Stock Update

Company Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Cummins India

Multiple engines to fuel growth

Capital Goods	Sharekhan code: CUMMINSIND

Reco/View: Buy	↔	CMP: Rs. 1,081	Price Target: Rs. 1,252	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

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 Jan 08, 2022

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

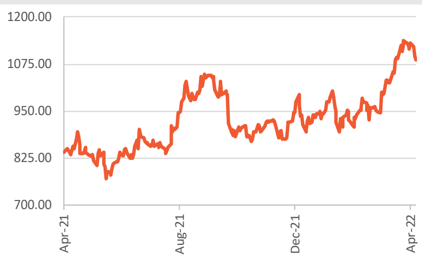
Company details

Market cap:	Rs. 29,965 cr
52-week high/low:	Rs. 1,162 / 747
NSE volume: (No of shares)	7.7 lakh
BSE code:	500480
NSE code:	CUMMINSIND
Free float: (No of shares)	13.6 cr

Shareholding (%)

Promoters	51.0
FII	12.5
DII	24.0
Others	12.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	5	8	19	27
Relative to Sensex	7	15	26	10

Sharekhan Research, Bloomberg

Summary

- Cummins will consolidate its leadership in the diesel genset industry through robust demand from data centres, growth in industrial and high-margin distribution business and through integrated solution offerings. Cummins could play a crucial role in making India carbon-neutral with its offerings in alternate and green technologies backed by its US-based parentage.
- Company plans to boost EBITDA margin by improving share of high-margin products particularly in exports, cost reduction and automation.
- Cummins has a strong pedigree, industry-leading margins and improving earnings trajectory. We expect revenue/PAT CAGR of ~22%/24% over FY21-24E. The stock trades at ~26xFY24E EPS. It has a healthy balance sheet with a strong cash position of ~Rs. 1000cr and therefore deserves premium valuation. We reiterate Buy on the stock with an unchanged PT of Rs 1,252.
- Our rating is led by a strong long-term growth outlook driven by demand revival in both domestic and export markets, in segments such as data centres, railways, telecom and expectation of strong traction from alternate fuel industries such as hydrogen in the future.

Cummins India is a market leader in the power gensets industry and boasts of strong technological capabilities given the support of its US based parent – Cummins Inc. It is well geared to gain from demand revival across industries in both domestic and export segments, emergence of alternative and green fuels (blending with its parent company's strategy to achieve zero emission by 2050) and implementation of new CPCB IV+ norms. The long-term outlook for the company remains positive with industries like data centers where demand would be driven by the adoption of 5G technology, increasing storage data, rising OTT etc. Cummins is the largest player in data center in the domestic market and expects to clock strong growth in high capacity engines. Moreover, industries such as healthcare, commercial realty, pharma and manufacturing are also gradually improving after pandemic led disruption. In exports, Latin America, APAC, Europe and Middle East are witnessing improvement in demand.

- **Domestic demand outlook robust:** The domestic market has started gaining traction particularly from data centers, healthcare, infrastructure, rental and retail. This is expected to drive demand for High horse power (HP) and mid HP diesel gensets. Demand outlook from data centres is positive led by adoption of 5G technology, increasing storage data, rising OTT etc. Cummins is significantly large players in data centre and over the next five years, robust growth is expected especially for high capacity engines. Further, increasing spends b the telecom and healthcare segments and implementation of CPCB IV+ norms should lead to robust demand in the long-term for power gensets. The industrial segment's sales will be driven by demand from railway electrification, mining, marine, oil & gas, defence; etc. The distribution business would be driven by increasing demand for maintenance in core industries such as data centers. Further, in the long-term alternate and greener technologies like hydrogen and battery electric systems would drive growth. The company has bid for tenders in green technologies and expect breakthrough in CY2022. We expect domestic market to grow at ~25% over FY21-FY24E.
- **Exports to improve gradually:** Currently, exports demand from Asia-Pacific region, Europe and Middle East is picking up with increase in oil prices. Moreover, roll out of faster and reliable 5G mobile network as well as expansion of Internet of Things (IoT) infrastructure offers growth prospects for Cummins' products. It is also targeting industrial segments such as rail, marine amongst others in Asia Pacific. The company has been continuously revamping its product portfolio and offering fit-for-market products in exports and thus has regained its lost market share. Exports contribute 25-30% to the business and boasts of better realization and margins. We expect exports to grow at a ~15% CAGR over FY21-24E.
- **Q4FY22E – Decent performance eyed:** Q4 is generally the second weakest quarter as large government spenders and companies taper down buying and clear inventories. Further, supply chain issues, particularly semiconductor shortage, could also impact revenues. However, given lower base, we expect ~13%/~16% YoY growth in sales/PAT. We expect revenue growth to be driven by domestic powergen and industrial segments. While the impact of passing of price hikes to customers may reflect in the numbers. Nevertheless, we expect margin to remain under pressure in the near-term given the continuous spike in raw material prices. The management's guidance on exports and over-all demand outlook would be key monitorable. Further, update on impact of Russia-Ukraine war on its business is keenly awaited.

