20 February 2013

Update | Sector: Capital Goods

Cummins India

BSE SENSEX	S&P CNX
19,636	5,940

CMP: INR504 **TP: INR585** **Buy**

LHP products to be an important growth driver

Cross service charges at INR100-200m/quarter

- **The initial traction in LHP exports has been encouraging and the revised expectations are that revenues could potentially increase to INR20b pa in the next 4-5 years (v/s the earlier expectation of INR12b).**
- **The strategy for domestic power generation markets would be: 1) to defend market share in MHP/HHP segments and 2) launch new products in the LHP segment (and the attempt is to increase channel density, broaden retail network etc).**
- **Cross service charges will be recovered by the parent company from Jan 2013, and while the amount is still under discussion, the impact is likely at INR100-200m/quarter (4-8% of PBT by FY14).**

We attended Cummins India's (KKC) analyst meet and also visited the HHP engine manufacturing plant at Kothrud, Pune. The key takeaways are:

- **LHP exports show increased traction:** The initial traction in LHP exports has been encouraging and the revised expectations are that revenues could potentially increase to INR20b pa in the next 4-5 years (v/s the earlier expectation of INR12b). The key markets are Middle East and South Africa, and India is being established as a global hub for such products. The powergen factory (for Urja Gensets) will be commissioned in April/May 2013. Exports in 3QFY13 were impacted given the ongoing inventory correction and the trend has now normalized.
- **Domestic power generation to be supported by price increases/LHP products:** The strategy for domestic power generation markets would be: 1) to defend market share in MHP/HHP segments and 2) launch new products in the LHP segment (and the attempt is to increase channel density, broaden retail network etc). LHP products could be important growth drivers, going forward.
- **Cross service charges at 4-8% of FY14 PBT:** Cross service charges will be recovered by the parent company from Jan 2013, and while the amount is still under discussion, the impact is likely at INR100-200m/quarter (4-8% of PBT by FY14). These charges pertain to support like product/marketing/HR related services etc and are separate from technical support, which is being recovered through royalty.
- **Margins supported by twin trends of currency movements and declining commodity prices:** Margin expansions witnessed in 3QFY13 to 19.1% are largely driven by value engineering, cost rationalization programs etc. However, given the volatility in commodity prices, unfavorable currency movement etc, management stated that EBITDA margin could possibly decline by 50bp, going forward.
- **Valuation and view:** We model revenue growth of 11%/16%/17% in FY13E/14E/15E and EBITDA margin of 18.8%/19.4%/19.5% (FY12 16.9%). On current estimates, KKC trades at 20x FY13E, 17.4x FY14E and 15.3x FY15E. Maintain **Buy** with a target price of INR585 based on 18x FY15E EPS.

Bloomberg	KKC IN
Equity Shares (m)	277.2
M.Cap. (INR b)/(USD b)	139.7/2.6
52-Week Range (INR)	550/396
1,6,12 Rel. Perf. (%)	4/-3/0

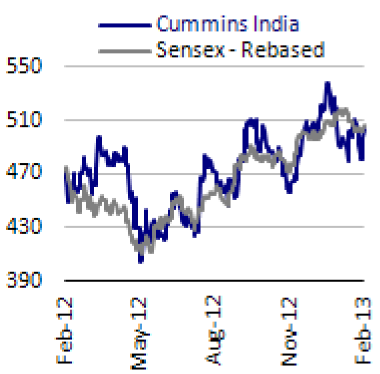
Financials & Valuation (INR b)

Y/E March	2013E	2014E	2015E
Net Sales	45.6	52.7	61.8
EBITDA	8.6	10.2	12.0
Adj PAT	7.0	8.0	9.1
EPS (INR)	25.3	28.9	33.0
EPS Gr. (%)	27.2	14.4	14.2
BV/Sh. (INR)	86.1	97.5	110.6
RoE (%)	31.7	31.5	31.7
RoCE (%)	31.8	31.6	31.9
Payout (%)	55.6	60.7	60.3
Valuation			
P/E (x)	20.0	17.4	15.3
P/BV (x)	5.9	5.2	4.6
EV/EBITDA (x)	15.3	12.8	10.8
Div Yield (%)	2.4	3.0	3.4

