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Investors' delight: Cummins India Ltd. (CIL) – "Accumulate"

Sep. 16, 2019

Cummins India Ltd. price chart



Source: Moneycontrol website

Cummins India Ltd. (CIL)

CMP: Rs. 578.45, FV: Rs. 2, Book value: Rs. 149, Market Cap: Rs. 16,100 crores, FY19 ROE: 18.9 percent, Target price: Rs. 665, Upside: 18%

Cummins India Limited (51% subsidiary of US based Cummins Inc Limited), headquartered in Pune since 1962, is the country's leading manufacturer of diesel and natural gas engines for power generation, industrial and automotive markets. Its parent Cummins Inc. is the world's largest designer and manufacturer of diesel engines of above 200 horse power. The key markets for Cummins' engines are on-highway vehicles, industrial equipments, and power generation. In addition to this, Cummins provides filtration and acoustic systems, natural gas engines, engine components and electronic systems. Cummins India Limited comprises three major business units - Engine, Power Systems, and Distribution.

The Engine Business manufactures engines from 60 HP for low, medium and heavy-duty on-highway commercial vehicle markets and off-highway commercial equipment industry spanning construction and compressor. Today, Cummins India Limited is the **country's leading manufacturer of diesel and natural gas engines.**

The Power Systems Business designs and manufactures high horsepower **engines from 700 HP to 4500 HP for marine, railways, defense and mining applications as well as power generation systems comprising** of integrated generator sets in the range of 7.5 kVA to 3750 kVA including transfer switches, paralleling switchgear and controls for use in standby, prime and continuous rated systems.



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The Distribution Business provides products, packages, services and solutions for uptime of Cummins equipment. Through its country-wide network of over 120 dealership branch offices and 450 service touch points, the business provides parts, new and rebuilt engines, batteries, services and customer support solutions to products manufactured by Cummins. This network offers a strong team of **more than 3500 company trained engineers and technicians who handle service events of 5,25,000 engines on the field, serving over 2,00,000 customers across various markets in India, Nepal and Bhutan in off-highway segments.** The Company expects to grow at double digit growth rate on the back of government spending in areas of infrastructure and fleet modernization of railways, growth in power generation segment and its business development initiatives. The overall power deficit of the country is expected to continue its declining trend. However, the Company believes there will be a sustained demand for backup power due to rapid urbanization, GDP growth and need for power assurance by the consumers. **The Company expects the Power generation segment to continue the growth, owing to Governments' emphasis on infrastructure projects and 'Make in India' initiative.** With increasing digitalization of the economy, the Data centres segment is expected to grow, which would fuel demand for High Horsepower generator sets, where the Company holds a significant market share.

Industrial: In the Industrial business, the Company established a Power Systems plant in Pirangut dedicated to cater to the growing needs of the Rail, Construction and Marine business.

Railways offers a big opportunity..

Further strengthening its relations with the Indian Railways (IR), **the Company has began production and supply of the underslung power pack introduced last year for Diesel Electric Tower Cars (DETCs).** Additionally, the scope was expanded beyond engines to a complete power pack along with installation and commissioning support. **The Company also ramped up the supply of underslung gensets used in Power Cars for long-distance trains thus enhancing revenue generation for Indian Railways.** For their recently launched Self-Propelled Inspection Car (SPIC) used for inspection of tracks, level crossings and stations, Indian Railways chose the Cummins NTA855 engine due to its underslung capability. The Company also successfully provided Central Railways with engines and loco-control system for a toy-train locomotive used on steep gradients and winding curves making this development a significant achievement for Cummins.

With focus by Indian Railways on safety and modernization, the production for Linke Hofmann Busch (LHB) passenger coaches is expected to drive the continued demand for power cars. Similarly, the safety focus has prompted the Railways to increase its fleet of Self Propelled Accident Relief Trains (SPART) to improve the accident relief coverage for its entire network. In the next couple of years, the focus on electrification by Indian Railways is expected to sustain the demand for Diesel Electric Tower Cars (DETC) for installation and maintenance of overhead electric equipment.

Marine: In the Marine segment, the Company **continued to deliver value to the Indian Navy, Coast Guard and Shipyards with its propulsion engines and diesel generator set offerings; and introduced powertrain solutions in the range 140 hp to 300hp for the fishing boats segment.** Commencement of cargo movement on inland waterway routes (like National Waterway 1 - NW1) coupled with the 'Make in India' focus, will boost manufacturing of transport vessels thereby, increasing demand for marine main propulsion engines and diesel generator sets.

