



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. 582	
Price Target: Rs. 690	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

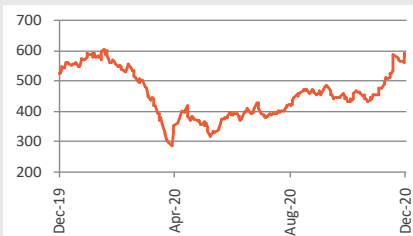
Company details

Market cap:	Rs. 16,127 cr
52-week high/low:	Rs. 282/653
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	8.2
DII	28.0
Others	12.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	28	24	49	10
Relative to Sensex	22	5	15	-4

Sharekhan Research, Bloomberg

Summary

- We retain Buy on Cummins India (Cummins) with a revised PT of Rs. 690, given high net earnings growth trajectory over FY2021E-FY2023E and discounted valuations.
- Domestic sales on a gradual recovery path as seen from macro indicators signaling strong recovery in business activities post the decline in H1FY2021.
- Exports to benefit from improved demand from data centre 5G rollout and China+1 strategy.
- Well placed to take advantage given its preparedness on the technology front and market leadership position along with newer technologies such as CPCB 1V norms can lead to further market share gains.

Cummins India (Cummins) is expected to benefit from strong rebound in domestic industrial activities with easing of lockdown restrictions as can be seen from macro indicators. IIP growth for October 2020 came in the positive territory (+0.2% y-o-y) after witnessing declining y-o-y trend over the preceding six months. Manufacturing and mining indices also showed month after month recovery since March 2020. Further, going ahead, we expect improving industrial activity, which should lead to improvement in demand for domestic power gensets to benefit Cummins. Commercial real estate during Q3CY2020 also saw improved traction with net absorption and new supply rising by 63% q-o-q and 59% q-o-q, respectively. India's data centre capacity is slated to increase from 375MW in H1CY2020 to 1078MW by 2025, entailing addition of 703MW, which would provide strong growth opportunities for Cummins. The government's Rs. 111 lakh crore investments envisaged over FY2020-FY2025 with 31% share allocated towards roads (18%) and railways (12%) are expected to sustain the growth momentum for Cummins. On the export front, the company is expected to benefit from improved demand from data centre and additional benefits to accrue with 5G mobile network roll out, which would lead to resumption of the high horse power as well as low horse power products for the company. Further, post Covid, prospects for Cummins remain bright as many countries are looking apart from China for their supplies and develop alternatives, which would help them spread the supply chain disruption risk in case of any future unforeseen circumstances. The company remains well placed given its strong manufacturing base to take advantage of the opportunities given its preparedness on the technological front (supply of CPCB IV compliant products once implemented in India), which can lead to further market share gains. Cummins' distribution business has grown steadily over the years (having an installed base of 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. 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 leadership in a highly competitive market. Cummins is currently trading at 26x/22x its FY2022E/FY2023E net earnings, which is at a steep discount to its long-term historical average. Considering revival in its net earnings growth trajectory (23% CAGR) over FY2021E-FY2023E, strong balance sheet and steady cash flow generation, we remain constructive on the company and retain our Buy rating on the stock with a revised price target (PT) of Rs. 690.

Our Call

**Valuation – Retain Buy with a revised PT of Rs. 690:** Cummins, being the market leader, is in a sweet spot to leverage on gradual pickup in demand in the power generation segment (HHP and mid horse power diesel gensets), led by infrastructure, commercial real estate, data centres, and 5G rollout. Further, the industrial segment's sales will be driven by demand from railways, metro, road (compressors), and bottoming out of diesel generator demand for water well rigs. Improvement in core business and increased outsourcing of maintenance services by clients are expected to boost the distribution business. Cummins is currently trading at 26x/22x its FY2022E/FY2023E net earnings, which is at a steep discount to its long-term historical average. Considering revival in its net earnings growth trajectory (23% CAGR) over FY2021E-FY2023E, strong balance sheet, and steady cash flow generation, we remain constructive on the company and retain our Buy rating on the stock with a revised PT of Rs. 690.