Shareholding pattern %

As on	Dec-12	Sep-12	Dec-11
Promoter	51.0	51.0	51.0
Dom. Inst	21.7	21.9	21.5
Foreign	13.2	12.7	11.9
Others	14.2	14.4	15.6

Stock performance (1 year)



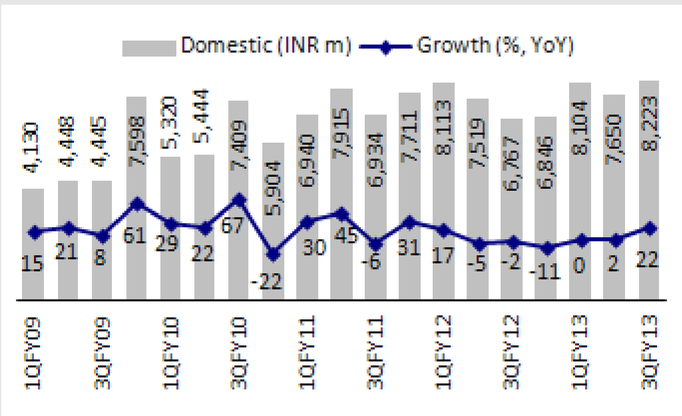
Satyam Agarwal (AgarwalS@MotilalOswal.com); +91 22 3982 5410

Deepak Narnolia (Deepak.Narnolia@MotilalOswal.com); +91 22 3982 5126

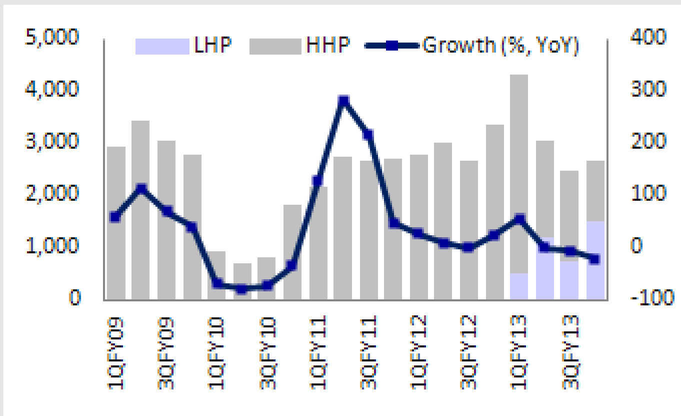
LHP exports show increased traction; Domestic power gen to be supported by price increases/LHP products

- **LHP exports show increased traction:** The initial traction in LHP exports has been encouraging and the revised expectations are that revenues could potentially increase to INR20b pa in the next 4-5 years (v/s the earlier expectation of INR12b). During FY13, LHP exports should contribute ~INR4-4.5b in revenues, of which Urja Gensets will contribute ~INR2b. The key markets are Middle East and South Africa, and India is being established as a global hub for such products. The powergen factory (for Urja Gensets) will be commissioned in April/May 2013 with initial capacity of 15,000-20,000 units pa and will be ramped up to 50,000 units in next 2-3 years. Exports in 3QFY13 were impacted given the ongoing inventory correction and the trend has now normalized.
- **Domestic power gen to be supported by price increases/LHP products:** The strategy for domestic power gen markets would be: 1) to defend market share in MHP/ HHP segments and 2) launch new products in the LHP segment (and the attempt is to increase channel density, broaden retail network etc). LHP products could be important growth drivers going forward. Also, revenues in FY14/FY15 will be supported by the 15-20% price increase expected post implementation of CPCB norms (likely in 4QCY13). KKC reiterated its long term expectations that growth over 3 years would be in high teens in the domestic market.
- **Emerging growth drivers:** In industrial business, the key drivers are mining, railways and construction. During 3QFY13, industrial/auto business witnessed cyclical uptick, with revenues rising +35%/+100% on QoQ basis respectively; also, on YoY basis, the revenue decline has moderated to ~5% YoY. Medium term growth drivers will be offshore oil and gas (QSK 60), railways (attempt to influence policy for replacing batteries), new OEM business (like SANY, Leigeng), mining etc.

