Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Cummins India Limited

Geared up amidst business recovery

Capital Goods	Sharekhan code: CUMMINSIND	Company Update

Summary

- We retain a Buy on Cummins India Limited (Cummins) with a revised PT of Rs. 1,030, considering strong earnings growth potential, led by a domestic economic revival.
- Domestic sales are recovering as visible in macro indicators, signaling a strong pick-up in business activities; exports would benefit from improved demand from data centres, 5G rollout and the China+1 strategy.
- Company is well-placed to take advantage given that it is technologically prepared and has market leadership position; CPCB-IV norms can lead to further market share gains.
- Led by AatmaNirbhar Bharat, localized procurement and a faster pick-up in manufacturing activity, the entire sector is getting rerated which augurs well for Cummins, which trades at a discount to its peak 5-year average multiple.

Cummins India (Cummins) remains a beneficiary of the strong rebound in domestic industrial activity given its presence across most user segments such as infrastructure, construction, data centers, healthcare, mining railways etc. Demand environment remains encouraging in domestic market both in power generation and industrial segment on account of a recovery in infrastructure construction activity with a push from government providing strong outlook ahead too. Further, macro-economic indicators have remained positive such as Index of Industrial Production (IIP), GST collections, core sectors broad based recovery (cement, fertilisers) manufacturing PMI with sequential m-o-m pick-up. In a recent media interaction, management indicated that company operations have been normal with a 100% manpower capacity levels at all manufacturing sites and operations at ~90% at pre-COVID levels. Construction activities such as real estate have recovered post the lockdown and expected to be strong, providing a multi-year growth rate. Mining too has rebounded strongly with trends seen for higher mechanised inputs (higher tonnage dumpers) and demand being seen for the same. Data centers continue with their growth momentum and are expected to keep growing in double-digits as demand for medium to hyper-term data centres emanate largely from telecom and financial services segments. Cummins remains best suited in these segments from a technological perspective with different solutions for varied customers. The company's domestic powergen business have seen faster recovery indicative from the last quarter results fueled by stronger recovery in data centres, industrial business and rental segment with slower recovery seen across hospitality, tourism entertainment and education division. Cummins' distribution business has grown steadily over the years (having an installed base of over 600,000 engines and handles similar quantum of service request) supported by higher aftermarket sales distribution and is expected to get well leveraged over time. The company remains well placed given its strong manufacturing base to take advantage of opportunities, given its preparedness on the technological front with supply of CPCB-IV compliant products once implemented in India, which can lead to further market share gains on the back of a better engine and emissions technology. The exports business too has started reviving and demand across Africa and Middle East is starting to improve. The company's continues to look at end markets where growth is decent and Indian being one of the most cost-effective manufacturing hubs (apart from China and US) and Cummins looking at all options to use India as export base wherever possible remains positive. Further, the company is expected to benefit from improved demand from data centre (most countries and companies looking at setting up onsite data centres) and additional benefits to accrue with 5G mobile network roll out across many markets, which would lead to resumption of the high horse power as well as low horse power products for the company. With respect to rising commodity prices, the company has structured program to mitigate inflationary pressures and hopes to tide over the impact without significant impact. Overall, the company is expected to benefit in the longer run, given its strong product portfolio-wide distribution network to provide superior aftermarket sales and cost-effective products to maintain its leadership position in a highly competitive market. The stock is trading at valuations of 39.1x and 33.6x its FY2022E and FY2023E earnings, respectively and with AatmaNirbhar Bharat and domestic procurement, the entire sector is getting rerated which augurs well for Cummins which is trading at a discount to the peak 5-year average multiple. We maintain a Buy rating on the Cummins with modestly increasing our target PE to factor overall rerating in the space along with strong growth potential in end-user industries, robust balance sheet, and steady cash flow generation to arrive at a revised price target of Rs 1,030.

