

Cummins India



Group strength

Contents

	Page No.
Excellent play on several mega trends	4
New products, Six Sigma to sustain profitable growth	5-7
Subsidiaries and affiliates add significant value	8-10
Financials and projections	11-13
Valuation and recommendation	14
Concerns	15
Annexure: Mega trends to benefit Cummins India	16-19
Financial statements	20-23

Cummins India

STOCK INFO.	BLOOMBERG
BSE Sensex: 13,665	KKC IN
S&P CNX: 4,093	REUTERS CODE CUMM.BO

2 July 2008

Buy

Previous Recommendation: Neutral

Rs239

Y/E MARCH	2007	2008	2009E	2010E
Net Sales (Rs m)	21,228	26,555	32,605	40,126
EBITDA (Rs m)	3,875	4,270	5,419	6,812
PAT (Rs m)	2,680	3,249	4,035	5,058
EPS (Rs)	13.5	16.4	20.4	25.5
EPS growth (%)	45.9	21.2	24.2	25.3
BV/share (Rs)	51.5	62.3	76.0	93.2
RoE (%)	28.6	28.8	29.5	30.2
RoCE (%)	36.0	34.1	36.3	37.3
P/E (x)		14.6	11.7	9.4
P/BV (x)		3.8	3.1	2.6
EV/EBITDA (x)		10.0	7.8	6.0
EV/Sales (x)		1.4	1.1	0.9

KEY FINANCIALS

Shares Outstanding (m)	198.0
Market Cap. (Rs b)	47.3
Market Cap. (US\$ b)	1.1
Past 3 yrs Sales Growth (%)	25.4
Past 3 yrs NP Growth (%)	30.4
Dividend Payout (%)	32.8
Dividend Yield (%)	1.9

STOCK DATA

52-W High/Low Range (Rs)	473/225
Major Shareholders (as of March 2008)	(%)
Cummins Inc, USA	51.0
Domestic Inst.	17.4
Foreign	15.7
Others	15.9
Average Daily Turnover	
Volume ('000 Shares)	539.4
Value (Rs m)	201.2
1/6/12 Month Rel. Performance (%)	-3/-10/-23
1/6/12 Month Abs. Performance (%)	-19/-43/-30

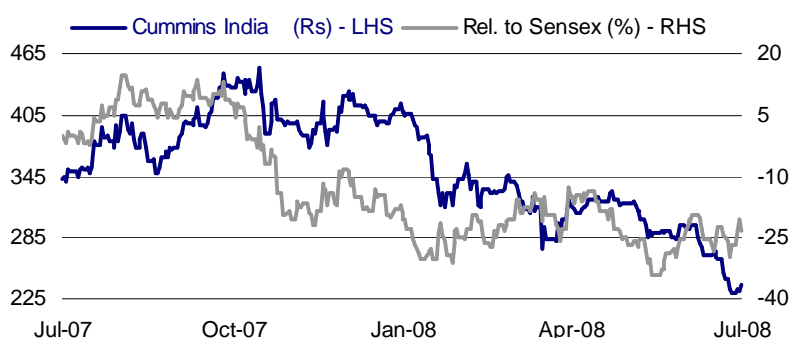
Excellent play on several mega trends: Cummins makes diesel engines and is an excellent play on several mega trends in India: (1) sustained demand for backup power, (2) huge investment in infrastructure and mining, and (3) India as a global outsourcing hub. We expect 23% topline CAGR through FY10E.

New products, Six Sigma to sustain profitability: Cummins is constantly introducing new products and expanding capacities. Current programs include: (1) new unit near Pune for low horsepower gensets; (2) migration to ISLe (i.e. electronic) platform, and (3) Cummins group campus. The company is confident of diluting cost pressures through its Six Sigma and ACE (accelerated cost efficiency) initiatives.

Subsidiaries and affiliates add significant value: Cummins' flagship subsidiary – Cummins Sales and Services (CSS) – is being merged w.e.f. FY09. Other than CSS, Cummins' affiliates include high-growth companies like Cummins Generator Technologies India (which makes Stamford brand of alternators) and Valvoline Cummins (which makes lubricants). For FY10E, we expect subsidiaries (including CSS), JVs and associates to account for 15-20% of Cummins' consolidated PAT.

25% EPS CAGR through FY10E; target of Rs383; Buy: We see consolidated EPS CAGR of 25% through FY10E. Cummins' fundamentals compare well with peers, but its stock trades at a sharp discount. We value Cummins at 15x FY10E consolidated EPS of Rs25.5 to arrive at a target is Rs383, a 60% upside from current levels. We upgrade Cummins to **Buy**.

STOCK PERFORMANCE (1 YEAR)



Excellent play on several mega trends

Cummins India (Cummins) is a 51% subsidiary of Cummins Inc, USA. Cummins is a leading manufacturer and exporter of engines, which have multiple applications – power generation, mining equipment, automotive, railways, marine, etc.

We believe Cummins is an excellent play on several mega trends, which will be integral to the Indian economy for the foreseeable future –

1. Sustained demand for backup power
2. Huge investment in infrastructure and mining
3. Boom in natural gas availability
4. Rising capex by Railways
5. India as a global outsourcing hub
6. Others – rising E&P activity, modernization of navy and marine sector.

Each of the above trends is a major positive for engines demand. Combined, we expect a steady 23% topline growth for Cummins through FY10E. (for details of each mega trend, see Annexure on page 20).

