10 July 2012

Annual Report Update | Sector: Capital Goods

Cummins India

BSE SENSEX	S&P CNX
17,618	5,345

Bloomberg	KKC IN
Equity Shares (m)	277.2
52-Week Range (INR)	506/322
1,6,12 Rel. Perf. (%)	-1/16/-1
M.Cap. (INR b)	124.5
M.Cap. (USD b)	2.2

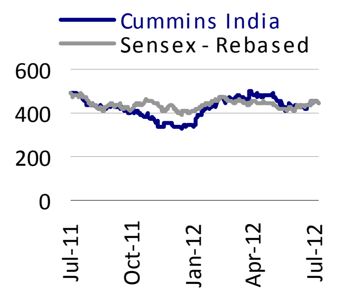
Valuation summary (INR b)

Y/E March	2012	2013E	2014E
Net Sales	41.2	45.8	51.6
EBITDA	7.0	8.2	9.3
NP	5.5	6.1	6.6
EPS (INR)	**19.8**	**21.9**	**24.0**
EPS Gr. (%)	-6.9	10.5	9.4
BV/Sh (INR)	73.5	81.3	90.1
P/E (x)	**22.6**	**20.5**	**18.7**
P/BV (x)	6.1	5.5	5.0
EV/EBITDA (x)	16.3	14.7	13.1
EV/Sales (x)	2.8	2.6	2.4
RoCE (%)	28.8	28.3	28.0
RoCA (%)	28.8	28.4	28.0

Shareholding pattern %

As on	Mar-12	Dec-11	Mar-11
Promoter	51.0	51.0	51.0
Dom. Inst	21.0	21.5	21.0
Foreign	13.6	11.9	11.7
Others	14.5	15.6	16.3

Stock performance (1 year)



Investors are advised to refer through disclosures made at the end of the Research Report.

CMP: INR449	TP: INR432	Neutral

Profitability supported by cost optimization measures

High capex to dilute returns, 60 L engine is INR2.6b opportunity in 5 years

- **Profitability supported by cost optimization – a widening moat**
- **Expect meaningful increase in capex at INR6.5b each in FY13/FY14 v/s INR2.1b in FY12**
- **60-liter engine has revenue potential of INR2.6b over 5 years, construction commences at Phaltan SEZ**
- **Liquidity crunch and slowing global economy likely to impact growth in 1HFY13**
- **Valuation and view: KKC currently trades at 9% premium to its LPA P/E whereas the capital goods sector is at a 9% discount to its LPA P/E. Such rich valuations leave little room for disappointments. Maintain Neutral.**

Profitability supported by cost optimization – a widening moat

In FY12, Cummins India (KKC) curtailed its EBITDA margin decline at 200bp to 16.9%, despite slowing sales (up 3% YoY) and rising input costs. Raw material (RM) costs rose only 3% YoY despite 16% YoY rise in pig iron prices, which forms over 50% of RM cost. This commendable achievement is a result of increased indigenization and cost optimization measures:

(i) RM imports have declined significantly from 29-30% of revenues in FY07-08 to 20% in FY12. Also, within RM, component imports have declined to 69% of RM consumed (from 77% in FY08) and share of semi-finished components have increased to 19% from 5% in FY08.

(ii) Cost optimization measures like ACE III (Accelerated Cost Efficiency) are expected to generate savings of INR2.3b till 2014 by reducing the total cost of ownership of direct materials by 20%. TRIMs (Total Reduction in Indirect Materials & Services) targets to reduce the direct cost of ownership in indirect materials by 10% over 3 years.

Expect a meaningful increase in capex

In its recent analyst meet, KKC stated that capex in FY13/14 is expected at ~INR6.5b each, which is meaningful given FY12 gross fixed assets at INR9.7b. Capex in FY12 increased to INR2.1b, and stood at 28% of the opening gross fixed asset. A large part of the incremental capex (~65%) pertains to the India Technical centre and India Office Campus, which will also be shared with group companies and thus KKC will earn lease income (IOC to commence in April 2014). This will likely dilute return ratios (FY12 ROE at 28%) and remains an area of concern. Capital commitments stood at INR4.3b in FY12, up from INR550m in FY11; thus, expect a steep increase in FY13 capex.