Domestic sales grew strongly supported by power shortages

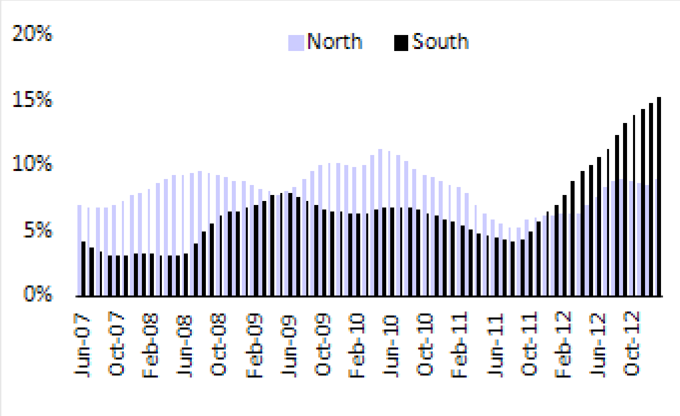


Export sales impacted by lower HHP sales

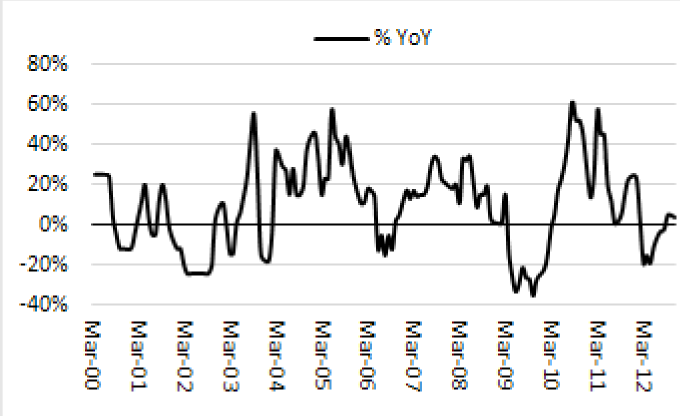


Source: Company, MOSL

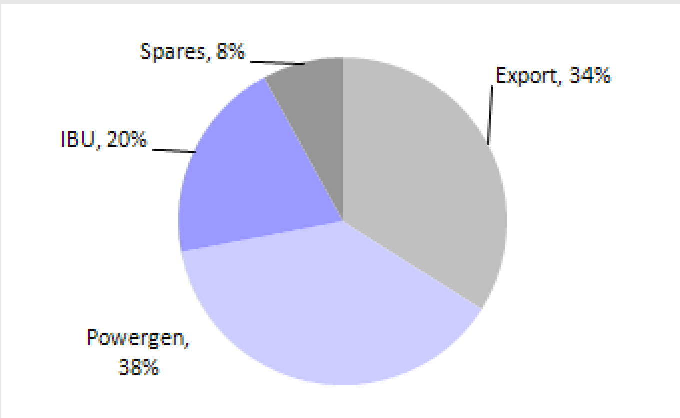
Power shortages driving demand, largely in South India



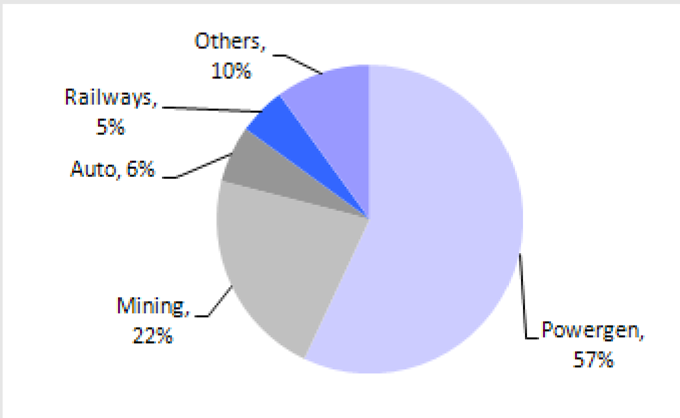
Caterpillar dealer statistics show initial signs of improvement