Our Call

Valuation – Retain Buy with a revised PT of Rs. 1,030: Cummins has started to witness the benefits arising from a strong revival in key segments such as power generation, construction, data centres and mining, which are expected to sustain going forward. Further, the industrial segment's sales will be driven by demand from railways, metro and road (compressors). Improvement in core business and increased outsourcing of maintenance services by clients are expected to boost the distribution business. Further, cost initiatives undertaken by the company have been yielding benefits in terms of improved OPM. We remain constructive on Cummins and expect a 15% net earnings CAGR over FY2021E-FY2023E, as it continues to gain from healthy demand led by a domestic economic revival. The stock is trading at valuations of 39.1x and 33.6x its FY2022E and FY2023E earnings, respectively and with AatmaNirbhar Bharat and domestic procurement, the entire sector is getting rerated which augurs well for Cummins, which is trading at a discount to the peak 5-year average multiple. We maintain Buy rating on the Cummins and modestly raise our target PE to factor overall rerating in the space along with strong growth potential in end-user industries, robust balance sheet, and steady cash flow generation to arrive at a revised target price of Rs. 1,030.

Key Risks

Slowdown in the domestic macro-environment and higher loss funding in roads can negatively affect business outlook and earnings growth.

Valuation (Standalone) Rs cr

Particulars	FY20	FY21E	FY22E	FY23E
Revenue	5,158	4,390	5,000	5,501
OPM (%)	11.4	12.7	12.7	13.3
Adjusted PAT	643	532	608	706
% YoY growth	(11.0)	(17.2)	14.1	16.2
Adjusted EPS (Rs.)	23.2	19.2	21.9	25.5
P/E (x)	36.9	44.6	39.1	33.6
P/B (x)	5.7	5.6	5.4	5.1
EV/EBITDA (x)	39.2	40.9	35.8	30.6
RoNW (%)	15.5	12.6	14.1	15.6
RoCE (%)	17.2	15.3	17.0	18.9

Source: Company; Sharekhan estimates

3R MATRIX

	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 857**	
Price Target: **Rs. 1,030**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

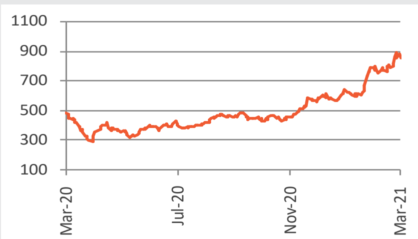
Company details

Market cap:	Rs. 23,756 cr
52-week high/low:	Rs. 899/282
NSE volume: (No of shares)	15.9 lakh
BSE code:	500480
NSE code:	CUMMINSIND
Free float: (No of shares)	13.6 cr

Shareholding (%)

Promoters	51.0
FII	9.0
DII	26.2
Others	13.8

Price chart



Price performance

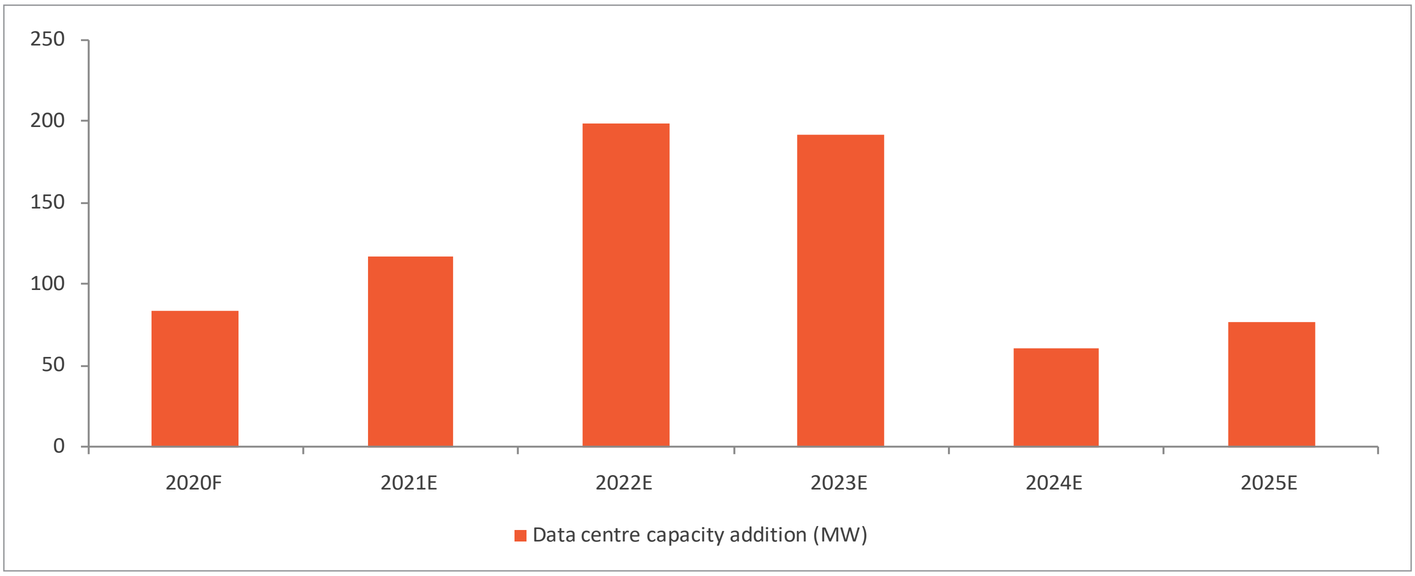
(%)	1m	3m	6m	12m
Absolute	11	45	86	77
Relative to Sensex	11	34	53	34