Key Risks

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

Valuation (Standalone)

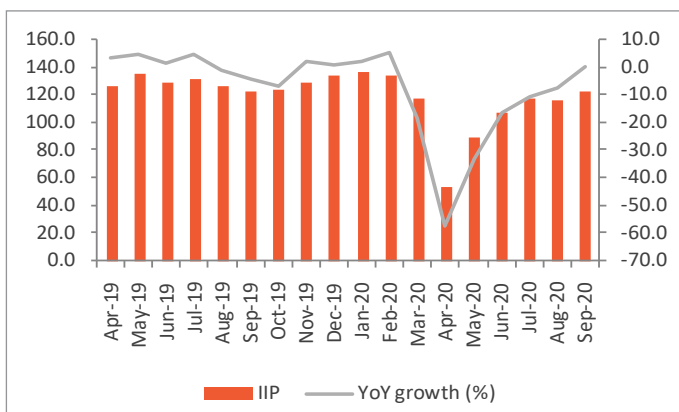
Particulars	FY20	FY21E	FY22E	FY23E
Revenue	5,158	4,587	5,198	5,747
OPM (%)	11.4	10.8	12.7	13.5
Adjusted PAT	643	488	628	737
% YoY growth	(11.0)	(24.2)	28.7	17.5
Adjusted EPS (Rs.)	23.2	17.6	22.6	26.6
P/E (x)	25.0	33.0	25.6	21.8
P/B (x)	3.1	3.1	3.0	2.8
EV/EBITDA (x)	21.1	24.6	18.3	15.3
RoNW (%)	15.5	11.6	14.6	16.3
RoCE (%)	17.2	14.1	17.7	19.8

Source: Company; Sharekhan estimates

### Macro indicators signal pick up in industrial activity - Expect to sustain

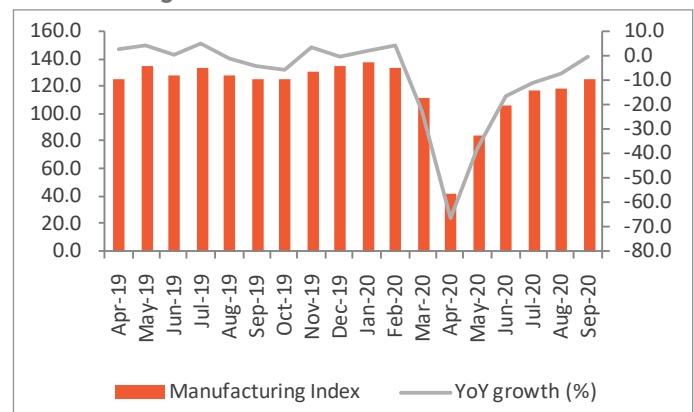
Cummins' business is classified into three businesses: 1) engine business (serving the construction and compressor markets), power systems (serving mining, marine, rail, oil and gas, defence, and power generation), and distribution business. Due to its exposure to core sectors of the economy, the company's performance draws strong co-relation with IIP and economic indicators such as IIP are witnessing an uptick, indicating pickup in industrial activities. We expect Cummins is set to revive its growth trajectory as demand from key end-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 get better. IIP growth for October 2020 came in the positive territory (+0.2% y-o-y) after witnessing a declining y-o-y trend over the preceding six months. Manufacturing and mining indices also showed month after month recovery since March 2020.

