



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	■	↔	■

ESG Disclosure Score **NEW**

**ESG RISK RATING** 29.69  
Updated Oct 08, 2021

**Medium Risk**

NEGL	LOW	<b>MED</b>	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

Company details

Market cap:	Rs. 25,369 cr
52-week high/low:	Rs. 1,065 / 485
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	12.0
DII	24.6
Others	12.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	0.6	-7.7	9.4	78.9
Relative to Sensex	3.9	-15.5	-10.1	42.1

Sharekhan Research, Bloomberg

Capital Goods

Sharekhan code: CUMMINSIND

Reco/View: Buy

CMP: Rs. 915

Price Target: Rs. 1,252

Upgrade ↔ Maintain ↓ Downgrade

Summary

- We retain Buy on Cummins India (Cummins) with an unchanged PT of Rs. 1,252, given its strong performance during the quarter and strong growth outlook.
- Cummins reported strong outperformance in revenues and operating margins for Q2FY2022 led by sharp rise in domestic revenues and despite pressure on gross margins. Its price hikes are lagging by quarter and a half.
- On the ESG front, the company is actively working with all stakeholders providing strategies for green energy transition. Global parent's exposure in alternate technologies would aid the company as and when transition happens.
- Export markets pick up led by Asia Pacific region followed by Africa, Middle East and Latin America.

Cummins India's reported strong outperformance on both the revenue and operating margin front for Q2FY2022. The standalone revenues rose by 48.9% y-o-y to Rs. 1727 crore aided by domestic revenues rising by 66% y-o-y to Rs. 1284 crore while export revenues were up 10% y-o-y at Rs. 405 crore. Within domestic, PowerGen/Distribution/Industrial registered 148%/15%/34% y-o-y rise in revenues. The OPM at 15% (up 58bps y-o-y) were better than estimate despite pressure on gross margins (lower by 504bps y-o-y at 33%). Consequently, consolidated operating profit/net profit were up 55%/51% y-o-y. On power ministry's recent notification with regard to reducing diesel gensets usage, the company is working with all stakeholders to provide solutions such as implementation of CPCB IV plus, scrappage policies for older technologies and devising strategy for wider scale implementation. The company does not see an immediate threat and would be well prepared as and when the transition towards greener energies is implemented because of its global parent's exposure in alternate technologies. The management did not provide guidance but the demand outlook from various end markets continue to remain positive.

Key positives

- Revenues from PowerGen/Distribution/Industrial rose by 81%/22%/21% q-o-q.
- Exports grew by 41% q-o-q almost equal growth witnessed in Low Horse Power and High Horse Power segments.
- The quarter had one large (100MW+) data centre project contribution of \$20 million in revenues.

Key negatives

- Gross margins declined by 504bps y-o-y/141bps q-o-q.
- Supply chain disruptions hampered exports performance which could have been higher by 20-25%.

Management Commentary

- The commodities like copper have more than doubled and steel in excess of 40%. The price hikes taken by the company absorbs 60% of that impact. The price hikes are still lagging by quarter and half behind commodities.
- The company has 50 litre engine (85% localization) which can go up to 2000KV which nobody has. It has 60 litre products which has 50% localisation and is expected to reach 80% over next 18 months.
- Globally, Asia Pac leads with biggest growth followed by Africa, Middle East and Latin America.
- The demand for backup power will continue at least till 2035. The management expects somewhere in late 2030s it will see movement into technologies like solid fuel oxide cells.

**Revision in estimates** – We have revised our estimates upwards for FY2022-FY2024, factoring improved demand environment both domestically and internationally.

Our Call

**Valuation – Retain Buy with an unchanged PT of 1,252:** Cummins is expected to benefit from strong domestic demand especially in infrastructure, mining and data centers. The exports have started to recover led by strong growth continuing in Asia Pacific regions followed by Africa, Middle East and Latin America. On the ESG front, the company is aptly placed on account of its global parent which has been investing in alternate technologies and can cater to Indian markets as and when the transition happens. Cummins is currently trading at 23x its 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 an unchanged PT of Rs. 1252.

Key Risks

Slowdown in the domestic and global macro-environment can negatively affect business outlook and earnings growth.

Valuation (Standalone)

Particulars	FY21	FY22E	FY23E	FY24E
Net sales (Rs. mn)	4,329	5,698	6,531	7,470
OPM (%)	13.4	13.6	15.3	15.7
Adj Net profit (Rs. cr)	618	732	925	1,092
Adjusted EPS (Rs.)	22.3	26.4	33.4	39.4
PER (x)	41.1	34.7	27.4	23.2
P/B (x)	5.8	5.4	4.9	4.4
EV/EBIDTA (x)	41.6	30.7	23.5	19.6
RoE (%)	14.4	16.1	18.8	20.0
RoCE (%)	17.8	21.1	24.7	26.3

