

May 16, 2012

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Rating	Accumulate
Price	Rs450
Target Price	Rs495
Implied Upside	10.0%
Sensex	16,030
Nifty	4,858

(Prices as on May 16, 2012)

Trading data

Market Cap. (Rs bn)	89.2
Shares o/s (m)	198.0
3M Avg. Daily value (Rs m)	139.5

Major shareholders

Promoters	51.00%
Foreign	13.29%
Domestic Inst.	20.97%
Public & Other	14.74%

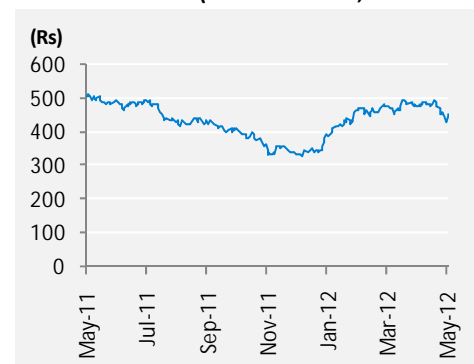
Stock Performance

(%)	1M	6M	12M
Absolute	(5.9)	34.6	(11.4)
Relative	0.7	39.0	1.2

How we differ from Consensus

EPS (Rs)	PL	Cons.	% Diff.
2013	22.6	25.0	-9.8
2014	26.0	29.2	-10.8

Price Performance (RIC: CUMM.BO, BB: KKC IN)



Source: Bloomberg

■ **Margin improvement driven by a better product mix:** Cummins India reported a flat top-line YoY of Rs10.4bn (sales break-up: 34% PowerGen, 13% IBU, 4% Auto, 17% Distribution and 32% Exports). The company highlighted that demand in the PowerGen segment has been holding up quite well, especially from the South (driven by shortage in TN). Margins improved 110bps YoY due to improved mix in favour of high HP machines during the quarter. Also, various cost-cutting initiatives have aided in improving margins (savings of Rs68m in this quarter). Increased depreciation by 32% led to flat PAT YoY of Rs1.4bn.

■ **Targeting US\$6bn sales by 2016 for the Cummins group in India:** The Cummins group in India has revenue of US\$2.3bn. Cummins Inc is targeting sales of US\$6bn for the group, while also targeting 16% PBIT and 25% return on net assets for the group. Cummins India is targeting to reach US\$1.5bn in sales over the next five years (15% CAGR) and aspires to maintain better margins in the same period. It is looking at growing its domestic business in high teens and export business in low teens.

■ **Looking at consolidating market position:** The company is confident of being able to increase its market share, post emission norm changes, as most of the competitors will have to procure most of the components from outside and successfully integrate it, unlike Cummins, giving it a cost advantage. It also highlighted that competition is increasing in mid and high HP segment with few global players like CAT and MTU coming to India. It believes that its distribution network is its competitive edge in India and will take time for other newer players to replicate the same (MTU, CAT and Cummins are leaders in major markets of worlds based on distribution capability in various markets).

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Key financials (Y/e March)

	2011	2012	2013E	2014E
Revenues (Rs m)	40,568	41,172	48,703	56,113
Growth (%)	39.9	1.5	18.3	15.2
EBITDA (Rs m)	7,748	6,972	8,572	10,100
PAT (Rs m)	5,992	5,493	6,253	7,218
EPS (Rs)	21.6	19.8	22.6	26.0
Growth (%)	31.4	(8.4)	13.8	15.4
Net DPS (Rs)	10.7	10.7	11.3	13.0

Profitability & Valuation

	2011	2012	2013E	2014E
EBITDA margin (%)	19.1	16.9	17.6	18.0
RoE (%)	35.6	28.6	28.7	29.1
RoCE (%)	35.5	28.5	28.0	27.6
EV / sales (x)	3.1	3.0	2.6	2.2
EV / EBITDA (x)	16.0	17.6	14.6	12.5
PE (x)	20.8	22.7	20.0	17.3
P / BV (x)	6.9	6.1	5.4	4.7
Net dividend yield (%)	2.4	2.4	2.5	2.9

Source: Company Data; PL Research

- Cummins Technology India (CTIL) to be a vehicle to introduce various technologies in India:** The company highlighted that CTIL will be used as a vehicle to manufacture various products with new technology platform for export markets and will act as a sourcing base for Cummins India for domestic demand. It also highlighted that the export opportunity from India will have to be from the current product line (like hub for low HP products).
- Capex on technical centre and office building not a drag:** The management believes that capex of Rs8bn for India office premise will help reduce lease cost of various offices spread out currently and also help increase productivity and coordinated effort by housing all employees under one roof. The technical centre capex of Rs5.5bn will also have a rub-off effect on Cummins India's business as it will be working more closely with technical centre and help design for market solutions.
- Downgrade to 'Accumulate':** The stock is trading at 20X FY13E earnings. It has outperformed the broader markets by ~25% YTD. Though the stocks offer strong long-term potential, given the huge opportunity in PowerGen market in India and export (being the low cost hub) strong franchises, distribution network and a strong balance sheet. Given the limited upside in the near term after strong outperformance, we downgrade the stock to '**Accumulate**' from '**BUY**'.