IIP Trend



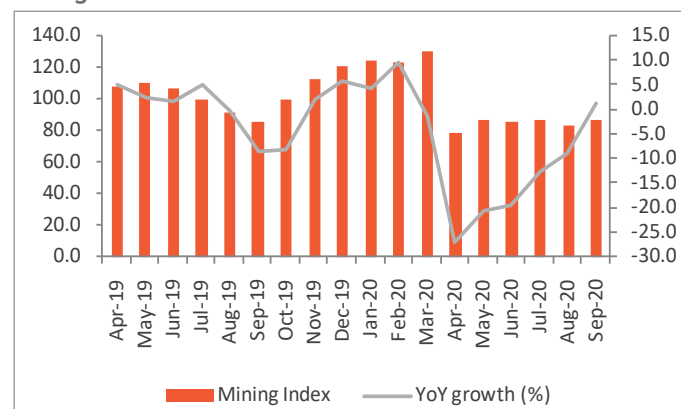
Source: Industry; Sharekhan Research

Manufacturing Index Trend



Source: Industry; Sharekhan Research

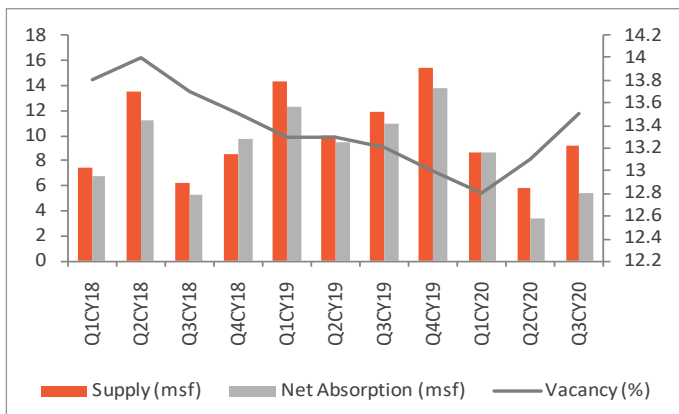
Mining Index Trend



Source: Industry; Sharekhan Research

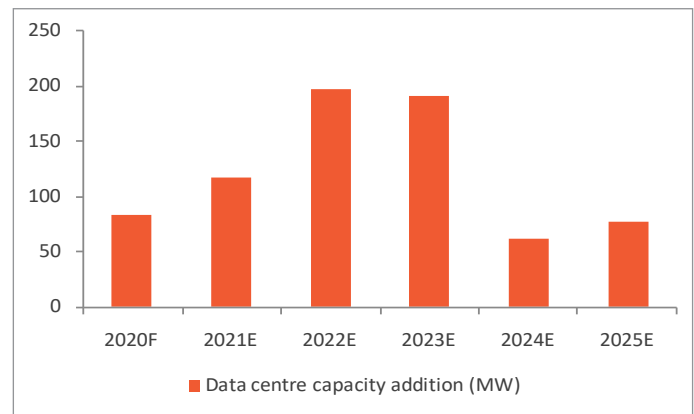
**Opportunities from commercial real estate and data centres:** The commercial real estate during Q3CY2020 also saw improved traction, with net absorption and new supply rising by 63% q-o-q and 59% q-o-q, respectively. India's data centre capacity is slated to increase from 375MW in H1CY2020 to 1078MW by 2025, entailing addition of 703MW, which would provide strong growth opportunities for Cummins.

**India Office Market Trend**



Source: Industry; Sharekhan Research

**Data Centre Trend**



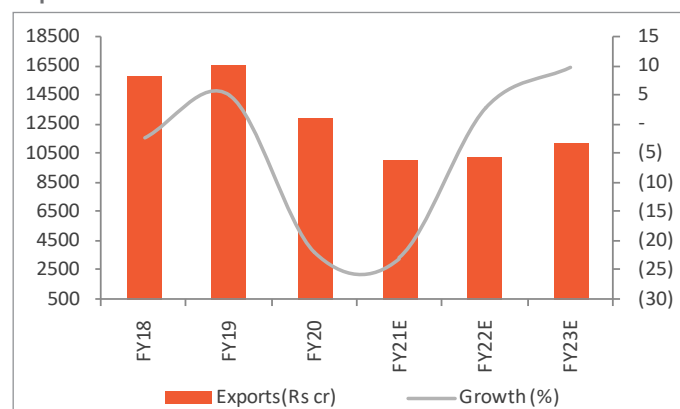
Source: Industry; Sharekhan Research

**Government infra focus to provide long-term sustainable growth:** The government’s Rs. 111 lakh crore investments envisaged over FY2020-FY2025 with 31% share allocated towards roads (18%) and railways (12%) are expected to sustain the growth momentum for Cummins. Cummins, being the market leader, is in a sweet spot to leverage on demand pick up. Further, the industrial segment’s sales will be driven by demand from railways, metro, road (compressors), and bottoming out of diesel generator demand for water well rigs. Improvement in core business and increased outsourcing of maintenance services by clients will also boost the distribution business. The company remains well placed, given its strong manufacturing base to take advantage of the opportunities and its preparedness on the technological front (supply of CPCB IV compliant products once implemented in India), which can lead to further market share gains. Cummins’ distribution business has grown steadily over the years (having an installed base of 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. Earlier management in Q2 has indicated that it has been witnessing m-o-m and q-o-q improvement in almost all its segments, further substantiated by improving macros.

