

Cummins India

STOCK INFO.	BLOOMBERG
BSE Sensx: 8,069	KKC IN
	REUTERS CODE
S&P CNX: 2,444	CUMM.BO

21 October 2005

Neutral

Previous Recommendation: Neutral

Rs136

Equity Shares (m)	198.0
52-Week Range	163/105
1,6,12 Rel. Perf. (%)	-2/-4/-30
M.Cap. (Rs b)	26.8
M.Cap. (US\$ b)	0.6

YEAR	NET SALES*	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/05A	14,711	1,334	6.7	38.0	20.1	3.5	17.9	20.5	1.7	17.1
3/06E	17,474	1,634	8.3	22.4	16.4	3.3	20.6	28.6	1.3	10.5
3/07E	20,841	1,915	9.7	17.2	14.0	3.0	22.3	31.9	1.1	9.0

* Consolidated nos.

Robust 2QFY06 performance driven by higher exports, margin improvement: During Q2FY06, revenue was up 20.4% YoY to Rs3.57b, while net profit (adjusted for extraordinary) stood at Rs421m, up 30% YoY. Exports grew 46%YoY, while domestic revenues were up 8% YoY during the same period.

EBIDTA margin expansion: EBIDTA margins (adjusted for extraordinary of Rs64m) expanded to 13.6% in Q2FY06 vs 11.4% in Q2FY05. Initiatives to improve supply-chain management, ERP upgradation and possibility of 2% price hike in Q4FY06 in product prices could result in further margin expansion, in our opinion.

Fairly optimistic about future performance: Management seemed fairly optimistic in delivering strong financial performance going forward, and exuded confidence in achieving targeted revenue growth of ~20% in exports and 13-15% in domestic revenues over FY04-FY08. Further, with better working capital management, the company has turned net cash generator vs cash consumer in business operations.

Valuation and Recommendation: At CMP of Rs136, Cummins trades at a P/E of 14x FY07E (consolidated) and EV/EBITDA of 9x FY07E. We maintain **Neutral** rating.

QUARTERLY PERFORMANCE									(Rs Million)	
	FY 05				FY 06				FY 05	FY 06E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Sales	2,815	2,968	2,968	3,168	3,280	3,573	3,591	3,731	11,918	14,175
Change (%)	32.5	30.7	32.2	16.2	16.5	20.4	21.0	17.8	27.8	18.9
EBITDA	381	339	263	464	439	422	352	514	1,448	1,727
Change (%)	34.9	18.3	28.7	80.3	15.3	24.3	33.9	10.7	32.8	19.3
As of % Sales	13.5	11.4	8.9	14.6	13.4	11.8	9.8	13.8	12.1	12.2
Depreciation	90	96	84	87	83	83	88	109	357	363
Interest	2	1	2	7	2	2	3	5	12	12
Other Income	135	189	273	200	161	216	300	173	797	850
PBT	409	425	450	569	516	553	561	573	1,853	2,203
Tax	120	134	121	105	162	175	168	67	481	573
Effective Tax Rate (%)	29.3	31.6	27.0	18.5	31.4	31.7	30.0	11.7	26.0	26.0
Reported PAT	289	291	329	464	354	378	393	506	1,372	1,630
Adj PAT	299	295	329	464	354	421	393	506	1,388	1,630
Change (%)	0.8	-3.5	21.2	56.9	18.2	42.6	19.6	9.1	12.9	17.4

E: MOST Estimates, Standalone nos.

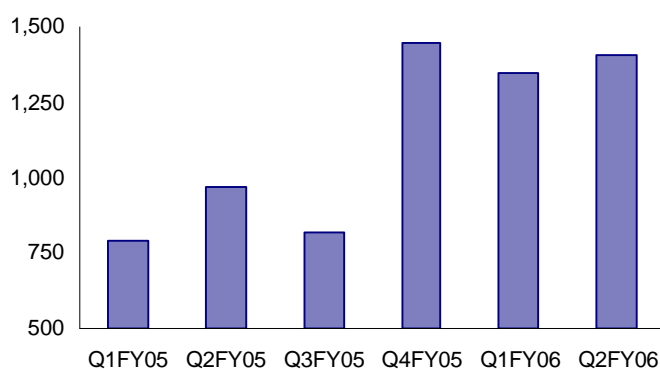
Robust Q2FY06 performance

Cummins India (CIL) reported strong financial performance for Q2FY06. Revenue was up 20.4% YoY to Rs3.57b in 2QFY06 as against Rs2.96m in 2QFY05. Net profit (adjusted for extraordinary) stood at Rs421m during Q2FY06, up 30% YoY.