CUMMINS TO BENEFIT FROM SEVERAL MEGA TRENDS IN INDIA

MEGA TREND	BRIEF EXPLANATION	POSITIVE IMPLICATION(S) FOR CUMMINS
Sustained demand for backup power	India's power deficit stands at about 10%, with peak deficit of 17%	<p>✍ Huge demand for backup power and standby power gensets</p> <p>✍ High growth in telecom, IT, realty and retail also driving demand for gensets</p>
High level of investment in infrastructure and mining	Infrastructure investment in the five years to FY12 (11th Five-Year Plan) is expected to be US\$500b – 2.3x that of the preceding five years	<p>✍ Huge demand for engines to power construction and mining equipment such as excavators, loaders, dumpers, etc.</p>
Boom in natural gas availability	Gas finds such as that of Reliance in KG basin is expected to significantly improve availability of gas in India	<p>✍ Cummins' gas-based products include: (1) lean burn gas engines for high-end buses, and (2) gas-based engines for power gensets</p>
Rising capex by Railways	Indian Railways is reporting high net surplus for the last few years, enabling higher investment in locomotives, wagons etc.	<p>✍ Cummins has engines for Railways – for locomotives, DEMUs, power cars, etc</p>
India as global outsourcing hub	Several global companies are seeking to outsource products from India	<p>✍ Cummins India is emerging as an important outsourcing hub for Cummins Inc; exports should remain healthy.</p>
Others	Rising E&P activity, modernization of Indian navy, etc	<p>✍ Cummins has engines for oil rigs, and gensets for naval and marine applications</p>

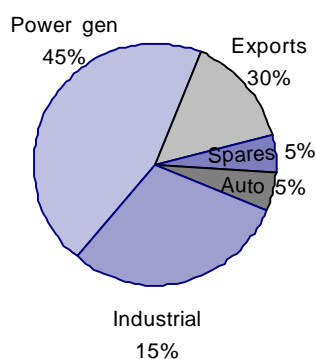
Source: Motilal Oswal Securities

Six mega trends to drive engines demand for next five years

New products, Six Sigma to sustain profitable growth

CUMMINS SALES MIX

(FY08 - TOTAL NET SALES RS23.3B)



Source: Company/MOSL

Wide range of engines

Cummins manufactures a wide range of engines for a variety of applications. It has four plants around Pune (Kothrud, Lonikand, Pirangut and Nagar Road) and one in Daman.

CUMMINS: PRODUCT RANGE AND APPLICATIONS

USER SEGMENT	RANGE (HP)	MAJOR APPLICATION
Engines & Power Business Groups	125-1,470	DG sets for prime power, standby, peak sharing systems and cogeneration systems; various industries such as IT, telecom, realty, hospitality, healthcare, textiles, etc
Industrial Business Group		
Construction & Mining	100-1,600	Various equipment such as dumpers, excavators, tyre handlers, loaders, cranes, etc
Compressors	125-600	Portable compressors, waterwell drill rigs, blast hole drill rigs
Pumps	300-1,835	Firefighting pumps, industrial pumps, dredge pumps
Railways	100-2,000	Diesel locomotives, overhead equipment cars, and track machines
Oil fields	90-1,470	Rigs, mud pumps, cranes, gensets, power packs and compressors
Marine	90-1,250	On barges, bulk carriers, fishing trawlers, ferries, patrol boats and auxiliary power generation sets on vessels
Defense	90-525	Trucks, tanks, gun towing vehicles and gensets
Automotive Business Group	100-300	Engines for trucks and buses, including lean-burn natural gas engines

Source: Motilal Oswal Securities

Foray into sub-100kva gensets; capacity doubling at Kothrud, Nagar Road

New products, expansion to sustain growth momentum

Cummins is constantly introducing new products and expanding capacities of its existing products:

1. Recently commissioned unit in Pirangut for sub-12kva consumer gensets and 12-100kva gensets for light commercial applications
2. Doubling of capacity at Kothrud and Nagar Road
3. Phased migration of several engine series to the ISLe (i.e. electronic) platform
4. Cummins campus spread over 150 acres at Phaltan, near Pune. Apart from Cummins India, the campus will house other Cummins group companies, which will set up capacities for domestic and export market. (Cummins India will own the land and charge rentals from other units.)

New plant at Pirangut: Currently, Cummins manufactures small gensets at its unit in Daman, with a capacity of about 15,000 units per annum. It has recently commissioned a new Rs200m plant at Pirangut, with a capacity of ~50,000 units. Of this, 20,000 units are under an EOU (export-oriented unit), and the balance for the domestic market. Considering the huge demand for sub-100kva gensets, Cummins has decided to continue with the Daman facility as well.

Doubling of capacity at Kothrud and Nagar Road: Cummins is doubling its capacity at Kothrud (N, K, V and Q series engines) and Nagar Road (C series engine) plants to ~50,000 units per annum. The expected capex is Rs800m over 2008 and 2009.

Migration of engines to ISLe platform: ISLe is the electronics platform for Cummins engines worldwide, leading to compliance with ever-tightening norms on emission and NVH (noise, vibration and harshness). Beginning with the C series engines, Cummins will offer its customers the ISLe platform option for most of its engines in India, improving unit realizations.

*Group strength: 150-acre
Cummins campus near Pune
to house group companies*

Cummins campus at Phaltan, Maharashtra: The Indian arms of Cummins Inc are jointly setting up a huge 150-acre campus in Phaltan in the Satara district of Maharashtra to manufacture various engines and components, both for the domestic market and exports. Cummins plans to invest ~Rs1b over 2008 and 2009 to set up capacities for C- and L-series (ISLe) engines.

Other initiatives: Cummins owns 50% in Cummins Research & Technology India, with the balance 50% held by Cummins Inc. CRTI aims to provide design and analysis services to all Cummins units worldwide. In FY08, this JV reported PAT of only Rs26m. However, over time, this venture could have significant value for intellectual property rights.

Apart from the above, Cummins is also working with institutions like the IISc Bangalore (Indian Institute of Science) and IIT Mumbai (Indian Institute of Technology) to commercialize engines based on feedstock such as bio-diesel and bio-mass such as wood or rice- or corn husk. Any breakthroughs here will help Cummins participate in huge opportunities such as rural electrification.