Construction: Sustained government focus on building India's infrastructure mainly highways, railway, port and housing through initiatives like Bharatmala, Sagarmala, Smart City Mission, Housing for all would contribute to the growth of excavators and other earth moving equipment. With stricter Construction Equipment Vehicle (CEV) Bharat Stage (BS) IV emission norms announced for wheeled construction equipment (from October 2020) and non-wheeled BSIV CEMM (Construction, Earthmoving, Material Handling and Mining Equipment) under discussion, the Company is looking forward to leveraging its global experience and



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technology leadership along with strong partnerships with all major equipment manufacturers to continue its growth in this sector.

Mining: In the Mining segment, **the Company's QSK 50 and QSK 60 engines successfully powered the recently launched 150 ton and 205 ton electric dump trucks by Bharat Earth Movers Limited (BEML).** This has resulted in opening of avenues in the high tonnage dump truck market in India. With increased demand for coal stemming from thermal power plants, Coal India Ltd. has taken an aspirational target of 700 MT for FY 2019-20. The Company anticipates that the stiff targets would drive an increased demand for higher tonnage mining equipment.

Oil & Gas and Pumps: With the Letter of Intent distribution stage being completed for the 10th round of City Gas Distribution (CGD) bidding, the Company expects increased demand for gas engines in the city gas compression market based on the government's smart city initiative.

Port and Logistics is another segment where growth is going to increase exponentially. Strong growth potential, favourable investment climate and sops provided by state governments have encouraged domestic and foreign private players to enter the Indian ports sector.

Exports: The Company has opportunities to grow in the Powergen markets, with focus on Africa and Middle East regions. Specifically, in Africa, where a quarter of world's population resides, power deficit presents a sizeable opportunity for growth. Reliable power grid in developed markets is putting further pressure on price realization and growth.

Over the years, **Cummins India has been a significant contributor to the Indian economy through the innovative and dependable solutions they have been providing for over five decades.** India is also one of the key emerging markets and like all other markets, has its own unique set of challenges. With stringent emission norms and massive infrastructure growth posing as the primary drivers of the economy, the Company looks at these as an opportunity to provide even better solutions. The Company continues to lead the industry in emissions technology with expertise in fuel systems, filtration, exhaust systems, turbochargers, electronics and combustion research.

The Company contributed in country's prestigious project – Journey to moon– "Chandrayaan 2 mission"

- a) Lift off powered by specially engineered Cummins genset
- b) 640 ton rocket launcher transported to Launchpad by Tata Motors' Prima truck powered by Cummins engine
- c) Team of service engineers deployed during lift off to handle emergencies, if any

For FY19, the Company registered a topline growth of 12 percent to touch Rs. 5,526 crores. Domestic sales witnessed a rise of 15 percent to Rs. 3,873 Crores while exports rose by 5 percent to Rs 1,652 crores. Profit before tax at Rs. 1,030 Crores, grew 21% (excluding exceptional items) over the previous year is a record high. The Company **has a strong balance sheet with robust Free Cash Flow (Rs. 784 crores in FY19) and decent ROE.** However, the Company reported weak financial performance in Q1FY20 owing to slowdown in the construction and mining end-market led by overall economic slowdown due to liquidity crunch. Exports also witnessed slowdown across the different geographies that the Company participated in and this is certainly an area of concern for CIL.

Going ahead, **EBITDA margins are expected to improve from Q2FY20 onwards** as there would be improvement product mix.



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We like the Company as it **would be a major beneficiary of capex revival in the country once economic activity starts kicking in.** Government's continued impetus through different initiatives especially in manufacturing and infrastructure sectors, along with the "Make in India" push will boost growth across the product portfolio.

Cummins has been a wealth creator for equity shareholders in the past and will continue to be owing to robust management pedigree and strong business metrics. Rs. 100 invested in CIL in 1965 would give Rs. 25.2 Lakhs in Mar-19.

We believe that the worst has been discounted at CMP and expect the Company to do well in H2FY20 and FY21. At CMP, the stock trades at a P/E of 22x at FY19 EPS of Rs. 26.1. We recommend a "Accumulate" with a target price of Rs. 682 (P/E of 22x at estimated FY21 EPS of Rs. 31) for investors with a horizon of 9-12 months.



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Buy – Absolute return of 20% and above

Accumulate – Absolute return between 15% and above

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