Ticker: CNHI
Price (as of 11/28): $16.94
Target Price: $23.00
Market Capitalization: $23B

Date: November 28, 2021
Sector: Industrials
Company: CNH Industrials (NYSE: CNHI)
Sector Team: Abigail Sneddon, Daniella Smith, Kyle Gregor, Dianna Nielsen, Anthony Chafik

BUY: CNHI

Investment Thesis:

CNH Industrial engages in the design, production, marketing, sale and financing of agricultural and construction equipment, commercial vehicles, buses and specialty vehicles for firefighting, defense, and other uses. Our original catalyst surrounding the Infrastructure Package is already priced in and realized. However, the upcoming spin-off of the highway business will allow for both margin expansion and re-rating potential. Moreover, CNHI has medium-term catalyst of increased demand for agricultural equipment due to the agricultural cycle driving the current booming in agriculture commodity prices and pent-up demand for tractors given an aging tractor fleet. Long-term CNHI has a catalyst in their innovation of clean engines that rely on natural gas and electric. Given the large upside potential and limited downside risk, and we rate CNHI a BUY.

Catalysts:

- On-highway Spin-off: CNH Industrials announced the spin-off of its on-highway business, which includes trucks and power trains, in early 2020. The final vote to approve the spin-off will occur in the upcoming month, and then the company will begin trading early in the first quarter of 2022, under the name Iveco Group. The on-highway business is a lower-margin business that trades at a lower multiple than the off-highway business. The on-highway business is valued at a 10x P/E multiple across the street, but the off-highway business is valued at an 18x P/E multiple. Moreover, this spin-off simplifies CNHI's story, with 80% of its revenue and 90% of its profits being driven by agricultural equipment and the remainder from construction equipment. This move positions CNHI as the clear market second to Deere.
    - CEO: This spin-off is the work of CEO Scott Wine, who became CEO in 2020. Wine is a well-respected manager in the industry and is working to focus CNHI.
- Re-rating: Following the completion of the spin-off, the discount that CNHI is trading at will likely narrow significantly. CNHI currently trades at a massive discount and has the potential to re-rate as they spin-off the less profitable truck segment. CNHI, in many ways, is a legitimate #2 to Deere in the agricultural equipment space, but currently trades at a 45% P/E discount and a 58% EV/EBITDA to Deere, and a nearly 10% P/E discount to #3 industry AGCO.
- Agricultural Supercycle: There is a global agricultural "supercycle", which is a period of higher commodity prices, driven by increased demand for biofuels and continued grains buying from China. This cycle began in early 2021, but is predicted to last for the next several years. The boom in agriculture drives revenues for CNHI in the agricultural equipment segment. This is a long-term driver of growth for the entire industry, which CNHI will be very well suited to take advantage of, following the spin-off.

Q3 Earnings Report:

- Revenue of $7.97B up 23% YoY and beating estimates of $7.63B.\
- Diluted EPS of $0.36, beating the analyst estimates of $0.22

- Tractor demand was up 29% for tractors over 140HP in North America
- Truck order intake in Europe increased 68% YoY
- Strong performance as a result of higher volumes and favorable price realization

Downside Risks:

Farmer income and sentimenet is currently beging supported by record-high levels of government direct payments, which began in 2020 in response to the COVID-19 pandemic. Once government direct payments slow, farmer income and sentiment may fall and the recovery in agriculatural equipment demand may not be sustainable. However, these possible headwinds are not likely to impact in the short or medium term. Moreover, the economic recovery across Europe is very mixed and may remain weaker for longer durations than expected in Iveco's legacy markets (Spain and Italy), delaying plans to spin off the On-Highway segment in Q1'22.

Valuation:

- Price Target: $23.00
- Potential Upside: 36%
- EV/EBITDA Multiple: 10x
- Current P/E (FY 2021): 13x
- Implied Target P/E (FY 2021): 17x