Six Sigma and other efficiency measures to support margins

Cummins is facing margin pressures on several counts –

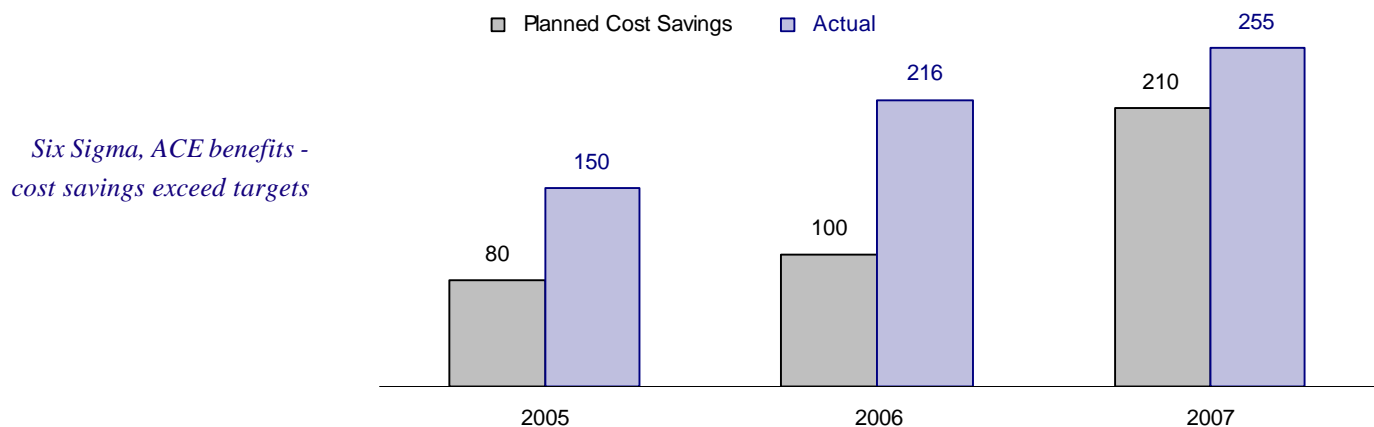
- ✍ Rising cost of inputs such as steel and manpower
- ✍ Sharp strengthening of the rupee (specially in FY08), hurting export margins
- ✍ Increase in overall competition, both domestic and from imports, again due to strengthening of the rupee.
- ✍ Lastly, shift in product mix towards the mid-range (100-300 hp) will also lower the EBITDA margin percentage.

However, Cummins is confident of offsetting most of these pressures through the following counter strategies –

1. Aggressive Six Sigma program to strengthen business processes
2. ACE (accelerated cost efficiency) initiative to reduce TCO (total cost of ownership), which also involves partnering with suppliers
3. Implementation of Oracle 11i ERP to further enable ACE
4. Lean manufacturing and business process re-engineering based on principles such as Turbo Kaizen
5. Low-cost capacity addition.

The results from the above are already visible, with actual cost savings exceeding targets. We expect such benefits to continue accruing in future.

CUMMINS' ACE UP ITS SLEEVE - COST SAVINGS (RS M)



Source: Company

Subsidiaries and affiliates add significant value

Cummins' flagship subsidiary – Cummins Sales and Services (CSS) – is being merged w.e.f. FY09. Other than CSS, Cummins' affiliates include high-growth companies like Cummins Generator Technologies India (which makes Stamford brand of alternators) and Valvoline Cummins (which makes lubricants). For FY10E, we expect subsidiaries (including CSS), JVs and associates to account for 15-20% of Cummins' consolidated PAT.

CUMMINS GROUP IN INDIA

COMPANY NAME	RELATIONSHIP WITH CUMMINS INDIA	HOLDING STRUCTURE	BRIEF BUSINESS DESCRIPTION
Cummins India	—	51% subsidiary of Cummins Inc, USA	Engines, gensets and spares, both for the Indian and international market
Cummins Sales & Service (CSS)	Subsidiary	100% owned by Cummins India	Sale of Cummins engines, gensets and after sales service
Cummins Auto Service	Subsidiary	100% owned by Cummins India	AMCs with truck fleet owners and retailing of parts and accessories
Cummins Exhaust India	Joint venture	50:50 JV of Cummins Filtration Inc, USA and Cummins India	Leader in exhaust system products for trucks and buses, gensets, agricultural and construction equipment
Cummins Research & Technologies India	Joint venture	50:50 JV of Cummins Inc and Cummins India	Provides IT-enabled mechanical engineering design services for Cummins group worldwide
Cummins Generator Technologies India (CGTI)	Associate	51.5:48.5 JV between CGT, UK and Cummins India	Manufactures Stamford brand of alternators in the 5kva to 2,200 kva range
Valvoline Cummins	Associate	50:50 JV of Ashland Inc, USA and Cummins Sales & Service	One of India's fastest growing producers of automotive lubricants, transmission fluids, gear oils, hydraulic lubricants, filters, etc
Tata Cummins	Business Partner	50:50 JV of Cummins Inc and Tata Motors	Low emission 78-235 hp diesel engines for new generation of Tata Motors M&HCVs; also supplies B-series engines to Cummins India
Cummins Turbo Technologies	Business Partner	100% owned by Cummins Turbo Technologies, UK	Provides Holset brand of turbocharger solutions for medium and heavy-duty diesel engines for automotive, off-highway, power generation and marine applications
Fleetguard Filters India	Business Partner	100% owned by Cummins Filtration Inc, US	Leading manufacturer of heavy-duty air, fuel, lube and hydraulic filters and coolants for on- and off-highway applications
KPIT Cummins Infosystems	Trade Investment	Professionally owned and managed	SEI CMM Level 5 certified leading provider of IT services and solutions

Source: Company / Motilal Oswal Securities

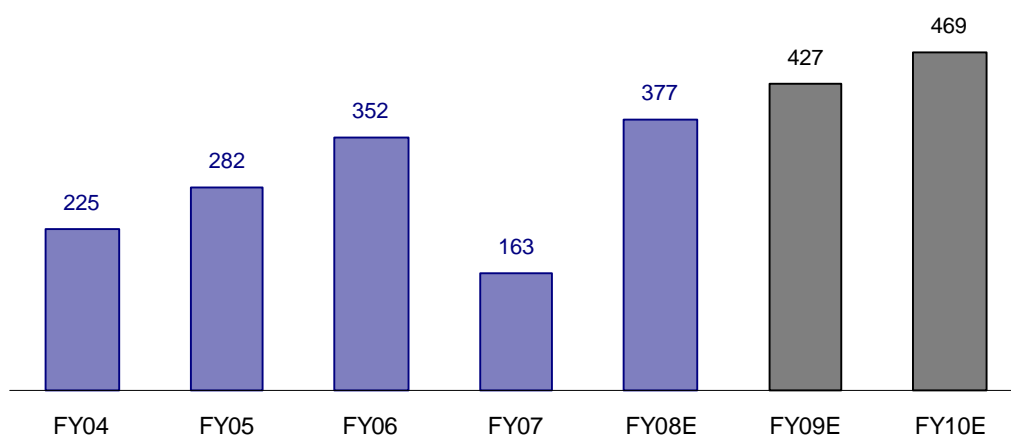
CSS merger positive - expect operational synergies and financial savings

CSS to be merged with Cummins India

Beginning FY09, Cummins plans to merge its 100% subsidiary Cummins Sales and Service (CSS) with itself. Prima facie, the merger is a positive in terms of operational and financial synergies, including savings on VAT and corporate dividend tax.

