Cummins India Limited

Business recovery provides optimism

Capital Goods	Sharekhan code: CUMMINSIND	Company Update

Summary

- We retain Buy on Cummins India Limited (Cummins) with a revised PT of Rs. 917, considering strong earnings growth potential, led by domestic economic revival.
- Domestic sales on a gradual recovery path as seen from macro indicators, signaling strong recovery in business activities.
- 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.

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. 766**	
Price Target: **Rs. 917**	↑

↑ Upgrade ⇔ Maintain ↓ Downgrade

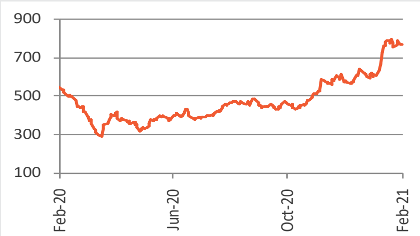
Company details

Market cap:	Rs. 21,229 cr
52-week high/low:	Rs. 806/282
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	9.0
DII	27.5
Others	12.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	25	50	65	41
Relative to Sensex	23	37	36	18

Sharekhan Research, Bloomberg

Cummins India Limited (Cummins) is expected to benefit from strong rebound in domestic industrial activities with easing of lockdown restrictions, as can been seen from macro indicators. IIP has been in the positive territory for three out of the past four months coupled with IHS Markit India Manufacturing PMI, which has been on the improving trajectory on m-o-m basis. 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 has also witnessed 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. Further, in the recently announced Budget 2021, government focus remains on reviving infra spend and promote domestic manufacturing along with 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-19, 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 its leadership position in a highly competitive market. Cummins is currently trading at 34.9/30.1x its FY2022E/FY2023E net earnings, which we believe provides further room for upside, considering strong growth potential in end-user industries, robust balance sheet, and steady cash flow generation. Hence, we retain Buy on the stock with a revised price target (PT) of Rs. 917.

Our Call

Valuation – Retain Buy with a revised PT of Rs. 917: Cummins has started to witness the benefits arising from strong revival in key segments such as power generation, construction, data centres, and mining, which is expected to sustain going forward. Further, the industrial segment's sales will be driven by demand from railways, metro and road (compressors). Improvement in core business and increased outsourcing of maintenance services by clients are expected to boost the distribution business. Further, cost initiatives undertaken by the company have been yielding benefits in terms of improved OPM. We remain constructive on Cummins and expect a 15% net earnings CAGR over FY2021E-FY2023E, as it continues to benefit from healthy demand led by domestic economic revival. Cummins is currently trading at 34.9/30.1x x its FY2022E/FY2023E net earnings. Considering strong growth potential in end-user industries, strong balance sheet, and steady cash flow generation, we retain Buy on the stock with a revised PT of Rs. 917.

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

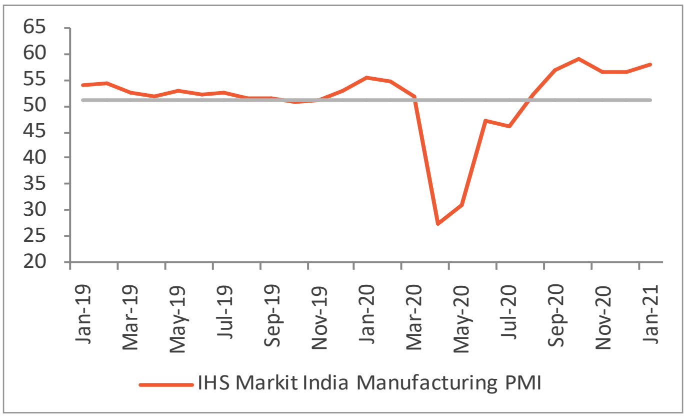
Particulars	FY20	FY21E	FY22E	FY23E
Revenue	5,158	4,390	5,000	5,501
OPM (%)	11.4	12.7	12.7	13.3
Adjusted PAT	643.0	532.0	608.0	706.0
% YoY growth	(11.0)	(17.2)	14.1	16.2
Adjusted EPS (Rs.)	23.2	19.2	21.9	25.5
P/E (x)	33.0	39.9	34.9	30.1
P/B (x)	5.1	5.0	4.8	4.6
EV/EBITDA (x)	34.9	36.4	31.8	27.2
RoNW (%)	15.5	12.6	14.1	15.6
RoCE (%)	17.2	15.3	17.0	18.9

