Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Cummins India Limited

Near term blip, recovery on track

Capital Goods	Sharekhan code: CUMMINSIND	Result Update

Stock Update

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. 772**	
Price Target: **Rs. 1,030**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

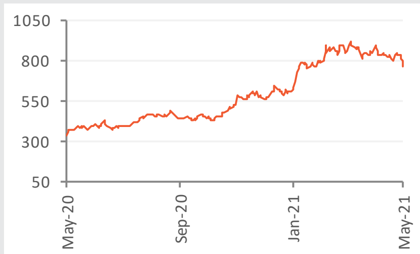
Company details

Market cap:	Rs. 21,393 cr
52-week high/low:	Rs. 933/339
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	10.9
DII	25.3
Others	12.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-14	24	32	124
Relative to Sensex	-18	16	16	62

Sharekhan Research, Bloomberg

Summary

- We retain Buy on Cummins India (Cummins) with an unchanged PT of Rs1030, given its high net earnings growth trajectory over FY2021-FY2023E and discounted valuations.
- The company reported inline revenues and margins while net profit remained better than estimates. Domestic sales grew 26% y-o-y while exports remained flat y-o-y
- The company is witnessing recovery in key segments such as power generation, construction, and mining, which are expected to do well going ahead. In exports, demand is expected to come back strongly where North America, China and India are expected to be growth areas. Management remains optimistic but has refrained from giving guidance for FY2022.
- The company continues to carry out new product initiatives, cost rationalising, and conserving cash. The company is expected to maintain its technologically driven market leadership across all business segments.

Cummins India Limited (Cummins) reported a largely inline quarter where revenues and margins remained in line while operating leverage and higher other income offset by higher tax led to higher than expected net profit. During Q4FY2021, standalone revenue came in at Rs. 1247 crore, improving 18% y-o-y (inline with estimates). Domestic sales improved 25.9% y-o-y to Rs 976 crore led by recovery in construction, power generation and mining segments. Exports remained flat y-o-y at Rs 255 crore due to soft end market demand. Domestic revenue was primarily driven by the power-generation segment (revenue up 34% y-o-y), the industrial segment (revenue up 10% y-o-y) and distribution business (up 33% y-o-y). Within the industrial segment, the company witnessed stable operation towards mining and construction, while railways continued to lag. Cost saving measures led by lower employee cost and other expenses led to EBITDA margin expansion of 710 bps y-o-y to 13.4% (in line with estimates). Accordingly, operating profit came at Rs 167 crore vs Rs 67 crore. Better operating leverage along with higher other income (up 30% y-o-y, higher dividend from JV) partially offset by higher tax rate (24.3% vs -1.1% in Q4FY20) leading to 52.1% y-o-y growth in adjusted net profit to Rs 185.7 crore (better than estimates). Management seemed optimistic of the demand environment, although some domestic segments are yet to recover, while the exports demand is expected to come back strongly wherein North America, China and India are expected to be growth areas. However, LATAM and Africa remains sluggish, affected by subsequent COVID-19 waves. The management expects gradual improvement in demand over coming months. Consequently, the management has not given guidance for FY2022 on account of the second wave of COVID led uncertainty on end user industry demand. It would continue to focus on cost management and efficiencies. The domestic power generation is strong and inventory is low. On CPCB-IV the management has indicated that it does not expect much delay in implementation and expects some amount of pre-buying. Although, it has not shared the pricing strategy, the company has been able to improve margins with change in emission norms. On the sector front, datacentres, telecom, IT, healthcare, hospitals have performed well while hospitality, residential and commercial were weak last year while manufacturing and infrastructure were affected but began to pick up. Hospitality and some part of commercial real estate will recover gradually. The company has leading market share in construction and is very optimistic on its growth outlook. The company is holding its market share across most segments. The competitive intensity is high currently, but the management expects consolidation to take place which should lead to better pricing environment. On the capex front, the company is done with major capex and will spend lower than the previous years' spent while the newer capex will be towards upgrades and new product technologies. The company remains a market leader in most of the segments and holding its market share despite tough competition and expects consolidation to take place. This should lead to better pricing environment.

