Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Cummins India

Expanding horizons, growth momentum to sustain

Capital Goods	Sharekhan code: CUMMINSIND
Reco/View: Buy ↔	CMP: Rs. 1,523
	Price Target: Rs. 1,755 ↑

↑ 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 Oct 08, 2022

Medium Risk

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

Source: Morningstar

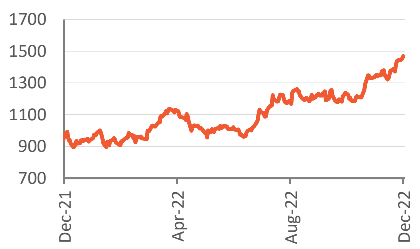
Company details

Market cap:	Rs. 42,218 cr
52-week high/low:	Rs. 1,552 / 877
NSE volume: (No of shares)	6.3 lakh
BSE code:	500480
NSE code:	CUMMINSIND
Free float: (No of shares)	13.6 cr

Shareholding (%)

Promoters	51.0
FII	10.4
DII	26.7
Others	11.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	10.0	19.1	45.3	56.5
Relative to Sensex	7.7	14.2	31.3	50.7

Sharekhan Research, Bloomberg

Summary

- Cummins is well-poised for a formidable growth in both domestic and export markets through sustainable demand in traditional sectors and new offerings in alternate and green technologies.
- CPCB-IV plus norms from July 01, 2023 would bring structural transformation in the gensets industry through technological changes and price revision. Barring brief disruption post pre-buying in H1CY23, long-term implications are favorable for a leader like Cummins in terms of revenue and profitability.
- Cummins has a strong pedigree, industry-leading margins and we expect its earnings trajectory to sustain going forward. We expect revenue/PAT CAGR of ~18%/19% over FY22-25E.
- It has a healthy balance sheet with strong cash and investments of ~Rs. 2,000 crore. We reiterate Buy on the stock with a revised PT of Rs 1,755.

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. We expect growth momentum to continue in both domestic and export markets led by sustained demand in key sectors, implementation of new CPCB IV plus norms and emergence of alternative and green fuels (blending with its parent company's strategy to achieve zero emission by 2050). 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 witness strong growth in high-capacity engines. In exports, Latin America, Asia Pacific and Middle East would drive long-term growth. We are bullish on Cummins' long-term prospects as it has a strong pedigree, healthy balance sheet as well as a robust product portfolio.

- **Long-term demand to remain firm in both domestic and export markets:** Cummins expects demand to continue arising from data centers, healthcare, commercial realty, pharmaceutical, biotech, and manufacturing industries in domestic powergen segment. Further, it is seeing a demand revival from construction and residential housing segments. The supply chain and logistics issues have been resolved to a certain extent although shortage of some electronic components which are used for HHP engines have restricted sales in this space. However, Cummins India can leverage its globally integrated supply chain to mitigate this risk to a certain extent. The industrial segment's sales will be driven by demand from railway electrification, mining, marine, oil & gas, defence; etc. The company is also focusing on growing its rail business particularly in the electrification domain. Export demand is stable in Latin America, Asia-Pacific region and Middle East, while demand seems to slowdown in Europe. 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. We expect exports to grow at ~15% CAGR over FY22-25E.
- **New CPCB-IV plus norms, new technologies and products would pave the way for future growth:** CPCB-IV plus norms would be implemented from July 2023 onwards for power gensets and genset engines which is expected to bring structural transformation in the powergen industry in terms of technology and pricing. It is expected that the cost would increase by ~30-40%. Cummins, therefore, expects strong pre-buy in the first half of CY2023 and the dealers and distributors who have the old inventory could continue selling it for another six months. As per the past trend, whenever the emission norms are changed, there is a pre-buying before the norms are implemented and market gets disrupted for a brief period before stabilizing. In the long run, the company can also tap export markets in Europe, Canada and North America as the technology is equivalent to US tier-4 emission standards. Cummins would also 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. For instance, Cummins would provide technology to build one of India's largest proton exchange membrane (PEM) electrolyzer for GAIL's plant at Vijaipur, in Madhya Pradesh. Cummins' parent, Cummins Inc. has its proprietary PEM electrolysis technology which is used to manufacture PEM electrolyzers globally.
- **Margin profile to improve in the near to medium term:** As commodity prices have started softening, the company anticipate gross margin to continue to improve over subsequent quarters. Cummins commands pricing power and has not rolled back price hikes. Hence, it expects sequential improvement in gross margins to continue and could get back to erstwhile gross margins of 34-35% in the next 18-24 months. Further, 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.