Sharekhan Research, Bloomberg

Improving demand environment provides optimism:

Cummins India (Cummins) remains a beneficiary of the strong rebound in domestic industrial activity given its presence across most user segments such as infrastructure, construction, data centers, healthcare, mining railways etc. Demand environment remains encouraging in domestic market both in power generation and industrial segment on account of a recovery in infrastructure construction activity with a push from government providing strong outlook ahead too. Further, macro-economic indicators have remained positive such as Index of Industrial Production (IIP), GST collections, core sectors broad based recovery (cement, fertilisers) manufacturing PMI with sequential m-o-m pick-up. In a recent media interaction, indicated that company operations have been normal with a 100% manpower capacity levels at all manufacturing sites and operations at ~90% at pre-COVID levels. Construction activities such as real estate have recovered post the lockdown and expected to be strong, providing a multi-year growth rate. Mining too has rebounded strongly with trends seen for higher mechanised inputs (higher tonnage dumpers) and demand being seen for the same. Data centers continue with their growth momentum and are expected to keep growing in double-digits as demand for medium to hyper-term data centres emanate largely from telecom and financial services segments. Cummins remains best suited in these segments from a technological perspective with different solutions for varied customers. The company's domestic powergen business have seen faster recovery indicative from the last quarter results fueled by stronger recovery in data centres, industrial business and rental segment with slower recovery seen across hospitality, tourism entertainment and education division. Cummins' distribution business has grown steadily over the years (having an installed base of over 600,000 engines and handles similar quantum of service request) supported by higher aftermarket sales distribution and is expected to get well leveraged over time. The company remains well placed given its strong manufacturing base to take advantage of opportunities, given its preparedness on the technological front with supply of CPCB-IV compliant products once implemented in India, which can lead to further market share gains on the back of a better engine and emissions technology.

