CMI	1.65%	14.34%	\$0.40	8/17/12

Financials: CMI's financial metrics are far superior to its industry's averages:

Ticker	Return on Assets	Return on Equity	Return on Investment	Current Ratio	Total Debt/Equity	Operating Margin	Interest Coverage
CMI	18.00%	36.04%	27.26%	2.02	0.11	15.01%	65.40
Industry Avgs.	5.39%	13.53%	8.88%	1.39	0.74	10.57%	0.55

We feel that the pullback in CMI is overdone, and that CMI should be one of the best dividend stocks to buy and trade for undervalued growth. The natgas engines story is compelling over the long term – as more and more companies and cities convert their fleets, Cummins will get a major slice of that business.

Company Profile: Cummins Inc., a global power leader, is a corporation of complementary business units that design, manufacture, distribute and service engines and related technologies, including fuel systems, controls, air handling, filtration, emission solutions and electrical power generation systems. Headquartered in Columbus, Indiana, (USA) Cummins employs approximately 44,000 people worldwide and serves customers in approximately 190 countries and territories through a network of more than 600 company-owned and independent distributor locations and approximately 6,500 dealer locations. Cummins earned \$1.85 billion on sales of \$18.0 billion in 2011. (Source: Cummins website)

Disclosure: Author was short CMI put options at the time of this writing.

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