Cummins India
Decent Q4, optimistic outlook

Capital Goods
Sharekhan code: CUMMINS

Reco/View: Buy
CMP: Rs. 1,015
Price Target: Rs. 1,252

Summary
- We reiterate Buy on Cummins India (Cummins) with an unchanged PT of Rs 1,252 given its resilient performance during the quarter and optimistic future outlook.
- Cummins reported strong standalone revenues with robust 66% y-o-y growth in exports, while domestic sales grew by 7% y-o-y to Rs 1,046 cr. OPM improved by 40 bps y-o-y despite cost and supply side challenges.
- The demand outlook is robust in both domestic and exports driven by underlying demand from data centers, rail electrification, healthcare, manufacturing. Double digit price hikes and cost rationalization measures would further improve margins.
- Cummins has a strong pedigree, industry-leading margins and improving earnings trajectory. We expect revenue/PAT CAGR of ~14%/21% over FY22-24E. It has a healthy balance sheet with a strong net cash position of ~Rs 1,030 cr.

ESG Disclosure Score
ESG RISK RATING
Updated Jan 08, 2022
29.69

What has changed in 3R MATRIX
Old New
RS ➔
RQ ➔
RV ➔

Company details
Market cap: Rs. 28,136 cr
52-week high/low: Rs. 1162/747
NSE volume: 6.5 lakh
BSE code: 500480
NSE code: CUMMINSIND
Free float: 13.6 cr

Shareholding (%)
Promoters 51.0
FII 12.5
DII 24.0
Others 12.5

Price chart

Price performance ( % ) 1m 3m 6m 12m
Absolute -1.2 5.4 16.0 26.4
Relative to Sensex 2.2 6.4 20.2 18.8

Valuation (Standalone)

Particulars FY21 FY22 FY23E FY24E
Net sales 4,329 6,140 7,027 8,031
OPM (%) 13.4 14.4 15.4 16.0
Adj Net profit 618 794 973 1,172
Adj, EPS (Rs.) 22.3 28.6 35.1 42.3
PER (x) 45.5 35.4 28.9 24.0
P/B (x) 6.4 5.8 5.3 4.7
EV/EBIDTA (x) 46.3 30.0 24.5 20.2
RoE (%) 14.4 17.2 19.2 20.8
RoCE (%) 17.8 21.1 23.6 25.8

Source: Company, Sharekhan estimates

Management Commentary
- Cummins has seen robust demand and inquiry pipeline across segments in both domestic and export markets.
- Demand for power gensets has been good so far due to coal shortage and frequent power outages despite the government notification in April 2022 to discontinue the use of diesel generator sets.
- The company has taken price hikes in the double-digit. However, the entire cost escalation could not be passed through due to the unprecedented rise in commodity cost.
- CPCB-4 plus are the tightest emission norms and Cummins has invested in the technology and therefore expects to be a front runner when the norms are implemented in 2022.
- The company refrained from giving guidance for FY23 given the uncertain environment in terms of supply side challenges and geopolitical crisis.

Revision in estimates – We have broadly retained our estimates for FY2023-FY2024E.

Our Call
Valuation – Retain Buy with an unchanged PT of Rs. 1,252: Cummins is well geared to gain from increasing demand from data centres, 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 and thus has regained its lost market share. 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 space. Cummins is currently trading at ~24x 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 ~14%/21% over FY22-24E. Hence, we retain a Buy on the stock with an unchanged PT of Rs 1,252.

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.

Cummins India reported strong standalone operational results, wherein sales and operating profit exceeded our estimates. Total revenue (including other operating income) grew by ~20% y-o-y to Rs 1,494 cr (vs our estimate of Rs 1,409 cr). Domestic sales increased by 7% y-o-y to Rs 1,046 cr. Exports sales increased by 66% to Rs 423 cr. Operating profit grew by 23% y-o-y to Rs 207 cr (vs our estimate of Rs 190 cr) despite the hike in raw material cost which was able to control employee cost and other expenses. Therefore, OPM came in at 13.8% up 40 bps y-o-y. Consolidated sales increased by 19% y-o-y to Rs 1,477 cr, while PAT increased by 28% y-o-y to Rs 216 cr. The company’s net cash position stands at ~Rs 1,030 cr (Rs 807 cr in FY21). Considering the uncertain times and challenges, the company has not given its revenue guidance for FY23.

