



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. 975	
Price Target: Rs. 1,252	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

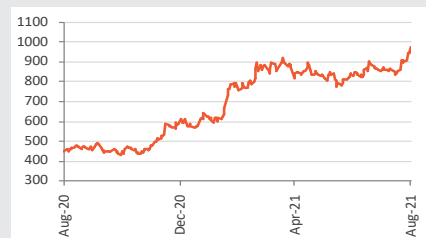
Company details

Market cap:	Rs. 27,027 cr
52-week high/low:	Rs. 989/415
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	11.7
DII	24.4
Others	12.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	13	19	29	117
Relative to Sensex	5	14	8	46

Sharekhan Research, Bloomberg

Summary

- We retain Buy on Cummins India (Cummins) with a revised PT of Rs. 1,183, given its strong performance during the quarter and introduction of new products, which will help increase market share.
- Cummins reported Q1FY2022 numbers slightly above our estimates with revenue/EBITDA/PAT at Rs. 1,184 crore (+138% y-o-y)/Rs. 149 crore/Rs. 104 crore, respectively, owing to strong performance in the domestic and exports markets.
- 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 the 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's Q1FY2022 numbers were slightly above our estimates. Revenue/ EBITDA/PAT stood at Rs. 1,184 crore (+138% y-o-y)/Rs. 149 crore/Rs. 104 crore, respectively, owing to strong performance in the domestic and exports markets. Gross profit margin (GPM) stood at 34.4% (-683 bps y-o-y), whereas operating profit margin (OPM) was reported at 12.6%. Performance was impacted by disruption caused by the second wave, which impacted supply of parts, leading to inefficiencies in plant operations that impacted shipments during the quarter. Domestic sales stood at Rs. 859 crore, which improved by 140% y-o-y. Exports sales stood at Rs. 308 crore, up 144% y-o-y, the growth has been significant due to favorable base as a result of nationwide lockdown. Domestic markets for the quarter continued to show promise, propelled by the government's push on infrastructure, pent-up demand, and economic recovery across multiple segments. In the export market, Cummins saw demand revival in quite a few regions, as countries recovered based on an increased vaccination pace and an abating infection trend. The company continues to take steps to introduce newer and more efficient technologies in the market. During the quarter, the company introduced several new products in power generation, industrial, and distribution segments to continue to provide world-class products and technologies to domestic and export customers. During the quarter, the company has introduced many new products, four in the powergen business, seven in the industrial segment, and three in the distribution segment. Management mentioned that it is hopeful for sequential recovery, however potential third wave of COVID-19 has been forecasted by many government agencies. Hence, management would refrain itself from providing any guidance for FY2022. Management seemed optimistic of the demand environment, although some domestic segments are yet to recover, while exports demand is expected to come back strongly, wherein North America, China, and India are expected to be the growth areas. Management expects gradual improvement in demand over the coming months. On CPCB-IV, management has indicated that it does not expect much delay in implementation and expects some amount of -buying. Although, it has not shared the pricing strategy, the company has been able to improve margins with change in emission norms. The government is likely to adhere to emission norm deadline and this can result in market consolidation in the medium to long term. We believe Cummins' long-term structural story is intact, given the change in emission norms, technological leadership, testing, other preparedness, and investments done by the company.

Key positives

- Domestic sales stood at Rs. 859 crore, improving by 140% y-o-y; and exports sales were reported at Rs. 308 crore, improving by 144% y-o-y.
- In Q1, the company has introduced many new products, four in the powergen business, seven in the industrial segment, and three in the distribution segment.

Key negatives

- GPM stood at 34.4% (-683 bps y-o-y) due to increased raw-material prices

Our Call

Valuation – Retain Buy with a revised PT of 1,252: Demand from China and ASEAN countries had been healthy and continues to remain strong. The overall lull in the global economy under powergen is showing signs of turning around with a medium- to long-term perspective. The export growth recovery is likely to continue given the overall uptick in demand from most geographies. Government is likely to adhere to emission norm deadline and this can result in market consolidation in medium to long term. 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. Cummins is currently trading at 34/29x its FY2023E/FY2024E 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 a revised PT of Rs. 1252.