Revenue composition (industrial business)



Revenue composition (distribution business)



Source: Company, MOSL

Cross service charges at 4-8% of FY14 PBT; Charges would be over and above royalty

- Cross service charges will be recovered by the parent company from Jan 2013, and while the amount is still under discussion, the impact is likely at INR100-200m/ quarter (4-8% of PBT by FY14).
- These charges pertain to support like product/marketing/HR related services etc and are separate from technical support which is being recovered through royalty. Management stated that there is intense scrutiny by US regulators regarding the corporate expenses being incurred by US companies, which leads to passing on the benefits to overseas subsidiaries. The attempt is to increasingly pass these costs to the benefiting entities.
- As per FY12 annual report, Cummins India paid INR1.5b to Cummins Inc group (3.7% of revenues), which includes royalty of INR649m and service charges of INR832m. Since FY10, these charges increased from 2.1% of revenues to 3.7% in FY12. We have not factored the increase in charges to the parent company in our estimates.
- Management stated that CPCB norms would not lead to any meaningful increase in royalty charges.

KKC currently pays 3.7% of revenues to Cummins Inc (INR m)

	FY10	FY11	FY12
Services Received			
Cummins Power Generation Ltd	0	130	155
Cummins Technologies Ltd	208	414	556
others	124	114	121
Transfer of technology including royalty			
Cummins Inc	274	612	649
Others	0	9	0
Payment by Cummins India	606	1,278	1,480
% of Revenues	2.1	3.2	3.7

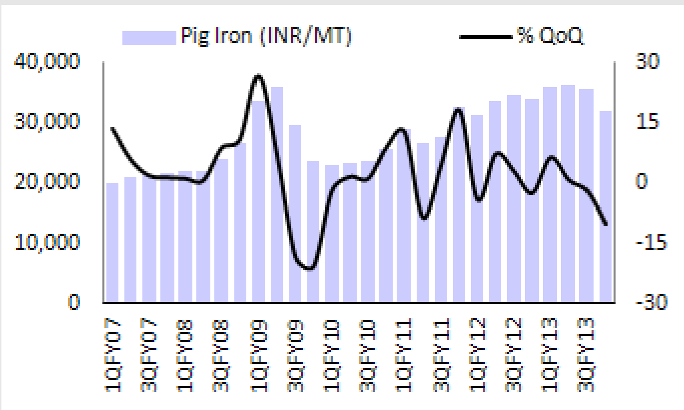
Source: Company, MOSL

Margins supported by twin trends of currency movements and declining commodity prices

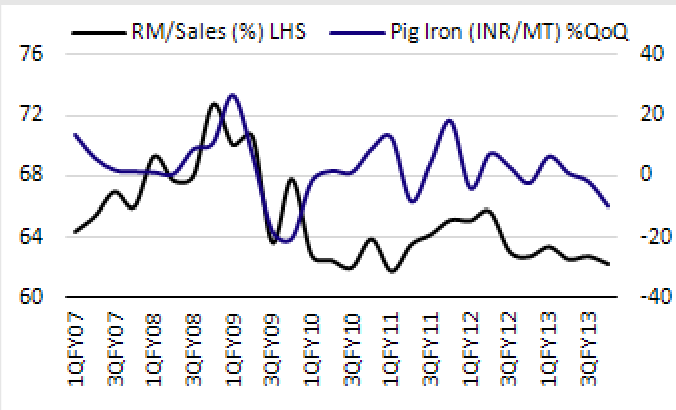
- Margin expansions witnessed in 3QFY13 to 19.1% are largely driven by value engineering, cost rationalization programs etc. However, given the volatility in commodity prices, unfavorable currency movement etc, management stated that EBITDA margin could possibly decline by 50bp, going forward. During 3QFY13, KKC's margins improved despite flat revenues, supported by (i) twin trends of currency depreciation and lower commodity prices and (ii) benefits accruing from