CSS is primarily engaged in after-sales service for Cummins engines. After a lackluster FY07, CSS seems to have come back on track in FY08. Going forward, we have factored in 10% growth in CSS revenue.

CSS RECOVERS AFTER A WEAK FY07 - PAT (RS M)



E: Estimates

Source: Company/Motilal Oswal Securities

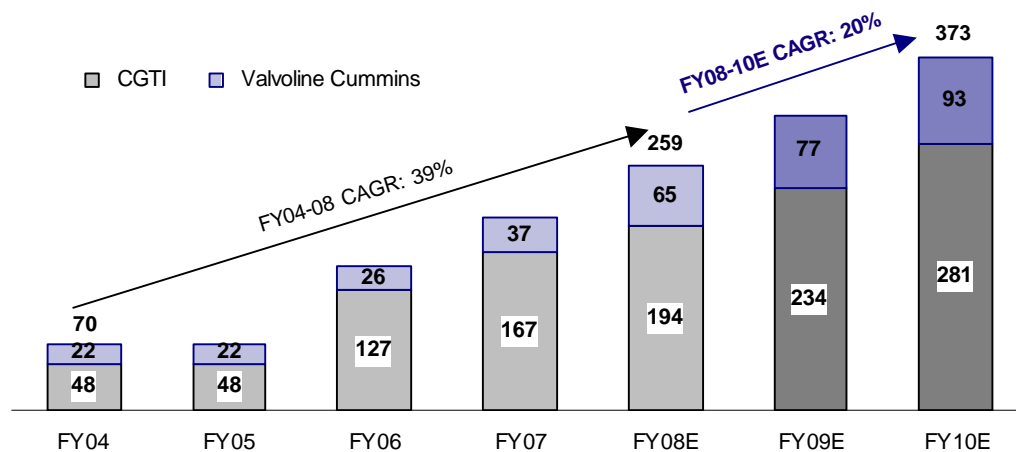
Associates continue to do well

Share of profit from associates is growing at a healthy rate of 39% CAGR FY04-08. Cummins' two major associates are (1) Cummins Generator Technologies (India), and (2) Valvoline Cummins. CGTI manufactures *Stamford* brand of alternators, which are the preferred choice for most gensets. Recently, the company has quadrupled its capacity from 25,000 to 100,000 alternators by setting up a new plant near Pune. We expect CGTI profits to grow at least 20% CAGR through FY10E.

Like CGTI, Valvoline Cummins is another high-growth associate. It is a leading brand for automotive lubricants and car care products, and has celebrities like Australian cricket captain Ricky Ponting as brand ambassador. We expect Valvoline profits to also grow at 20% CAGR through FY10E.

CUMMINS ASSOCIATES ARE DOING WELL - PAT (RS M)

*Valvoline Cummins
and CGTI profits -
20% CAGR through FY10E*



E: Estimates

Source: Company/Motilal Oswal Securities

For FY10, we expect subsidiaries (including CSS), JVs and associates to together account for 15-20% of Cummins consolidated PAT. We believe there is upside to our earnings estimate of subsidiaries and affiliates, specially from high-potential companies like CGTI and CRTI.

Financials and projections

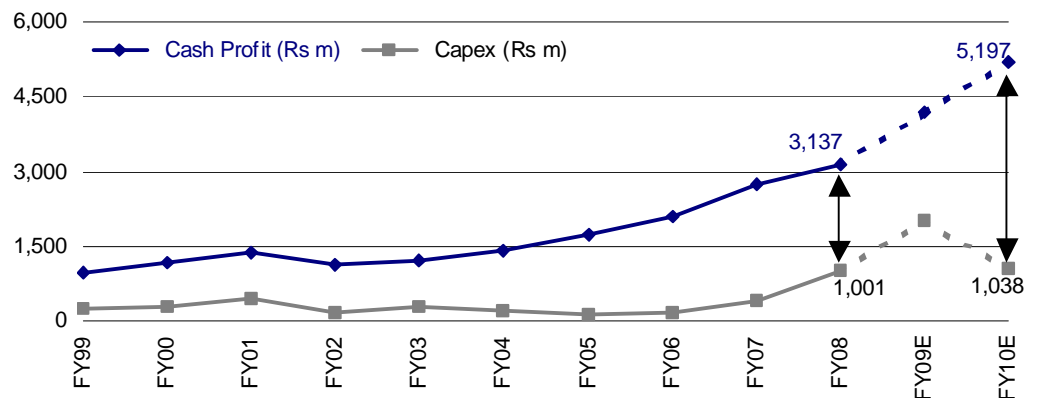
Cummins has attained financial critical mass

Cummins' financial track record clearly suggests that the company has attained critical mass in terms of sales, profits and cash flow to support its growth without recourse to external funding, whether debt or equity.

FY03-FY08 CAGR of sales is 23% and PAT CAGR is 24%. Debt has remained zero, and RoE has nearly doubled to 28%. Average payout ratio is over 50%.

CUMMINS HAS ACHIEVED CRITICAL MASS OF CASH FLOWS

Cash flow to support its growth without recourse to external funding



E: Estimates

Source: Company / Motilal Oswal Securities

Strong rupee, high metal prices mute FY08 profits

In FY08, the rupee strengthened 12% YoY. With 30% of Cummins' revenue coming from exports, it took a total currency hit of about Rs280m. Further, Cummins claims to have lost sales of about Rs330m due to a two-week production shutdown for Oracle 11i ERP implementation. Finally, 4QFY08 profitability was hit by two factors -

1. Higher input costs, including some costs with retrospective effect; and
2. Increase in Pune octroi from 3% to 7% (the rate has been reversed w.e.f. June 1).

