



Cummins India

STOCK INFO.	BLOOMBERG
BSE SENSEX: 14,565	KKC IN
	REUTERS CODE
S&P CNX: 4,360	CUMM.BO

30 August 2008

Buy

Rs319

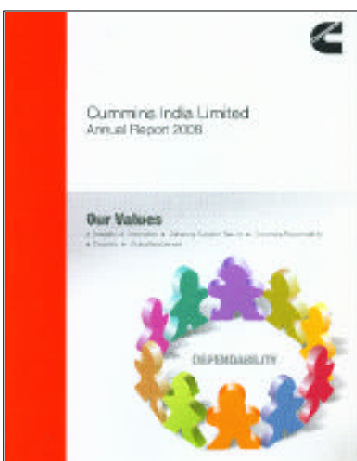
Previous Recommendation: Buy

Equity Shares (m)	198.0
52-Week Range	463 / 225
1, 6, 12 Rel. Perf. (%)	-5/-8/-23
M. Cap. (Rs b)	46.0
M. Cap. (US\$ b)	1.1

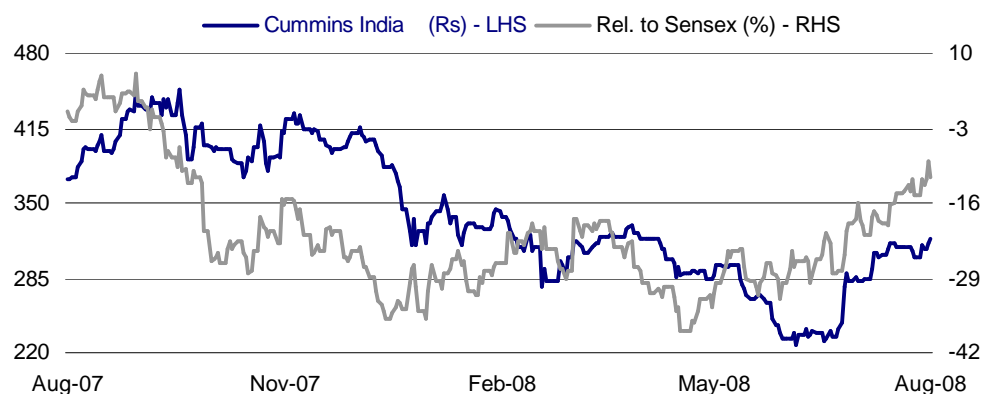
YEAR END	NET SALES (RS M)	EBITDA MARGIN %	PAT (RS M)	EPS (RS)	EPS YoY (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/SALES	EV/EBITDA
03/08A	26,555	14.1	3,249	16.4	21.2	19.4	5.1	28.8	34.9	1.9	13.1
03/09E	32,960	14.7	4,062	20.5	25.0	15.5	4.2	29.7	36.5	1.6	10.7
03/10E	40,552	15.0	5,123	25.9	26.1	12.3	3.4	30.6	38.1	1.2	8.3
03/11E	49,530	14.7	6,389	32.3	24.7	9.9	2.8	31.0	38.8	1.0	6.5

FY08 Annual Report Highlights

- Several positive statements:** Cummins FY08 Annual Report makes several positive statements on (1) its overall performance and prospects, (2) costs and cost management, (3) value system, (4) expansions and product launches, and (5) growth strategies.
- Share of affiliates continues to improve:** In FY08, share of profit from affiliates (Rs442m) continued to improve, accounting for 14% of consolidated PAT, up from 10% in FY07. Going forward, we expect share from affiliates to contribute 15-20% of consolidated PAT.
- Cummins cash flow position is comfortable:** As of March 2008, Cummins cash and cash equivalents stand at Rs4.4b. For FY08, Cummins declared dividend of 230% (Rs4.6 per share), translating into a dividend payout of 33% of profits. We believe Cummins has attained financial critical mass to be able to support its growth without recourse to external sources of capital.
- EPS CAGR of 25% through FY11E, target of Rs388; maintain Buy:** We factor in revenue CAGR of 23% and PAT and EPS CAGR of 25% through FY11E. We believe Cummins stock will enjoy premium valuation considering 25% EPS CAGR, coupled with 30% RoE, 33% dividend payout and zero debt-equity. We value the stock at 15x FY10E EPS to arrive at a target of Rs388, 22% upside from current levels. **Maintain Buy.**



STOCK PERFORMANCE (1 YEAR)



Several positive statements

Cummins India's FY08 Annual Report carries a letter to shareholders by its CMD, Anant Talaulicar, which makes several positive statements:

On overall performance in FY08 -

"I am pleased to note that the company has delivered on its commitments and remains positive about its prospects for the future".

"Our domestic business grew 30% to Rs16,069m, and exports grew 20% to Rs7,239m".

