

CUMMINS INDIA

INR 268

Changing gears

BUY



Cummins India's (CIL) Q2FY07 results were in line with our expectations in terms of revenue growth and above our expectations in terms of profitability. Revenue grew by 30% Y-o-Y to INR 4.6 bn in the backdrop of an encouraging demand scenario. EBITDA margin expanded by an impressive 500bps Y-o-Y and 100bps Q-o-Q to 16.8% in the quarter on account of better product mix and positive impact of cost reduction initiatives. Consequently, EBITDA grew by 86% Y-o-Y and net profit grew by 66% Y-o-Y to INR 786 mn and INR 627 mn, respectively, in Q2FY07. CIL continues to post superior margins compared to its peers on account of wider product portfolio and a more profitable product mix. We believe the macro environment continues to remain favorable for CIL with the capex cycle momentum being strong in the medium term.

* **Margins to stabilize at lower levels**

CIL posted EBITDA margin of 16.8% for Q2FY07 compared to 11.8% in Q2FY06 and 15.8% in Q1FY07. This was primarily because of higher heavy engine contribution in the product mix and positive impact of cost reduction initiatives. CIL plans to grow more aggressively in the small engine segment (below 300 HP) and it has completed the acquisition of land for a manufacturing facility for below 300 HP engines. We believe this will result in lowering the margin in the medium-to-long term from the current high level of 16.8% for Q2FY07. We expect CIL to post EBITDA margin of ~15% in FY07E and FY08E.

* **Exports slightly muted, though no long term risks to our estimates**

Exports grew 4% Y-o-Y to INR 1.4 bn compared to a 30% growth in net revenue. This was primarily because of more stringent emission norms coming into enforcement in some of the target countries. However, we do not believe this poses a major risk to CIL's export portfolio as it continues to show strong growth in heavy duty engines.

* **Outlook and valuations**

On our current EPS estimates of INR 11.6 and INR 15.7, the stock trades at 23x and 17x FY07E and FY08E earnings, respectively. We expect a revenue growth of ~30% over the next two years with potential of positive surprises. We believe that the revenue growth is likely to be primarily driven by a wider product portfolio. CIL's valuations are attractive with respect to its return metric and vis-à-vis mid-sized capital goods and engineering companies. We favor CIL's central position in the capex cycle, strong growth story, improving profitability, and relatively attractive valuations, and reiterate our 'BUY' recommendation.

Financials

Year to March	Q2FY07	Q2FY06	% change	Q1FY07	% change	FY06	FY07E
Revenues (INR mn)	4,674	3,573	30.8	3,914	19.4	17,751	22,146
EBITDA (INR mn)	786	422	86.2	619	27.0	2,543	3,332
Net profit (INR mn)	627	378	66.1	501	25.1	1,836	2,304
EPS (INR)	3	2	66.1	3	23.5	9	12
PE (x)						28.8	23.0
EV/EBITDA (x)						19.9	15.2
ROAE (%)						22.8	25.5

October 31, 2006

Priyanko Panja
+91-22-2286 4300
priyanko.panja@edelcap.com

Misal Singh
+91-22-2286 4316
misal,singh@edelcap.com

Reuters : CUMM.BO
Bloomberg : KKC IN

Market Data

52-week range (INR) : 269 / 138
Share in issue (mn) : 198.0
M cap (INR bn/USD mn) : 53.1 / 1,180.0
Avg. Daily Vol. BSE ('000) : 980.2

Share Holding Pattern (%)