Power, auto engines to drive 23% sales growth through FY10E

We have factored in 25% sales CAGR in power generation engines, 15% CAGR in industrial and mining engines, and 70% CAGR in auto engines on a low base. We have factored in 20% CAGR in dollar exports, without taking any view on the rupee. Finally, we have assumed 10% CAGR in CSS sales. The net impact is 23% CAGR in sales through FY10E.

CUMMINS SALES ESTIMATES (RS M)

	FY07	FY08E	FY09E	FY10E	CAGR (%) FY08-10E
Domestic Sales	12,358	16,193	20,512	25,971	27
YoY (%)	33	31	27	27	
% of Total	58	61	63	65	
Power gen	7,912	10,223	12,779	15,973	25
YoY (%)	41	29	25	25	
Industrial	2,633	3,216	3,698	4,253	15
YoY (%)	21	22	15	15	
Auto	652	1,524	2,742	4,388	70
YoY (%)	100	134	80	60	
Spares	1,160	1,231	1,293	1,358	5
YoY (%)	-2	6	5	5	
Exports	6,050	7,117	8,524	10,228	20
YoY (%)	14	18	20	20	
% of Total	29	27	26	25	
Cummins Sales & Service	4,745	5,190	5,709	6,280	10
YoY (%)	4	9	10	10	
% of Total	22	20	18	16	
Others & Eliminations	-1,925	-1,945	-2,140	-2,354	
Total Sales	21,228	26,555	32,605	40,126	23
YoY (%)	20	25	23	23	

E: Estimates

Source: Company / Motilal Oswal Securities

Power gen and auto engines
to drive 23% sales CAGR
through FY10E

Capex of Rs4.4b through FY10E

Cummins has chalked out plans to invest about Rs4.4b in the three years to FY10:

- ✍ Rs200m unit in Pirangut near Pune for sub-100 kva gensets
- ✍ Rs800m for doubling engines capacity at Kothrud
- ✍ Rs2,000m towards Cummins campus in Phaltan
- ✍ Rs1,390m recurring capex.

CUMMINS CURRENTLY ANNOUNCED CAPEX PROGRAM

LOCATION	COST (RS M)	COMM. DATE	FY07	FY08E	FY09E	FY10E	CAPEX DETAILS
Pirangut	200	Nov-07	100	100			50,000 low kva gensets
Kothrud	800						Doubling of mid- and high-range engines capacity
2008	400	Mar-08	239	161			
2009	400	Jun-09		120	250	30	
Phaltan	2,000						Setting up of Cummins campus along with other Indian arms
2008	1,000	Mar-09		200	800		
2009	1,000	Dec-09			500	500	
Routine Capex	1,390		65	420	462	508	
Total Capex			404	1,001	2,012	1,038	
Of which CWIP			343	320	750	0	

E: Estimates

Source: Company / Motilal Oswal Securities

Note: Box indicates commissioning of project

*100bp EBITDA margin
improvement over FY08-10E*

25% EPS CAGR through FY10E

Demand outlook for engine-based power is strong, and Cummins has fair degree of pricing power. We have factored in sales growth of 23% through FY10E, whereas the company had guided for only mid-teen growth rates. However, we have chosen to be more conservative on the margin front. We have increased margin by only 1% over FY08-10E, whereas the company has guided for “at least 2%” improvement in FY09 itself.

Our earnings estimates for FY09 and FY10 factor in the following key assumptions -

- ✍ 25% CAGR in power genset engines.
- ✍ 15% CAGR in industrial engines, including for mining equipment, railways and ships.
- ✍ Auto engines to continue in hyper growth mode - 80% growth in FY09, 60% in FY10
- ✍ Total sales CAGR of 23% through FY10
- ✍ 100bp EBITDA margin improvement over FY08 due to economies of scale, benign rupee and benefits of management interventions such as ACE , Six Sigma and Oracle 11i ERP.
- ✍ Capex of about Rs3b in FY09 and FY10, including purchase of 150 acres of land at Phaltan near Pune for the Cummins campus. (This land will be leased out to all Cummins entities in India. However, we have not factored in any lease income in our estimates.)
- ✍ PAT for subsidiaries and JVs to grow at ~20% per annum.

Based on the above, we arrive at a PAT and EPS CAGR of 25% through FY10E. There are potential upsides to our estimates by way of (1) margins being at least 1% higher than our estimates, in line with the company guidance, and (2) lease rental income from group companies, which set up units in Cummins campus.

Valuation and recommendation

Cummins cheaper than engineering peers

Cummins compares well with major engineering peers on fundamental metrics like EBITDA margin, EPS growth, and RoE. However, in terms of valuation, its stock is trading at a discount to all of them, as tabled below.

This discount is partly explained by the fact that Cummins makes engines which are intermediate, and not the final, products. At the same time, however, engines are the heart of most equipment such as gensets, pumps, compressors, construction equipment, etc. Hence, going forward, we do not expect any significant de-rating in Cummins' valuation.