Key positives

- Margin improved 710bps y-o-y.
- Domestic performance was healthy and witnessed 26% y-o-y growth

Key negatives

- Exports remained flat y-o-y wherein LATAM and African markets remained weak.

Our Call

Valuation – Retain Buy with unchanged PT of 1030: Cummins has been witnessing the benefits arising from the revival in key segments such as power generation, construction, and mining, which is expected to sustain going forward. The cost initiatives undertaken by the company have been yielding benefits in terms of improved OPM. The management seemed optimistic of the demand environment while the exports demand is expected to come back strongly wherein North America, China and India are expected to be growth areas. We have fine-tuned our estimates for FY2021-FY2023E and we remain constructive on Cummins as it continues to benefit from healthy demand led by domestic economic revival. Cummins is currently trading at 33.7/29.6x its FY2022E/FY2023E net earnings, which we believe provides further room for upside considering strong growth potential in end-user industries, strong balance sheet, and steady cash flow generation. Hence, we retain Buy on the stock with an unchanged PT of Rs. 1030.

Key risk

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	FY21	FY22E	FY23E
Revenue	5,158	4,329	4,885	5,433
OPM (%)	11.4	13.4	13.6	13.9
Adjusted PAT	643	618	635	722
% YoY growth	(11.0)	(3.9)	2.8	13.7
Adjusted EPS (Rs.)	22.7	22.3	22.9	26.1
P/E (x)	34.0	34.6	33.7	29.6
P/B (x)	5.1	4.9	4.7	4.4
EV/EBITDA (x)	35.2	34.7	29.8	26.0
RoNW (%)	15.5	14.4	14.1	15.3
RoCE (%)	17.2	17.8	18.5	20.1

Source: Company; Sharekhan estimates

Revenues and margins inline while PAT remains higher than estimates: Cummins India Limited (Cummins) reported largely inline quarter where the revenues and margins remained in line while higher operating leverage and other income offset by higher tax led to higher than expected net profit. During Q4FY2021, standalone revenue came in at Rs. 1247 crore, improving 18% y-o-y (inline with estimates). Domestic sales improved 25.9% y-o-y to Rs 976 crore led by recovery construction, power generation and mining segments. Exports remained flat y-o-y at Rs 2550 crore due to soft end market demand. Domestic revenue was primarily driven by the power-generation segment (revenue up 34% y-o-y), the industrial segment (revenue up 10% y-o-y) and distribution business (up 33% y-o-y). Within the industrial segment, the company witnessed stable operation towards mining and construction, while railways continued to lag. Cost saving measures led by lower employee cost and other expenses led to EBITDA margin expand by 710 bps y-o-y to 13.4% (in line with estimates). Accordingly, operating profit came at Rs 167 crore vs Rs 67 crore. Better operating leverage along with higher other income (up 30% y-o-y, higher dividend from JV) offset by higher tax rate (24.3% vs -1.1% in Q4FY20) led to 52.1% y-o-y growth in adjusted net profit to Rs 185.7 crore (better than estimates).

Optimistic commentary on mid-long term: The Management seemed optimistic of the demand environment, although some domestic segments are yet to recover, while the exports demand is expected to come back strongly wherein North America, China and India are expected to be growth areas. However, LATAM and Africa remains sluggish, affected by subsequent COVID-19 waves. The management expects gradual improvement in demand over coming months. Consequently, management has not given guidance for FY2022 on account of the second wave of COVID led uncertainty on end user industry demand. It would continue to focus on cost management and efficiencies. The domestic power generation is strong and inventory is low. ON CPCB-IV management indicated that it does not expect much delay in implementation and expects some amount of pre-buying. Although, it has not shared pricing strategy but historically the company has been able to improve margins with change in emission norms. On the sector front, datacentres, telecom, IT, healthcare, hospitals have performed well while hospitality, residential and commercial were weak last year while manufacturing and infrastructure were affected but began to pick up and hospitality and some part of commercial real estate to recover gradually. The company has leading market share in construction and is very optimistic on its growth outlook. The company is holding its market share across most segments. The competitive intensity is high currently but the management expects consolidation to take place which should lead to a better pricing environment. On the capex front, the company is done with major capex and will spend a lot lower than what it spent in the past while the newer capex will be towards upgrades and new product technologies. The company remains a market leader in most of the segments and holing its market share despite tough competition and expect consolidation to take place which should lead to a better pricing environment.