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	FY21	FY22E	FY23E	FY24E
Net sales	4,329	5,054	5,782	6,612
OPM (%)	13.4	13.1	14.2	14.7
Adj Net profit	618	644	793	938
Adjusted EPS (Rs.)	22.3	23.2	28.6	33.8
PER (x)	43.7	42.0	34.1	28.8
P/B (x)	6.1	5.9	5.5	5.0
EV/EBITDA (x)	44.4	38.7	30.7	25.7
RoE (%)	14.4	14.3	16.7	18.1
RoCE (%)	17.8	18.7	21.8	23.8

Source: Company; Sharekhan estimates

Strong quarter, beat estimates: The company's Q1FY2022 numbers were slightly above our estimates. Revenue/EBITDA/PAT at Rs. 1,184 crore (+138% y-o-y)/Rs. 149 crore/Rs. 104 crore, respectively, owing to strong performance in the domestic and exports market. GPM stood at 34.4% (-683 bps y-o-y), whereas OPM was reported at 12.6%. Performance was impacted by disruption caused by the second wave, which impacted supply of parts, leading to inefficiencies in plant operations that impacted shipments during the quarter. Domestic sales stood at Rs. 859 crore, up 140% y-o-y; and exports sales were reported at Rs. 308 crore, up 144% y-o-y. Domestic markets for the quarter continued to show promise, propelled by the government's push on infrastructure, pent-up demand, and economic recovery across multiple segments. In the export market, Cummins saw demand revival in quite a few regions as countries recovered based on increased vaccination pace and an abating infection trend. The company continues to take steps to introduce newer and more efficient technologies in the market. During the quarter, the company introduced several new products in power generation, industrial, and distribution segments to continue to provide world-class products and technologies to domestic and export customers. During the quarter, the company has introduced many new products, four in the powergen business, seven in the industrial segment, and three in the distribution segment.

Optimistic commentary on the mid-long term: Management seemed optimistic of the demand environment, although some domestic segments are yet to recover, while exports demand is expected to come back strongly, wherein North America, China, and India are expected to be the growth areas. Management expects gradual improvement in demand over the coming months. Consequently, management has not given guidance for FY2022 on account of the second wave of COVID-led uncertainty on the end-user industry's demand. It would continue to focus on cost management and efficiencies. 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. The company has a leading market share in construction and is very optimistic on its growth outlook. The company is holding its market share across most segments. The company remains a market leader in most segments and holding its market share despite tough competition and expects consolidation to take place, which should lead to a better pricing environment.

Conference call Highlights:

- ♦ **Outlook:** Management expects gradual improvement in demand over the coming months. It is not giving FY2022 guidance on account of COVID second wave-led uncertainty on the end-user industry's demand. It would continue to focus on cost management and efficiencies.
- ♦ **CPCB IV:** 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. Of total export revenue, APAC contributed Rs. 90 crore, LATAM contributed Rs. 68 crore, Middle East contributed Rs. 48 crore, Europe contributed Rs. 47 crore, Africa contributed Rs. 32 crore, and remaining from others
- ♦ **Sectors outlook:** Datacentres, telecom, IT, healthcare, and 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 parts of commercial real estate are likely to recover gradually. Construction was on track till the second wave. The company has a 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 have started to show revival.
- ♦ **Market share:** The company is holding its market share across most segments. Competitive intensity is high currently but management expects consolidation to take place, which should lead to a better pricing environment. Management mentioned that with the introduction of new products, market share is expected to increase.
- ♦ **Distribution:** In this business, penetration from aftermarket in off and on highway is significantly low, which provides a huge opportunity and Cummins does not has an online presence and it can use its already established distribution network for selling components.

- ♦ **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 the price increase to customers, which is lagging by a quarter now. During the quarter, price hikes have been taken to offset higher commodities prices, pricing, and foreign exchange together had 0.5% impact on material margins.
- ♦ **Capex:** New capex would be towards upgrades and new product technologies. Capex would be lot lower than spent in the past.
- ♦ **Hydrogen and electric battery:** Cummins is present in hydrogen and electric battery. However, these technologies are not expected to play a major role up to 15 years. It does not have a clearly defined plan for hydrogen technology as of now.
- ♦ **AGM:** The company has taken an internal target of 100 bps growth in OPM annually. This can be achieved with the introduction of new products, better pricing, improving operating leverage, and cost-efficiency measures. Cummins unveiled its 'Made in India' - QSK60 G23: 2500-2750 kVA Diesel Generator (DG) in AGM. The diesel generator set, which is an integrated power solution has been launched to meet the increasing power requirements by industry segments such as data centres and largescale infrastructure projects such as airports and commercial realty in India.