"Our exposure to any particular segment is limited, and the portfolio is fairly balanced. Specifically, in the domestic market, automotive grew 152%, industrial grew 27%, power generation grew 24%."

On costs and cost management -

"Pig iron, which is a basic constituent of the castings we use, increased 35% between April 2007 and March 2008, while steel increased at an average of 35% in the same time frame".

"The company incurred significant excess air freight costs of having to import components in a stretched supply chain to meet the very strong customer demand".

"We completed 88 Six Sigma projects, during the year, which resulted in annualized savings of Rs624m" (This figure is about 16% of FY08 standalone PBT).

On Cummins values

The CMD's letter refers to six values -

1. Integrity – Strive to do what is right and do what we say we will do
2. Innovation – Apply the creative ingenuity necessary to make us better, faster, first
3. Delivering Superior Results – Exceed expectations, consistently
4. Corporate Responsibility – Serve and improve the communities in which we live

5. Diversity – Embrace the diverse perspectives of all people and honour both with dignity and respect
6. Global involvement – Seek a world view and act without boundaries

On expansions and product launches -

At Kothrud: "The KV (38- and 50 liter engines) assembly and test facility within the original Kothrud campus, will now expand our production from 12 engines/day to 24 engines/day".

Small generators at Pirangut: "The power generation small generator facility in Pirangut, near Pune, will allow us to expand the output from approximately 12,000 units/year to 50,000 units/year".

Cummins megasite at Phaltan: "Going forward, we have not taken a very bold and long-term oriented step of acquiring about 150 acres in Phaltan, Maharashtra. All of the future group company manufacturing operations will be co-located on this Cummins Campus. We refer to this as our 'Megasite'. The ground breaking ceremony was held in January 2008 in the presence of the Cummins Inc Chairman and CEO, Tim Solso".

X3.3 gensets: "In January 2008, our Power Generation Business Unit launched a new line of generator sets, the X3.3, rated 30 to 38 kVA at 50 Hz and 27 to 35 kW at 60 Hz. ... The X series has generated tremendous excitement on the part of Cummins distributors in India, Africa, Europe, Asia, Latin America and the Middle East".

QSK23 engine: "Our Industrial Engine Business Unit introduced the QSK23 engine to India ... The compact design of this product saves crucial space for our customers, making it the preferred option for the construction, mining, IT/ITeS, manufacturing, commercial and realty sectors".

Natural gas engine: "In December 2007, Delhi Transport Corporation's (DTC)'s latest environment-friendly buses supplied by Tata Motors were fitted with our B Gas International (BGI) engine. This natural gas engine,

manufactured in our Daman facility, uses a highly clean and efficient lean burn combustion technology that is unique to India”.

On objectives and strategy –

“Going forward, we will continue with our objective to significantly increase our business profitably, while continuing to earn the respect of all our stakeholders including customers, channel partners, employees, shareholders, suppliers and community. Our four-fold strategy to achieve these objectives for the fourth successive year continues to be:

- ✍ Retain/grow domestic market share leadership
- ✍ Become a low cost producer in the segments in which we operate
- ✍ Grow exports
- ✍ Create a great place to work

After much hard work, we believe we now have earned the right to target to become a Zero Defect company. Zero Defect will be the measure of success that demonstrates our brand promise of DEPENDABILITY”.

Share of affiliates continues to improve

Cummins India’s affiliates are tabled below.

CUMMINS INDIA AFFILIATES

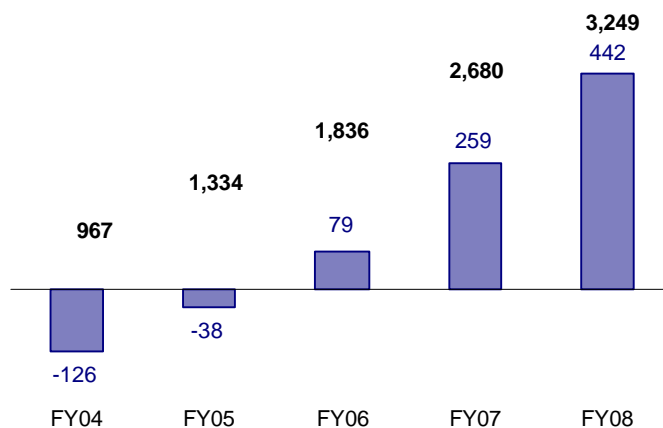
AFFILIATE	RELATIONSHIP	STAKE (%)
Cummins Sales & Service	Subsidiary	100
Cummins Auto Services	Subsidiary	100
Cummins Exhaust India	Joint Venture	50
Cummins Research & Tech.	Joint Venture	50
Valvoline Cummins	Associate	50
Cummins Generator Tech.	Associate	48.5

Note: From FY09, Cummins India is merging Cummins Sales & Service and Cummins Auto Services with itself.