Conference call Highlights

- **Outlook:** The company's utilisation was 50% in April and May 2021 versus 70% before that. The management expects a gradual improvement in demand over coming months. It is not giving guidance for FY2022 on account of covid second wave led uncertainty on end user industry demand. It would continue to focus on cost management and efficiencies. The domestic power generation is strong and inventory is low. The exports demand is expected to come back strongly. North America, China and India are expected to be growth areas.

- **CPCB IV:** The management does not expect much delay in the implementation of CPCB-IV norms. It expects some amount of pre-buying. It has not shared its pricing strategy but historically the company has been able to improve margins with change in emission norms.

- **Exports outlook:** During last year, China and some parts of Asian markets recovered, Latin America was lower, middle east was flat, Europe and Africa were significantly lower. Spare parts were higher.

Currently, China is strong, parts of North America and Europe recovering faster while latin America and Africa continue to be weak.

- **Sectors outlook:** Datacentres, Telecom, IT, Healthcare, Hospitals have performed well while Hospitality, Residential and commercial were weak last year. Manufacturing and infrastructure were affected but began to pick up. Hospitality and some part of commercial real estate to recover gradually. Construction was on track till the second wave. The company has leading market share in construction and is very optimistic on its growth outlook. Rail had been significantly affected by covid pandemic and is expected to take time to recover. Mining was not impacted. Marine and pumps has started to show revival.
- **Market share:** The company is holding its market share across most segments. The competitive intensity is high currently but the management expects consolidation to take place which should lead to better pricing environment.
- **Commodity rise:** The company has two strategies to counter the significant price increase in commodities. The first one being lowering of raw material costs through cost reductions internally and second to pass on price increase to customers which is lagging by a quarter now.
- **Power gen market:** The power generation market has been declining over 3-4 years globally but have not started doing well.
- **Capex:** The new capex would be towards upgrades and new product technologies. Capex would be lot lower than spent in the past.
- **Hydrogen & electric battery:** Cummins has presence in hydrogen and electric battery. However, these technologies are not expected to play a major role upto 15 years. It does not have clear defined plan for hydrogen technology as of now.

Results (Standalone) Rs cr

Particulars	Q4FY21	Q4FY20	YoY (%)	Q3FY21	QoQ (%)
Revenues	1,247	1,053	18.4	1,424	(12.5)
Operating Expenses	900	748	20.4	888	1.4
Operating profits	167	67	-	242	(30.7)
Other Income	112	86	29.8	98	13.4
Interest	3	5	(33.3)	5	(28.8)
Depreciation	31	31	(0.6)	32	(4.3)
PBT	245	117	-	304	(19.2)
Tax	60	(1)	-	70	(14.4)
Adj PAT	185.7	122.1	52.1	234.1	(20.7)
Reported PAT	186	118	57.0	234	(20.7)
Adj EPS	6.7	4.3	57.0	8.4	(20.7)
			bps		**bps**
OPM	13.4%	6.3%	710	17.0%	(354)
NPM	14.9%	11.6%	330	16.4%	(154)
Tax rate	24.3%	-1.1%	-	23%	-

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Continued government focus on infrastructure spending to provide growth opportunities

To make India a $5 trillion economy by FY2025, and to continue growing at an escalated trajectory until 2030, it is estimated that India would need to spend $4.5 trillion on infrastructure by 2030. In order 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 projects, Brownfield projects and those at conceptualization stage were captured. Consequently, the 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.