60-liter engine has revenue potential of INR2.6b over 5 years

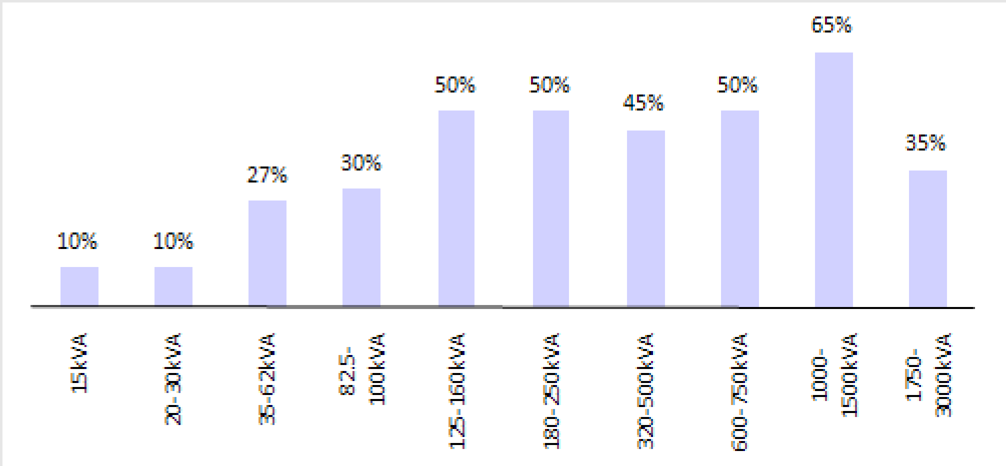
KKC's FY12 Annual Report states that the 60-liter engine will be an INR2.6b opportunity over 5 years. This is meaningful given that KKC's domestic engine sales in FY12 is ~INR12.6b. Construction for high horsepower QSK60/23 engines in India commenced in FY12 at Phaltan megasite. We believe that going forward, there exists possibilities that some of the new products will be manufactured / exported by Cummins Inc, while KKC retains the marketing rights in India.

Satyam Agarwal (AgarwalS@MotilalOswal.com); +91 22 3982 5410
Deepak Narnolia (Deepak.Narnolia@MotilalOswal.com); +91 22 3982 5126

Rising competition could impact market share and pricing

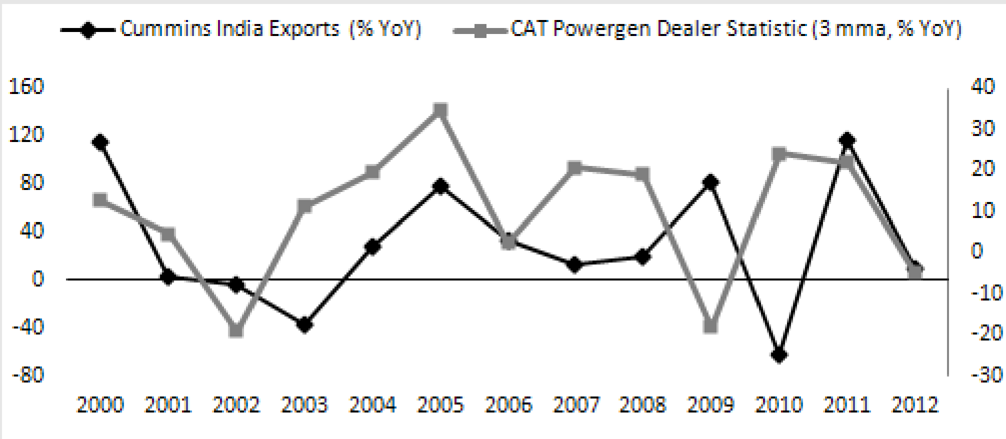
MNC players like Perkins (subsidiary of Caterpillar), MTU (subsidiary of Daimler Chrysler), and Volvo are making definite inroads to the Indian market. Perkins has announced an investment of USD150m in December 2011 to set up a manufacturing facility in India.