EBITDA margin supported by twin trends of lower commodity prices and depreciating rupee

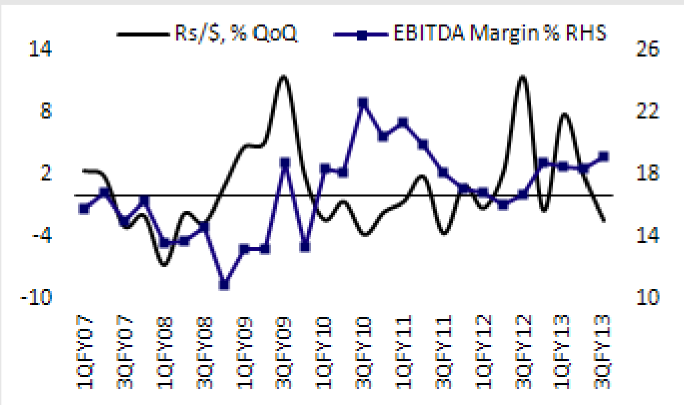
Pig iron prices declined meaningfully in 4QFY13



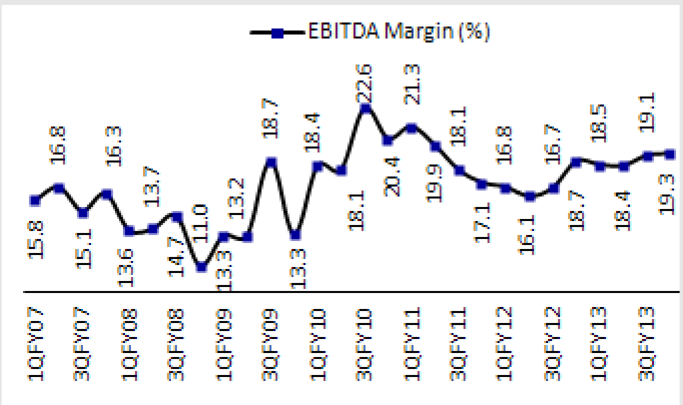
KKC's RM cost has a very direct co-relation with pig iron prices



Depreciating rupee likely to have positive impact on margins



EBITDA margin supported by twin trends



Source: Company, MOSL

2.5-3% price hike from June 2012. We believe that the 3% further price increase taken during Jan 2013 will again support margins and expect 4QFY13 EBITDA margin at 19.3%.

- KKC's raw material costs have historically demonstrated very direct correlation with pig iron prices. Stabilizing/declining trend in commodity prices should lead to savings in KKC's raw material costs, particularly due to its ongoing efficiency measures such as Six Sigma, ACE and TRIMs. Currency depreciation makes KKC more competitive in the global network of Cummins Inc, leading to possibilities for increased outsourcing. The currency movement also improved KKC's competitive positioning vis-à-vis competitors, particularly Perkins (Caterpillar), MTU, Volvo, MHI, Kohler, Navistar etc. Several of these global players rely on imports, thus severely impacting their pricing ability. In contrast, KKC has very low import content at ~20% of its total RM basket.

Valuation and view

- We estimate revenue growth of 11%/16%/17% in FY13E/14E/15E and EBITDA margin of 18.8%/19.4%/19.5% (FY12 16.9%).
- Our EPS estimate stands at INR25.3 (up 27% YoY) for FY13E, INR28.9 (up 13% YoY) for FY14E and INR33 (up 14%) for FY15E.
- On current estimates, KKC trades at 20x FY13E, 17.4x FY14E and 15.3x FY15E.
- Maintain **Buy** with a target price of INR585 based on 18x FY15E EPS.