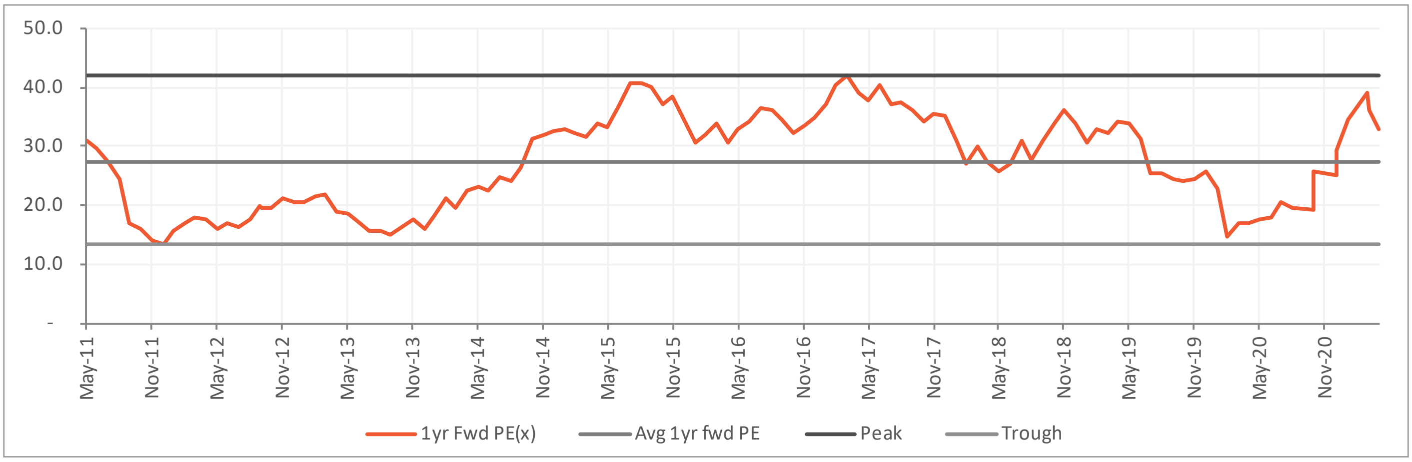
■ Company Outlook – Domestic market expected to perform well, exports to improve gradually

Cummins' strong parentage and technological capabilities give it an edge over competitors. The company's innovative products and solutions, market leadership particularly in HHP in the domestic market, rising optimism for export recovery, and margin expansion make us positive on its prospects. The company has begun 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 initiatives undertaken by the company have been yielding benefits in terms of improved OPM.

■ Valuation – Retain Buy with unchanged PT of 1030

Cummins has been witnessing the benefits arising from revival in key segments such as power generation, construction, and mining, which is expected to sustain going forward. The cost initiatives undertaken by the company have been yielding benefits in terms of improved OPM. The management seemed optimistic of the demand environment while the exports demand is expected to come back strongly wherein North America, China and India are expected to be growth areas. We have fine-tuned our estimates for FY2021-FY2023E and we remain constructive on Cummins as it continues to benefit from healthy demand led by domestic economic revival. Cummins is currently trading at 33.7/29.6x its FY2022E/FY2023E net earnings, which we believe provides further room for upside considering strong growth potential in end-user industries, strong balance sheet, and steady cash flow generation. Hence, we retain Buy on the stock with an unchanged PT of Rs. 1030.

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 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 India is the largest standby genset player in India with lead market share in medium and l arge 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 contributes 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 reflecting in recent earnings downgrades and valuation de-rating, we believe that the stock offers favourable risk-reward for long-term investors, given vast product offerings, management's focus on efficiency/cost, and a healthy potential scale from domestic infra and global market pick up.

Key Risks

- Slowdown in domestic macro-environment can result inslower-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: Company Website

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

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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

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