Promoters : 51.0
MFs, FIs & Banks : 18.0
FIs : 16.0
Others : 15.0

Financials snapshot						(INR mn)		
Year to March	Q2FY07	Q2FY06	% change	Q1FY07	% change	FY06	FY07E	FY08E
Revenues (net)	4,674	3,573	30.8	3,914	19.4	17,751	22,146	29,050
Raw material	3,055	2,404	27.0	2,519	21.3	11,729	14,263	18,747
Staff cost	287	285	0.7	270	6.2	1,395	1,772	2,270
Other operating expenses	547	462	18.5	507	7.9	2,084	2,779	3,631
Total expenditure	3,888	3,151	23.4	3,295	18.0	15,208	18,814	24,649
EBITDA	786	422	86.2	619	27.0	2,543	3,332	4,401
Depreciation	94	83	13.1	81	16.0	400	444	502
EBIT	692	339	104.2	538	28.6	2,143	2,888	3,899
Interest	0	2	(74.2)	0	(8.5)	45	46	53
Other income	195	216	(9.7)	163	19.8	645	650	762
Extraordinary items	-	-	NM	7	-	5	-	-
PBT	886	553	60.3	693	27.8	2,738	3,492	4,608
Tax	259	175	47.7	192	34.8	902	1,188	1,497
Adjusted net profit	627	378	66.1	501	25.1	1,836	2,304	3,112
Reported net profit	627	378	66.1	508	23.5	1,841	2,304	3,112
Equity capital(FV:INR2)	396	396	-	396	-	396	396	396
# of shares (mn)	198	198	-	198	-	198	198	198
EPS (INR)	3.2	1.9	66.1	3	23.5	9.3	11.6	15.7
Market cap. (INR mn)						53,064	53,064	53,064
PE (x)						28.8	23.0	17.1
EV/EBITDA (x)						19.9	15.2	11.6
Market cap / Revenues (x)						3.0	2.4	1.8
as % of net revenues								
Raw material	65.3	67.3	(2.9)	64.3	1.6	66.1	64.4	64.5
Other operating expenses	11.7	12.9	(9.5)	12.9	(9.6)	11.7	12.6	12.5
EBITDA	16.8	11.8	42.4	15.8	6.3	14.3	15.0	15.1
Adjusted net profit	13.4	10.6	26.9	12.8	4.8	10.3	10.4	10.7
Tax rate	29.2	31.7	(7.8)	27.7	5.5	32.9	34.0	32.5

Financial Statements

Income statement					(INR mn)
Year to March	FY04	FY05	FY06	FY07E	FY08E
Income from operations	11,778	14,711	17,751	22,146	29,050
Direct costs	7,790	9,908	11,729	14,263	18,747
Employee costs	1,305	1,157	1,395	1,772	2,270
Other expenses	1,420	1,852	2,084	2,779	3,631
Total operating expenses	10,515	12,917	15,208	18,814	24,649
EBITDA	1,263	1,794	2,543	3,332	4,401
Depreciation and amortisation	347	414	400	444	502
EBIT	916	1,380	2,143	2,888	3,899
Interest expenses	44	41	45	46	53
Other Income	613	671	645	650	762
Profit before tax	1,484	2,010	2,743	3,492	4,608
Provision for tax	412	653	902	1,188	1,497
Extraordinary items	106	23	5	-	-
Reported profit	967	1,334	1,836	2,304	3,112
Adjusted net profit	1,072	1,357	1,841	2,304	3,112
Shares outstanding	198	198	198	198	198
Dividend per share	4.0	4.0	4.0	5.3	5.5
Dividend payout %	73.9	58.4	43.0	45.8	34.7

Common size metrics- as % of net revenues

Year to March	FY04	FY05	FY06	FY07E	FY08E
Operating expenses	89.3	87.8	85.7	85.0	84.9
Depreciation	2.9	2.8	2.3	2.0	1.7
Interest expenditure	0.4	0.3	0.3	0.2	0.2
EBITDA margins	10.7	12.2	14.3	15.0	15.1
Net profit margins (adjusted)	9.1	9.2	10.4	10.4	10.7

Growth metrics (%)

Year to March	FY04	FY05	FY06	FY07E	FY08E
Revenues	10.8	24.9	20.7	24.8	31.2
EBITDA	(0.5)	42.0	41.7	31.0	32.1
PBT	14.2	35.4	36.5	27.3	32.0
Net profit	20.4	26.5	35.7	25.1	35.1
EPS	20.6	26.5	35.7	25.1	35.1