Source: Company/Motilal Oswal Securities

In FY08, share of profit from affiliates continued to improve, accounting for 14% of consolidated PAT, up from 10% in FY07. Going forward, we expect share from affiliates to contribute 15-20% of consolidated PAT.

CUMMINS’ PROFITS FROM AFFILIATES IS RISING (RS M)

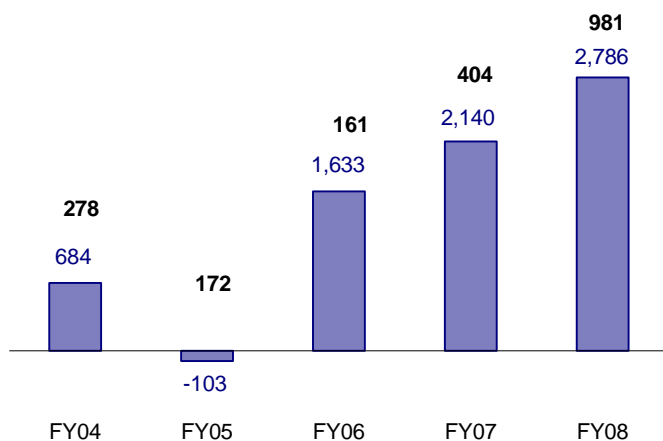


Note: Figures in bold are consolidated profit for the respective years
Source: Company/Motilal Oswal Securities

Cummins cash flow position is comfortable

Cummins is a zero net debt company. It enjoys positive cash flow from operations, which is significantly higher than its annual capex.

CUMMINS SHOWS HEALTHY OPERATING CASH FLOW (RS M)



Note: Figures in bold are capex for the respective years
Source: Company/Motilal Oswal Securities

As of March 2008, Cummins cash and cash equivalents stand at Rs4.4b. For FY08, Cummins declared dividend of 230% (Rs4.6 per share), translating into a dividend payout of 33% of profits.

We believe Cummins has attained financial critical mass to be able to support its growth without recourse to external sources of capital.

25% EPS CAGR through FY11E

For Cummins, we have factored in 23% CAGR in revenue through FY11, led by several mega trends which will drive engine demand -

- ✍ Rising need for backup power gensets
- ✍ Huge investment in construction and mining, requiring engines for equipment
- ✍ Rise in CNG usage in auto, leading to demand for CNG engines
- ✍ Improving profitability of Indian Railways, leading to higher capex including on auxiliary power engines
- ✍ Growing exports due to emergence of Cummins India as one of Cummins Inc's global sourcing hubs.

We expect Cummins to maintain margins through a combination of judicious price hikes and aggressive cost savings through Six Sigma, value engineering, ERP, etc. Thus, we expect PAT and EPS CAGR of 25% through FY11E.

Target of Rs388, maintain Buy

We believe Cummins stock will enjoy premium valuation considering steady 25% earnings growth, high RoE of around 30%, zero debt, and high dividend payout of 33%.

We value Cummins at 15x FY10E EPS of Rs25.9 to arrive at a target of Rs388, 22% upside from current levels. We maintain **Buy**.

INCOME STATEMENT		(Rs Million)				
Y/E MARCH	2007	2008	2009E	2010E	2011E	
Net Sales	21,228	26,555	32,960	40,552	49,530	
Change (%)	19.6	25.1	24.1	23.0	22.1	
Reported EBITDA	3,454	3,739	4,838	6,096	7,581	
Change (%)	36.6	8.2	29.4	26.0	24.4	
Margin (%)	16.3	14.1	14.7	15.0	15.3	
Operating Other Income	420	706	659	811	991	
EBITDA	3,875	4,445	5,497	6,907	8,572	
Change (%)	36.7	14.7	23.7	25.7	24.1	
EBITDA Margin (%)	18.3	16.7	16.7	17.0	17.3	
Depreciation	381	383	439	513	578	
EBIT	3,494	4,062	5,058	6,394	7,994	
Interest	65	25	14	0	0	
Financial Other income	257	350	478	597	747	
PBT & EO items	3,686	4,386	5,523	6,991	8,740	
Extraordinary items	31	0	0	0	0	
PBT	3,717	4,386	5,523	6,991	8,740	
Tax	1,241	1,396	1,746	2,211	2,762	
Tax / PBT (%)	33.4	31.8	31.6	31.6	31.6	
Profit excl. affiliates	2,476	2,990	3,777	4,780	5,978	
Change (%)	47.1	20.7	26.3	26.6	25.1	
PAT margin (%)	11.7	11.3	11.5	11.8	12.1	
Add: Share of affiliates	204	259	285	342	411	
Consolidated PAT	2,680	3,249	4,062	5,123	6,389	
Change (%)	45.9	21.2	25.0	26.1	24.7	