KKC has a very high market share (55-65%) in the MHP and HHP segments in India



On the exports front, global slowdown may imact Cummins' exports

KKC exports closely follows Caterpillar dealer statistics which has shown a 17% decline in the month of Apr and May 2012



Profitability helped by cost optimization measures – widening moat

ACE, TRIMs & Six-sigma programs: ongoing cost optimization measures to lead to significant savings

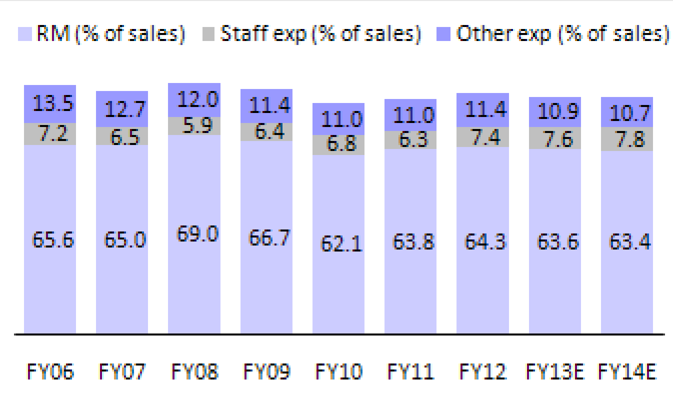
ACE III is expected to generate savings of INR2.3b till 2014 by reducing the total cost of ownership of direct materials by 20%. TRIMs targets to reduce the direct cost of ownership in indirect materials by 10% over 3 years.

Accelerated Cost Efficiency (ACE)	ACE was launched in 2005, and ACE II in 2008 through 2011
	ACE III was launched in 2011 through 2014 and Targets to reduce the total cost of ownership for direct materials by 20% over 3 years
	Expected to generate savings of INR2.3b upon completion in 2014; in first year of implementation savings have been INR300m
Total reduction in Indirect Material and Services (TRIMS)	Launched in 2010, to reduce the total cost of ownership in indirect materials and services by 10% every year over a period of three years.
	In 2011, the savings along with other purchasing projects stood at INR81m and avoidance savings of INR121m
Six Sigma	Ongoing project since last 12 years with an objective to reduce costs across organisation through efficiency improvement measures
	All together, these projects have generated savings of INR1b
	In FY12, the six sigma program was extended to Junior managers

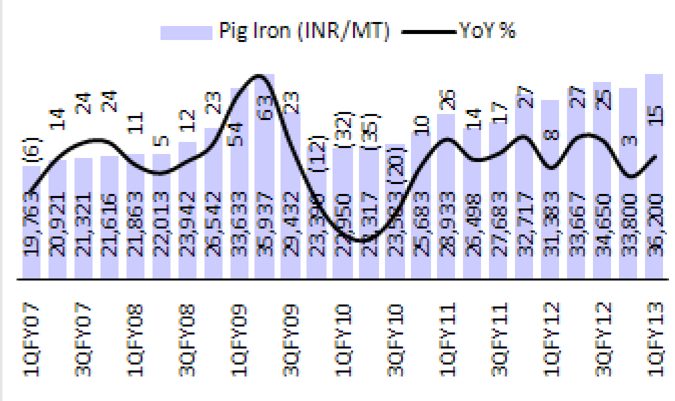
EBITDA margin decline curtailed at 200bp in FY12 despite sales growth of just 3%; supported by ongoing cost savings measures

Raw material cost has increased by only 3% YoY (in line with sales growth) despite a 16% YoY rise in pig iron prices, which forms over 50% of the raw material cost. This is commendable and improves the maneuverability given increased competitive intensity.