CUMMINS: COMPARATIVE FUNDAMENTALS AND VALUATIONS

COMPANY	YEAR	SALES (RS B)	PAT (RS B)	EPS (RS)	EPS YOY (%)	ROE (%)	ROCE (%)	P/E (X)	EV/ EBITDA (X)
ABB (CMP: Rs788)	12/07A	59,303	4,908	23.2	44.2	34.7	53.3	38.3	24.9
	12/08E	78,214	6,604	31.2	34.5	34.4	53.1	28.5	18.1
	12/09E	103,041	8,761	41.3	32.7	33.7	52.1	21.5	13.1
Alstom (CMP: Rs333)	3/08E	15,992	1,159	17.3	6.1	31.8	48.8	19.3	11.4
	3/09E	19,652	1,254	18.7	8.2	29.1	44.8	17.8	10.1
	3/10E	23,980	1,723	25.7	37.4	32.8	50.9	13.0	6.5
Crompton Greaves (CMP: Rs219)	3/08E	38,759	3,879	10.6	60.4	38.6	47.1	20.7	16.7
	3/09E	46,365	4,620	12.6	19.1	32.8	40.8	17.4	15.1
	3/10E	55,385	6,100	16.6	32.0	32.9	43.0	13.2	11.9
Thermax (CMP: Rs366)	03/08E	32,029	2,885	24.2	46.0	42.4	63.3	15.1	10.0
	03/09E	43,345	3,647	30.6	26.4	40.8	61.1	12.0	7.0
	03/10E	55,640	4,697	39.4	28.8	39.1	58.8	9.3	4.8
Cummins India (CMP: Rs239)	03/08E	26,555	3,249	16.4	21.2	28.8	34.1	14.6	10.0
	03/09E	32,605	4,035	20.4	24.2	29.5	36.3	11.7	7.8
	03/10E	40,126	5,058	25.5	25.3	30.2	37.3	9.4	6.0

E: Estimates

Source: Motilal Oswal Securities

Fundamentals in line with peers, valuations at discount

Target price of Rs383 implies 60% upside; Buy

The Cummins stock price has almost halved from its highs. At current levels, the stock is trading at a P/E of 15x FY08, 12x FY09E and 9x FY10E.

Cummins has a strong set of intrinsic valuation factors - 25% EPS CAGR, RoE of 30% and rising, zero debt (cash of Rs4.3b as of March 2008), and consistent dividend payout of around 33% of profits.

We value Cummins at 15x FY10E consolidated EPS of Rs25.5 to arrive at a target of Rs383, implying 60% upside from current levels. We upgrade Cummins to **Buy**.

Concerns

Lower guidance by the company

Cummins is guiding for "high-teen" rate of growth in domestic sales, and "low-teen" rate of growth in exports. However, our estimates factor in sales growth of 23%. If the actual numbers are closer to company guidance, there is downside to our earnings estimates and target price.

Mitigant: The company has been guiding for low growth for the past couple of years, and consistently over-delivering. Huge domestic and export opportunity, Cummins' wide range of products, and support from global parent convince us that the company will continue to beat its own guidance going forward.

Exports affected by global slowdown, rising rupee

For the three years ended FY07, exports accounted for 30-35% of Cummins sales. Going forward, we have factored in 20% exports growth in dollar terms. As all exports are to group companies worldwide, any major slowdown across the globe or in specific Cummins markets could affect exports.

Mitigant: We believe the export opportunity for Cummins is far from saturated. Outsourcing from low-cost manufacturing bases like India and China is an integral aspect of Cummins Inc's global strategy.

Annexure: Mega trends to benefit Cummins India

Mega trend 1: Sustained demand for backup power

India's power deficit is about 10%, with a peak deficit of 17%. As a result, most industries are dependent on backup power from DG sets (diesel power generation sets). India's industrial sector is expected to grow at a healthy rate of 10-12% over the next five years, implying strong demand for DG sets.

INDIA'S PEAK POWER DEFICIT AT 17%

	ENERGY (M UNITS)				PEAK (MW)			
	DEMAND	SUPPLY	SHORTAGE	SHORTAGE %	DEMAND	SUPPLY	SHORTAGE	SHORTAGE %
2002-03	545,983	497,690	48,093	-8.8	81,492	71,547	9,945	-12.2
2003-04	559,264	519,398	39,866	-7.1	84,574	75,066	9,508	-11.2
2004-05	591,373	548,115	43,258	-7.3	87,906	77,652	10,254	-11.7
2005-06	631,757	578,819	52,938	-8.4	93,255	81,792	11,463	-12.3
2006-07	690,587	624,495	-66,092	-9.6	100,715	86,818	-13,897	-13.8
2007-08	739,345	666,007	-73,338	-9.9	108,866	90,793	-18,073	-16.6

Source: Ministry of Power / Motilal Oswal Securities

Further, there are several new segments of DG sets demand –

- ✍ **Telecom sector**, where each cell-site needs backup power
- ✍ Boom in **commercial construction**, including offices, malls and multiplexes, all of which require backup power
- ✍ Setting up of huge **server rooms** by many companies, both in IT and other sectors
- ✍ Trend of **high-rise residential buildings**, which need backup power for essential services like elevators and water pumps.

The Eleventh Five Year Plan (FY08-12) targets ~82,000mw of power capacity, including 13,500mw based on renewable resources. If all these projects come through, the demand-supply gap for power should be bridged. However, demand for backup power via DG sets will continue, as there could be power outages due to various reasons other than short supply. At best, the DG sets may not run for as much time as they do in the current power shortage situation.

Mega trend 2: Huge investment in infrastructure and mining

Infrastructure investment in the Eleventh Five Year Plan is expected to be Rs20t (US\$500b), which is 2.3x that of the preceding five years.

Likewise, investment in the mining sector will be significantly higher, specially in coal and lignite, where private mining for captive consumption (power, steel, cement) has been opened up. For instance, coal mined in the private sector is estimated to rise from 25m tonnes in FY08 to 104m tonnes in FY12, a CAGR of 42%.

INFRASTRUCTURE INVESTMENT BY SECTOR

SECTOR	X PLAN		XI PLAN		GROWTH (X)
	RS B	% SHARE	RS B	% SHARE	
Electricity	2,982	33.6	6,165	30.4	2.1
Roads & Bridges	1,449	16.3	3,118	15.4	2.2
Telecom	1,234	13.9	2,670	13.2	2.2
Railways	1,197	13.5	2,580	12.7	2.2
Irrigation	1,115	12.6	2,231	11.0	2.0
Water Supply, Sanitation	648	7.3	1,991	9.8	3.1
Ports	41	0.5	739	3.6	18.1
Airports	68	0.8	347	1.7	5.1
Storage	48	0.5	224	1.1	4.6
Gas	87	1.0	205	1.0	2.4
Total	8,868	100.0	20,272	100.0	2.3

Source: Planning Commission

Huge investment in infrastructure and mining leads to high demand for construction, mining and material-handling equipment. Cummins has several engines that find application in equipment such as excavators, crawler drills, compactors, dumper trucks, etc.