Financials and Valuation

Income Statement (INR Million)

Y/E March	2011	2012	2013E	2014E	2015E
Total Revenues	**40,425**	**41,172**	**45,588**	**52,706**	**61,823**
Change (%)	39.5	1.8	10.7	15.6	17.3
Raw Materials	25,803	26,454	28,584	32,783	38,485
Staff Cost	2,546	3,039	3,343	3,744	4,306
Other Expenses	4,441	4,706	5,083	5,956	6,986
EBITDA	**7,635**	**6,973**	**8,578**	**10,223**	**12,047**
% of Total Revenues	18.9	16.9	18.8	19.4	19.5
Depreciation	366	420	470	575	650
Other Income	804	1,233	1,661	1,536	1,549
Interest	48	54	45	60	60
PBT	**8,025**	**7,732**	**9,725**	**11,124**	**12,885**
Tax	2,114	2,334	2,796	3,115	3,737
Rate (%)	26.3	30.2	28.8	28.0	29.0
Adjusted PAT	**5,911**	**5,502**	**7,000**	**8,009**	**9,148**
Extra-ordinary Income (net)	0	514	475	0	0
Reported PAT	**5,911**	**5,913**	**7,404**	**8,009**	**9,148**
Change (%)	33.1	0.0	25.2	8.2	14.2
Adj. Consolidated PAT	**5,911**	**5,502**	**7,000**	**8,009**	**9,148**
Change (%)	33.1	-6.9	27.2	14.4	14.2

Balance Sheet (INR Million)

Y/E March	2011	2012	2013E	2014E	2015E
Share Capital	396	554	554	554	554
Reserves	17,667	19,877	23,388	26,530	30,163
Net Worth	**18,063**	**20,432**	**23,943**	**27,085**	**30,718**
Loans	183	0	0	0	0
Deferred Tax Liability	-187	-70	-70	-70	-70
Capital Employed	**18,058**	**20,362**	**23,873**	**27,015**	**30,648**
Gross Fixed Assets	9,144	9,703	11,203	14,203	16,703
Less: Depreciation	4,734	5,054	5,524	6,099	6,749
Net Fixed Assets	**4,411**	**4,649**	**5,679**	**8,104**	**9,954**
Investments	7,255	5,976	5,976	5,976	5,976
Curr. Assets	**16,804**	**19,826**	**22,681**	**24,829**	**28,528**
Inventory	5,190	5,676	6,245	7,220	8,469
Debtors	7,182	6,783	7,494	8,664	10,163
Cash & Bank Balance	1,037	2,235	3,589	3,300	3,876
Loans & Advances	3,297	5,082	5,303	5,595	5,970
Other Assets	98	50	50	50	50
Current Liab. & Prov.	**10,325**	**10,509**	**11,263**	**12,778**	**14,674**
Creditors	6,129	5,186	5,745	6,642	7,791
Other Liabilities	894	1,587	1,598	1,849	2,171
Provisions	3,302	3,736	3,919	4,287	4,711
Net Current Assets	**5,356**	**7,006**	**7,729**	**8,636**	**9,842**
Application of Funds	**18,058**	**20,362**	**23,873**	**27,015**	**30,648**

E: MOSL Estimates

Financials and Valuation

Ratios

Y/E March	2011	2012	2013E	2014E	2015E
Basic (INR)					
Adj EPS	**21.3**	**19.8**	**25.3**	**28.9**	**33.0**
Cash EPS	22.6	21.4	26.9	31.0	35.3
Book Value	64.5	73.5	86.1	97.5	110.6
DPS	15.0	11.0	12.0	15.0	17.0
Payout (incl. Div. Tax.)	82.3	64.2	55.6	60.7	60.3
Valuation (x)					
P/E		22.1	20.0	17.4	15.3
Cash P/E		20.5	18.7	16.3	14.3
EV/EBITDA		16.3	15.3	12.8	10.8
EV/Sales		2.8	2.9	2.5	2.1
Price/Book Value		6.0	5.9	5.2	4.6
Dividend Yield (%)		2.5	2.4	3.0	3.4
Profitability Ratios (%)					
RoE	35.5	28.8	31.7	31.5	31.7
RoCE	35.4	28.8	31.8	31.6	31.9
Turnover Ratios					
Debtors (Days)	65	60	60	60	60
Inventory (Days)	47	50	50	50	50
Creditors. (Days)	55	46	46	46	46
Asset Turnover (x)	4.3	4.2	4.0	3.7	3.6
Leverage Ratio					
Debt/Equity (x)	0.0	0.0	0.0	0.0	0.0