Our Call

Valuation – Cummins is well geared to gain from demand revival from data centers, healthcare, infrastructure, rental and retail. This is expected to drive demand for high horse-power (HP) and mid HP diesel gensets. In exports as well, the company has been continuously revamping its product portfolio and offering fit-for-market products in exports and thus has regained its lost market share. Also, Cummins would benefit from emergence of alternative and green fuels and would play a crucial role in India's transition to zero carbon country by 2070 by offering products in alternative and green space. Cummins is currently trading at ~26x 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. Cummins' industry leading margins, product depth and strong parentage makes it the best bet in industrial space. We expect revenue/PAT CAGR of ~22%/24% over FY21-24E. Hence, we retain Buy on the stock with an unchanged PT of Rs. 1,252.

Key Risks

- Slowdown in the domestic macro-environment can negatively affect business outlook and earnings growth.
- Global market demand weakness due to current geopolitical crisis between Russia and Ukraine poses key downside risk to exports

Valuation (Standalone) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Net sales (Rs. cr)	4,329	6,056	6,944	7,948
OPM (%)	13.4	14.3	15.5	16.2
Adj Net profit (Rs. cr)	618	821	984	1,173
Adjusted EPS (Rs.)	22.3	29.6	35.5	42.3
PER (x)	48.5	36.5	30.4	25.5
P/B (x)	6.8	6.2	5.6	4.9
EV/EBITDA (x)	49.5	32.6	25.9	21.3
RoE (%)	14.4	17.7	19.2	20.4
RoCE (%)	17.8	22.4	25.2	26.9

Source: Company; Sharekhan estimates

Domestic market on a strong footing

The company expects healthy demand from data centres, healthcare, commercial realty, pharma and manufacturing industries. Further, it is seeing a bounceback in demand from infrastructure and residential housing segments. The demand outlook from data centres is positive led by adoption of 5G technology, increasing storage data, rising OTT etc. Cummins is significantly large players in data centres and over the next five years, robust growth is expected especially for high capacity engines. Further, increasing spend in telecom and healthcare and implementation of CPCB IV+ norms should lead to robust demand in the long-term for power gensets. The industrial segment's sales will be driven by demand from railway electrification, mining, marine, oil & gas, defence; etc. The distribution business would be driven by increasing demand for maintenance in core industries such as data centers. Further, in the long-term alternate and greener technologies like hydrogen and battery electric systems would drive growth. The company has two opportunities in hydrogen 1) from auto (small orders for buses in Leh-Ladakh, demand from electrolysers) and 2) trains running on hydrogen technology. The company has bid for tenders in green technologies and expect breakthrough in CY2022. We expect domestic market to grow at ~25% over FY21-FY24E. The company may face near-term challenges given supply chain issues which had affected revenue by 10-15% in Q3FY22 on account of semi-conductor shortages. However, Cummins India can leverage its globally integrated supply chain to mitigate this risk to a certain extent.

Exports growth would be aided by new product offerings

Export demand environment has improved in Latin America, Asia Pacific region, Europe and Middle East with increase in oil prices. Moreover, roll out of faster and reliable 5G mobile network as well as expansion of Internet of Things (IoT) infrastructure offers growth prospects for Cummins' products. It is also targeting industrial segments such as rail, marine amongst others in Asia Pacific. The company has been continuously revamping its product portfolio and offering fit-for-market products in exports and thus has regained lost market share. Exports contribute 25-30% of the business and boast of better realization and margins. We expect exports to grow at ~15% CAGR over FY21-24E.