Source: Company; Sharekhan estimates

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

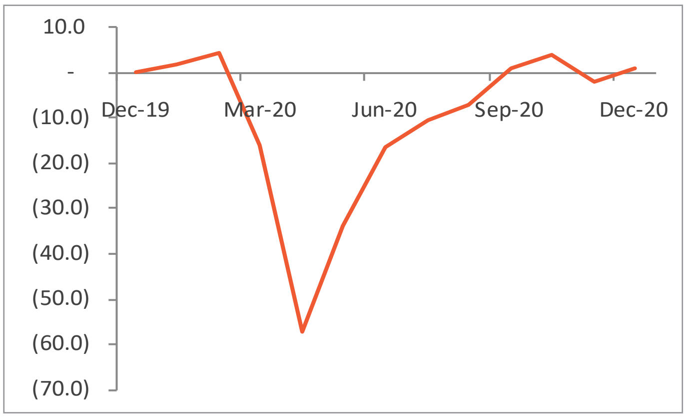
Cummins' business is classified into three businesses: 1) engine business (serving the construction and compressor markets), power systems (serving mining, marine, rail, oil and gas, defence, and power generation), and distribution business. Due to its exposure to core sectors of the economy, the company's performance draws strong co-relation with IIP and economic indicators such as IIP are witnessing an uptick, indicating pickup in industrial activities. We believe 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 improve. IIP has been in the positive territory for three out of the past four months coupled with IHS Markit India Manufacturing PMI, which has been on the improving trajectory m-o-m basis.

Manufacturing Index Trend



Source: Industry; Sharekhan Research

IIP 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 had 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 will improve in H2FY2021. 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.

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. 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.

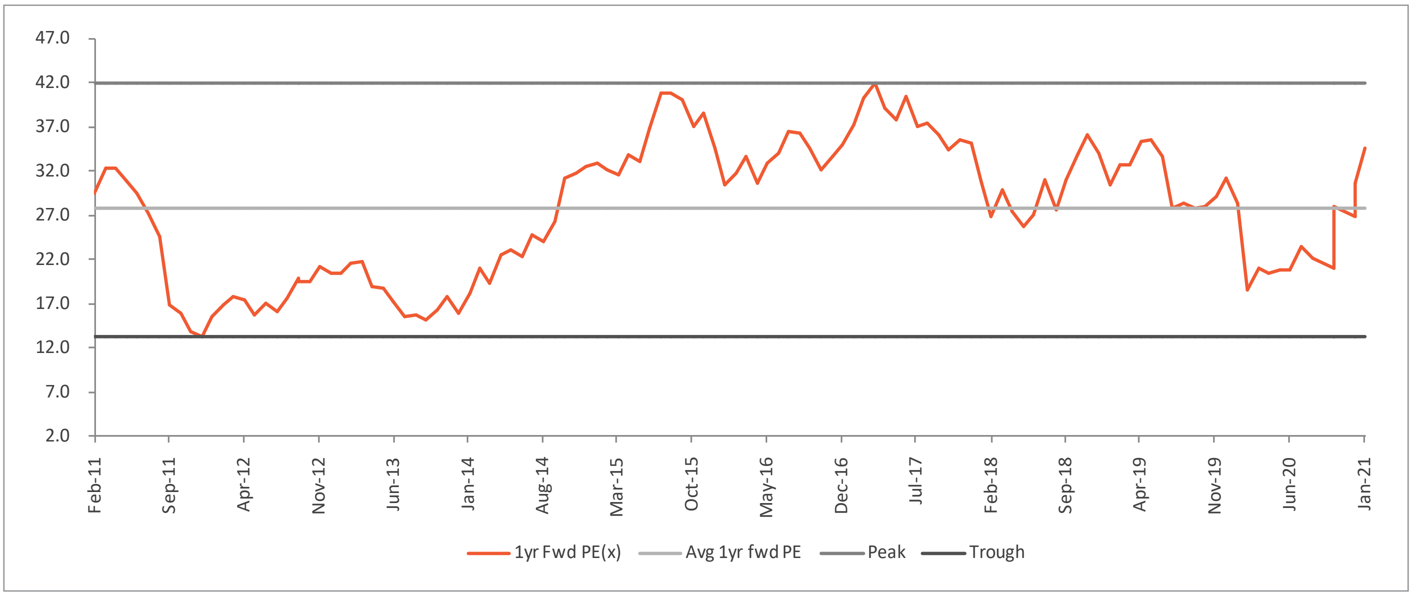
■ Company outlook - Domestic market expected to perform well, exports to improve gradually

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 started 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 Rs. 917

Cummins has started to witness the benefits arising from strong revival in key segments such as power generation, construction, data centres, and mining, which is expected to sustain going forward. Further, the industrial segment's sales will be driven by demand from railways, metro and road (compressors). Improvement in core business and increased outsourcing of maintenance services by clients are expected to boost the distribution business. Further, cost initiatives undertaken by the company have been yielding benefits in terms of improved OPM. We remain constructive on Cummins and expect a 15% net earnings CAGR over FY2021E-FY2023E, as it continues to benefit from healthy demand led by domestic economic revival. Cummins is currently trading at 34.9/30.1x x its FY2022E/FY2023E net earnings. Considering strong growth potential in end-user industries, strong balance sheet, and steady cash flow generation, we retain Buy on the stock with a revised PT of Rs. 917.

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 leading 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 its vast product offerings, management's focus on efficiency/cost, and a healthy potential scale from domestic infra and global market pickup.

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

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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