Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Cummins India

Strong growth outlook despite supply side headwinds

Capital Goods	Sharekhan code: CUMMINSIND

Reco/View: Buy	↔	CMP: Rs. 1,238	Price Target: Rs. 1,430	↑

↑ 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 July 08, 2022

Medium Risk

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

Source: Morningstar

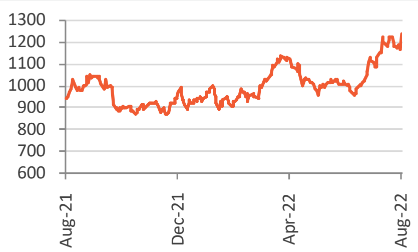
Company details

Market cap:	Rs. 34,317 cr
52-week high/low:	Rs. 1256/842
NSE volume: (No of shares)	6.4 lakh
BSE code:	500480
NSE code:	CUMMINSIND
Free float: (No of shares)	13.6 cr

Shareholding (%)

Promoters	51.0
FII	10.4
DII	25.3
Others	13.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	11.4	26.5	31.9	31.0
Relative to Sensex	2.3	16.8	29.8	22.3

Sharekhan Research, Bloomberg

Summary

- We reiterate Buy on Cummins India (Cummins) with a revised PT of Rs 1,430 given its robust performance during the quarter and bullish outlook.
- Cummins reported strong standalone revenues with 42% y-o-y growth driven by both domestic and export markets. Adjusted net profit grew by ~60% y-o-y.
- The demand outlook is robust in both domestic and exports driven by demand from data centers, mining, healthcare, realty and infrastructure. The Company could achieve double digit volume growth given the promising demand.
- Cummins has a strong pedigree, healthy balance sheet, constantly evolving product portfolio to meet the changing emission norms and improving earnings trajectory. We expect revenue/PAT CAGR of ~19%/21% over FY22-24E.

Cummins India's standalone results exceeded our estimates barring a miss on OPM. Total revenue grew by ~42% y-o-y to Rs 1,687crore (vs our estimate of Rs 1,365 crore). Domestic sales were at Rs 1,172 crore up by 36% y-o-y and by 12% q-o-q. Exports sales were at Rs 485 crore up by 58% y-o-y and by 14% q-o-q. Operating profit grew by 44% y-o-y to Rs 214 crore (vs our estimate of Rs 180crore). OPM came in at 12.7% up 12 bps y-o-y but lower than our estimate of 13.2%. Reported net profit declined by 16% y-o-y to Rs 199crore. However, adjusting for one-time gain on property sale in Q1FY22 and exceptional expense on account of voluntary retirement scheme in Q1FY23, the adjusted net profit grew by ~60% y-o-y to Rs 213 crore driven by other income of ~Rs 100 crore (up 82% y-o-y).

Key positives

- Revenues from domestic PowerGen/Distribution/Industrial rose by 41%/29%/25% y-o-y.
- Exports reported robust growth led by rise in both HHP (high horse power) and LHP (low horse power) sales.
- Other income grew by 82% y-o-y to Rs 100 crore; thereby contributing to net profit growth.
- OPM improved 12 bps y-o-y led by lower employee cost (down 240 bps y-o-y) and other expenses (down 100 bps y-o-y).

Key negatives

- Despite strong revenue growth, gross profit margin (GPM) declined by 330bps/90bps y-o-y and q-o-q.
- Profitability was low in LHP segment and construction sector.
- Shortage of raw materials such as semi-conductor and other electronics components restricted revenue growth.

Management Commentary

- Cummins has seen robust demand across most of the segments in both domestic and export markets.
- The company is seeing an unprecedented amount of demand in the Powergen segment emanating from infrastructure, pharmaceuticals, real estate, biotech, and data center.
- The company is envisaging strong export growth as markets in the middle east, Latin America, Asia Pacific are being driven by higher oil prices.
- CPCB-4 plus are the tightest emission norms and Cummins has invested in the technology and would be launching products. It is likely that there will be significant price increases to introduce these technologies.
- There has been a shortage of electronics, wiring elements, and other parts in the electric sub system. Cummins India has been adding additional suppliers and improving inventory management. However, complete normalization of the supply chain in the industry may take a year or two.

