

Equities

10 February 2012 | 13 pages

Cummins India (CUMM.BO)

Upgrade To Buy – All Set For A Business Rebound

- Company Update
- Rating Change
- Target Price Change
- Estimate Change

■ **Upgrade to Buy (from Sell), target price increases to Rs486** — We increase our target price to Rs486 (from Rs334 earlier) to factor in: (1) 4-8% upward EPS revision (2) increase in target P/E multiple to 20x (from 15x) and (3) roll forward of target P/E to Jun13E (Mar13E). Our target P/E multiple is well supported by 19% EPS growth over FY12E-14E and average RoEs of 30%+. The high P/E multiple is well supported by (1) solid high RoE business (2) generating steady operating cash flows (3) higher than industry dividends (4) a strong management team and (5) dominant market share. CIL is one our top industrial picks along with Havells.

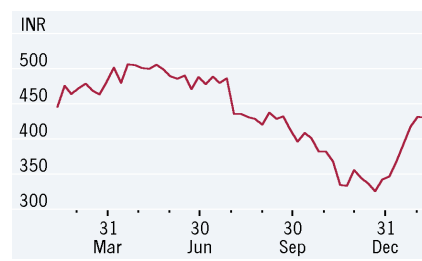
■ **PAT 14% ahead of expectations** — CIL's 3Q12 PAT at Rs1.4bn +2% YoY and 10% QoQ was 14% ahead of CIRA expectations of Rs1.2bn. This is primarily on account of (1) EBITDA margins expanding 24bps YoY (v/s CIRA at 111bps margin contraction) (2) higher other income/ other operational income and (3) lower effective rates.

■ **Business bottomed out in 2Q12/3Q12 – All set for a rebound in FY13E** — EBITDA margins contracted from 19.7% in 1Q11 all the way to 14.5% in 2Q12. With a sequential improvement in 3Q12 to 15.4% (on better export realizations and improved product mix), we believe margins might have bottomed out. Though domestic sales declined 9% YoY in 3Q12 (reductions in power generation/ auto), our conversation with the management post results suggest (1) new order intake has already started to improve from Jan12 and (2) management expects sales growth of 12-15% in FY13E.

■ **What would drive growth over FY13E/14E?** — We believe RBI starting the rate cut cycle over the next 3-6 months could have a strong +ve impact on the business. Further, continuing power deficits in the country on account of severe coal deficits are another contributing factor for growth. Last but not the least, CPCB Stage 2 norms might become effective in June-July 2013 (FY14E) which would lead to consolidation in the industry bringing down the number of competitors from 15-20 to < 10 given that most of the unorganized sector is not prepared for this change.

Buy	1
<i>from Sell</i>	
Price (09 Feb 12)	Rs431.65
Target price	Rs486.00
<i>from Rs334.00</i>	
Expected share price return	12.6%
Expected dividend yield	2.7%
Expected total return	15.3%
Market Cap	Rs119,653M US\$2,438M

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



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2010A	4,439	16.01	6.6	27.0	7.7	30.0	2.0
2011A	5,877	21.20	32.4	20.4	6.6	34.9	2.5
2012E	5,449	19.66	-7.3	22.0	5.9	28.4	2.7
2013E	6,468	23.33	18.7	18.5	5.3	30.2	3.0
2014E	7,694	27.76	18.9	15.6	4.7	32.2	3.6

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Cummins India (CUMM.BO)
10 February 2012