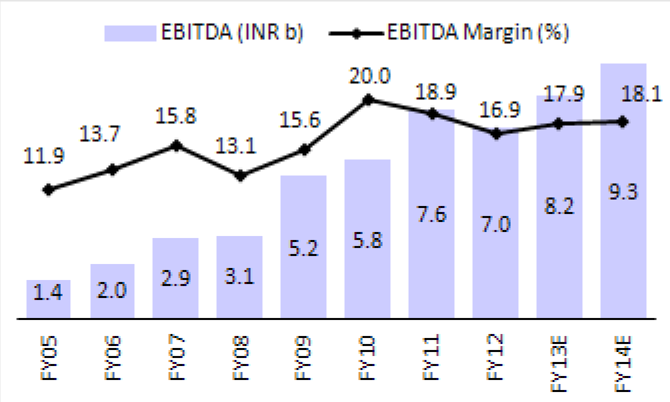
Cost Composition: Tight Control



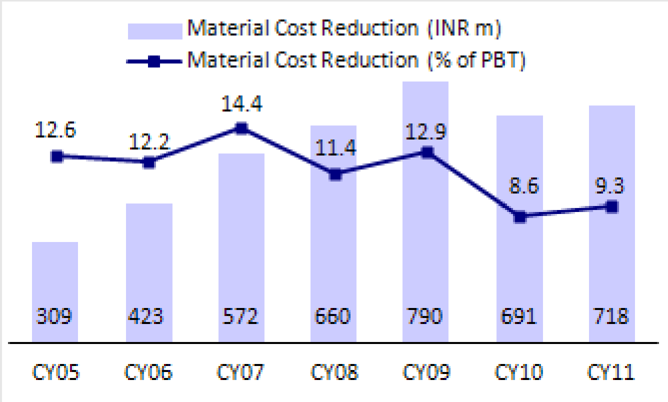
Pig Iron prices up 16% YoY in FY12



EBIDTA margin decline curtailed at 200bp in FY12



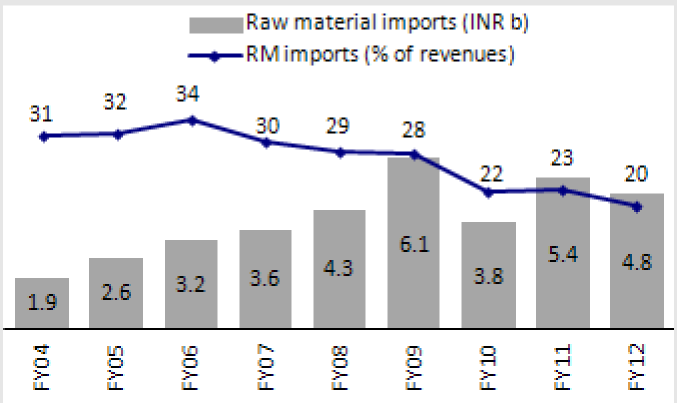
Cost optimization measures leading to visible results



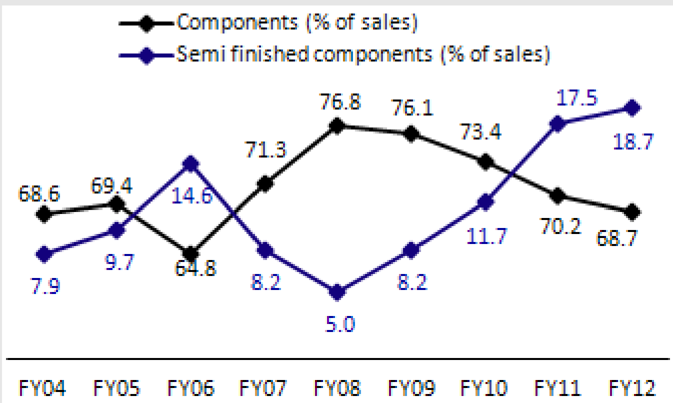
Increased indigenization: an important determinant of cost competitiveness

Raw material imports have declined significantly from 29-30% of revenues in FY07-08 to 20% this year. Also, within RM consumption basket, component imports have declined to 69% of RM consumed (from 77% in FY08) and share of others (including semi finished components) have increased from 5% to 19% in this period.

RM imports has declined meaningfully



Share of semi finished goods have also increased



60-liter engine an INR2.6b opportunity in India

New product initiatives across segments; QSK60 a INR2.6b opportunity in India

KKC has introduced several products / line extensions to the portfolio in FY12. The management stated that 60-liter engine will be an INR2.6b opportunity over 5 years. Construction for manufacturing HHP QSK60/23 engines in India commenced in FY12 at Phaltan megasite.