BALANCE SHEET		(Rs Million)				
Y/E MARCH	2007	2008	2009E	2010E	2011E	
Equity share capital	396	396	396	396	396	
Reserves	9,811	11,945	14,663	18,071	22,329	
Net Worth	10,207	12,341	15,059	18,467	22,725	
Loans	353	344	0	0	0	
Net deferred tax	-103	-151	-103	-103	-103	
Capital employed	10,457	12,534	14,956	18,365	22,622	
Gross fixed assets	5,659	6,673	7,964	8,964	9,964	
Less: Depreciation	3,898	4,236	4,593	4,929	5,255	
Net fixed assets	1,761	2,437	3,371	4,034	4,708	
Capital WIP	343	311	100	100	100	
Investments	3,191	4,867	4,100	5,336	7,190	
Curr. assets	10,149	12,125	15,320	18,469	22,111	
Inventory	3,418	3,799	4,876	6,045	7,381	
Debtors	4,463	5,813	7,731	9,512	11,618	
Cash & Bank	553	245	345	445	545	
Loans, Adv. & Others	1,715	2,267	2,367	2,467	2,567	
Current liab. & prov.	4,988	7,206	7,934	9,575	11,487	
Creditors	3,330	5,173	5,393	6,608	8,045	
Other Liabilities	398	515	249	269	289	
Provisions	1,260	1,518	2,292	2,699	3,154	
Net current assets	5,161	4,919	7,385	8,894	10,624	
Application of funds	10,457	12,534	14,956	18,365	22,622	

E: MOST Estimates

RATIOS						
Y/E MARCH	2007	2008E	2009E	2010E	2011E	
Basic (Rs)						
EPS	13.5	16.4	20.5	25.9	32.3	
Growth (%)	45.9	21.2	25.0	26.1	24.7	
Cash EPS	15.5	18.3	22.7	28.5	35.2	
Book value	51.5	62.3	76.1	93.3	114.8	
Divd. Per Share	4.0	4.6	5.8	7.4	9.2	
Payout (incl. Divd. Tax)	35.3	32.8	33.1	33.5	33.4	
Valuation (x)						
P/E		19.4	15.5	12.3	9.9	
Cash P/E		17.4	14.0	11.2	9.1	
Price/Book value		5.1	4.2	3.4	2.8	
EV/Sales		1.9	1.6	1.2	1.0	
EV/EBITDA		13.1	10.7	8.3	6.5	
Dividend yield (%)		1.4	1.8	2.3	2.9	
Profitability ratios (%)						
Average RoE	28.6	28.8	29.7	30.6	31.0	
Average RoCE	35.8	34.9	36.5	38.1	38.8	
Turnover ratios						
Debtors (days sales)	67	70	75	75	75	
Inventory (days sales)	59	52	54	54	54	
Creditor (days total exp)	68	83	70	70	70	
Asset turnover (x)	2.0	2.1	2.2	2.2	2.2	
Leverage ratio						
Debt/Equity (x)	0.0	0.0	0.0	0.0	0.0	

CASH FLOW STATEMENT		(Rs Million)				
Y/E MARCH	2007	2008E	2009E	2010E	2011E	
PBT before EO items	3,686	4,386	5,523	6,991	8,740	
Add : Depreciation	381	383	439	513	578	
Interest	65	25	14	0	0	
Less : Direct taxes	1,241	1,396	1,746	2,211	2,762	
(Inc)/Dec in WC	-434	-66	-2,367	-1,409	-1,630	
CF from operations	2,457	3,332	1,862	3,885	4,927	
Extraordinary items	31	0	0	0	0	
CF from opn. incl. EO	2,488	3,332	1,862	3,885	4,927	
(Inc)/Dec in FA	-556	-1,026	-1,161	-1,177	-1,252	
(Pur)/Sale of investment	-468	-1,676	767	-1,236	-1,854	
CF from investments	-1,024	-2,702	-394	-2,413	-3,106	
Inc/(Dec) in netw orth	119	210	285	389	550	
Inc/(Dec) in debt	-78	-9	-344	0	0	
Inc/(Dec) in deferred tax	-101	-48	48	0	0	
Less : Interest paid	65	25	14	0	0	
Dividend paid	915	1,066	1,344	1,761	2,270	
CF from fin. activity	-1,040	-938	-1,368	-1,372	-1,721	
Inc/Dec in cash	425	-308	100	100	100	
Add: Beginning balance	128	553	245	345	445	
Closing balance	553	245	345	445	545	



For more copies or other information, contact

Institutional: Navin Agarwal. **Retail:** Manish Shah

Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: inquire@motilaloswal.com

Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021

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Cummins India

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|---|----|
| 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 |

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