CUMM.BO: Fiscal year end 31-Mar						Price: Rs431.65; TP: Rs486.00; Market Cap: Rs119,653m; Recomm: Buy					
Profit & Loss (Rsm)	2010	2011	2012E	2013E	2014E	Valuation ratios	2010	2011	2012E	2013E	2014E
Sales revenue	28,449	39,454	41,023	47,176	54,759	PE (x)	27.0	20.4	22.0	18.5	15.6
Cost of sales	-18,552	-25,804	-26,761	-30,759	-35,703	PB (x)	7.7	6.6	5.9	5.3	4.7
Gross profit	9,897	13,651	14,261	16,417	19,056	EV/EBITDA (x)	21.9	17.3	18.7	15.9	13.2
Gross Margin (%)	34.8	34.6	34.8	34.8	34.8	FCF yield (%)	5.4	3.1	3.3	3.7	4.5
EBITDA	5,275	6,635	6,124	7,237	8,686	Dividend yield (%)	2.0	2.5	2.7	3.0	3.6
EBITDA Margin (%)	18.5	16.8	14.9	15.3	15.9	Payout ratio (%)	54	51	59	56	56
Depreciation	-361	-366	-408	-493	-579	ROE (%)	30.0	35.1	30.9	30.2	32.2
Amortisation	0	0	0	0	0	Cashflow (Rsm)	2010	2011	2012E	2013E	2014E
EBIT	4,914	6,268	5,715	6,743	8,107	EBITDA	5,275	6,635	6,124	7,237	8,686
EBIT Margin (%)	17.3	15.9	13.9	14.3	14.8	Working capital	2,238	-1,054	86	-48	-357
Net interest	-21	-19	-16	-16	-16	Other	-415	-376	197	-275	-413
Associates	0	0	0	0	0	Operating cashflow	7,098	5,205	6,406	6,913	7,915
Non-op/Except	1,216	1,774	1,962	2,256	2,595	Capex	-607	-1,440	-2,500	-2,500	-2,500
Pre-tax profit	6,109	8,024	7,661	8,984	10,686	Net acq/disposals	0	0	0	0	0
Tax	-1,670	-2,147	-2,212	-2,515	-2,992	Other	-3,337	75	0	0	0
Extraord./Min.Int./Pref.div.	0	33	463	0	0	Investing cashflow	-3,944	-1,366	-2,500	-2,500	-2,500
Reported net profit	4,439	5,910	5,912	6,468	7,694	Dividends paid	-2,775	-3,457	-3,717	-4,202	-5,010
Net Margin (%)	15.6	15.0	14.4	13.7	14.1	Financing cashflow	-2,918	-3,361	-3,717	-4,202	-5,010
Core NPAT	4,439	5,877	5,449	6,468	7,694	Net change in cash	236	478	189	211	406
Per share data	2010	2011	2012E	2013E	2014E	Free cashflow to s/holders	6,491	3,764	3,906	4,413	5,415
Reported EPS (Rs)	16.01	21.32	21.33	23.33	27.76						
Core EPS (Rs)	16.01	21.20	19.66	23.33	27.76						
DPS (Rs)	8.57	10.71	11.50	13.00	15.50						
CFPS (Rs)	25.61	18.78	23.11	24.94	28.56						
FCFPS (Rs)	23.41	13.58	14.09	15.92	19.54						
BVPS (Rs)	56.31	65.16	73.08	81.26	90.94						
Wtd avg ord shares (m)	277	277	277	277	277						
Wtd avg diluted shares (m)	277	277	277	277	277						
Growth rates	2010	2011	2012E	2013E	2014E						
Sales revenue (%)	-13.9	38.7	4.0	15.0	16.1						
EBIT (%)	13.8	27.6	-8.8	18.0	20.2						
Core NPAT (%)	6.6	32.4	-7.3	18.7	18.9						
Core EPS (%)	6.6	32.4	-7.3	18.7	18.9						
Balance Sheet (Rsm)	2010	2011	2012E	2013E	2014E						
Cash & cash equiv.	559	1,037	1,226	1,438	1,843						
Accounts receivables	5,229	7,182	7,467	8,158	9,469						
Inventory	4,097	5,190	5,382	5,877	6,822						
Net fixed & other tangibles	3,337	4,411	6,503	8,509	10,431						
Goodwill & intangibles	0	0	0	0	0						
Financial & other assets	10,287	10,838	10,838	11,212	11,212						
Total assets	23,508	28,657	31,415	35,193	39,776						
Accounts payable	3,768	6,129	6,356	7,306	8,480						
Short-term debt	0	0	0	0	0						
Long-term debt	86	183	183	183	183						
Provisions & other liab	4,044	4,282	4,619	5,180	5,905						
Total liabilities	7,898	10,594	11,157	12,669	14,568						
Shareholders' equity	15,610	18,063	20,258	22,524	25,209						
Minority interests	0	0	0	0	0						
Total equity	15,610	18,063	20,258	22,524	25,209						
Net debt	-473	-855	-1,044	-1,255	-1,661						
Net debt to equity (%)	-3.0	-4.7	-5.2	-5.6	-6.6						