Exports	■ In March 2012, two ranges of low kva DG sets (40-75kva S3.8 Series and 90-125kva 6BTA5.9 Series) were added to the portfolio for global markets
	■ Exports of low kva products declined 16% in FY12; we understand that this segment contributes 30% of exports
Domestic	■ Local assembly of 60-liter engine in India; potential to generate revenues of INR2.6b over the next five years
	■ 6 Cylinder and 4 Cylinder mechanical solutions for the wheeled construction market to facilitate the transition to BS III CEV emission norms; to yield business of INR 120-150m annually
	■ Obtained consent from Indian Railways to develop power pack for "End-on-Generation' for the express mail, which reduces the life cycle costs for the trains as compared to existing technology. Expected to cater to 500 express mail which is likely to be an INR3000m opportunity.

Capex of INR2.1b in FY12 (~28% of gross block), capital commitments at INR4.3b (vs INR550m)

Phaltan Megasite: 2011 - 3 factories commissioned; 2012 - PDC commissioned, and commenced construction for 3 additional projects

In 2011, KKC commenced construction for low kva generator set exports factory, which will add ~INR10b to exports revenue (FY12 INR11.9b). This factory is expected to be commissioned in mid-2013. In the interim period, we expect exports to remain range-bound. Also, margins in low kva generator sets are expected to be lower than HHP segment

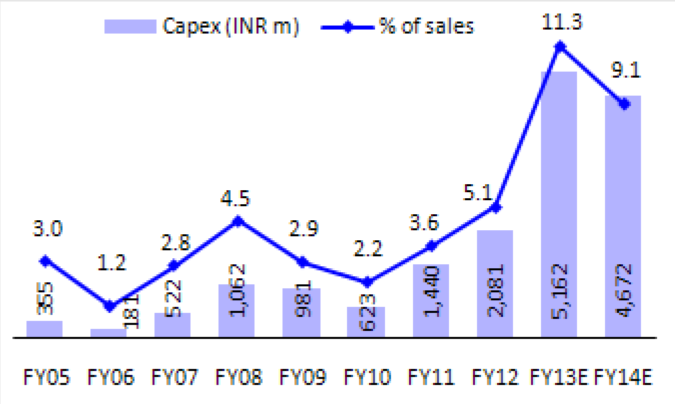
Capacity addition at Phaltan Megasite

Project name	Objective	Time frame
HHP Rebuild Center	Facility to rebuild HHP engines	Mar-11
Parts Distribution Center (PDC)	Will distribute parts and components from a centralized location. Objective is to enhance supply chain efficiency in aftermarket parts distribution.	3QFY12
Unit for manufacture/assembly and upfit of B, C and L series engines	Annual capacity of ~20,000 engines catering to construction, compressor, marine and fire pump markets.	3QFY13
Power gensets and G-drives manufacturing facility in low and medium horse power range	Set up at the MIDC SEZ in Phaltan; would have matured annual capacity of 51,000 units by 2015, mainly for exports. Management in recent analyst meet stated that this can contribute INR10b pa to KKC's exports	mid 2013

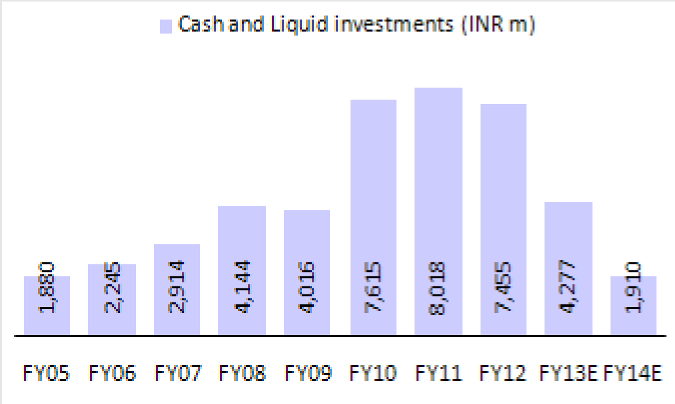
Capex at INR2.1b in FY12 (28% of gross block): expect a meaningful jump in FY13/14 as capital commitments stands at INR4.3b (up from INR550m)

Apart from Phaltan megasite, KKC is also investing in India Technical Center at Kothrud, Pune and India Office Campus (IOC) at Balewadi, Pune. Occupation in IOC is likely to start from April 2014 and KKC will earn lease income for a large part of the facility leased to group companies. These investments could dilute return ratios (FY12 ROCE at 29%) and continue to be an area of concern.