Source: Company; Sharekhan estimates

### Strong quarter, beat estimates:

Cummins India's reported strong outperformance on both revenue and operating margin front for Q2FY2022. The standalone revenues rose by 48.9% y-o-y to Rs. 1727 crore aided by domestic revenues rising by 66% y-o-y to Rs. 1284 crore while export revenues were up 10% y-o-y at Rs. 405 crore. The quarter had a one large projects business order for a data centre which contributed to little lower than \$20 million. The order was 100 plus in MW terms. Within domestic, PowerGen/Distribution/Industrial registered 148%/15%/34% y-o-y rise in revenues at Rs. 637 crore/Rs. 365 crore/Rs. 228 crore respectively. The OPM at 15% (up 58bps y-o-y) were better than estimate despite pressure on gross margins (lower by 504bps y-o-y at 33%). The commodities like copper have more than doubled and steel in excess of 40%. The price hikes taken by the company absorbs 60% of that impact. It had also some mixed differences which caused some material margin reduction in Q2. The company has taken significant price hikes but is still lagging by quarter and half behind commodities. Overall, consolidated operating profit rose by 55% y-o-y at Rs. 259 crore. Strong operational performance led to net profit growth of 51% y-o-y to Rs. 220 crore.

### Domestic demand strong; Exports picking up

The demand from the data centre continued to remain strong, while healthcare and realty have picked up. Infrastructure demand lagged because of monsoons but has started to pick up. The road construction sector has started to bounce back from end of quarter. Rail segment is recovering slowly which is expected to come back over next two quarters. Mining continued to remain strong and is likely to sustain. Marine and defense are likely to pick up from end of the year. The rail segment is expected to remain subdued in near term owing to its slower pace of recovery and electrification. The company is introducing new products and have started to win some tenders with those new products. The company is bullish on medium term outlook for rail. Overseas, the company sees biggest growth in Asia PAC region because of strong demand from China. Other Asia pacific regions like Philippines, Malaysia, Indonesia continue to do well. Latin America is gradually coming out of covid impact. Europe will take another two quarters to pick up. Middle East market is slowly recovering. Africa is bouncing back from low base.

### Conference call Highlights:

- ◆ **Outlook:** The management did not provide any guidance but the demand outlook from various end markets continue to remain positive
- ◆ **Ministry of Power notification impact:** The company is working with all stakeholders. It is 1) pushing to get CPCB 4 plus implemented 2) Introduce scrappage policy for technologies 3) strategy for wide scale implementation 4) reducing well to wheel emissions.
- ◆ **Gross margin impact:** The commodities like copper have more than doubled and steel in excess of 40%. The price hikes taken by the company absorbs 60% of that impact. It had also some mixed differences which caused some material margin reduction in Q2. The company has taken significant price hikes but is still lagging by quarter and half behind commodities.
- ◆ **Power Gen business:** The quarter had a one large projects business order for a data centre which contributed to little lower than \$20 million. The order was 100 plus in MW terms. Data centre continue to remain strong, healthcare and realty have picked up. Infrastructure lagged because of monsoons but has started to pick up.
- ◆ **Alternate technologies:** The management expects somewhere in late 2030s it will see movement into technologies like solid fuel oxide cells. It is already experimenting on few customers in Korea and other few other places. Globally, it owns one of the biggest hydrogen companies in the world and have set up three major gigawatt hydrogen production centres. The demand for backup power will continue at least till 2035.

- ◆ **Industrial:** The road construction sector has started to bounce back from end of quarter. Rail segment is recovering slowly which is expected to come back over next two quarters. Mining continued to remain strong and is likely to sustain. Marine and defence are likely to pick up from end of the year.
- ◆ **Rail:** The rail segment is expected to remain subdued in near term owing to its slower pace of recovery and electrification. The company is introducing new products and have started to win some tenders with those new products. The company is bullish on medium term outlook for rail.
- ◆ **Large size gensets:** the company has 50 litre engine which can go up to 2000KV which nobody has. The 50 litre product has 85% indigenisation. It has 60 litre products which has 50% localisation and is expected to reach 80% over next 18 months. The company continue to remain market leader in big genset market.
- ◆ **Exports:** Overseas, the company sees biggest growth in Asia PAC region because of strong demand from China. Other Asia pacific regions like Philippines, Malaysia, Indonesia continue to do well. Latin America is gradually coming out of covid impact. Europe will take another two quarters to pick up. Middle East market is slowly recovering. Africa is bouncing back from low base. Globally, Asia Pac leads followed by Africa, Middle East and Latin America.