Revision in estimates – We have maintained our estimates for FY23-25E and have rolled forward our target price based on FY25E EPS.

Our Call

Valuation – Retain Buy with a revised PT of Rs. 1,755: Cummins is likely to sustain the growth momentum as demand continues to be robust in sectors like data centers, healthcare and infrastructure. In exports as well, the company has been continuously revamping its product portfolio and offering fit-for-market products which has helped it gain market share. Moreover, Cummins would benefit from 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 space. Cummins has 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. Hence, we retain a Buy on the stock with a revised PT of Rs. 1,755.

Key Risks

- Slowdown in domestic macro-environment can affect business outlook and earnings growth.
- Global market demand weakness due to geopolitical crisis between Russia and Ukraine and economic slowdown in some of the countries pose key downside risk to exports.

Valuation (Standalone) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Total Revenue	6,140	7,595	8,837	10,143
OPM (%)	14.4	14.1	14.9	15.5
Adj Net profit	794	930	1,141	1,349
Adj. EPS (Rs.)	28.6	33.6	41.2	48.7
PE (x)	53.2	34.9	37.0	31.3
P/B (x)	8.7	8.0	7.2	7.2
EV/EBITDA (x)	45.9	37.9	30.6	25.9
RoE (%)	17.2	18.4	20.5	23.0
RoCE (%)	21.1	22.7	25.6	29.0

Source: Company; Sharekhan estimates

Strong demand momentum to continue in the long-term

Cummins expects demand momentum to continue from data centers, healthcare, commercial realty, pharmaceutical, biotech, and manufacturing industries in domestic powergen segments. Further, it is seeing demand revival from construction and the residential housing segments. The supply chain and logistic issues have been resolved to a certain extent although shortages of some electronic components which are used for HHP engines have restricted sales in this space. However, Cummins India can leverage its globally integrated supply chain to mitigate this risk to a certain extent. The industrial segment's sales will be driven by demand from railway electrification, mining, marine, oil & gas, defense; etc. The company is also focusing on growing its rail business particularly in the electrification space by offering converters. Moreover, the company is now doing the entire powertrain including the whole compartment. Distribution business would be driven by increasing demand for maintenance and the company is improving its offerings in this segment.

Exports growth would be aided by new product offerings

Export demand is stable in Latin America, Asia-Pacific and the Middle East, while demand seems to slowdown in Europe. The company has been witnessing strong volume growth in the last few quarters. Moreover, roll out of faster and reliable 5G mobile network as well as the expansion of Internet of Things (IoT) infrastructure offers growth prospects for Cummins' products in exports markets. 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. Exports contribute 25% to the total revenue and has better realization and margins. We expect exports to grow at a ~15% CAGR over FY22-25E.

New CPCB-IV plus norms to bring structural changes in the industry

The CPCB-IV plus norms would be implemented from July 2023 onwards for power gensets and genset engines which is expected to bring structural transformation in the powergen industry in terms of technology and pricing. It is expected that the cost would increase by ~30-40%. Cummins, therefore, expects strong pre-buys in the first half of CY2023 and the dealers and distributors who have the old inventory could continue selling it for another six months. Hence, post the new norms, there may be a demand slowdown for 12-18 months. As per the past trend, whenever the emission norms are changed, there is a pre-buying before the norms are implemented and market gets disrupted for a brief period before stabilizing. In the long run, the company can also tap export markets in Europe, Canada and North America as the technology is equivalent to US tier-4 emission standards.