Capex to witness a meaningful increase



Cash / Liquid investments to decline



KKC: Management expects a step increase in capex during FY13/14 (INR m)

	FY11	FY12	FY13	FY14	FY15	Total
Megasite	848	911	2,099	2,004	1,141	7,002
India Office Campus	903	1,297	2,488	2,133	472	7,293
Others	759	934	2,001	2,258	688	6,640
Total	**2,510**	**3,142**	**6,588**	**6,395**	**2,301**	**20,936**

Source: Company/MOSL

Increase is mainly due to fall in sundry creditors given increased vendor support. Loans and advances have risen sharply because of inclusion of capital advances for procurement of fixed assets

Working capital remains comfortable despite slowdown in sales (days)

	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
Inventories	66	73	58	55	50	51	52	47	50
Sundry Debtors	89	91	90	83	86	74	66	65	60
Loans and advnaces	22	35	31	30	30	30	35	31	45
Total Current assets	**177**	**199**	**179**	**168**	**167**	**155**	**153**	**142**	**156**
Sundry Creditors	64	53	49	45	63	52	47	55	46
Other Current liabilities	16	16	14	16	15	13	18	9	15
Provisions	30	26	23	25	23	19	33	30	33
Total Current Liabilities	**110**	**95**	**86**	**86**	**101**	**84**	**98**	**94**	**94**
Net Working Capital	**67**	**104**	**93**	**82**	**65**	**71**	**54**	**48**	**62**
Add: Provision for dividend	17	14	11	9	9	7	17	14	17
Less: Capital advances								2	10
Adjusted net working captial	**85**	**118**	**105**	**91**	**75**	**78**	**72**	**61**	**69**

Source: Company/MOSL

Multiple headwinds, rich valuations leave limited room for disappointments

The DG-sets business faces multiple headwinds:

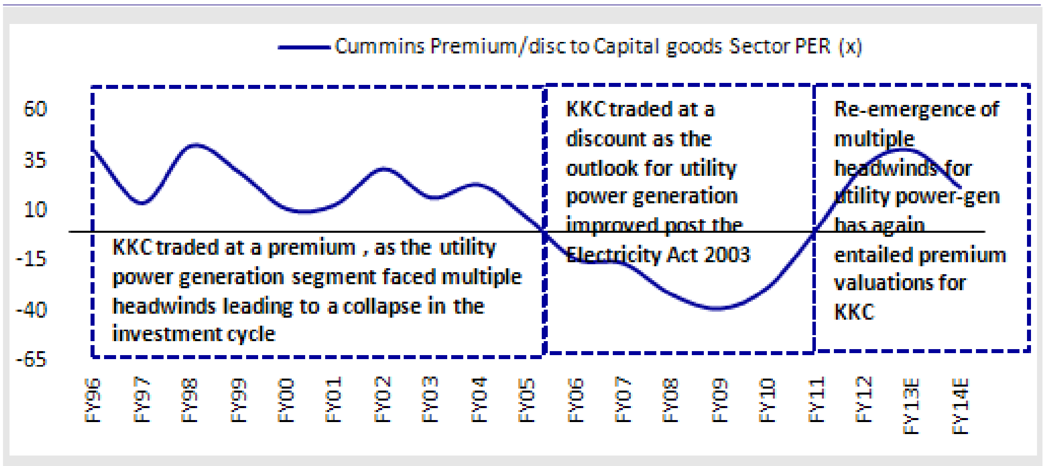
i) Limited demand drivers given economic slowdown and tight liquidity conditions

ii) Increased competitive intensity particularly in HHP segment (from imports / domestic players), which contributes ~60% to KKC's power gen revenues