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Figure 1. CIL 3QFY12 Results Review

Year End Mar31 (Rsmn)	1QFY11	2QFY11	3QFY11	4QFY11	FY11	1QFY12	2QFY12	3QFY12
Net sales	9,100	10,675	9,584	10,096	39,454	10,219	10,698	9,705
<i>Growth</i>	45.4%	73.2%	17.6%	30.7%	39.4%	12.3%	0.2%	1.3%
Exports	2,155	2,760	2,650	2,686	10,250	2,719	3,179	2,900
<i>YoY</i>						26%	15%	9%
Domestic	6,945	7,915	6,934	7,410	29,204	7,501	7,519	6,805
<i>YoY</i>						8%	-5%	-9%
Raw materials	(5,726)	(6,928)	(6,367)	(6,782)	(25,804)	(6,713)	(7,158)	(6,130)
% of net sales	62.9%	64.9%	66.4%	67.2%	65.4%	65.7%	66.9%	63.2%
Gross Margins	37.1%	35.1%	33.6%	32.8%	34.6%	34.3%	33.1%	36.8%
Employee Cost	(530)	(672)	(643)	(701)	(2,546)	(698)	(750)	(782)
% of net sales	5.8%	6.3%	6.7%	6.9%	6.5%	6.8%	7.0%	8.1%
Other expenditure	(1,049)	(1,141)	(1,119)	(1,161)	(4,470)	(1,186)	(1,236)	(1,297)
% of net sales	11.5%	10.7%	11.7%	11.5%	11.3%	11.6%	11.5%	13.4%
EBITDA	1,796	1,933	1,455	1,451	6,635	1,623	1,554	1,496
Margins	19.7%	18.1%	15.2%	14.4%	16.8%	15.9%	14.5%	15.4%
<i>Growth</i>	73.2%	89.4%	-17.7%	0%	25.8%	-10%	-20%	3%
Depreciation	(93)	(93)	(91)	(89)	(366)	(94)	(98)	(109)
EBIT	1,702	1,840	1,364	1,362	6,268	1,529	1,456	1,387
Margins	18.7%	17.2%	14.2%	13.5%	15.9%	15.0%	13.6%	14.3%
Interest	(4)	(4)	(3)	(8)	(19)	(4)	(5)	(3)
Other Income	97	205	103	213	617	159	163	269
Other Operating Income	179	239	342	397	1,157	234	205	293
PBT	1,974	2,281	1,805	1,964	8,024	1,918	1,819	1,945
Margins	21.7%	21.4%	18.8%	19.5%	20.3%	18.8%	17.0%	20.0%
Tax	(572)	(602)	(416)	(557)	(2,147)	(609)	(534)	(536)
Rate %	29.0%	26.4%	23.0%	28.4%	26.8%	31.8%	29.3%	27.5%
Recurring PAT	1,402	1,679	1,389	1,407	5,877	1,309	1,286	1,410
Margins	15.4%	15.7%	14.5%	13.9%	14.9%	12.8%	12.0%	14.5%
<i>Growth</i>						-6.7%	-23.4%	1.5%
Exceptional	0	0	0	33	33	515	0	0
Tax Adjustment	0	0	0	0	0	(51)	0	0
Reported PAT	1,402	1,679	1,389	1,440	5,910	1,772	1,286	1,410

Source: Company and Citi Investment Research and Analysis

Figure 2. CIL EPS Revision Table

Year End Mar31 (Rsmn)	FY12E	FY13E	FY14E
Net Sales			
New	41,023	47,176	54,759
Old	41,940	48,231	56,023
Change	-2.2%	-2.2%	-2.3%
EBITDA Margins			
New	14.9%	15.3%	15.9%
Old	14.5%	15.5%	16.2%
Change	41	-16	-30
PAT			
New	5,449	6,468	7,694
Old	5,031	6,176	7,421
Change	8.3%	4.7%	3.7%
EPS			
New	19.7	23.3	27.8
Old	18.1	22.3	26.8
Change	8.3%	4.7%	3.7%