Quarterly results (Standalone)

Particulars	Rs cr				
	Q2FY22	Q2FY21	YoY (%)	Q1FY22	QoQ (%)
<b>Revenues</b>	<b>1,727</b>	<b>1,160</b>	<b>48.9</b>	<b>1,184</b>	<b>45.8</b>
<b>Operating profits</b>	<b>259</b>	<b>167</b>	<b>54.8</b>	<b>149</b>	<b>74.2</b>
Other Income	69	58	19.8	187	(62.9)
Interest	2	4	(44.8)	2	26.9
Depreciation	34	33	2.7	31	8.6
<b>PBT</b>	<b>293</b>	<b>189</b>	<b>55.2</b>	<b>303</b>	<b>(3.5)</b>
Tax	73	43	69.1	67	9.3
<b>Adj PAT</b>	<b>220</b>	<b>146</b>	<b>51.1</b>	<b>133</b>	<b>64.9</b>
Exceptional items				103	
<b>Reported PAT</b>	<b>220</b>	<b>146</b>	<b>51.1</b>	<b>237</b>	<b>(7.1)</b>
Adj EPS	7.9	5.3	51.1	4.8	64.9
<b>Margins (%)</b>			<b>BPS</b>		<b>BPS</b>
OPM	15.0%	14.4%	58	12.6%	244
NPM	12.7%	12.5%	19	11.3%	147
Tax rate	24.9%	22.9%	205	22%	290

Source: Company; Sharekhan Research

## Outlook and Valuation

### ■ Sector outlook – 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.

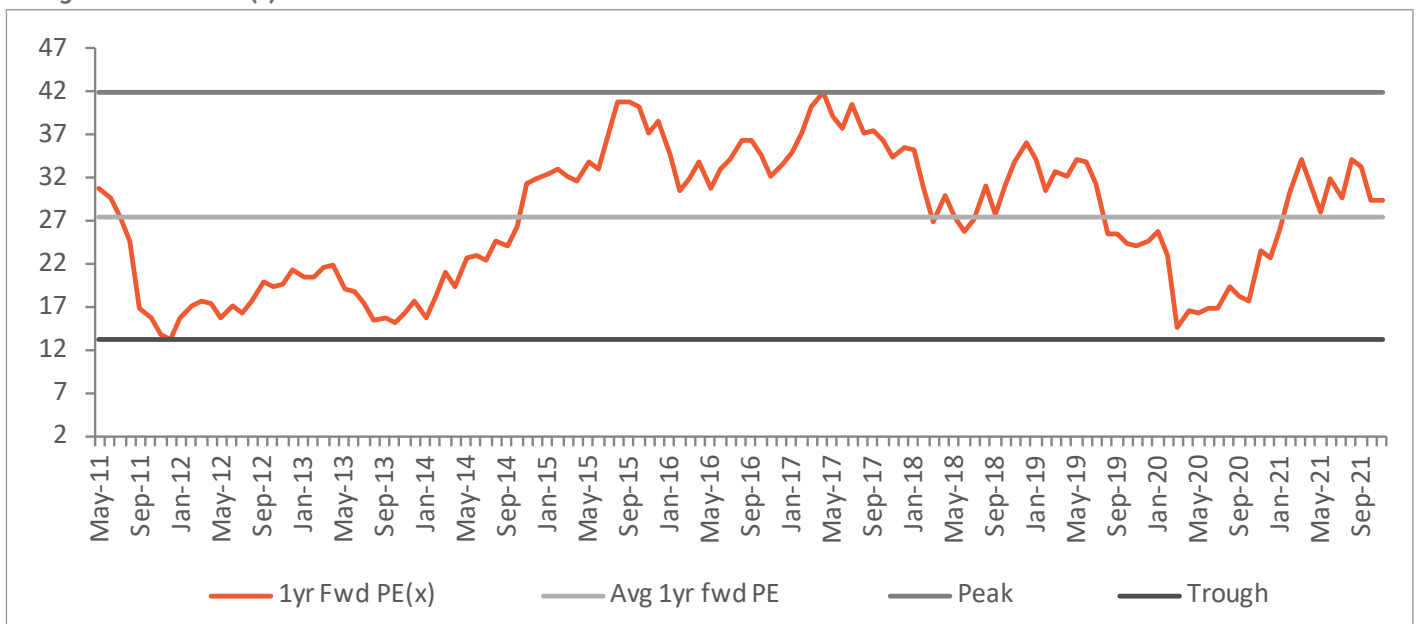
### ■ Company outlook – Domestic market expected to perform well, exports improving

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 an unchanged PT of 1,252

Cummins is expected to benefit from strong domestic demand especially in infrastructure, mining and data centres. The exports have started to recover led by strong growth continuing in Asia pacific regions followed by Africa, Middle East and Latin America. On the ESG front, the company is aptly placed on account of its global parent which has been investing in alternate technologies and can cater to Indian markets as and when the transition happens. Cummins is currently trading at 23x its 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 an unchanged 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 to 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 favorable 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: Company Website

### Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Cummins Inc.	51.0
2	SBI Fund Management Pvt. Ltd.	6.1
3	LIC of India	5.7
4	ICICI PruAmc	1.7
5	Aditya Birla Sun Life Trustee Co Pvt. Ltd.	1.6
6	Sundaram AMC	1.5
7	Kotak Mahindra AMC	1.5
8	Franklin Resources Inc.	1.4
9	UTI AMC	1.4
10	Aditya Birla Sun AMC	1.3

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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