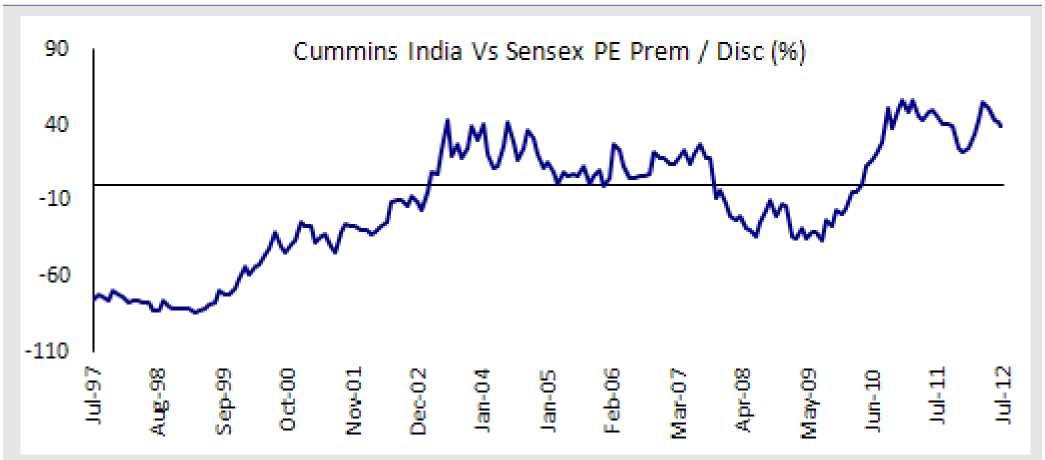
iii) Overhang on margins given adverse sales mix (towards LHP segment), commodity prices at peak and low capacity utilization of 40-70% impacting fixed cost absorption.

KKC currently trades at 9% premium to its LPA P/E whereas the capital goods sector is at a 9% discount to its LPA P/E. We believe KKC's premium valuation reflects its dominant market positioning, strong free cash generation, and robust 30-35% RoE. Such rich valuations leave little room for disappointments.

KKC's valuation premium



Relative valuations near upper range of trading across cycles



Cummins India: Financials and Valuation

Income Statement (INR Million)

Y/E March	2010	2011	2012	2013E	2014E
Total Revenues	**28,973**	**40,425**	**41,172**	**45,757**	**51,579**
Change (%)	-13.5	39.5	1.8	11.1	12.7
Raw Materials	18,003	25,803	26,454	29,101	32,701
Staff Cost	1,983	2,546	3,039	3,495	4,019
Other Expenses	3,189	4,441	4,706	4,988	5,519
EBITDA	**5,798**	**7,635**	**6,973**	**8,173**	**9,340**
% of Total Revenues	20.0	18.9	16.9	17.9	18.1
Depreciation	361	366	420	550	650
Other Income	694	804	1,233	836	436
Interest	21	48	54	20	20
PBT	**6,111**	**8,025**	**7,732**	**8,440**	**9,106**
Tax	1,670	2,114	2,334	2,363	2,459
Rate (%)	27.3	26.3	30.2	28.0	27.0
Adjusted PAT	**4,440**	**5,911**	**5,502**	**6,077**	**6,647**
Extra-ordinary Income (net)	0	0	514	0	0
Reported PAT	**4,440**	**5,911**	**5,913**	**6,077**	**6,647**
Change (%)	2.4	33.1	0.0	2.8	9.4
Adj. Consolidated PAT	**4,440**	**5,911**	**5,502**	**6,077**	**6,647**
Change (%)	0.0	33.1	-6.9	10.5	9.4

Balance Sheet (INR Million)

Y/E March	2010	2011	2012	2013E	2014E
Share Capital	396	396	554	554	554
Reserves	15,214	17,667	19,877	22,061	24,490
Net Worth	**15,610**	**18,063**	**20,432**	**22,615**	**25,044**
Loans	87	183	0	0	0
Deferred Tax Liability	-170	-187	-70	-70	-70
Capital Employed	**15,527**	**18,058**	**20,362**	**22,546**	**24,974**
Gross Fixed Assets	7,776	9,144	9,703	14,703	19,203
Less: Depreciation	4,440	4,734	5,054	5,495	6,023
Net Fixed Assets	**3,337**	**4,411**	**4,649**	**9,208**	**13,180**
Investments	7,329	7,255	5,976	1,976	1,076
Curr. Assets	**12,113**	**15,767**	**17,591**	**19,150**	**21,144**
Inventory	4,097	5,190	5,676	6,268	7,066
Debtors	5,229	7,182	6,783	7,522	8,479
Cash & Bank Balance	559	1,037	2,235	3,056	1,590
Loans & Advances	2,695	3,297	5,082	5,310	5,549
Other Assets	93	98	50	50	50
Current Liab. & Prov.	**7,669**	**10,325**	**10,509**	**11,294**	**12,501**
Creditors	3,768	6,129	5,186	5,767	6,500
Other Liabilities	1,266	894	1,587	1,604	1,809
Provisions	2,634	3,302	3,736	3,923	4,192
Net Current Assets	**4,301**	**5,356**	**7,006**	**7,756**	**8,529**
Application of Funds	**15,527**	**18,058**	**20,362**	**22,546**	**24,974**