Key positives
- Revenues from Power Gen/Distribution rose by 23%/10% y-o-y.
- Exports reported robust growth led by 50% y-o-y rise in HHP (high horse power) and 97% y-o-y rise in LHP (low horse power).
- OPM improved 40bps y-o-y.
- PAT grew by 28% y-o-y while PAT margin widened by 1.9% y-o-y.
- In the domestic market, Industrial segment sales have plunged 29%/34% y-o-y/q-o-q.
- OPM improved by 40bps y-o-y.

Key negatives
- Exports reported robust growth led by 50% y-o-y rise in HHP (high horse power) and 97% y-o-y rise in LHP (low horse power).
- OPM improved 40bps y-o-y.
- PAT grew by 28% y-o-y while PAT margin widened by 1.9% y-o-y.
- In the domestic market, Industrial segment sales have plunged 29%/34% y-o-y/q-o-q.
- OPM improved by 40bps y-o-y.

Valuation (Standalone)

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Source: Company, Sharekhan estimates
Sales and operating profit surprise positively, net profit below estimates

Cummins India reported strong standalone operational results, wherein sales and operating profit exceeded our estimates. Total revenue (including other operating income) grew by ~20% y-o-y to Rs 1,494 cr (vs our estimate of Rs 1,409 cr). Domestic sales increased by 7% y-o-y to Rs 1,046 cr. Exports sales increased by 66% to Rs 423 cr. Operating profit grew by 23% y-o-y to Rs 207 cr (vs our estimate of Rs 190 cr) despite the hike in raw material cost as the company was able to control employee cost and other expenses. Therefore, OPM came in at 13.8% up 40 bps y-o-y (vs our estimate of 13.5%). Net profit, however, was below our estimates and increased marginally by 1.9% y-o-y to Rs 189cr (vs our estimate of Rs 216cr). The low growth was largely on account of lower other income (down 31% y-o-y). Consolidated sales increased by 19% y-o-y to Rs 1,477cr, while PAT increased by 28% y-o-y to Rs 216 cr. The company’s net cash position stands at Rs 1,033 cr (Rs 807 cr in FY21). Considering the uncertain times and challenges, the company has not given revenue guidance for FY23.

Demand environment robust across segments

The company expects healthy demand from data centres, healthcare, commercial realty, pharma and manufacturing industries. Further, it is seeing a demand revival from construction and residential housing segments. The demand outlook from data centres is positive led by the adoption of 5G technology, increasing storage data, rising OTT etc. Cummins is a significantly large players in data centres 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, defence; etc. The distribution business would be driven by increasing demand for maintenance in core industries such as data centres. 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.

Conference call Highlights:

- **Q4 is a weaker quarter**: Q4 is the second weakest quarter, particularly in exports markets as corporates, taper down buying and clear inventories at the end of Q3 and thereafter two weeks are lost in the festive season at the beginning of January. Despite these constraints, better product mix and cost containment measures and price hikes have helped the company deliver decent growth in sales and operating profit.

- **Segment-wise revenue break up**: In the domestic segment – Powergen sales stood at Rs 471 crore (up 23% y-o-y, down 6% q-o-q), Distribution came in at Rs 369 crore (up 10% y-o-y, down 18% q-o-q). Industrial – Rs 191 crore, (down 29% y-o-y/34% qoq). In exports – HHP was at Rs 203 crore (up 50% y-o-y/5% qoq), LHP was at Rs 187 crore (up 97% y-o-y, down 14% qoq).