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

Exports business seems to be improving from the medium to long-term perspective as new demand drivers in terms of data centre and 5G telecom network roll out would lead to demand resumption of HHP as well as LHP products of the company and earlier management has also indicated that exports to be better in H2FY21. 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 has a competitive position within the Cummins ecosystem for capturing related exports opportunity in America and Europe over time. 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.

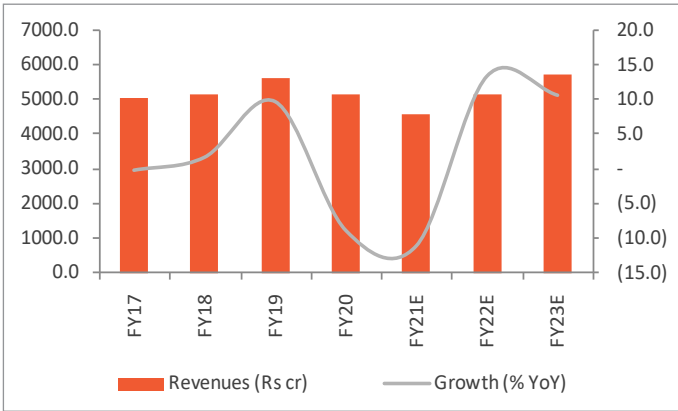
**Exports Trend**



Source: Company, Sharekhan Research

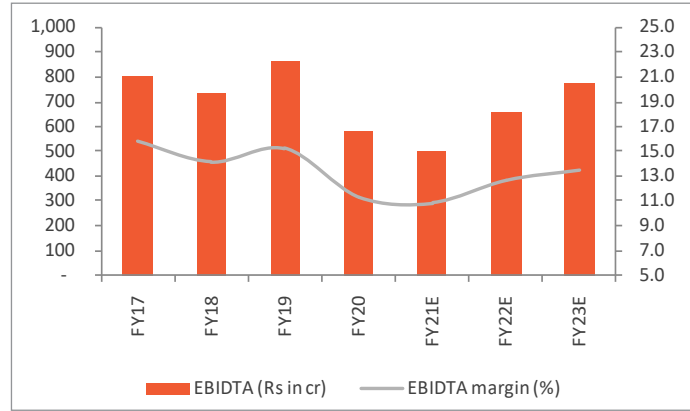