Cash Flow Statement (INR Million)

Y/E March	2011	2012	2013E	2014E	2015E
PBT before EO Items	8,025	7,732	9,725	11,124	12,885
Add: Depreciation	366	420	470	575	650
Interest	48	54	45	60	60
Less: Direct Taxes Paid	2,114	2,334	2,796	3,115	3,737
(Inc)/Dec in WC	(1,253)	(1,072)	(723)	(974)	(1,407)
CF from Operations	**5,072**	**4,800**	**6,721**	**7,670**	**8,452**
EO Income	0	514	475	0	0
CF from Oper. Incl. EO Items	**5,072**	**5,315**	**7,196**	**7,670**	**8,452**
(Inc)/Dec in FA	(1,440)	(2,082)	(1,903)	(3,100)	(2,500)
Investment in subsidiaries	0	(148)	0	0	0
Investment in liquid assets	75	1,761	0	0	0
CF from Investments	**-1,366**	**-469**	**-1,903**	**-3,100**	**-2,500**
(Inc)/Dec in Networth	1,389	(226)	(1)	(2)	(2)
(Inc)/Dec in Debt	96	-183	0	0	0
Less: Interest Paid	48	54	45	60	60
Dividend Paid	4,666	3,185	3,892	4,798	5,314
CF from Fin. Activity	**(3,228)**	**(3,648)**	**(3,938)**	**(4,860)**	**(5,376)**
Inc/Dec of Cash	**478**	**1,198**	**1,354**	**(289)**	**576**
Add: Beginning Balance	559	1,037	2,235	3,589	3,300
Closing Balance	**1,037**	**2,235**	**3,589**	**3,300**	**3,876**

E: MOSL Estimates

Disclosures

This report is for personal information of the authorized recipient and does not construe to be any investment, legal or taxation advice to you. This research report does not constitute an offer, invitation or inducement to invest in securities or other investments and Motilal Oswal Securities Limited (hereinafter referred as MOSt) is not soliciting any action based upon it. This report is not for public distribution and has been furnished to you solely for your information and should not be reproduced or redistributed to any other person in any form.

Unauthorized disclosure, use, dissemination or copying (either whole or partial) of this information, is prohibited. The person accessing this information specifically agrees to exempt MOSt or any of its affiliates or employees from, any and all responsibility/liability arising from such misuse and agrees not to hold MOSt or any of its affiliates or employees responsible for any such misuse and further agrees to hold MOSt or any of its affiliates or employees free and harmless from all losses, costs, damages, expenses that may be suffered by the person accessing this information due to any errors and delays.

The information contained herein is based on publicly available data or other sources believed to be reliable. While we would endeavour to update the information herein on reasonable basis, MOSt and/or its affiliates are under no obligation to update the information. Also there may be regulatory, compliance, or other reasons that may prevent MOSt and/or its affiliates from doing so. MOSt or any of its affiliates or employees shall not be in any way responsible and liable for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report . MOSt or any of its affiliates or employees do not provide, at any time, any express or implied warranty of any kind, regarding any matter pertaining to this report, including without limitation the implied warranties of merchantability, fitness for a particular purpose, and non-infringement. The recipients of this report should rely on their own investigations.

This report is intended for distribution to institutional investors. Recipients who are not institutional investors should seek advice of their independent financial advisor prior to taking any investment decision based on this report or for any necessary explanation of its contents.

MOSt and/or its affiliates and/or employees may have interests/positions, financial or otherwise in the securities mentioned in this report. To enhance transparency, MOSt has incorporated a Disclosure of Interest Statement in this document. This should, however, not be treated as endorsement of the views expressed in the report.