Data center capacity addition to remain strong

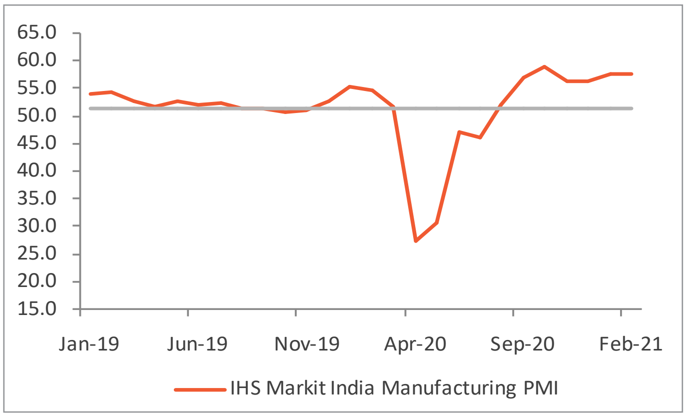


Source: JLL; Sharekhan Research

Macro indicators signal pick up in industrial activity -

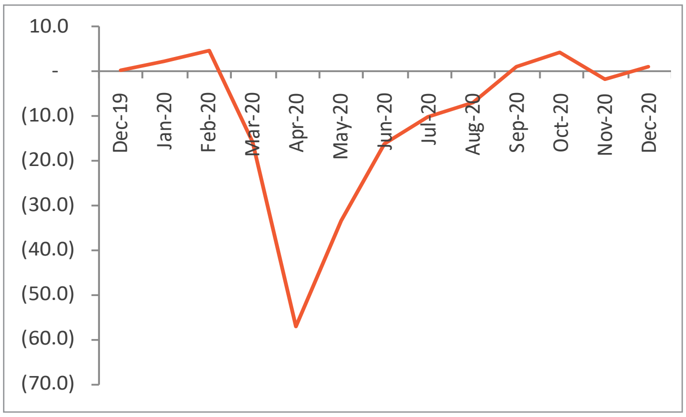
Due to its exposure to core sectors of the economy, Cummins' performance draws strong co-relation with IIP and economic indicators such as IIP are witnessing an uptick, indicating pickup in industrial activities. We believe that Cummins is set to revive its growth trajectory as demand from key end-user markets shows initial signs of recovery post the decline in H1FY2021. Management has also indicated that the domestic business is gradually improving in every segment, substantiated by economic indicators such as IIP and PMI manufacturing index; so, it is optimistic that over the next two-three quarters, the domestic business will improve. IIP has been in the positive territory for three out of the past four months coupled with IHS Markit India Manufacturing PMI, which has been improving m-o-m.

Manufacturing Index Trend



Source: Industry; Sharekhan Research

IIP trend

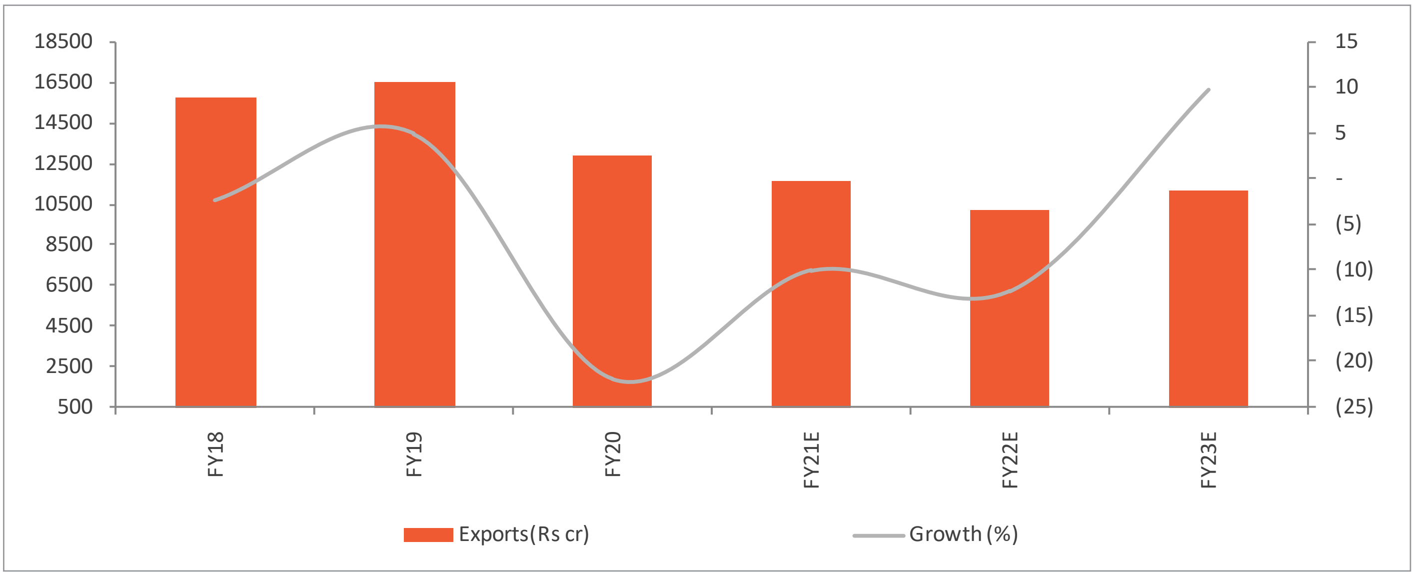


Source: Industry; Sharekhan Research

Exports to benefit from improved demand from data centre and 5G mobile network roll out

The exports business seems to be improving from the medium to long-term perspective as new demand drivers in terms of data centre and roll-out of the 5G telecom network would lead to demand resumption of HHP as well as LHP products of the company and earlier management has also indicated that exports will improve in H2FY2021. Further, post COVID-19, prospects for Cummins remain bright as different countries are looking apart from China for their supplies and develop alternatives, which helps them spread the supply chain disruption risk in case of any future unforeseen circumstances. Moreover, Cummins India has a competitive position within the Cummins ecosystem for capturing related exports opportunity in America and Europe over time. Further, demand across Africa and Middle East starting to improve providing opportunities ahead. On the key criteria of cost, delivery, and quality, the company expects to be competitive and potentially better than the other two manufacturing hubs in America and China.