- **Exports**: The company has realigned its focus on exports by offering specific products and solutions suitable to the individual export markets. Geography-wise break up for Q4FY22 –HHP: – Asia pacific Rs 73 crore, Latin America – Rs 33 crore, Middle East – Rs 35 crore, Europe – Rs 46 crore, Africa – Rs 19 crore. LHP:– Latin America – Rs 64 crore, Asia pacific – Rs 23 crore, Europe – Rs 46 crore, Middle East– Rs 36 crore, Africa – Rs 18 crore.

- **Guidance**: The company refrained from giving guidance for FY23 given the uncertain environment in terms of supply side challenges and political geopolitical crisis. However, the company stated that the underlying demand across sectors and geographies has picked up and it expects good performance in FY23 as well.

- **Price hikes**: The company has taken price hikes in the double-digit in last one year. However, the company has not been able to pass through the rise in cost completely due to the unprecedented rise in commodity costs. The price increases should catch up in the coming quarters if the commodity prices stabilize and thereby help improve margins.

- **Healthy demand for power gensets despite the recent government amendment**: The company has seen healthy demand for the powergen sets in the domestic market due to coal shortage and frequent power outages despite the government notification in April, 2022 to dissuade the use of diesel generator sets. The management stated that these government measures sometimes result in few customers shifting to LNG/CNG engines. However, Cummins India has offerings in LNG/CNG as well.
• **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. Cummins has invested in all of these technologies in India and therefore expects to be a front runner once the norms are implemented in 2023.

• **Demand outlook:** The company has seen robust demand and inquiry pipeline across segments in both domestic and export markets. However, supply side constraints in terms of shortage of semiconductors and several other components is a challenge which has restricted revenue growth in the last few quarters. On a ballpark basis, Cummins has not been able to meet 10-15% of the demand/order bookings due to supply side constraints. Going forward, the company expects demand from the construction segment to pick up. In Rail, company has recently bagged orders in the rail electrification segment and demand from the traditional areas has also revived. In rail electrification, the company sees the opportunity of Rs 300-400cr over the next few years. In power gen-HHP: - demand from industrial, pharmaceuticals, hospitality, real estate- residential and commercial has been showing good traction. Further, the company expects double-digit growth from data centres for the next 5-8 years as the company is strongly positioned in this space. LHP is witnessing good demand due to peak summer and power outages.

• **Mitigating cost and supply side challenges:** Cummins India has been focusing on cost rationalization measures to contain rise in commodity prices and freight cost which has more than doubled. The company is adding additional suppliers and improving inventory management. Employee cost has also been controlled since the last two-three years by increasing productivity, bringing in more automation and offering VRS to employees.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Q4FY22</th>
<th>Q4FY21</th>
<th>YoY (%)</th>
<th>Q3FY22</th>
<th>QoQ (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues</td>
<td>1,494</td>
<td>1,247</td>
<td>19.8</td>
<td>1,735</td>
<td>(13.9)</td>
</tr>
<tr>
<td>Operating profit</td>
<td>207</td>
<td>167</td>
<td>23.4</td>
<td>271</td>
<td>(23.6)</td>
</tr>
<tr>
<td>Other Income</td>
<td>77</td>
<td>112</td>
<td>(31.4)</td>
<td>87</td>
<td>(11.5)</td>
</tr>
<tr>
<td>Interest</td>
<td>5</td>
<td>3</td>
<td>48.2</td>
<td>3</td>
<td>78.9</td>
</tr>
<tr>
<td>Depreciation</td>
<td>35</td>
<td>31</td>
<td>13.5</td>
<td>35</td>
<td>(0.4)</td>
</tr>
<tr>
<td>PBT</td>
<td>244</td>
<td>245</td>
<td>(0.6)</td>
<td>320</td>
<td>(23.7)</td>
</tr>
<tr>
<td>Tax</td>
<td>55</td>
<td>60</td>
<td>(8.4)</td>
<td>79</td>
<td>(30.6)</td>
</tr>
<tr>
<td>Adjusted PAT</td>
<td>189</td>
<td>186</td>
<td>1.9</td>
<td>241</td>
<td>(21.5)</td>
</tr>
<tr>
<td>Adjusted EPS</td>
<td>6.8</td>
<td>6.7</td>
<td>1.9</td>
<td>8.7</td>
<td>(21.5)</td>
</tr>
<tr>
<td>Margins (%)</td>
<td>bps</td>
<td>bps</td>
<td>40</td>
<td>15.6%</td>
<td>(176)</td>
</tr>
<tr>
<td>OPM</td>
<td>13.8%</td>
<td>13.4%</td>
<td>40</td>
<td>15.6%</td>
<td>(176)</td>
</tr>
<tr>
<td>NPM</td>
<td>12.7%</td>
<td>14.9%</td>
<td>(223)</td>
<td>13.9%</td>
<td>(122)</td>
</tr>
<tr>
<td>Tax rate</td>
<td>22.4%</td>
<td>24.3%</td>
<td>(190)</td>
<td>25%</td>
<td>(220)</td>
</tr>
</tbody>
</table>