**Financials in charts**

**Revenue Trend**



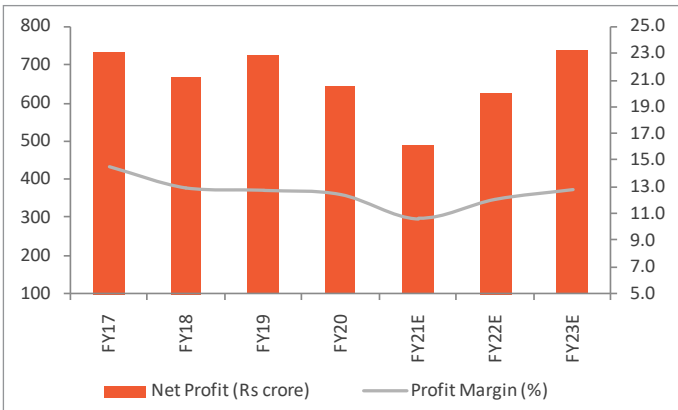
Source: Company, Sharekhan Research

**EBITDA Trend**



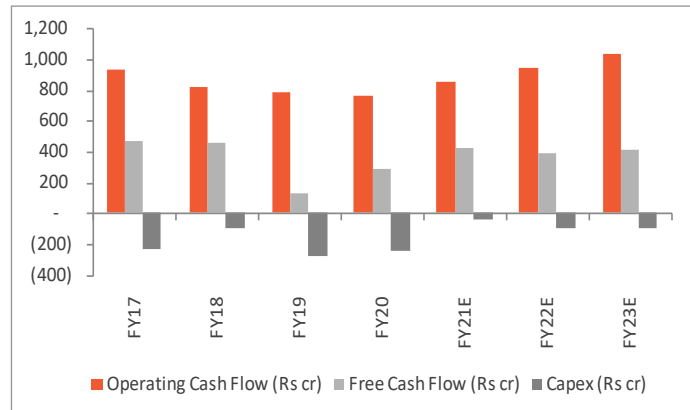
Source: Company, Sharekhan Research

**Net Profit Trend**



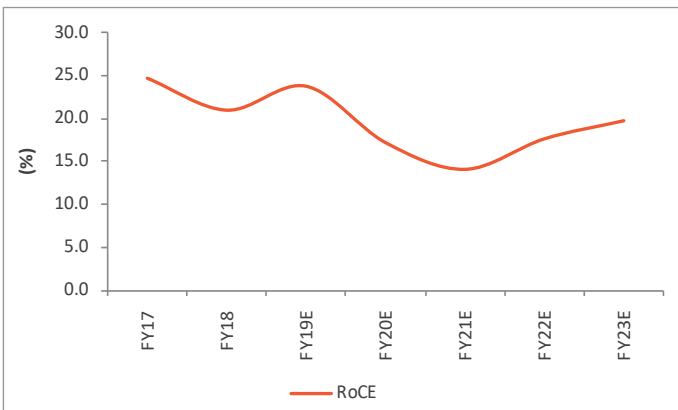
Source: Company, Sharekhan Research

**OCF/FCF Trend**



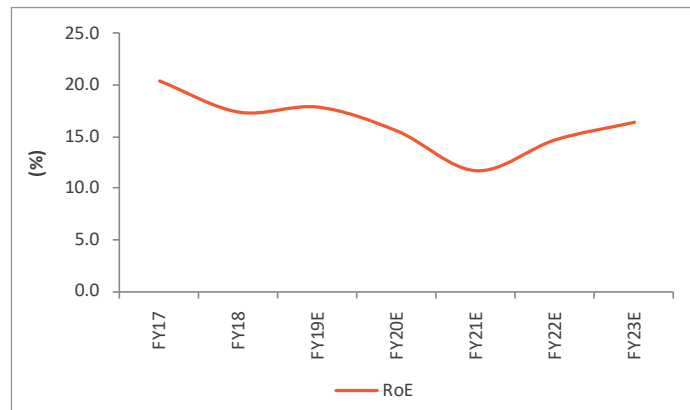
Source: Company, Sharekhan Research

**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. 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 conceptualisation 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.

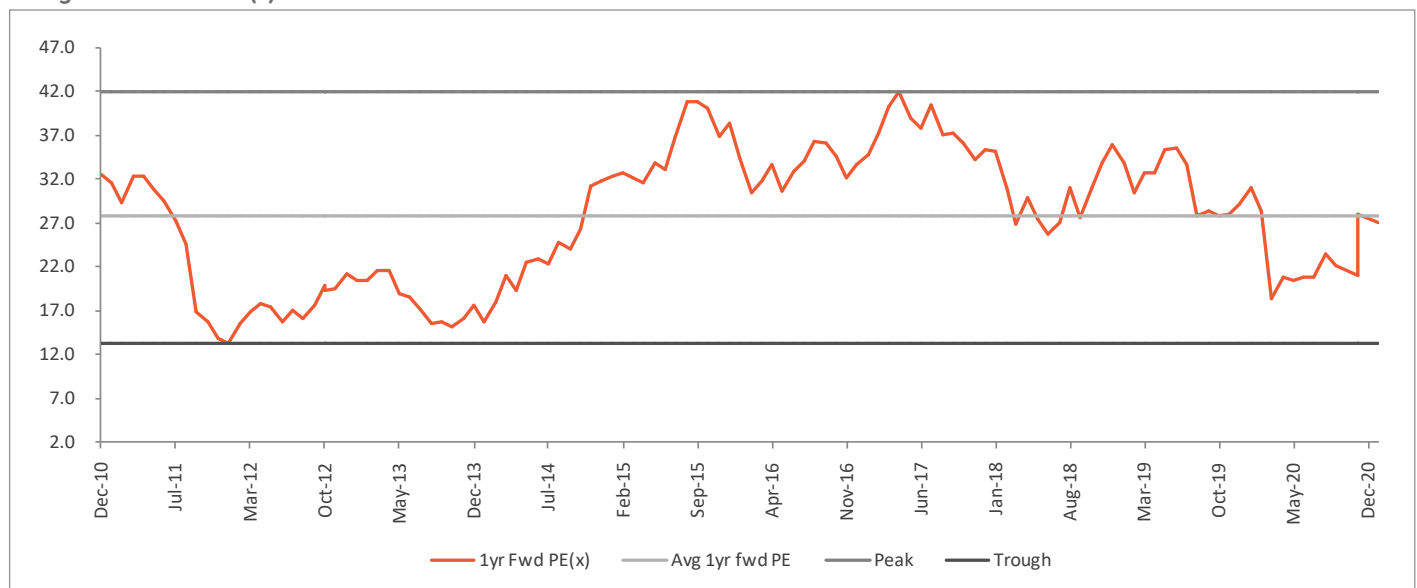
### ■ Company outlook - Domestic market expected to perform well, exports to improve gradually