Exhibit 1: Q4FY12 Result Overview (Rs m)

Y/e March	Q4FY12	Q4FY11	YoY gr. (%)	Q3FY12	FY12	FY11	YoY gr. (%)
Net Sales	10,404	10,493	(0.8)	9,998	41,758	40,612	2.8
Expenditure							
Raw Material	6,521	6,782	(3.8)	5,587	24,502	25,806	(5.1)
<i>% of Net Sales</i>	<i>62.7</i>	<i>64.6</i>		<i>55.9</i>	<i>58.7</i>	<i>63.5</i>	
Personnel Cost	810	701	15.4	782	3,039	2,546	19.4
<i>% of Net Sales</i>	<i>7.8</i>	<i>6.7</i>		<i>7.8</i>	<i>7.3</i>	<i>6.3</i>	
Others	1,125	1,161	(3.1)	1,840	6,865	4,469	53.6
<i>% of Net Sales</i>	<i>10.8</i>	<i>11.1</i>		<i>18.4</i>	<i>16.4</i>	<i>11.0</i>	
Total Expenditure	8,456	8,644	(2.2)	8,209	34,406	32,822	4.8
EBITDA	1,948	1,849	5.4	1,789	7,352	7,790	(5.6)
<i>Margin (%)</i>	<i>18.7</i>	<i>17.6</i>		<i>17.9</i>	<i>17.6</i>	<i>19.2</i>	
Other income	242	213	13.5	269	832	617	34.8
Depreciation	119	89	32.8	109	420	366	14.6
EBIT	2,071	1,972	5.0	1,948	7,764	8,041	(3.4)
Interest	21	8	174.0	3	32	19	70.5
PBT	2,049	1,964	4.3	1,945	7,732	8,022	(3.6)
Total Taxes	604	525	15.1	536	2,334	2,114	10.4
<i>ETR (%)</i>	<i>29.5</i>	<i>26.7</i>		<i>27.5</i>	<i>30.2</i>	<i>26.4</i>	
PAT	1,446	1,440	0.4	1,410	5,912	5,908	0.1

Source: Company Data, PL Research

**Exhibit 2: Operating Metrics (Rs m)**

Y/e March	Q4FY12	Q4FY11	YoY gr. (%)	Q3FY12	FY12	FY11	YoY gr. (%)
Gross Revenues							
Engine Business	9,417	9,275	1.5	8,839	37,730	36,362	3.8
Others	796	820	(2.9)	867	3,106	3,096	0.3
Total	10,213	10,096	1.2	9,705	40,835	39,457	3.5
EBIT							
Engine Business	1,756	1,493	17.6	1,542	6,363	6,384	(0.3)
Others	73	266	(72.4)	138	569	1,042	(45.4)
Total	1,829	1,759	4.0	1,680	5,103	5,667	(9.9)
EBIT Margins (%)							
Engine Business	18.6	16.1		17.4	16.9	17.6	
Others	9.2	32.4		15.9	18.3	33.7	

Source: Company Data, PL Research



Income Statement (Rs m)

Y/e March	2011	2012	2013E	2014E
Net Revenue	40,568	41,172	48,703	56,113
Raw Material Expenses	25,808	26,454	31,413	35,912
Gross Profit	14,760	14,718	17,290	20,201
Employee Cost	2,546	3,039	3,361	3,647
Other Expenses	4,466	4,706	5,357	6,453
EBITDA	7,748	6,973	8,572	10,100
Depr. & Amortization	366	420	553	712
Net Interest	19	54	168	218
Other Income	661	1,747	683	681
Profit before Tax	8,023	8,246	8,533	9,852
Total Tax	2,114	2,334	2,389	2,758
Profit after Tax	5,910	5,912	6,144	7,093
Ex-Od items / Min. Int.	82	(420)	109	125
Adj. PAT	5,992	5,493	6,253	7,218
Avg. Shares O/S (m)	276.9	277.2	277.2	277.2
EPS (Rs.)	21.6	19.8	22.6	26.0

Cash Flow Abstract (Rs m)