Margin profile to improve in the near to medium term

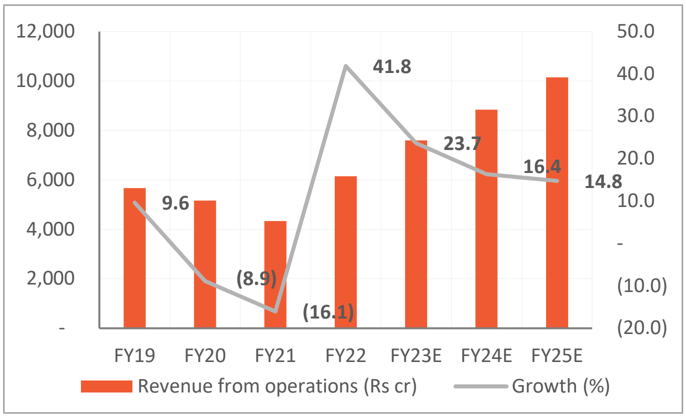
While commodity prices have started softening, the company is yet to catch up and anticipate gross margin to continue to improve over subsequent quarters. The company has not rolled back the price increases and being the market leader, Cummins commands pricing power. Hence, it expects sequential improvement in gross margins to continue and could get back to erstwhile gross margin of 34-35% in the next 18 to 24 months. Further, 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.

Foray into new technologies and products

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. India is emerging as a leading electrolyser manufacturing centre, with 8 GW of capacity due to come on line by 2025. Cummins is also contemplating to set up a electrolyzer or hydrogen fuel cell capacity on its own or tie-up with a partner. Cummins parent has a good experience of setting fuel cell capacity globally in the electrolyzer space. Recently, it is reported that in collaboration with the EPC player Tecnimont Private Limited (TCMPL), the Indian subsidiary of Maire Tecnimont Group, would provide technology to build one of India's largest proton exchange membrane (PEM) electrolyzers for GAIL's plant at Vijaipur, in Madhya Pradesh. Cummins' parent – Cummins Inc. has its proprietary PEM electrolysis technology used to manufacture PEM electrolyzers globally. Cummins Inc. has supplied and commissioned more than 600 electrolyzers worldwide with PEM and alkaline technologies. Therefore, decarbonization is a strong growth opportunity for Cummins. Cummins' US parent's acquisition of Meritor- (a leading global supplier of drivetrain, mobility, braking, aftermarket and electric powertrain solutions) may not have a meaningful impact on Cummins business. However, in construction and other heavy-duty applications, the entity can contemplate to offer entire power drill solutions rather than just an engine.