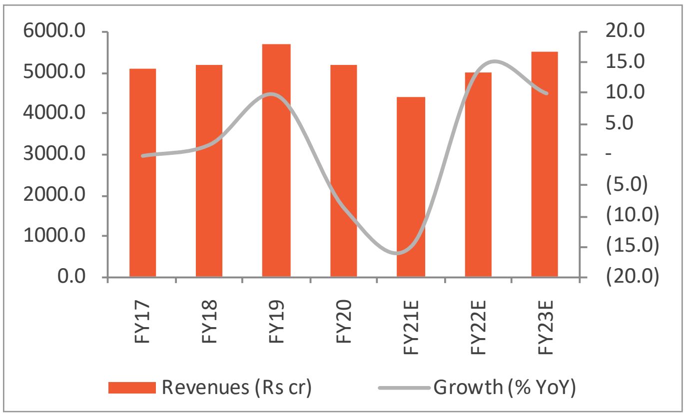
Trend in exports



Source: Company, Sharekhan Research

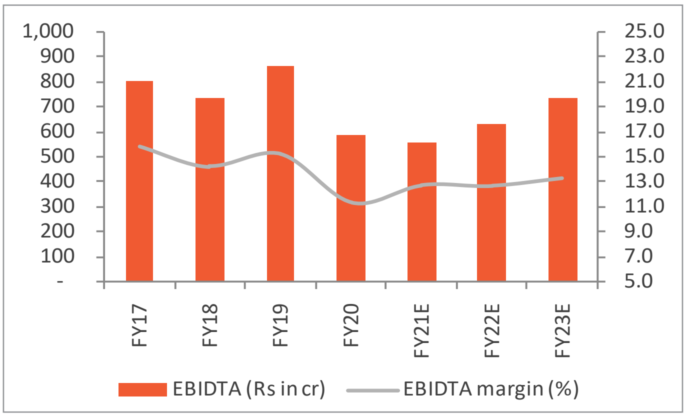
Financials in charts

Revenue Trend



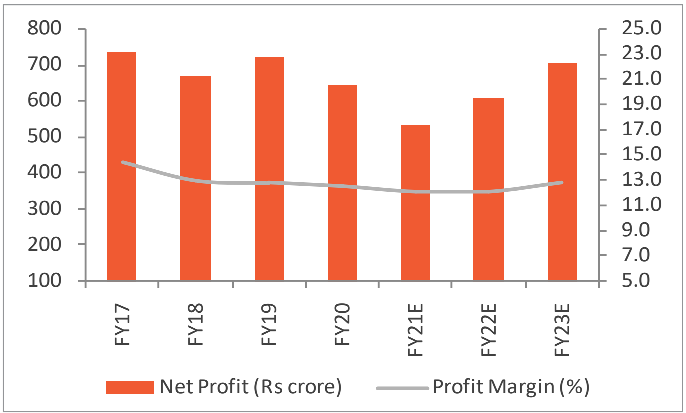
Source: Company, Sharekhan Research

EBITDA Trend



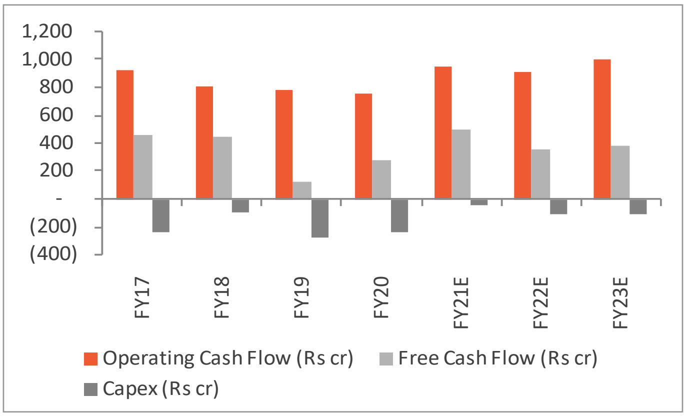
Source: Company, Sharekhan Research

Net Profit Trend



Source: Company, Sharekhan Research

OCF/FCF Trend

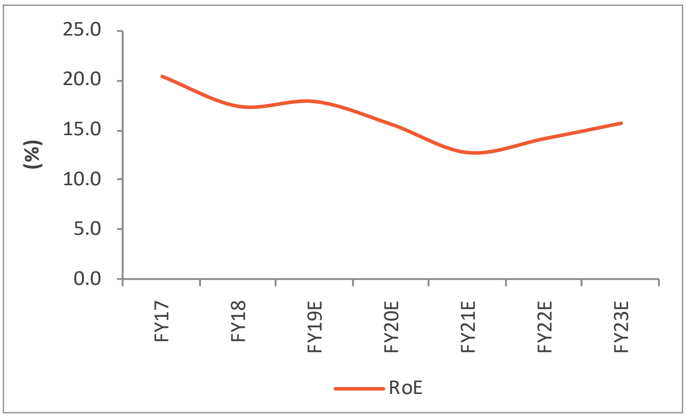


Source: Company, Sharekhan Research

ROCE Trend

Source: Company, Sharekhan Research

ROE Trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Continued government focus on infrastructure spending to provide growth opportunities

It is estimated that India would need to spend $4.5 trillion on infrastructure by 2030 to make India a $5-trillion economy by FY2025 and to continue growing at an escalated trajectory