Exports: key growth driver

The strong revenue growth of 20.4% YoY during Q2FY06 was driven by strong exports growth of 46% YoY. Domestic revenues increased 8% YoY during the same period.

EXPORTS PERFORMANCE (RS M)



Source: Company/Motilal Oswal Securities

SEGMENTWISE PERFORMANCE (RS M)

	Q1FY05	Q2FY05	Q3FY05	Q4FY05	Q1FY06	Q2FY06
Revenues	2,815	2,968	2,968	3,168	3,280	3,573
YoY growth (%)	32.5	30.7	32.2	16.2	16.5	20.4
- Exports	792	967	820	1445	1347	1410
YoY growth (%)	73.3	96.3	43.4	92.1	70.1	45.8
- Domestic sales	2,023	2,000	2,148	1,723	1,933	2,163
YoY growth (%)	21.3	12.5	28.5	-12.7	-4.5	8.1

Source: Company/Motilal Oswal Securities

The key reason for lower growth in domestic market has been the declining trend in compressor segment (used in water rigs), where Cummins has dominant presence. Excluding this, the domestic sales grew 10-12% YoY on back of higher sales to user industries like IT, telecom, automotive, mining, oil and gas and railways. The management expects a recovery in the compressor segment from H2FY07. During Q2FY06, in the domestic market, industrial application segment did well with 11% QoQ growth, while power systems revenues were up 4% QoQ. The management seemed confident of delivering a 13-14% CAGR in domestic revenues till FY08.

EBIDTA margins expansion

During Q2FY06, EBITDA was up 24.3% YoY to Rs422m; while EBITDA margins (adjusted for extraordinary) expanded to 13.6% vs 11.4% during the same period. The key reasons have been the strong revenue growth and cost-cutting initiatives. Initiatives to improve supply-chain management, ERP upgradation and possibility of 2% price hike in Q4FY06 in product prices could result in further margin expansion, in our opinion.

One-off expenses booked in Q2FY06

- ✍ Superannuation expenses: Rs16m
- ✍ Obsolescence charges for platforms, which were modernized: Rs 28m
- ✍ Upgradation of equipments: Rs20m

Key takeaways from the conference call

Fairly optimistic about future performance: Cummins seemed fairly optimistic in delivering a strong financial performance going forward. The management exuded confidence in achieving its targeted revenue growth of ~20% in exports and 13-15% in domestic revenues over FY04-FY08. There exists a possibility of price hike of ~2% in Q4FY06, which could improve margins. Further, with better working capital management, the company has turned net cash generator vs cash consumer in business operations.

New product launches: The management stated that the new product launch programme is on schedule, with new products contributing to 15-20% of FY06 revenues. FY07 would also witness a similar contribution.

Capex requirements: Over the next 12 months, the management indicated a capex requirement of Rs300-500m. There exists scope for capacity expansion through debottlenecking, at a minimal capex.

Valuation and Recommendation

At CMP of Rs136, Cummins trades at a P/E of 14x FY07E and EV/ EBITDA of 9x FY07E. We maintain **Neutral** rating.

Cummins India: an investment profile

Company description

Cummins India, established in 1962, is the flagship company of US\$6.3b Cummins group in India. It is the country's leading manufacturer of diesel engines. Cummins group in India comprises of 11 entities with a combined turnover of over Rs25b and employing more than 5000 people.

Key investment arguments

- ✍ Cummins India has been identified as exclusive supplier for Cummins' world-wide requirements for a few high capacity engines, driving exports (which grew by 46% in Q2FY06)
- ✍ Company continues to witness steady demand for both power generation and industrial applications products in domestic market.
- ✍ New launches account for 15-20% of revenues in FY06 and should maintain the same proportion in FY07
- ✍ Cost-cutting initiatives, supply chain management and possible price hike in 4QFY06, will drive margins

Key investment risks

- ✍ Reducing import duties and increasing number of domestic players in the market may increase competitive pressure
- ✍ Increasing capacities and efficiencies in China may alter the parent's outsourcing plan in India

Recent developments

- ✍ An additional facility will be set up in Pune to assemble engines and gensets in the 15-140 kva range at the cost of Rs150m.