Source: Citi Investment Research and Analysis estimates

Quants View – Unattractive

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Data as of: 03-Feb-12

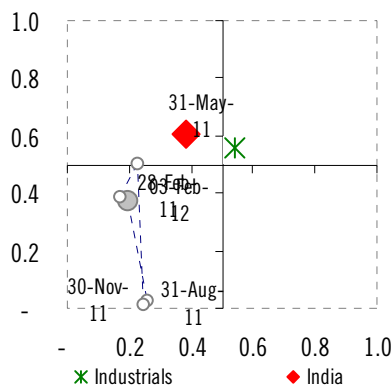
Radar Screen Quadrant Definitions

Glamor <i>Poor relative value but superior relative momentum</i>	Attractive <i>Superior relative value and superior relative momentum</i>
Unattractive <i>Poor relative value and poor relative momentum</i>	Contrarian <i>Superior relative value but poor relative momentum</i>

Cummins India currently lies in the Unattractive quadrant of our Value-Momentum map with weak momentum and weak value scores. It has been a resident there since the past 5 months. Compared to its peers in the Industrials sector, Cummins India fares worse on the valuation metric and on the momentum metric. Similarly, compared to its peers in its home market of India, Cummins India fares worse on the valuation metric and on the momentum metric.

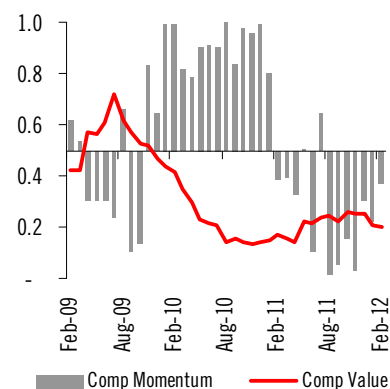
From a macro perspective, Cummins India has a low Beta to the region, so can be expected to hold its own given a decline in the regional market. It is also likely to benefit from falling Commodity (ex-oil) prices, falling EM yields, and a weaker US Dollar.

Figure 3. Radar Quadrant Chart History



Source: CIRA

Figure 4. Radar Valuation and Momentum Scores



Source: CIRA

Figure 5. Radar Model Inputs

IBES EPS (Actual and Estimates)			
FY(-2)	16.70	Implied Trend Growth (%)	7.62
FY(-1)	16.01	Trailing PE (x)	20.73
FY0	21.32	Implied Cost of Debt (%)	8.82
FY1	19.46	Standardised MCap	(0.14)
FY2	22.27		

Note: Standardised MCap calculated as a Z score – (mkt cap - mean)/std dev – capped at 3

Source: Citi Investment Research and Analysis, Worldscope, I/B/E/S

Figure 6. Stock Performance Sensitivity to Key Macro Factors

Region	0.52	Commodity ex Oil	(0.37)
Local Market	0.33	Rising Oil Prices	(0.03)
Sector	0.61	Rising Asian IR's	0.11
Growth Outperforms Value	(0.81)	Rising EM Yields	(0.50)
Small Caps Outperform Large Caps	1.17	Weaker US\$ (vs Asia)	1.01
Widening US Credit Spreads	(0.13)	Weaker ¥ (vs US\$)	0.33

Source: Citi Investment Research and Analysis

Cummins India

Company description

Cummins India Limited (CIL) is a 51% subsidiary of Cummins Inc., USA, the world's largest independent diesel engine designer and manufacturer above 200 HP. Set up in 1962, CIL is India's leading manufacturer of diesel engines with a range from 205 HP to 2365 HP and value packages serving the power generation, industrial and automotive markets. CIL also caters to the growing market for gas and dual fuel engines.

Investment strategy

We rate Cummins India as Buy. We believe RBI starting the rate cut cycle over the next 3-6 months could have a strong +ve impact on the business. Further continuing power deficits in the country on account of severe coal deficits are another contributing factor for growth. Last but not the least, CPCB Stage 2 norms might become effective in June-July 2013 (FY14E), which would lead to consolidation in the industry bringing down the number of competitors from 15-20 to <10 given that most of the unorganized sector is not prepared for this.