*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 an unchanged PT of Rs. 1,252**

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 and thus has regained its lost market share. 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 ~24x 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 ~14%/21% over FY22-24E. Hence, we retain a Buy on the stock with an unchanged PT of Rs. 1,252.

One-year forward P/E (x) band

![Graph showing 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 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 favourable 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 business outlook and earnings growth.
- Global market demand weakness due to current geopolitical crisis between Russia and Ukraine poses key downside risk to exports

Additional Data

Key management personnel

<table>
<thead>
<tr>
<th>Name</th>
<th>Position</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ashwath Ram</td>
<td>Managing Director</td>
</tr>
<tr>
<td>Rajiv Batra</td>
<td>Vice President – Finance Special Projects</td>
</tr>
<tr>
<td>Ajay Patil</td>
<td>Chief Financial Officer</td>
</tr>
</tbody>
</table>

Source: Bloomberg

Top 10 shareholders

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Holder Name</th>
<th>Holding (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Cummins Inc.</td>
<td>51.00</td>
</tr>
<tr>
<td>2</td>
<td>SBI Fund Management Pvt. Ltd.</td>
<td>3.68</td>
</tr>
<tr>
<td>3</td>
<td>LIC of India</td>
<td>3.52</td>
</tr>
<tr>
<td>4</td>
<td>Kotak Mahindra AMC</td>
<td>3.29</td>
</tr>
<tr>
<td>5</td>
<td>SBI Life Insurance</td>
<td>2.01</td>
</tr>
<tr>
<td>6</td>
<td>ICICI Pru AMC</td>
<td>1.99</td>
</tr>
<tr>
<td>7</td>
<td>NorgesBank</td>
<td>1.81</td>
</tr>
<tr>
<td>8</td>
<td>Government Pension Fund</td>
<td>1.79</td>
</tr>
<tr>
<td>9</td>
<td>Vanguard Group Inc.</td>
<td>1.52</td>
</tr>
<tr>
<td>10</td>
<td>HDFC AMC</td>
<td>1.43</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th><strong>Right Sector</strong></th>
<th><strong>Positive</strong></th>
<th>Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Neutral</strong></td>
<td>Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies</td>
<td></td>
</tr>
<tr>
<td><strong>Negative</strong></td>
<td>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.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Right Quality</strong></th>
<th><strong>Positive</strong></th>
<th>Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Neutral</strong></td>
<td>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</td>
<td></td>
</tr>
<tr>
<td><strong>Negative</strong></td>
<td>Weakening growth trend 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</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Right Valuation</strong></th>
<th><strong>Positive</strong></th>
<th>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.</th>
</tr>
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<tr>
<td><strong>Neutral</strong></td>
<td>Trading at par to historical valuations and having limited scope of expansion in valuation multiples.</td>
<td></td>
</tr>
<tr>
<td><strong>Negative</strong></td>
<td>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.</td>
<td></td>
</tr>
</tbody>
</table>

*Source: Sharekhan Research*