Mega trend 3: Boom in natural gas availability

Huge gas finds by Reliance in the KG basin will improve availability of gas going forward. Cummins has several products whose prospects are directly linked with gas availability – (1) lean burn gas engines for high-end buses, (2) gas-based engines for power gensets, and (3) dual-fuel (diesel and gas) engines for Railways.

GAS AVAILABILITY IN INDIA TO BOOM

(MMSCMD)

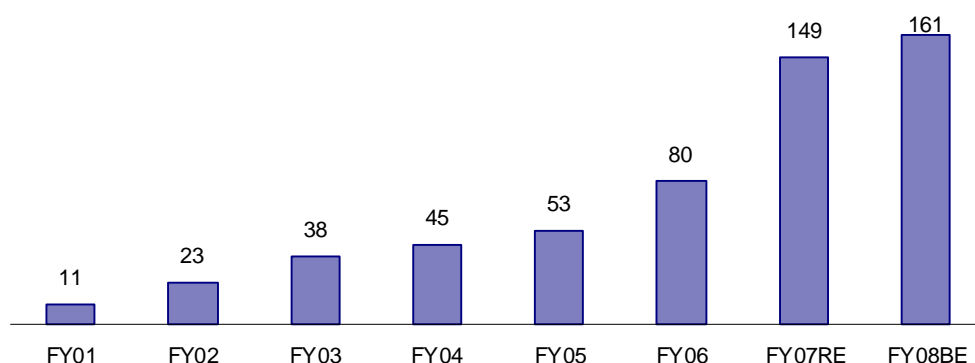
	FY08	FY09	FY10	FY11	FY12	CHG. FY12/08
Domestic Supply						
APM - ONGC / OIL	54	60	60	63	64	11
RIL KG-D6		16	84	89	109	109
Private / JVs (PMT, Cairn etc.)	21	25	25	25	25	4
Total Domestic Supply	75	101	169	177	198	124
LNG Imports	21	25	30	35	40	19
LNG Capacity	29	38	49	63	63	34
Total Supply	96	126	199	212	238	143

Source: Working Group for the XIth Plan/Motilal Oswal Securities

Mega trend 4: Rising capex by Railways

The financial position of the Indian Railways has improved significantly over the last five years. This translates into high capital spend, including power cars, DEMUs (diesel electric multiple units), new LHB (Linke-Hoffman-Busch, part of Alstom) type trains, locomotives, etc. Cummins has products to cater to these requirements.

INDIAN RAILWAYS GETTING FINANCIALLY STRONGER (NET SURPLUS IN RS B)



RE: Revised Estimates; BE: Budget Estimates (both of the Railway Budget)

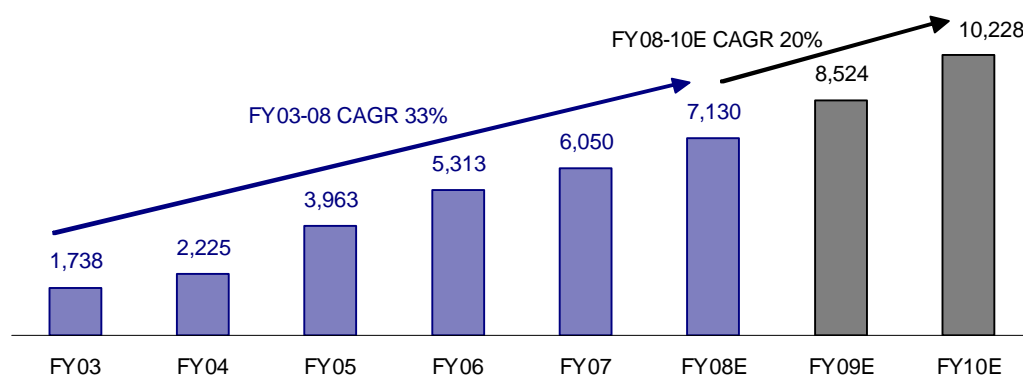
Source: MOSL

Mega trend 5: India as global outsourcing hub

India has strongly established itself as a hub for outsourcing of services such as IT and engineering design. Now, there are also signs of India emerging as a global outsourcing hub for products requiring engineering excellence. For example, India is Suzuki's global manufacturing hub for small cars. Similarly, bearing companies, SKF and FAG, export their products to their group companies worldwide.

Cummins India is a 51% subsidiary of Cummins Inc, which is headquartered in Columbus, Indiana, US. Cummins India is emerging as a major outsourcing hub for the Cummins group worldwide, including US, UK and rest of Europe. We expect steady growth in Cummins exports of engines to the group.

CUMMINS EXPORTS GROWTH REMAINS STEADY (RS M)



FY08 exports growth was muted due to the strong rupees Source: Company / Motilal Oswal Securities

Other trends

Rising E&P (oil exploration and production) activity, modernization of the Indian navy and marine sectors, and emergence of India as a global shipyard also benefit Cummins. For instance, in FY07, Cummins supplied engines to ONGC under the latter's rig revamp program. It also supplied to the Indian Navy complex value packages such as 1mw DA (diesel alternator) sets for stealth destroyers and anti-submarine warfare ships. Cummins is also strong in gensets for barges and ships.

In sum

We expect the above mega trends to play out over the next 5 years. This implies a huge, long-term business opportunity for Cummins, translating into 23% sales CAGR at least through FY10E.