Valuation

Our target price of Rs486 on CIL is based on a target P/E multiple of 20x Jun13E, set closer to the higher end of the P/E band of 7x to 26x. We believe our target P/E multiple is well supported by EPS CAGR of 19% over FY12-14E with average RoEs of ~ 30%+.

Risks

Key downside risks to our target price include: (1) Price competition from unorganized segments; (2) Low-cost imports from China; (3) High diesel prices; (4) Alternative backup power sources like UPS and inverters; and (5) INR appreciation.

Havells India

(HVEL.BO; Rs486.00; 1)

Valuation

Our target price of Rs554 is based on a sum-of-the-parts approach. We value the India business at Rs520 and Sylvania at Rs34. The parent business is valued at 18x March13 P/E, at a premium to its historical average of 14x to reflect buoyant demand and strong business traction in India. The 18x P/E is supported by a ~21% EPS CAGR over FY11-14E and ~21% average RoE. P/E is generally used to value branded consumer and capital goods companies, segments in which Havells operates. We value Sylvania on 5x March 13E EV/EBITDA. Despite recovery in operations and profitability, PAT is expected to remain depressed due to high depreciation and interest costs and thus we prefer to use EV/EBITDA. We conservatively use 5x, derived from a comps analysis and taking the European risks into consideration.

At our TP of Rs554, Havells will trade at consolidated P/E of ~16x on FY13 EPS with FY11-14 EPS CAGR of 19%.

Risks

Downside risks to our target price include poorer performance from Sylvania, higher commodity prices, unsuccessful new-product launches, increase in competitive intensity and demand slowdown in India.

Appendix A-1 Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

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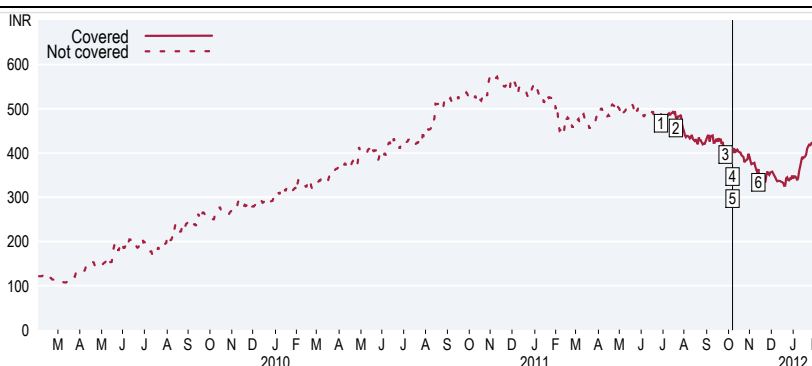
Cummins India (CUMM.BO)

Ratings and Target Price History

Fundamental Research

Analyst: Venkatesh Balasubramaniam

Covered since June 29 2011



	Date	Rating	Target Price	Closing Price
1	29-Jun-11	*3L	*486.43	488.11
2	20-Jul-11	3L	*488.57	479.82

* Indicates change

	Date	Rating	Target Price	Closing Price
3	28-Sep-11	3L	*387.00	412.95
4	7-Oct-11	Stock rating system changed		

	Date	Rating	Target Price	Closing Price
5	7-Oct-11	*3	387.00	406.25
6	13-Nov-11	3	*334.00	355.05

Rating/target price changes above reflect Eastern Standard Time

Cummins India (CUMM.BO)

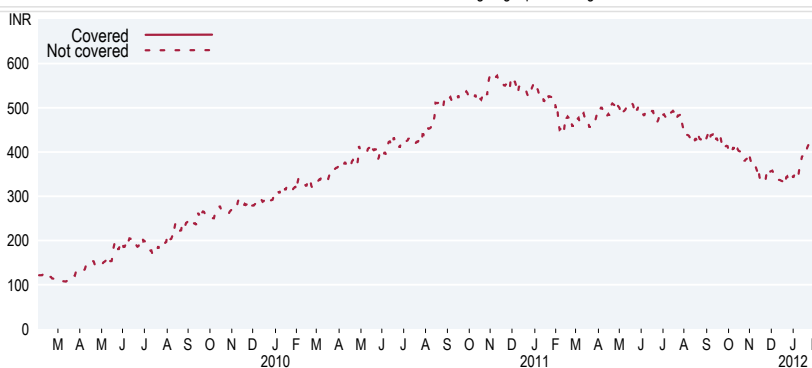
Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Venkatesh Balasubramaniam