Revision in estimates – We have tweaked our estimates to build in higher revenues but lower operating profit margin for FY2023-FY2024E. .

Our Call

Valuation – Retain Buy with a revised PT of 1,430: Cummins is well geared to gain from increasing demand from data centers, healthcare, infrastructure, real estate; etc. In exports as well, the company has been continuously revamping its product portfolio and offering fit-for-market products in exports. Also, Cummins would benefit from the emergence of alternative and green fuels and would play a crucial role in India's transition to a zero carbon country by 2070 by offering products in alternative and green spaces. Cummins is currently trading at ~30x its FY2024E net earnings, which we believe provides further room for upside considering its strong growth potential in end-user industries, strong balance sheet, and steady cash flow generation. Cummins' industry-leading margins, product depth and strong parentage give us further comfort. We expect revenue/PAT CAGR of ~19%/21% over FY22-24E. Hence, we retain a Buy on the stock with a revised PT of Rs. 1,430.

Key Risks

- If the supply side issues persist for a long time, it can negatively affect the business outlook and earnings growth.
- Global market demand weakness due to the current geopolitical crisis between Russia and Ukraine poses a key downside risk to exports

Valuation (Standalone) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Total Revenue	4,329	6,140	7,547	8,745
OPM (%)	13.4	14.4	13.8	14.5
Adj Net profit	618	794	941	1,159
Adj. EPS (Rs.)	22.3	28.6	34.0	41.8
PER (x)	55.5	43.2	34.4	29.6
P/B (x)	7.8	7.1	6.5	5.8
EV/EBIDTA (x)	57.0	37.0	31.6	25.5
RoE (%)	14.4	17.2	18.6	20.8
RoCE (%)	17.8	21.1	22.9	25.7

Source: Company; Sharekhan estimates

Sales and net profit surprise positively, margin below estimates

Cummins India's standalone results exceeded our estimates barring a miss on OPM. Total revenue grew by ~42% y-o-y to Rs 1,687crore (vs our estimate of Rs 1,365 crore). Domestic sales were at Rs 1,172 crore up by 36% y-o-y and by 12% q-o-q. Exports sales were at Rs 485 crore up by 58% y-o-y and by 14% q-o-q. Operating profit grew by 44% y-o-y to Rs 214 crore (vs our estimate of Rs 180crore). OPM came in at 12.7% up 12 bps y-o-y but lower than our estimate of 13.2%. Reported net profit declined by 16% y-o-y to Rs 199crore. However, adjusting for one-time gain on property sale in Q1FY22 and exceptional expense on account of voluntary retirement scheme in Q1FY23, the adjusted net profit grew by ~60% y-o-y to Rs 213 crore driven by other income of ~Rs 100 crore (up 82% y-o-y).

Demand environment robust across segments, near-term margin headwinds

The company expects healthy demand from data centers, healthcare, commercial realty, pharmaceutical, biotech, and manufacturing industries. Further, it is seeing a demand revival from construction and residential housing segments. The demand outlook from data centers is positive led by the adoption of 5G technology, increasing storage data, rising OTT etc. Cummins is a significantly large player in data centers and well placed to tap the demand. Further, increasing spending in telecom and healthcare and implementation of CPCB -4 plus norms should lead to robust demand for the company's products. The industrial segment's sales will be driven by demand from railway electrification, mining, marine, oil & gas, defense; etc. The distribution business would be driven by increasing demand for maintenance in core industries such as data centers. Export demand environment has improved in Latin America, Asia Pacific region, Europe and the Middle East with an increase in oil prices. The company has been continuously revamping its product portfolio and offering fit-for-market products in exports. However, meaningful improvement in margins could take time as price hikes in some of the products have not caught up with the cost increases. Further, there are supply side and logistics constraints that could keep the margins under pressure in the near term.