until 2030. To achieve the desired goal, the government drew up National Infrastructure Pipeline (NIP) through a bottoms-up approach, wherein all projects costing more than Rs. 100 crore per project under construction, proposed Greenfield and brownfield projects, and those at conceptualisation stage were captured. Consequently, total capital expenditure in infrastructure sectors in India during FY2020-FY2025 is projected at ~Rs. 111 lakh crore. During the same period, sectors such as energy (24%), roads (18%), urban (17%), and railways (12%) amount to ~71% of the projected infrastructure investments in India. The huge outlay towards the infrastructure sector is expected to provide healthy growth opportunities for infrastructure companies.

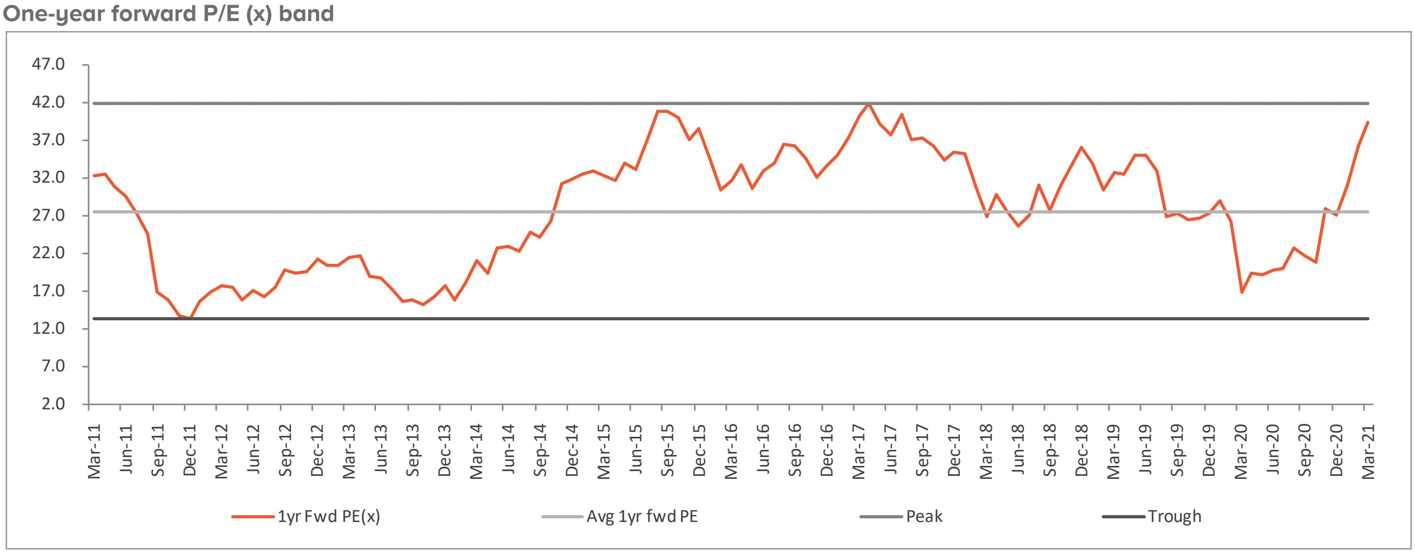
■ Company outlook - Domestic market expected to perform well, exports to improve gradually