Price hikes would combat inflationary pressures

Being the market leader, Cummins commands pricing power and therefore has been able to pass on hikes in commodity prices to customers. However, the positive impact of this would be reflected in the margins with a lag of a quarter and a half. In the long term, the company plans to grow its EBITDA margins by focusing on improving the share of high margin products particularly in exports, cost reduction initiatives through better engineering, designs and automation. Nevertheless, we expect margin to remain under pressure in the near-term given the continuous spike in raw material prices but expect improvement in the long term.

Q4FY22E performance likely to be decent

Q4 is generally second weakest quarter as large government spenders and companies taper down buying and clear inventories Further, supply chain issues could also impact its performance. However, given lower base, we expect ~13%/~16% YoY growth in sales/PAT. We expect revenue growth to be driven by domestic powergen and industrial segments. The management's guidance on exports and over-all demand outlook would be key monitorable. Further, update on impact of Russia-Ukraine war on its business is keenly awaited.

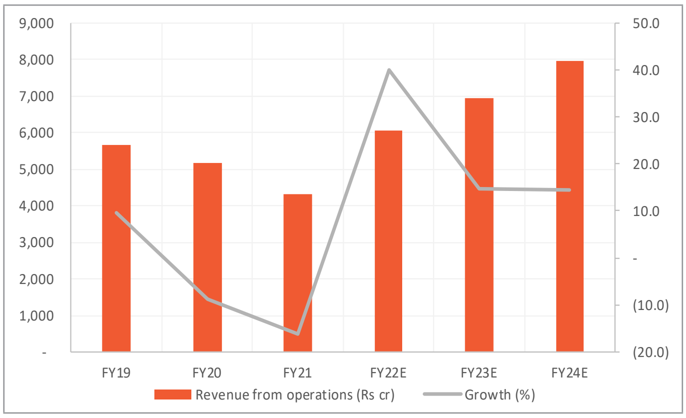
Q4FY22 Estimates

Particulars (Rs. cr)	Q4FY22E	Q4FY21	YoY%	Q3FY22	QoQ%
Net Sales	1,409	1,247	13.0	1,735	(18.8)
Operating Profit	190	167	13.6	271	(29.7)
Adjusted PAT	216	186	16.4	241	(10.3)
Reported PAT	216	234	(7.7)	220	(1.7)
			BPS		**BPS**
OPM(%)	13.5	13.4	6	15.6	(209)