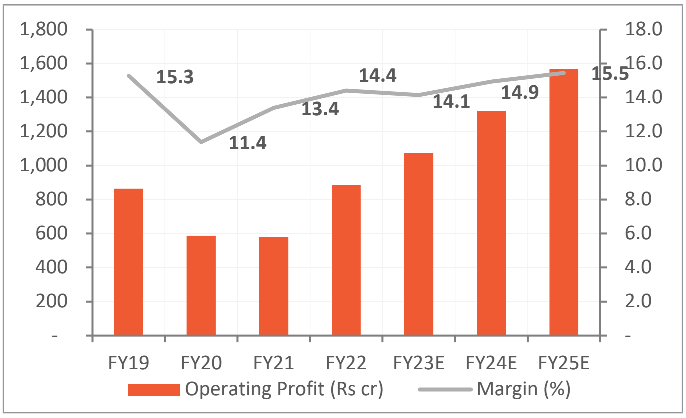
Financials in charts

Revenue growth trend



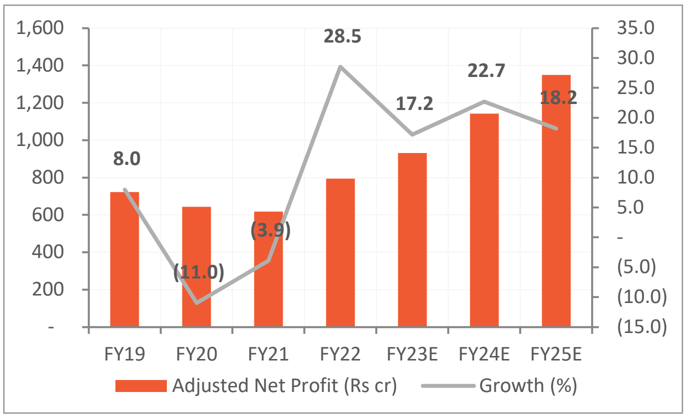
Source: Company, Sharekhan Research

Operating profit and margin trend



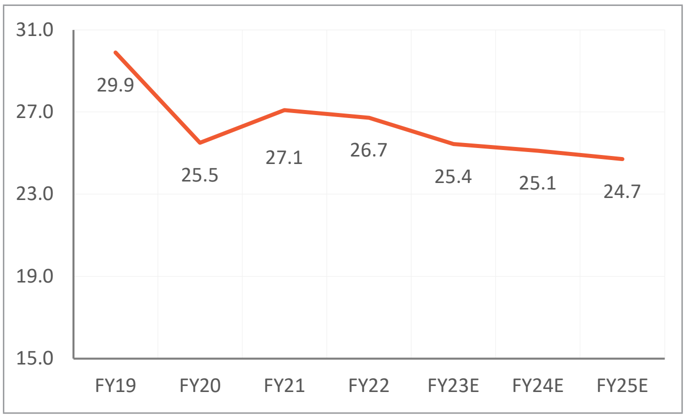
Source: Company, Sharekhan Research

Net profit growth trend



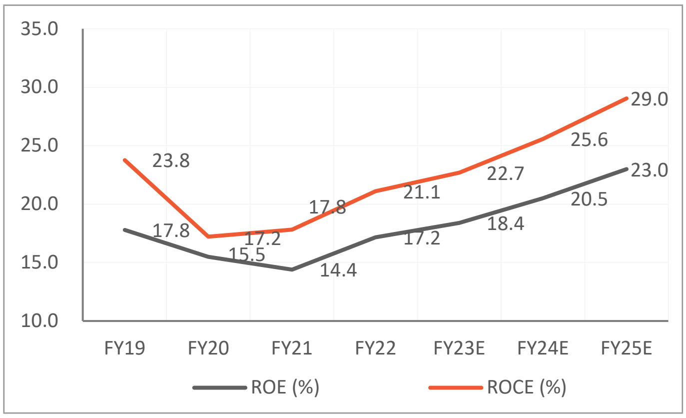
Source: Company, Sharekhan Research

Exports to total sales (%)



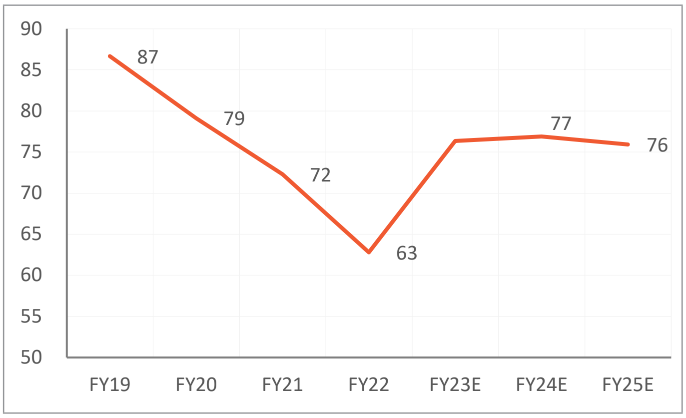
Source: Company, Sharekhan Research

Returns Ratios trend



Source: Company, Sharekhan Research

Working capital cycle (days)



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 the 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.