E: MOSL Estimates

Cummins India: Financials and Valuation

Ratios

Y/E March	2010	2011	2012	2013E	2014E
Basic (INR)					
Adj EPS	**16.0**	**21.3**	**19.8**	**21.9**	**24.0**
Cash EPS	17.3	22.6	21.4	23.9	26.3
Book Value	55.7	64.5	73.5	81.3	90.1
DPS	8.6	15.0	11.0	12.0	13.0
Valuation (x)					
P/E		23.1	22.1	20.5	18.7
Cash P/E		21.7	20.5	18.8	17.1
EV/EBITDA		16.8	16.3	14.7	13.1
EV/Sales		3.2	2.8	2.6	2.4
Price/Book Value		7.6	6.0	5.5	5.0
Dividend Yield (%)		3.0	2.5	2.7	2.9
Profitability Ratios (%)					
RoE	30.5	35.5	28.8	28.3	28.0
RoCE	30.2	35.4	28.8	28.4	28.0
Turnover Ratios					
Debtors (Days)	66	65	60	60	60
Inventory (Days)	52	47	50	50	50
Creditors. (Days)	47	55	46	46	46
Asset Turnover (x)	3.7	4.3	4.2	3.1	2.6
Leverage Ratio					
Debt/Equity (x)	0.0	0.0	0.0	0.0	0.0

Cash Flow Statement (INR Million)

Y/E March	2010	2011	2012	2013E	2014E
PBT before EO Items	6,111	8,025	7,732	8,440	9,106
Add : Depreciation	361	366	420	550	650
Interest	21	48	54	20	20
Less : Direct Taxes Paid	1,670	2,114	2,334	2,363	2,459
(Inc)/Dec in WC	2,238	(1,054)	(724)	(750)	(774)
CF from Operations	**7,059**	**5,270**	**5,149**	**5,897**	**6,543**
EO Income	0	0	514	0	0
CF from Oper. Incl. EO Items	**7,059**	**5,270**	**5,663**	**5,897**	**6,543**
(Inc)/Dec in FA	(623)	(1,440)	(2,081)	(5,162)	(4,672)
(Pur)/Sale of Investments	26	0	(148)	0	0
CF from Investments	**-597**	**-1,440**	**-2,229**	**-5,162**	**-4,672**
(Inc)/Dec in Net Worth	59	1,389	107	0	(2)
(Inc)/Dec in Debt	-126	96	-183	0	0
Less: Interest Paid	21	48	54	20	20
Dividend Paid	2,775	4,865	3,534	3,892	4,216
CF from Fin. Activity	**(2,863)**	**(3,427)**	**(3,664)**	**(3,912)**	**(4,238)**
Inc/Dec of Cash	**3,600**	**403**	**(230)**	**(3,177)**	**(2,367)**
Add: Beginning Balance	4,016	7,615	8,018	7,788	4,611
Closing Balance	**7,615**	**8,018**	**7,788**	**4,611**	**2,244**

E: MOSL Estimates

N O T E S

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.

MOSt is not a registered broker-dealer in the United States (U.S.) and, therefore, is not subject to U.S. rules. 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., Motilal Oswal has entered into a chaperoning agreement with a U.S. registered broker-dealer, Marco Polo Securities Inc. ("Marco Polo"). Any business interaction pursuant to this report will have to be executed within the provisions of this Chaperoning agreement

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.

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, Marco Polo 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.

MOTILAL OSWAL

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