Source: Company; Sharekhan estimates

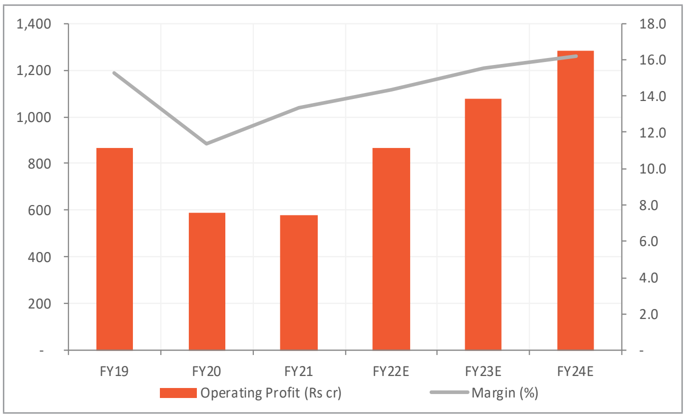
Financials in charts

Revenue growth trend



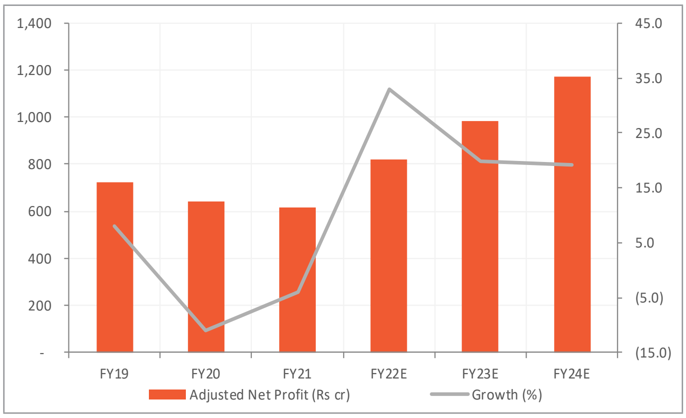
Source: Company, Sharekhan Research

Operating profit and margin trend



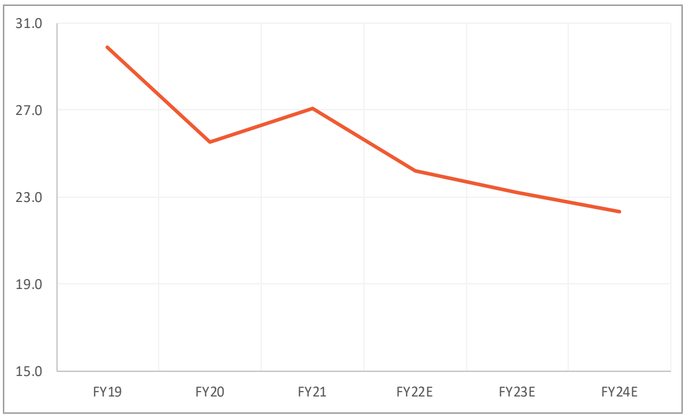
Source: Company, Sharekhan Research

Net profit growth trend



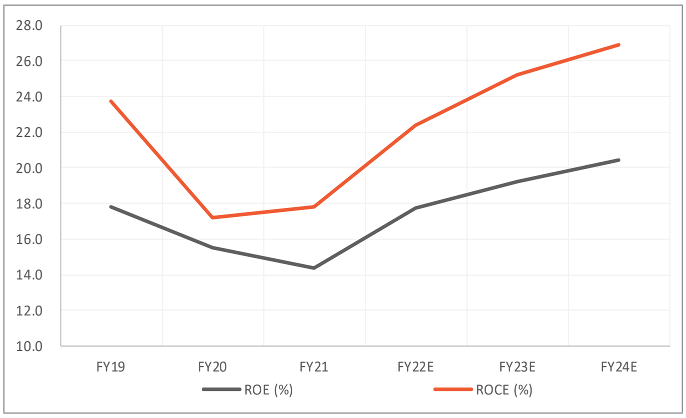
Source: Company, Sharekhan Research

Exports to total sales (%)



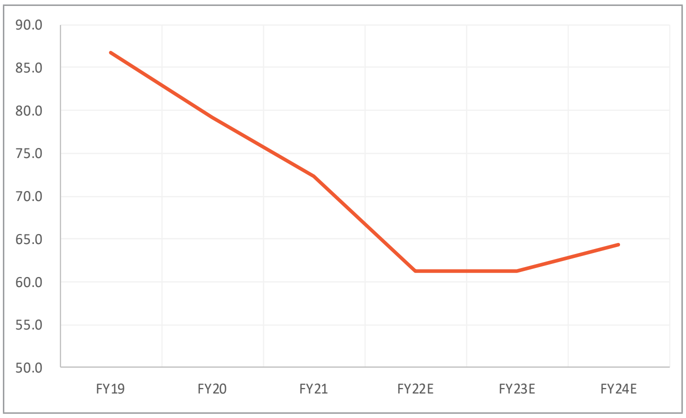
Source: Company, Sharekhan Research

Returns Ratios trend



Source: Company, Sharekhan Research

Working capital cycle



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector outlook – 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 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 including Cummins India.