Cash flow statement					(INR mn)
Year to March	FY04	FY05	FY06	FY07E	FY08E
Net profit	967	1,334	1,836	2,304	3,112
Add: Depreciation	347	414	400	444	502
Add: E.O.adjustments	106	23	5	-	-
Gross Cash Flow	1,420	1,771	2,241	2,748	3,613
Less: Dividends	935	935	947	1,266	1,297
Less: Changes in W. C.		1,645	322	972	1,608
Operating cash flow	484	(809)	972	510	708
Less: Change in investments		(1,057)	419	(9)	-
Less: Capex	-	515	160	664	871
Free cash flow	484	(268)	393	(145)	(164)

Balance sheet					(INR mn)
As on 31st March	FY04	FY05	FY06	FY07E	FY08E
Equity capital	396	396	396	396	396
Reserves & surplus	6,843	7,241	8,130	9,168	10,984
Shareholders funds	7,239	7,637	8,526	9,564	11,380
Secured loans	232	340	108	740	940
Unsecured loans	264	325	323	325	325
Borrowings	497	665	431	1,065	1,265
Sources of funds	7,735	8,302	8,958	10,630	12,645
Gross block	5,256	5,425	5,589	6,253	7,125
Accumulated depreciation	3,137	3,309	3,669	4,113	4,614
Net block	2,119	2,116	1,920	2,141	2,511
Total fixed assets	2,119	2,116	1,920	2,141	2,511
Investments	3,370.5	2,313.9	2,732.9	2,723.5	2,723.5
Inventories	2,112	2,806	2,784	3,458	4,537
Sundry debtors	2,578	3,363	4,054	5,036	6,606
Cash and equivalents	186	107	128	617	655
Loans and advances	644	1,164	1,348	1,335	1,751
Other current assets	85	94	101	61	80
Total current assets	5,605	7,534	8,415	10,506	13,627
Sundry creditors and others	2,352	2,600	3,081	3,458	4,537
Provisions	848	964	1,021	1,274	1,671
Total CL & provisions	3,200	3,564	4,102	4,732	6,207
Net current assets	2,405	3,970	4,313	5,774	7,420
Add / (Less) : deferred tax asset/ liability	(91)	(55)	1	1	1
Others	(68)	(43)	(10)	(10)	(10)
Uses of funds	7,735	8,302	8,958	10,630	12,645
Book value per share (BV)	37	39	43	48	57

Ratios

Year to March	FY04	FY05	FY06	FY07E	FY08E
ROAE (%)	24.6	18.2	22.8	25.5	29.7
ROACE (%)	19.9	17.2	24.8	29.5	33.5
Current ratio	1.8	2.1	2.1	2.2	2.2
Debtors (days)	80	83	83	83	83
Fixed assets t/o (x)	5.0	6.1	7.9	8.8	9.8
Average working capital t/o (x)	7.8	4.6	4.3	4.4	4.4
Gross Debt/Equity	0.1	0.1	0.1	0.1	0.1

Valuations parameters

Year to March	FY04	FY05	FY06	FY07E	FY08E
EPS (INR)	5.4	6.9	9.3	11.6	15.7
Y-o-Y growth (%)	20.6	26.5	35.7	25.1	35.1
CEPS (INR)	7.2	8.9	11.3	13.9	18.2
PE (x)	49.5	39.1	28.8	23.0	17.1
Price/BV(x)	7.3	6.9	6.2	5.5	4.7
EV/Sales (x)	4.2	3.5	2.9	2.3	1.8
EV/EBITDA (x)	39.6	28.6	19.9	15.2	11.6

Edelweiss Securities

14th Floor, Express Towers,
Nariman Point, Mumbai – 400 021
Board: (91-22) 2286 4400
Email: research@edelcap.com