Valuation and view

- ✍ At CMP of Rs136, Cummins trades at a P/E of 14x FY07E (consolidated) and EV/ EBITDA of 9x FY07E.
- ✍ We maintain **Neutral** rating.

Sector view

- ✍ Investments in manufacturing industries are likely to continue their momentum as they are operating at their peak utilization rates.
- ✍ The Government is finalizing capex plans for increased investments in the countries T&D segment.
- ✍ Import duty cuts may enhance scope of competition for the domestic companies.
- ✍ Many companies are emerging as outsourcing hubs for their parents due to high technical skills, cost competitiveness and excess capacity.

COMPARATIVE VALUATIONS

		CUMMINS	ABB	SIEMENS
P/E (x)	FY06E	16.4	34.0	27.6
	FY07E	14.0	24.7	20.6
P/BV (x)	FY06E	3.3	7.9	9.3
	FY07E	3.0	6.3	7.3
EV/Sales (x)	FY06E	1.3	2.2	2.2
	FY07E	1.1	1.5	1.7
EV/EBITDA (x)	FY06E	10.5	22.7	17.0
	FY07E	9.0	15.7	12.4

* For ABB, FY06 is CY05 and FY07 is CY06; For Siemens FY06 and FY07 is Sept ending FY05 and FY06 respectively

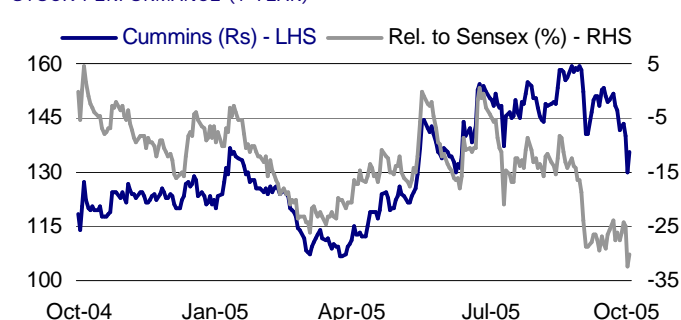
SHAREHOLDING PATTERN (%)

	SEP.05	JUN.05	SEP.04
Promoters	51.0	54.2	58.0
Domestic Institutions	15.5	13.2	11.9
FII's/FDIs	18.6	17.8	17.3
Others	14.8	14.8	12.8

EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VIATION (%)
FY06	8.3	8.3	-
FY07	9.7	9.6	-0.5

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT (Rs Million)					
Y/E MARCH	2003	2004	2005	2006E	2007E
Net Sales	10,627	11,778	14,711	17,474	20,841
Change (%)	4.2	10.8	24.9	18.8	19.3
Raw Material	6,657	7,745	10,211	11,881	14,421
Employee Cost	1,237	1,305	1,57	1,292	1,354
Other Manuf. Expenses	423	486	660	726	856
Admin. & Other Expenses	1,041	933	1,216	1,398	1,650
EBITDA	1,269	1,308	1,468	2,177	2,560
Change (%)	-4.4	3.1	2.3	48.3	17.6
% of Net Sales	11.9	11.1	10.0	12.5	12.3
Depreciation	304	340	406	393	418
VRS- Amortisation	2	106	0	0	0
EBIT	963	862	1,062	1,784	2,142
Interest & Finance Charges	53	44	41	29	29
Other Income	337	556	602	613	670
PBT	1,248	1,373	1,623	2,368	2,783
Tax	409	412	653	805	943
Effective Rate (%)	32.8	30.0	40.2	34.0	33.9
Minority Interest	0	0	0	0	0
Share Associate Profit	57	57	69	70	75
Reported PAT	889	967	1,334	1,634	1,915
Change (%)	-20.1	8.7	38.0	22.4	17.2
Adjusted PAT	889	967	1,334	1,634	1,915