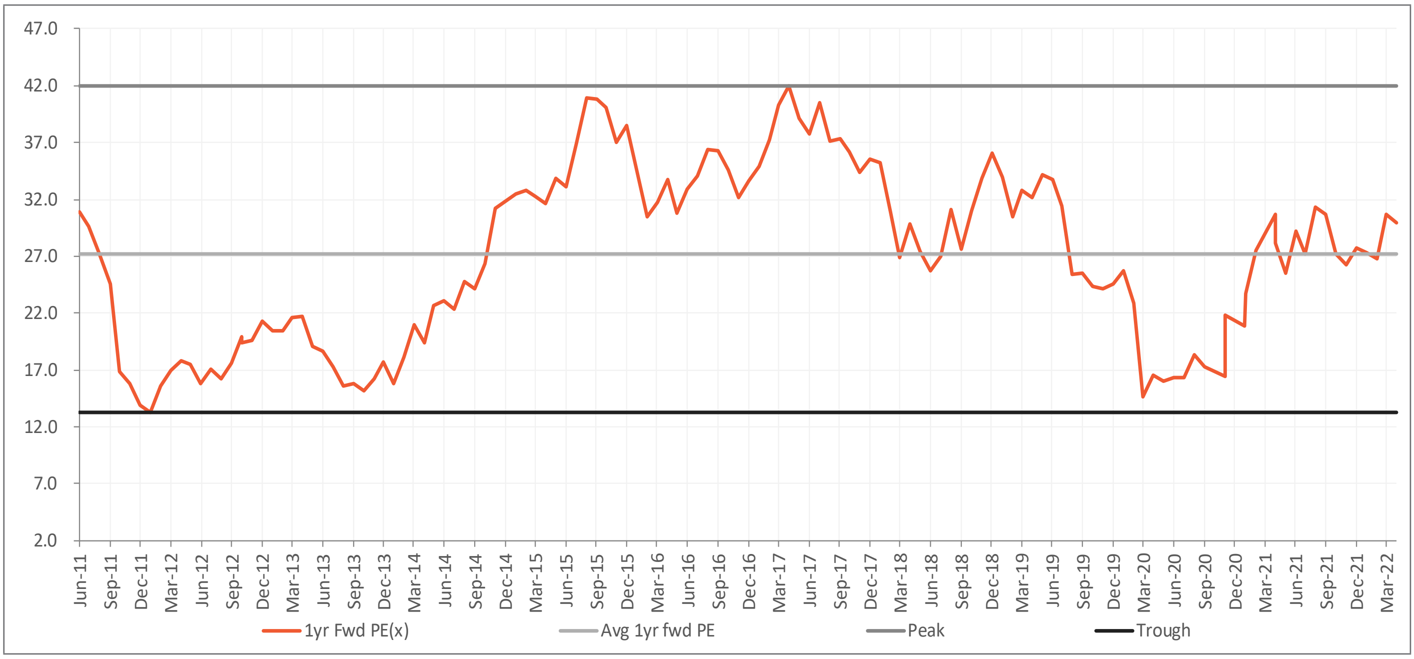
■ Company outlook – Domestic market to perform well, exports improving

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. Further, it sees opportunities arising from implementation of CPCB IV+ norms, railway electrification, gas compression engines, defence, telecom; etc.

■ Valuation – Retain Buy with an unchanged PT of Rs. 1,252

Cummins is well geared to gain from demand revival from data centers, healthcare, infrastructure, rental and retail. This is expected to drive demand for high horse-power (HP) and mid HP diesel gensets. In exports as well, the company has been continuously revamping its product portfolio and offering fit-for-market products in exports and thus has regained its lost market share. Also, Cummins would benefit from emergence of alternative and green fuels and would play a crucial role in India's transition to zero carbon country by 2070 by offering products in alternative and green space. Cummins is currently trading at ~26x 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. Cummins' industry leading margins, product depth and strong parentage makes it the best bet in industrial space. We expect revenue/PAT CAGR of ~22%/24% over FY21-24E. Hence, we retain Buy on the stock with an unchanged PT of Rs. 1,252.

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.

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. Although both domestic and exports market may face near-term challenges due to supply chain issues and Russia-Ukraine war impact, Cummins is well geared to gain from demand revival in both domestic and export segments, emergence of alternative and green fuels and implementation of new CPCB IV+ norms. 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 infrastructure and global market pick up.

Key Risks

Slowdown in domestic macro-environment can result in slower-than-expected growth Global market demand weakness due to current geopolitical crisis between Russia and Ukraine poses key downside risk to exports

Additional Data

Key management personnel

Ashwath Ram	Managing Director
Ajay Patil	Chief Financial Officer
Pradheepram Ottikkutti	Chief Technical Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Cummins Inc.	51
2	SBI Fund Management Pvt. Ltd.	3.68
3	LIC of India	3.52
4	Kotak Mahindra AMC	2.98
5	ICICI Prudential AMC	2.16
6	SBI Life Insurance	2.01
7	Norges Bank	1.81
8	Government Pension Fund Global	1.79
9	HDFC AMC	1.54
10	Vanguard Group Inc	1.48

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;

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