Naresh Kothari – 2286 4246

Head, Institutional Equities

Vikas Khemani – 2286 4206

Co-Head, Institutional Equities

INDIA RESEARCH	SECTOR	INSTITUTIONAL SALES
Shriram Iyer - 2286 4256	Head – Research	Nischal Maheshwari - 2286 4205
Gautam Roy - 2286 4305	Airlines, Textile	Rajesh Makharia - 2286 4202
Ashutosh Goel - 2286 4287	Automobiles, Auto Components	Shabnam Kapur - 2286 4394
Vishal Goyal - 2286 4370	Banking & Finance	Ashish Maheshwari - 2286 4418
Revathi Myneni - 2286 4413	Cement	Amish Choksi - 2286 4201
Sumeet Budhraj - 2286 4430	FMCG	Deepak Rao - 2286 4204
Harish Sharma - 2286 4307	Infrastructure, Auto Components, Mid Caps	Balakumar V - (044) 4263 8283
Priyanko Panja - 2286 4300	Infrastructure, Engineering, Telecom	Monil Bhala - 2286 4363
Hitesh Zaveri - 2286 4424	Information Technology	Ashish Agrawal - 2286 4301
Pritesh Vinay - 2286 4429	Metals, Mining	Nikhil Garg - 2286 4282
Priyank Singhal - 2286 4302	Media, Retail	Neha Shahra - 2286 4276
Prakash Kapadia - 2286 4432	Mid Caps	Priya Ramchandran - 2286 4389
Niraj Mansingka - 2286 4304	Oil & Gas, Petrochemicals	Anubhav Kanodia - 2286 4361
Nimish Mehta - 2286 4295	Pharmaceuticals, Agrochemicals	Tushar Mahajan - 2286 4439
Swati Khemani - 2286 4266	Textile	Harsh Biyani - 2286 4419
Manika Prem Singh - 4019 4847	Economist	Nirmal Ajmera - 2286 4258
Sachin Arora - 2286 4512	Alternative & Quantitative	Ankit Doshi - 2286 4671
Sunil Jain - 2286 4308	Alternative & Quantitative	Ravi Pilani - 4009 4533
Yogesh Radke - 2286 4328	Alternative & Quantitative	Dipesh Shah - 2286 4434

Email addresses: firstname.lastname@edelcap.com

e.g. naresh.kothari@edelcap.com

unless otherwise specified

RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	Reduce	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	Sell	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period	Trading Sell	Expected to depreciate more than 10% over a 45-day period

This document has been prepared by Edelweiss Securities Private Limited (Edelweiss). Edelweiss and its holding company and associate companies are a full service, integrated investment banking, portfolio management and brokerage group. Our research analysts and sales persons provide important input into our investment banking activities. This document does not constitute an offer or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. The information contained herein is from publicly available data or other sources believed to be reliable, but we do not represent that it is accurate or complete and it should not be relied on as such. Edelweiss or any of its affiliates 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. This document is provided for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigation as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult his own advisors to determine the merits and risks of such investment. The investment discussed or views expressed may not be suitable for all investors. We and our affiliates, officers, directors, and employees may: (a) from time to time, have long or short positions in, and buy or sell the securities thereof, of company (ies) mentioned herein or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as advisor or lender / borrower to such company (ies) or have other potential conflict of interest with respect to any recommendation and related information and opinions. This information is strictly confidential and is being furnished to you solely for your information. This information should not be reproduced or redistributed or passed on directly or indirectly in any form to any other person or published, copied, in whole or in part, for any purpose. This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject Edelweiss and affiliates to any registration or licensing requirements within such jurisdiction. The distribution of this document in certain jurisdictions may be restricted by law, and persons in whose possession this document comes, should inform themselves about and observe, any such restrictions. The information given in this document is as of the date of this report and there can be no assurance that future results or events will be consistent with this information. This information is subject to change without any prior notice. Edelweiss reserves the right to make modifications and alterations to this statement as may be required from time to time. However, Edelweiss is under no obligation to update or keep the information current. Nevertheless, Edelweiss is committed to providing independent and transparent recommendation to its client and would be happy to provide any information in response to specific client queries. Neither Edelweiss nor any of its affiliates, directors, employees, agents or representatives shall be liable for any damages whether direct, indirect, special or consequential including lost revenue or lost profits that may arise from or in connection with the use of the information. The analyst for this report certifies that all of the views expressed in this report accurately reflect his or her personal views about the subject company or companies and its or their securities, and no part of his or her compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this report. Analyst holding in stock: ves/no.