Conference call Highlights:

- **Segment-wise revenue break up:** All the segments in both domestic and exports markets performed well with strong y-o-y growth. In the domestic segment - Powergen sales stood at Rs 496 crore (up 41% y-o-y, up 5% q-o-q), distribution came in at Rs 415 crore (up 29% y-o-y/ 12.5% q-o-q). Industrial came in at Rs 237 crore (up 25%/24% y-o-y/q-o-q) and others at Rs 48crore. The industrial break up was as follows: compressors – Rs 12 crore, construction – Rs 90 crore, Mining Rs 22 crore, Rail – Rs 65 crore, Marine – Rs 7 crore and others Rs 41 crore. In exports – HHP was at Rs 232 crore (up 36% y-o-y/15% /qoq), LHP was at Rs 202 crore (up 74% y-o-y/8% qoq).
- **Strong growth outlook in domestic Powergen business:** The company is seeing an unprecedented amount of demand in the powergen segment emanating from infrastructure, pharmaceuticals, real estate, biotech, and data center. However, sales are being curtailed due to disruption in the global supply chain.
- **Exports- strong demand continues:** The company is envisaging strong export growth as markets in the middle east, Latin America, and Asia Pacific are being driven by higher oil prices. There is healthy demand coming from sectors such telecom, refurbishment of infrastructure, realty, as well as data centers. Cummins indicated that the company can achieve double-digit volume growth in both domestic and export based on the demand if supply side constraints ease out.
- **Geography-wise Exports sales break up:** In exports –HHP sales were at Rs 232 crore, while LHP sales were at Rs 202 crore and miscellaneous sales of Rs 48 crore. Geography-wise - Asia pacific @Rs 107 crore - Latin America @ Rs 97 crore, Middle East @ Rs 109 crore, Europe @ Rs 83 crore, Africa @ Rs 39 crore.
- **Industry- wise outlook:** The construction business is expected to bounce back, rail business while underperformed during covid has started to pick up gradually. Compressors demand is highly cyclical and is currently undergoing a cyclical downturn. Mining is growing at record levels as power shortage has spurred coal mining and capex in the steel sector is also driving the demand. Marine is doing well but since the orders have a long gestation period, the revenue can be lumpy.

- **High cost in LHP and construction sector has led to decline in gross margin:** Gross margin are down q-o-q and y-o-y despite strong revenue growth. This is largely attributed to LHP wherein price increases have not still caught up with the cost escalation. The construction sector also underperformed in terms of profitability. The price increases should catch up in the coming quarters if the commodity prices stabilize and thereby help improve margins.
- **Complete restoration of supply chain would take time:** There has been a shortage of Electronics, wiring elements and other parts in the electric sub-system. Many small and medium-size suppliers have gone bankrupt. Cummins India has been adding additional suppliers and improving inventory management. However, complete normalization of the supply chain may take a year or two.
- **Ready for a shift to CPCB-4 plus:** CPCB-4 plus are the tightest emission norms in power generation in the world and are technologically intensive. It is likely that there will be significant price increases to introduce these technologies. Cummins is developing dozens of products which are in the final stage of testing.

Results (Standalone) **Rs cr**

Particulars	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)
Total Revenue	**1,687**	**1,184**	**42.4**	**1,494**	**12.9**
RM cost	1,162	777	49.6	1,016	14.4
Staff cost	151	135	12.2	143	6.0
Other expenses	159	124	28.5	129	24.0
Operating Profit	**214**	**149**	**43.7**	**207**	**3.5**
Other Income	100	55	82.4	77	30.7
Interest	2	2	10.9	5	(59.8)
Depreciation	34	31	8.9	35	(3.1)
PBT	**264**	**303**	**(13.0)**	**244**	**8.4**
Tax	65	67	(2.3)	55	19.6
Adj PAT	**213**	**133**	**59.8**	**189**	**12.7**
Exceptional items	(14)	132	NM	-	NM
Reported PAT	199	237	(16.0)	189	5.1
Adj. EPS (Rs.)	**7.7**	**4.8**	**59.8**	**6.8**	**12.7**
Margins (%)			**bps**		**bps**
OPM	**12.7**	**12.6**	**12**	**13.8**	**(116)**
NPM	12.6	11.3	137	12.7	(3)
Tax rate	24.7	22.0	271	22.4	233

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 bottom-up approach, wherein all projects cost more than Rs. 100 crore per project under construction, proposed Greenfield projects, Brownfield projects, and those at the conceptualization 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.