Cummins' strong parentage and technological capabilities give it an edge over competitors. The company's innovative products and solutions, market leadership particularly in high horse power(HHP) in the domestic market, rising optimism for export recovery, and margin expansion make us positive on its prospects. The company has started to witness the benefits arising from strong revival in key segments such as power generation, construction, and mining, which are expected to sustain going forward. Cost savings initiatives undertaken by the company have been yielding benefits in terms of improved OPM. Well placed to take advantage given its preparedness on the technology front and market leadership position along with newer technologies such as CPCB-IV norms can lead to further market share gains.

■ Valuation - Retain Buy with a revised PT of Rs. 1,030

Cummins has started to witness the benefits arising from a strong revival in key segments such as power generation, construction, data centres and mining, which are expected to sustain going forward. Further, the industrial segment's sales will be driven by demand from railways, metro and road (compressors). Improvement in core business and increased outsourcing of maintenance services by clients are expected to boost the distribution business. Further, cost initiatives undertaken by the company have been yielding benefits in terms of improved OPM. We remain constructive on Cummins and expect a 15% net earnings CAGR over FY2021E-FY2023E, as it continues to gain from healthy demand led by a domestic economic revival. The stock is trading at valuations of 39.1x and 33.6x its FY2022E and FY2023E earnings, respectively and with AatmaNirbhar Bharat and domestic procurement, the entire sector is getting rerated which augurs well for Cummins, which is trading at a discount to the peak 5-year average multiple. We maintain Buy rating on the Cummins and modestly raise our target PE to factor overall rerating in the space along with strong growth potential in end-user industries, robust balance sheet, and steady cash flow generation to arrive at a revised target price of Rs. 1,030.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

Cummins is a subsidiary of Cummins Inc, USA – a global manufacturer of engines and other power-generation products. The company comprises three businesses – engine business (serving the construction and compressor markets with heavy, medium and light duty engines), power systems business (serving mining, marine, rail, oil and gas, defense, and power generation), and distribution business. Cummins has eight manufacturing facilities in Maharashtra and Gujarat. The company's product range primarily includes diesel engines/gensets from 15kVA to 2,000kVA for various power/industrial uses. Cummins also manufactures alternators, digital controls, transfer switches, etc. Cummins is the leader with 40% market share in the diesel engines/gensets industry. Further, Cummins has a strong presence in high-value and high-margin HHP gensets. The company's domestic business is divided into power generation, industrial, and distribution segments, contributing 60% to its sales. Exports contribute around 40% to sales. The company exports to over 40 countries comprising Middle East and Africa, which contribute 90% to its exports.

Investment theme

Cummins is the largest standby genset player in India with leading market share in medium and large gensets. The company has a strong technology/innovation track record, well supported by its parent, which helps it stay ahead of peers across changes in emission norms. The company's diversified business presence across power generation, industrial BU, exports, and distribution contribute to reasonable long-term growth prospects with healthy return/cash flow profile. While the recent drop in demand, both domestic and exports market has posed near-term challenges, reflected in recent earnings downgrades and valuation de-rating. We believe the stock offers favourable risk-reward for long-term investors, given its vast product offerings, management's focus on efficiency/cost, and a healthy potential scale from domestic infra and global market pickup.

Key Risks

- Slowdown in domestic macro-environment can result in slower-than-expected growth for the company.
- Global market demand weakness poses key downside risk to exports.

Additional Data

Key management personnel

Ashwath Ram	Managing Director
Rajiv Batra	Vice President – Finance Special Projects
Ajay Patil	Chief Financial Officer

Source: Bloomberg

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Cummins Inc	51.00
2	SBI Fund Management Pvt. Ltd.	6.10
3	LIC of India	5.70
4	ICICI PruAmc	1.73
5	Aditya Birla Sun Life Trustee Co Pvt. Ltd.	1.62
6	Sundaram AMC	1.54
7	Kotak Mahindra AMC	1.48
8	Franklin Resources Inc	1.37
9	UTI AMC	1.36
10	Aditya Birla Sun AMC	1.33

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

---

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;