INCOME STATEMENT					(RS MILLION)	
Y/E MARCH	2005	2006	2007	2008	2009E	2010E
Net sales	14,711	17,751	21,228	26,555	32,605	40,126
<i>Change (%)</i>	24.9	20.7	19.6	25.1	22.8	23.1
Reported EBITDA	1,764	2,529	3,454	3,739	4,767	6,010
<i>Change (%)</i>	53.3	43.4	36.6	8.2	27.5	26.1
<i>Margin (%)</i>	12.0	14.2	16.3	14.1	14.6	15.0
Operating Other Income	375	306	420	531	652	803
EBITDA	2,139	2,835	3,875	4,270	5,419	6,812
<i>Change (%)</i>	55.6	32.6	36.7	10.2	26.9	25.7
<i>EBITDA Margin (%)</i>	14.5	16.0	18.3	16.1	16.6	17.0
Depreciation	406	390	381	383	449	559
EBIT	1,732	2,444	3,494	3,887	4,970	6,254
Interest	41	45	65	25	0	0
Financial Other income	126	159	257	524	475	593
PBT & EO items	1,817	2,558	3,686	4,386	5,445	6,847
Extra-ordinary items (net)	101	27	31	0	0	0
PBT	1,918	2,585	3,717	4,386	5,445	6,847
Tax	653	902	1,241	1,396	1,720	2,163
<i>Tax / PBT (%)</i>	34.0	34.9	33.4	31.8	31.6	31.6
Profit excl. share of affiliates	1,265	1,683	2,476	2,990	3,724	4,684
<i>Change (%)</i>	39.1	33.0	47.1	20.7	24.6	25.8
<i>PAT margin (%)</i>	8.6	9.5	11.7	11.3	11.4	11.7
Add: Share of affiliates	69	153	204	259	311	373
Consolidated PAT	1,334	1,836	2,680	3,249	4,035	5,058
<i>Change (%)</i>	38.0	37.6	45.9	21.2	24.2	25.3
E: MOST Estimates						

BALANCE SHEET		(RS MILLION)				
Y/E MARCH	2005	2006	2007	2008E	2009E	2010E
Equity share capital	396	396	396	396	396	396
Reserves	7,241	8,130	9,811	11,945	14,659	18,063
Networth	7,637	8,526	10,207	12,341	15,055	18,459
Loans	665	431	262	0	0	0
Net deferred tax	55	-1	-103	-103	-103	-103
Capital employed	8,357	8,956	10,366	12,238	14,953	18,356
Gross fixed assets	5,399	5,505	5,659	6,684	8,266	10,054
Less: Depreciation	3,309	3,669	3,898	4,197	4,554	4,891
Net fixed assets	2,091	1,836	1,761	2,487	3,712	5,164
Capital WIP	38	94	343	320	750	0
Investments	2,301	2,724	3,191	4,013	4,379	5,594
Curr. assets	7,534	8,415	10,149	11,550	13,998	17,096
Inventory	2,806	2,784	3,418	4,152	4,987	6,130
Debtors	3,363	4,054	4,463	6,199	7,611	9,366
Cash & Bank	107	128	553	500	600	700
Loans, Adv. & Others	1,258	1,449	1,715	700	800	900
Current liab. & prov.	3,607	4,113	5,079	6,133	7,885	9,497
Creditors	2,385	2,852	3,330	4,376	5,339	6,543
Other Liabilities	258	240	489	320	350	380
Provisions	964	1,021	1,260	1,437	2,197	2,575
Net current assets	3,927	4,303	5,070	5,417	6,112	7,599
Misc. Exp. (not written off)	0	0	0	0	0	0
Application of funds	8,357	8,956	10,366	12,238	14,953	18,356

E: M0St Estimates

RATIOS

Y/E MARCH	2005	2006	2007	2008E	2009E	2010E
Basic (Rs)						
EPS	6.7	9.3	13.5	16.4	20.4	25.5
Growth (%)	38.0	37.6	45.9	21.2	24.2	25.3
Cash EPS	8.8	11.2	15.5	18.3	22.6	28.4
Book value	38.6	43.1	51.5	62.3	76.0	93.2
Divd. Per Share	4.0	4.0	4.0	4.6	5.7	7.1
Payout (incl. Divd. Tax) (%)	59.4	51.2	35.3	32.8	32.7	32.7
Valuation (x)						
P/E				14.6	11.7	9.4
Cash P/E				13.0	10.6	8.4
Price/Book value				3.8	3.1	2.6
EV/Sales				1.4	1.1	0.9
EV/EBITDA				10.0	7.8	6.0
Dividend yield (%)				1.9	2.4	3.0
Profitability ratios (%)						
Average RoE	17.9	22.7	28.6	28.8	29.5	30.2
Average RoCE	21.6	28.3	36.0	34.1	36.3	37.3
Turnover ratios						
Debtors (days of sales)	77	75	67	75	75	75
Inventory (days of sales)	70	57	59	57	56	56
Creditor (days of total exp.)	67	68	68	70	70	70
Asset turnover (x)	1.8	2.0	2.0	2.2	2.2	2.2
Leverage ratio						
Debt/Equity (x)	0.1	0.1	0.0	0.0	0.0	0.0
<i>E: MOST Estimates</i>						

CASH FLOW STATEMENT				(RS MILLION)		
Y/E MARCH	2005	2006	2007	2008E	2009E	2010E
PBT before EO items	1,817	2,558	3,686	4,386	5,445	6,847
Add : Depreciation	406	390	381	383	449	559
Interest	41	45	65	25	0	0
Less : Direct taxes	653	902	1,241	1,396	1,720	2,163
(Inc)/Dec in WC	-1,669	-355	-342	-400	-595	-1,387
CF from operations	-58	1,737	2,549	2,998	3,578	3,856
Extraordinary items	101	27	31	0	0	0
CF from opn. incl. EO items	44	1,764	2,579	2,998	3,578	3,856
(Inc)/Dec in FA	-406	-191	-556	-1,086	-2,104	-1,260
(Pur)/Sale of Investments	1,060	-423	-468	-822	-365	-1,215
CF from investments	653	-614	-1,024	-1,907	-2,469	-2,475
Inc/(Dec) in net worth	33	109	119	210	334	480
Inc/(Dec) in debt	169	-234	-170	-262	0	0
Inc/(Dec) in deferred tax liab.	-36	-56	-101	0	0	0
Less : Interest paid	41	45	65	25	0	0
Dividend paid	900	903	915	1,066	1,344	1,761
CF from fin. activity	-776	-1,129	-1,131	-1,143	-1,009	-1,281
Inc/Dec in cash	-79	21	425	-53	100	100
Add: Beginning balance	186	107	128	553	500	600
Closing balance	107	128	553	500	600	700

E: MOSt Estimates



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2. Group/Directors ownership of the stock
3. Broking relationship with company covered
4. Investment Banking relationship with company covered

Cummins India

No
No
No
No

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