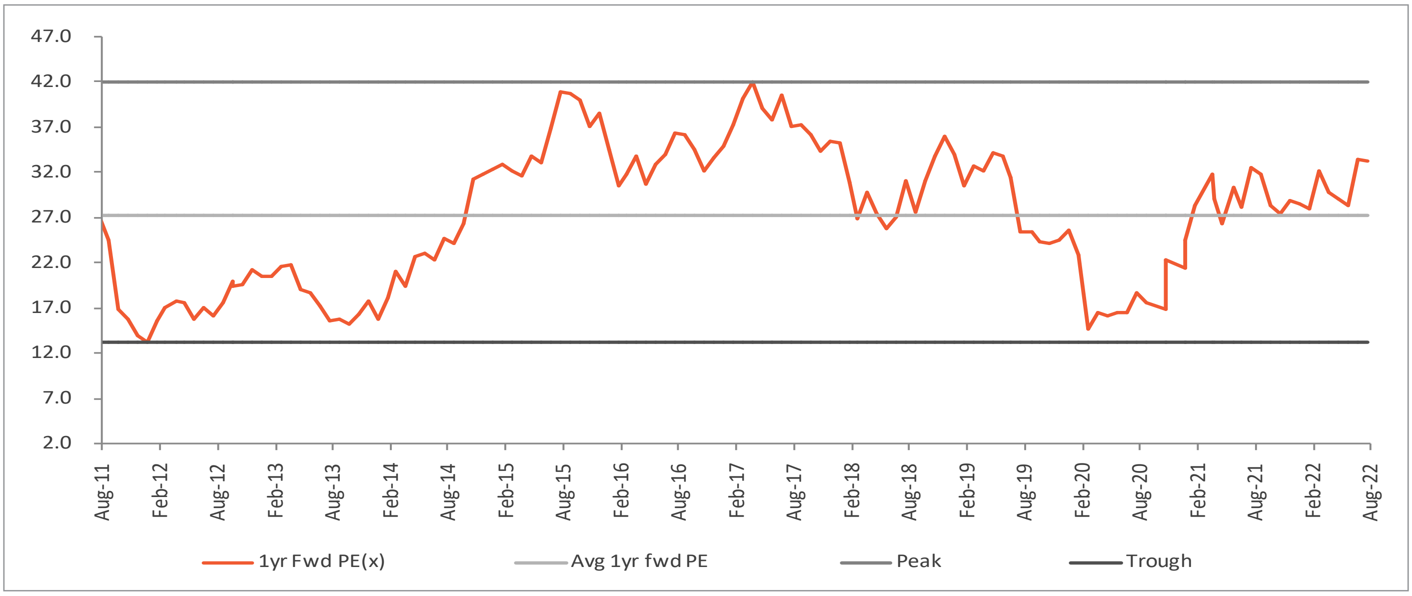
■ Company outlook - Domestic market expected to perform well, exports improving

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, and expectations of robust growth in exports and margin expansion make us positive on its prospects. The company has begun to witness the benefits arising from a 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 1,430

Cummins is well geared to gain from increasing demand from data centers, healthcare, infrastructure, real estate; etc. In exports as well, the company has been continuously revamping its product portfolio and offering fit-for-market products in exports. Also, Cummins would benefit from the 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 spaces. Cummins is currently trading at ~30x 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 give us further comfort. We expect revenue/PAT CAGR of ~19%/21% over FY22-24E. Hence, we retain a Buy on the stock with a revised PT of Rs. 1,430.

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 70% to its sales. Exports contribute around 25-30% to sales. The company exports to over 40 countries comprising the 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 a 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 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

- If the supply side issues persist for a long time, it can negatively affect the business outlook and earnings growth.
- Global market demand weakness due to the current geopolitical crisis between Russia and Ukraine poses a 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

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	SBI Fund Management Pvt. Ltd.	3.68
2	Kotak Mahindra AMC	3.35
3	LIC of India	3.28
4	SBI Life Insurance	1.95
5	ICICI Pru AMC	1.93
6	Norges Bank	1.81
7	Government Pension Fund	1.61
8	Vanguard Group Inc.	1.52
9	Franklin Resources Inc,	1.49
10	HDFC AMC	1.37

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

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Compliance Officer: Ms. Priya Sonavane; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA, Tel: 022 - 67502000/ Fax: 022 - 24327343. 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.