Disclosure of Interest Statement	Cummins India
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

Analyst Certification

The views expressed in this research report accurately reflect the personal views of the analyst(s) about the subject securities or issues, and no part of the compensation of the research analyst(s) was, is, or will be directly or indirectly related to the specific recommendations and views expressed by research analyst(s) in this report. The research analysts, strategists, or research associates principally responsible for preparation of MOSt research receive compensation based upon various factors, including quality of research, investor client feedback, stock picking, competitive factors and firm revenues.

Regional Disclosures (outside India)

This report is not directed or intended for distribution to or use by any person or entity resident in a state, country or any jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject MOSt & its group companies to registration or licensing requirements within such jurisdictions.

For U.K.

This report is intended for distribution only to persons having professional experience in matters relating to investments as described in Article 19 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (referred to as "investment professionals"). This document must not be acted on or relied on by persons who are not investment professionals. Any investment or investment activity to which this document relates is only available to investment professionals and will be engaged in only with such persons.

For U.S.

Motilal Oswal Securities Limited (MOSL) is not a registered broker - dealer under the U.S. Securities Exchange Act of 1934, as amended (the"1934 act") and under applicable state laws in the United States. In addition MOSL is not a registered investment adviser under the U.S. Investment Advisers Act of 1940, as amended (the "Advisers Act" and together with the 1934 Act, the "Acts), and under applicable state laws in the United States. Accordingly, in the absence of specific exemption under the Acts, any brokerage and investment services provided by MOSL, including the products and services described herein are not available to or intended for U.S. persons.

This report is intended for distribution only to "Major Institutional Investors" as defined by Rule 15a-6(b)(4) of the Exchange Act and interpretations thereof by SEC (henceforth referred to as "major institutional investors"). This document must not be acted on or relied on by persons who are not major institutional investors. Any investment or investment activity to which this document relates is only available to major institutional investors and will be engaged in only with major institutional investors. In reliance on the exemption from registration provided by Rule 15a-6 of the U.S. Securities Exchange Act of 1934, as amended (the "Exchange Act") and interpretations thereof by the U.S. Securities and Exchange Commission ("SEC") in order to conduct business with Institutional Investors based in the U.S., MOSL has entered into a chaperoning agreement with a U.S. registered broker-dealer, Motilal Oswal Securities International Private Limited. ("MOSIPL"). Any business interaction pursuant to this report will have to be executed within the provisions of this chaperoning agreement.

The Research Analysts contributing to the report may not be registered /qualified as research analyst with FINRA. Such research analyst may not be associated persons of the U.S. registered broker-dealer, MOSIPL, and therefore, may not be subject to NASD rule 2711 and NYSE Rule 472 restrictions on communication with a subject company, public appearances and trading securities held by a research analyst account.

For Singapore

Motilal Oswal Capital Markets Singapore Pte Limited is acting as an exempt financial advisor under section 23(1)(f) of the Financial Advisers Act(FAA) read with regulation 17(1)(d) of the Financial Advisors Regulations and is a subsidiary of Motilal Oswal Securities Limited in India. This research is distributed in Singapore by Motilal Oswal Capital Markets Singapore Pte Limited and it is only directed in Singapore to accredited investors, as defined in the Financial Advisers Regulations and the Securities and Futures Act (Chapter 289), as amended from time to time.

In respect of any matter arising from or in connection with the research you could contact the following representatives of Motilal Oswal Capital Markets Singapore Pte Limited:

Nihar Oza
Email: niharoza.sg@motilaloswal.com
Contact: (+65) 68189232

Kadambari Balachandran
Email : kadambari.balachandran@motilaloswal.com
Contact: (+65) 68189233 / 65249115

Office address: 21 (Suite 31), 16 Collyer Quay, Singapore 049318

Motilal Oswal Securities Ltd

Motilal Oswal Tower, Level 9, Sayani Road, Prabhadevi, Mumbai 400 025

Phone: +91 22 3982 5500 E-mail: reports@motilaloswal.com