

Investment idea for 2014

Investor’s Delight: **Cummins India Ltd. (CIL)** “BUY”

Cummins in India, a power leader, is a group of complementary business units that design, manufacture, distribute and service engines and related technologies, including fuel systems, air handling, filtration, emission solutions and electrical power generation systems. Part of the US \$17 billion Cummins Inc., Cummins in India is a Group of nine legal entities across 200 locations in the country. CIL was set up in Pune in 1962. Today, CIL is India’s leading manufacturer of diesel engines with a range from 15 kVA to 2000 kVA and value packages serving the Power Generation, Industrial and Automotive Markets. CIL’s products include diesel and natural gas engines in the range of 18 HP to 3,500 HP. It manufactures over 35,000 engines and gensets per annum and is among India’s largest exporters of engineering products. CIL offers the complete range of Cummins Worldwide products. Where indigenous production is not available, Cummins imports products from Cummins Inc. The Company’s plants are presently having capacity utilization rates of 50%-60%. Its efforts are on to cut shifts and reduce contract labours.

The Company is presented with a big opportunity in Genset segment. At present, exports from Cummins are just 7% of global power gensets business reflecting huge upside. In addition, depreciating rupee makes the prospects look even brighter. The growth in the industrial segment of the domestic market was largely on account of the compressor and mining segments. Improvement is expected in the domestic market in next six months. The Company’s inventory is at reasonable levels.

Cummins India, a manufacturer of diesel and natural gas engines for power generation, industrial and automotive applications has developed a series of generator sets (gensets) that are compliant with the new environmental norms (CPCB II), to be implemented by the Central Pollution Control Board in India. The new CPCB II norms will be applicable from April 1, 2014. Cummins has welcomed the positive measures taken by the Ministry of Environment and Forests in its commitment to improving air quality. Cummins’ advanced research and development and leadership positions in the wide spectrum of markets that it serves in the United States, Europe and other parts of the world, along with its over fifty-year legacy in India allows it to bring market competitive products that comply with regulations and norms in India. The company has already commenced production of the new series of generator sets at its plant in Pirangut in Maharashtra. So far, nearly 50 units have been field tested, successfully operating for more than 6,000 hours at customer sites across India. According to Mahesh Narang, chief operating officer, Cummins India a dedicated team of over 100 engineers from around the world have collaborated in designing the emission-compliant products.

Capex of Rs. 184 crore was incurred in H1FY2014. This is likely to be Rs. 450-500 crore in full year, up from about Rs. 220-230 crore in FY13. The margin is expected to stay at the current level excluding the impact of rupee volatility.

With due consideration to factors like a) good growth prospects for genset division, b) high entry barriers, c) company generating free cash flow with strong return ratios (ROE: 34% and ROC: 31.9%), d) quality management, we recommend a “BUY”. At CMP, the stock trades at a PE multiple of 18 x at 12 month (TTM) EPS OF Rs. 26.47. We value the stock at 15x FY15 estimated EPS of Rs.28.5 by street to arrive at a target price of Rs.570 for investors with a 12 months horizon.

CMP	Rs. 475
Target Price	Rs. 570
Upside	20 %
Beta vs Sensex	0.88
BSE/NSE Code	500480/CUMMINSIND
Bloomberg Code	KKC:IN
52 Week High	Rs. 550 (1 <sup>st</sup> Sep., 2013)
52 Week Low	Rs. 365.05 (28 <sup>th</sup> Aug, 2013)
Face Value	Rs. 2
Share Capital	Rs. 554.4 mn
Market Capitalization	Rs. 131 bn
Book Value	Rs. 54 per share
Shareholding Pattern (%)	As on Sep. 2013
Promoters	51
FII	15.48
DII	19.84
Others	13.68

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