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. Favourable commentary regarding pick up in the manufacturing sector aided growth in the medium and HHP engines. The industrial segment is also expected to post a stronger growth trajectory, driven by robust demand from railways and construction segments arising because of sustained investments in infrastructure.

### ■ Valuation - Retain Buy with a revised PT of Rs. 690

Cummins, being the market leader, is in a sweet spot to leverage on gradual pickup in demand in the power generation segment (HHP and mid horse power diesel gensets), led by infrastructure, commercial real estate, data centres, and 5G rollout. Further, the industrial segment's sales will be driven by demand from railways, metro, road (compressors), and bottoming out of diesel generator demand for water well rigs. Improvement in core business and increased outsourcing of maintenance services by clients are expected to boost the distribution business. Cummins is currently trading at 26x/22x its FY2022E/FY2023E net earnings, which is at a steep discount to its long-term historical average. Considering revival in its net earnings growth trajectory (23% CAGR) over FY2021E-FY2023E, strong balance sheet, and steady cash flow generation, we remain constructive on the company and retain Buy on the stock with a revised PT of Rs. 690.

#### 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 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 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 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

Sharekhan Limited, its analyst or dependant(s) of the analyst might be holding or having a position in the companies mentioned in the article.

## 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

# Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

**Disclaimer:** This document has been prepared by Sharekhan Ltd. (SHAREKHAN) and is intended for use only by the person or entity to which it is addressed to. This Document may contain confidential and/or privileged material and is not for any type of circulation and any review, retransmission, or any other use is strictly prohibited. This Document is subject to changes without prior notice. This document does not constitute an offer to sell or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. Though disseminated to all customers who are due to receive the same, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this report.

The information contained herein is obtained from publicly available data or other sources believed to be reliable and SHAREKHAN has not independently verified the accuracy and completeness of the said data and hence it should not be relied upon as such. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. This document is prepared for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Recipients of this report should also be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other reports that are inconsistent with and reach different conclusions from the information presented in this report.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject SHAREKHAN and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

The analyst certifies that the analyst has not dealt or traded directly or indirectly in securities of the company and that all of the views expressed in this document accurately reflect his or her personal views about the subject company or companies and its or their securities and do not necessarily reflect those of SHAREKHAN. The analyst further certifies that neither he or its associates or his relatives has any direct or indirect financial interest nor have actual or beneficial ownership of 1% or more in the securities of the company at the end of the month immediately preceding the date of publication of the research report nor have any material conflict of interest nor has served as officer, director or employee or engaged in market making activity of the company. Further, the analyst has also not been a part of the team which has managed or co-managed the public offerings of the company and no part of the analyst's compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this document. Sharekhan Limited or its associates or analysts have not received any compensation for investment banking, merchant banking, brokerage services or any compensation or other benefits from the subject company or from third party in the past twelve months in connection with the research report.

Either SHAREKHAN or its affiliates or its directors or employees / representatives / clients or their relatives may have position(s), make market, act as principal or engage in transactions of purchase or sell of securities, from time to time or may be materially interested in any of the securities or related securities referred to in this report and they may have used the information set forth herein before publication. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind.

Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: [compliance@sharekhan.com](mailto:compliance@sharekhan.com);

For any queries or grievances kindly email [igc@sharekhan.com](mailto:igc@sharekhan.com) or contact: [myaccount@sharekhan.com](mailto: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;

Disclaimer: Client should read the Risk Disclosure Document issued by SEBI & relevant exchanges and the T&C on [www.sharekhan.com](http://www.sharekhan.com); Investment in securities market are subject to market risks, read all the related documents carefully before investing.