Covered since June 29 2011

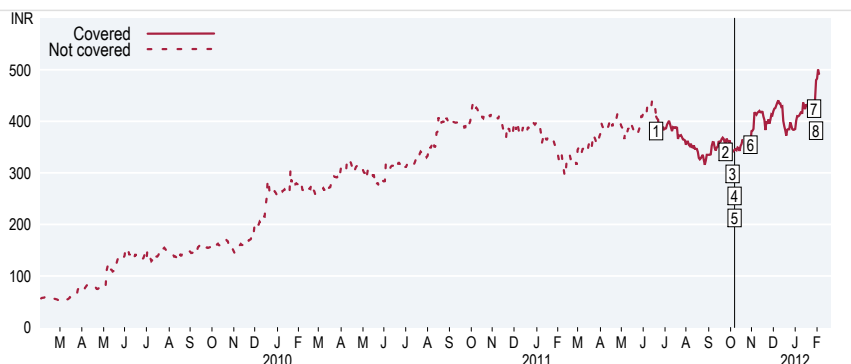


* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Havells India (HVEL.BO)
Ratings and Target Price History
Fundamental Research

Analyst: Atul Tiwari, CFA
Covered since June 20 2011



	Date	Rating	Target Price	Closing Price
1	20-Jun-11	*3L	*425.00	409.35
2	26-Sep-11	3L	*347.00	357.65
3	5-Oct-11	3L	*335.00	340.70

	Date	Rating	Target Price	Closing Price
4	7-Oct-11	Stock rating system changed		
5	7-Oct-11	*3	335.00	344.85
6	31-Oct-11	*1	*425.00	356.35

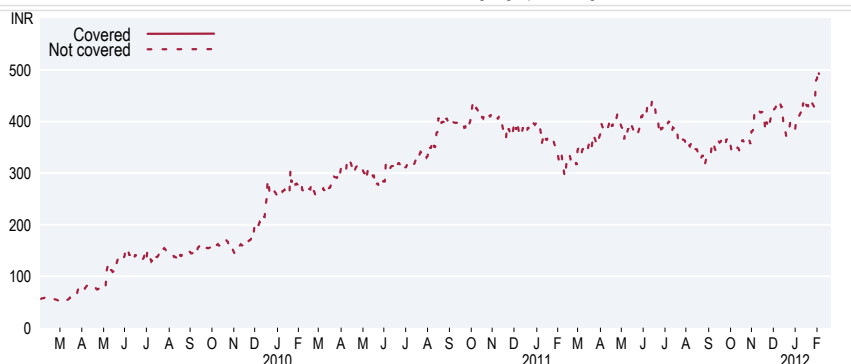
	Date	Rating	Target Price	Closing Price
7	27-Jan-12	1	*502.00	428.85
8	31-Jan-12	1	*554.00	480.00

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Havells India (HVEL.BO)
Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Atul Tiwari, CFA
Covered since June 20 2011



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 31 Dec 2011

	12 Month Rating			Relative Rating		
	Buy	Hold	Sell	Buy	Hold	Sell
Citi Investment Research & Analysis Global Fundamental Coverage	57%	34%	9%	10%	79%	10%
% of companies in each rating category that are investment banking clients	45%	41%	40%	49%	43%	41%
Citi Investment Research & Analysis Quantitative World Radar Screen Model Coverage	30%	40%	30%			
% of companies in each rating category that are investment banking clients	22%	24%	21%			
Citi Investment Research & Analysis Quantitative Decision Tree Model Coverage	52%	0%	48%			
% of companies in each rating category that are investment banking clients	54%	0%	44%			
Citi Investment Research & Analysis Asia Quantitative Radar Screen Model Coverage	20%	60%	20%			

<i>% of companies in each rating category that are investment banking clients</i>	21%	22%	20%
Citi Investment Research & Analysis Australia Radar Model Coverage	41%	0%	59%
<i>% of companies in each rating category that are investment banking clients</i>	22%	0%	17%

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