Y/e March	2011	2012	2013E	2014E
C/F from Operations	4,179	4,074	6,995	6,936
C/F from Investing	(788)	613	(5,391)	(3,841)
C/F from Financing	(2,913)	(3,490)	(2,228)	(3,869)
Inc. / Dec. in Cash	478	1,198	(624)	(774)
Opening Cash	559	1,037	2,235	1,611
Closing Cash	1,037	2,235	1,611	837
FCFF	3,936	2,960	1,436	2,877
FCFE	4,118	2,924	2,972	3,377

Key Financial Metrics

Y/e March	2011	2012	2013E	2014E
Growth				
Revenue (%)	39.9	1.5	18.3	15.2
EBITDA (%)	33.2	(10.0)	22.9	17.8
PAT (%)	31.4	(8.3)	13.8	15.4
EPS (%)	31.4	(8.4)	13.8	15.4
Profitability				
EBITDA Margin (%)	19.1	16.9	17.6	18.0
PAT Margin (%)	14.8	13.3	12.8	12.9
RoCE (%)	35.5	28.5	28.0	27.6
RoE (%)	35.6	28.6	28.7	29.1
Balance Sheet				
Net Debt : Equity	—	(0.1)	—	0.1
Net Wrkng Cap. (days)	37	67	39	39
Valuation				
PER (x)	20.8	22.7	20.0	17.3
P / B (x)	6.9	6.1	5.4	4.7
EV / EBITDA (x)	16.0	17.6	14.6	12.5
EV / Sales (x)	3.1	3.0	2.6	2.2
Earnings Quality				
Eff. Tax Rate	26.3	28.3	28.0	28.0
Other Inc / PBT	8.2	16.0	8.0	6.9
Eff. Depr. Rate (%)	4.0	4.1	3.5	3.6
FCFE / PAT	68.7	53.2	47.5	46.8

Source: Company Data, PL Research.

Balance Sheet Abstract (Rs m)

Y/e March	2011	2012	2013E	2014E
Shareholder's Funds	18,063	20,386	23,209	26,325
Total Debt	183	147	1,683	2,183
Other Liabilities	—	—	—	—
Total Liabilities	18,245	20,533	24,892	28,508
Net Fixed Assets	4,411	5,146	10,093	13,347
Goodwill	—	—	—	—
Investments	7,255	5,976	5,976	5,976
Net Current Assets	6,393	9,388	8,634	8,947
<i>Cash & Equivalents</i>	<i>1,037</i>	<i>2,235</i>	<i>1,611</i>	<i>837</i>
<i>Other Current Assets</i>	<i>15,767</i>	<i>17,591</i>	<i>19,228</i>	<i>22,123</i>
<i>Current Liabilities</i>	<i>10,411</i>	<i>10,438</i>	<i>12,205</i>	<i>14,013</i>
Other Assets	187	23	189	237
Total Assets	18,245	20,533	24,892	28,508

Quarterly Financials (Rs m)

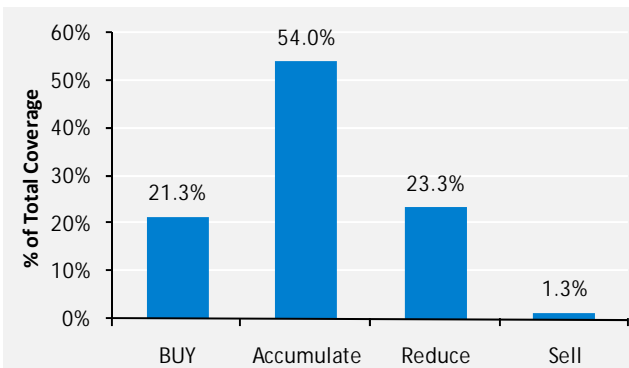
Y/e March	Q1FY12	Q2FY12	Q3FY12	Q4FY12
Net Revenue	10,453	10,903	9,998	10,404
EBITDA	1,856	1,759	1,789	1,948
<i>% of revenue</i>	<i>17.8</i>	<i>16.1</i>	<i>17.9</i>	<i>18.7</i>
Depr. & Amortization	94	98	109	119
Net Interest	4	5	3	21
Other Income	159	163	269	242
Profit before Tax	1,918	1,819	1,945	2,049
Total Tax	661	534	536	604
Profit after Tax	1,771	1,286	1,410	1,446
Adj. PAT	1,257	1,286	1,410	1,446

Source: Company Data, PL Research.



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Rating Distribution of Research Coverage



PL's Recommendation Nomenclature

BUY	: Over 15% Outperformance to Sensex over 12-months	Accumulate	: Outperformance to Sensex over 12-months
Reduce	: Underperformance to Sensex over 12-months	Sell	: Over 15% underperformance to Sensex over 12-months
Trading Buy	: Over 10% absolute upside in 1-month	Trading Sell	: Over 10% absolute decline in 1-month
Not Rated (NR)	: No specific call on the stock	Under Review (UR)	: Rating likely to change shortly

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