Result (Standalone)	Rs cr				
Particulars	Q1FY22	Q1FY21	YoY (%)	Q4FY21	QoQ (%)
Total Income	1,184	498	138%	1,247	-5%
EBITDA	149	3	-	167	-11%
Depreciation	31	30	2%	31	1%
Interest	2	4	-59%	3	-46%
Other Income	55	102	-46%	112	-51%
PBT	303	70	331%	245	24%
Total Tax	67	18	273%	60	12%
Reported PAT	237	53	350%	186	27%
Adjusted PAT	104	53	98%	186	-44%
EPS (Rs.)	3.76	1.90	98%	6.70	-44%
Margins			Bps		Bps
EBITDA Margin	12.6%	0.6%	-	13.4%	-87
PAT Margin	20.0%	10.5%	-	14.9%	508
Tax Rate	22%	25%	-	24%	-

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. 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 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.

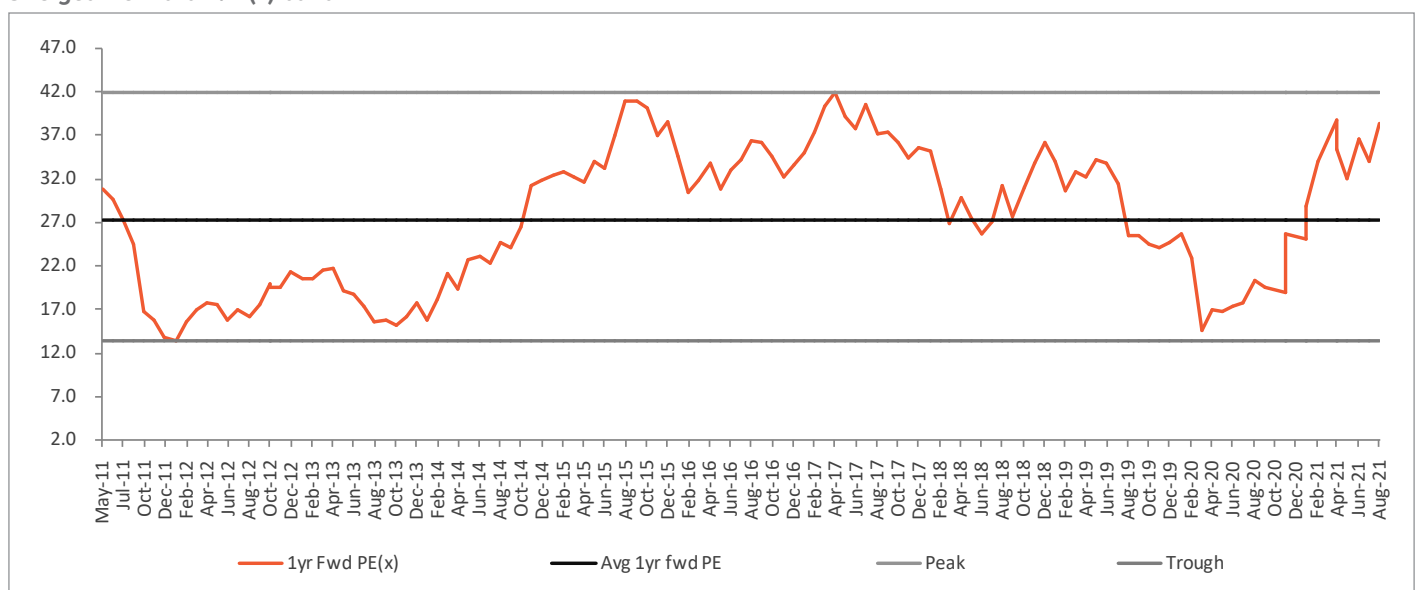
■ Company outlook - Domestic market expected to perform well, exports to improve gradually

Cummins' strong parentage and technological capabilities give it an edge over competitors. The company's innovative products and solutions, market leadership particularly in 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 a revised PT of 1,252

Demand from China and ASEAN countries had been healthy and continues to remain strong. The overall lull in the global economy under powergen is showing signs of turning around with a medium- to long-term perspective. The export growth recovery is likely to continue given the overall uptick in demand from most geographies. Government is likely to adhere to emission norm deadline and this can result in market consolidation in medium to long term. 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. Cummins is currently trading at 34/29x its FY2023E/FY2024E 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 a revised PT of Rs. 1252.

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 a 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 a lead 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 reasonably 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 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 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

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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 deteriorating 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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