BALANCE SHEET (Rs Million)					
Y/E MARCH	2003	2004	2005	2006E	2007E
Share Capital	396	396	396	396	396
Reserves	6,809	6,843	7,241	7,805	8,562
Net Worth	7,205	7,239	7,637	8,201	8,958
Loans	249	497	665	100	100
Minority Interest	0	0	0	0	0
Finance Lease Liability	6	68	43	0	0
Deferred Tax Liability	133	91	55	133	133
Capital Employed	7,593	7,894	8,357	8,434	9,191
Gross Fixed Assets	4,931	5,209	5,399	6,034	6,704
Less: Depreciation	2,921	3,137	3,309	3,671	4,089
Net Fixed Assets	2,010	2,073	2,091	2,363	2,615
Capital WIP	70	57	38	70	70
Investments	3,673	3,361	2,301	2,305	2,196
Curr. Assets	5,112	5,605	7,491	9,469	11,169
Inventory	1,973	2,112	2,806	3,016	3,711
Sundry Debtors	2,349	2,578	3,363	3,926	4,568
Cash & Bank Balances	299	186	64	1,697	1,818
Loans & Advances & Other	491	729	1,258	830	1,071
Current Liab. & Prov.	3,273	3,200	3,564	5,773	6,859
Sundry Creditors	1,827	2,224	2,385	2,968	3,711
Other Liabilities	179	159	215	300	425
Provisions	1,267	817	964	2,505	2,723
Net Current Assets	1,839	2,405	3,927	3,696	4,310
Application of Funds	7,593	7,894	8,357	8,434	9,191

E: MOS Estimates

RATIOS					
Y/E MARCH	2003	2004	2005	2006E	2007E
Basic (Rs)					
EPS	4.5	4.9	6.7	8.3	9.7
Cash EPS	6.0	6.6	8.8	10.2	11.8
Book Value per Share	36.4	36.6	38.6	41.4	45.2
DPS	4.0	4.0	4.0	4.8	5.2
Payout (Incl. Div. Tax) %	89.1	81.9	59.4	58.2	53.8
Valuation (x)					
P/E	30.2	27.7	20.1	16.4	14.0
Cash P/E	22.5	20.5	15.4	13.2	11.5
EV/EBITDA	18.2	18.2	17.1	10.5	9.0
EV/Sales	2.2	2.0	1.7	1.3	1.1
Price to Book Value	3.7	3.7	3.5	3.3	3.0
Dividend Yield (%)	3.0	3.0	3.0	3.5	3.8
Profitability Ratios (%)					
RoE	12.5	13.4	17.9	20.6	22.3
RoCE	17.4	18.3	20.5	28.6	31.9
Turnover Ratios					
Debtors (Days)	81	80	83	82	80
Inventory (Days)	68	65	70	63	65
Creditors (Days)	100	105	85	91	94
Working Capital (Days)	63	75	97	77	75
Asset Turnover (x)	5.3	5.7	7.0	7.4	8.0
Leverage Ratio					
Debt/Equity (x)	0.03	0.07	0.09	0.01	0.01

CASH FLOW STATEMENT (Rs Million)					
Y/E MARCH	2003	2004	2005	2006E	2007E
PBT before Extraordi	1,241	1,321	1,918	2,368	2,783
Add : Depreciation	310	347	414	393	418
Interest	53	44	41	29	29
Less : Direct taxes paid	409	412	653	805	943
(Inc)/Dec in WC	1,053	-680	-1,644	1,864	-493
CF from operations	2,248	622	77	3,850	1,795
Minority Interest & share c	57	57	69	70	75
CF from operations in	2,304	679	146	3,920	1,870
(Inc)/dec in FA	-243	-396	-414	-697	-670
(Pur)/Sale of Investments	-1,365	313	1,060	-4	109
CF from investments	-1,609	-83	646	-701	-561
(Inc)/Dec in Networth	190	20	-61	34	0
(Inc)/Dec in Debt	26	247	169	-565	0
Less : Interest Paid	53	44	41	29	29
Dividend Paid	894	933	935	1,069	1,158
CF from Fin. Activity	-729	-710	-870	-1,629	-1,187
Inc/Dec of Cash	-34	-114	-78	1,590	122
Add: Beginning Balance	334	299	186	107	1,697
Closing Balance	299	186	108	1,697	1,818

N O T E S

For more copies or other information, contact

Institutional: Navin Agarwal. **Retail:** Manish Shah, Mihir Kothari

Phone: (91-22) 56575200 Fax: (91-22) 22885038. E-mail: inquire@motilaloswal.com

This report is for the personal information of the authorized recipient and does not construe to be any investment, legal or taxation advice to you. 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.

The report is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon such. MOST or any of its affiliates or employees shall not be in any way responsible 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.

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
MOST is not engaged in providing investment-banking services.	

This information is subject to change without any prior notice. MOST reserves the right to make modifications and alternations to this statement as may be required from time to time. Nevertheless, MOST is committed to providing independent and transparent recommendations to its clients, and would be happy to provide information in response to specific client queries.