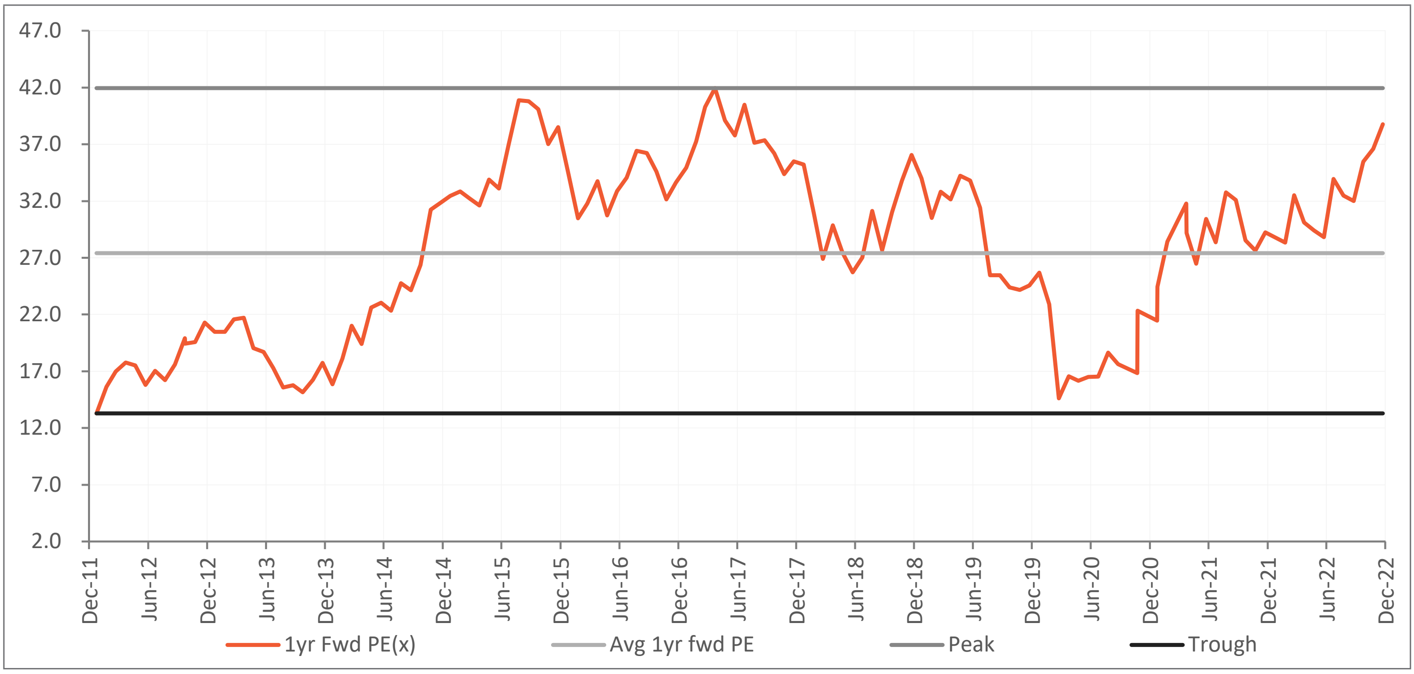
■ **Company Outlook – Domestic and export markets expected to perform well**

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 from the low levels.

■ **Valuation – Retain Buy with a revised PT of Rs. 1,755**

Cummins is likely to sustain the growth momentum as demand continues to be robust in sectors like data centers, healthcare and infrastructure. In exports as well, the company has been continuously revamping its product portfolio and offering fit-for-market products which has helped it gain market share. AlsoMoreover, Cummins would benefit from 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 space. Cummins has 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. Hence, we retain a Buy on the stock with a revised PT of Rs. 1,755.

One-year forward P/E (x) band



Source: Company, 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 indicate reasonably long-term growth prospects with a healthy return/cash flow profile. We believe the stock has strong growth potential given vast product offerings, management's focus on efficiency/cost and introduction of new technologies.

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 Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Kotak Mahindra AMC	3.80
2	SBI Fund Management Pvt. Ltd	3.75
3	Norges Bank	1.81
4	ICICI Pru AMC	1.71
5	LIC of India	1.62
6	SBI Life Insurance	1.60
7	Vanguard Group Inc.	1.54
8	Franklin Resources Inc,	1.53
9	Aditya Birla Sun Life Asset Management 9	1.24
10	HDFC AMC	1.14

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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