Update

SECTOR: ENGINEERING

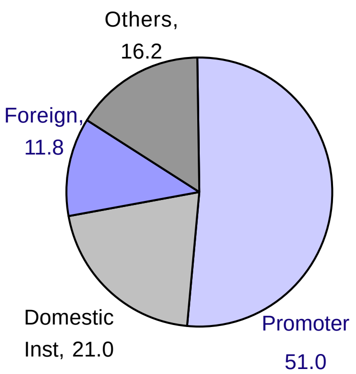
Cummins India

BSE SENSEX	S&P CNX
18,180	5,462

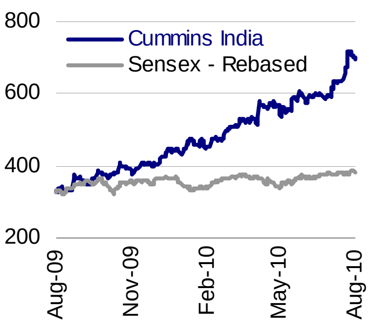
Bloomberg	KKC IN
Reuters	CUMM.BO
Equity Shares (m)	198.0
52-Week Range (Rs)	732/320
1,6,12 Rel. Perf. (%)	17/42/97
M.Cap. (Rs b)	138.2
M.Cap. (US$ b)	2.9

Y/E MARCH	2010	2011E	2012E
Net Sales (Rsb)	28.4	39.1	52.5
EBITDA (Rsb)	5.3	8.2	11.1
NP (Rsb)	4.4	6.1	8.3
EPS(RS)	22.4	30.8	42.0
EPS GR. (%)	7.1	37.3	36.4
BV/Share (Rs)	78.0	94.7	119.2
P/E (x)	31.2	22.7	16.6
P/BV (x)	9.0	7.4	5.9
EV/EBITDA (x)	24.8	15.7	11.3
EV/Sales (x)	4.6	3.3	2.4
RoE (%)	30.4	35.7	39.3
RoCE (%)	39.5	46.3	49.5

SHAREHOLDING PATTERN % (JUN-10)



STOCK PERFORMANCE (1 YEAR)



Rs698 | Buy

Exports to grow 3x by FY12, driving 37% EPS CAGR over FY10-12

Encouraging long-term outlook, as parent looks at sourcing more from India; domestic sales to grow at a steady pace

- **Strong demand to boost growth:** Cummins India (CIL), the largest engine manufacturer in India, is likely to post accelerated growth over the next two years, led by improving demand in the domestic market and strong rebound in exports on the back of increased outsourcing by its parent. Better product mix, healthy pricing environment, stable commodity prices, and continuous cost-cutting initiatives will keep margins strong.
- **Domestic business to grow at 26% CAGR over FY10-12:** After sluggish demand in FY09 and 1HFY10, the domestic engine market has shown impressive recovery. With growing power shortage, diesel engine demand for power-generation applications will continue to be strong. We expect robust demand pull from the industry segment as well, particularly from construction and mining.
- **Exports to grow 3x by FY12; parent raises guidance:** CIL is among Cummins Inc's leading manufacturing bases, and meets its global requirement for several key products and components. After reaching a high of Rs13b in FY09, exports sharply declined to Rs4.8b in FY10, as US and European economies shrank. However, buoyed by strong recovery in American and Asian markets, its exports have grown sharply since 4QFY10. We expect exports to reach Rs15b by FY12. Cummins Inc has also raised its sales guidance for CY10 to US$13b, which augurs well for CIL.
- **Superior product mix, cost-cutting boost margins; more surprises likely:** CIL has surprised markets by sharp improvement in margins during the last two years. In FY10, EBITDA margin expanded 410bp to 18.5%. The company has maintained strong margin momentum, posting 21.3% (up 290bp YoY) in 1QFY11. We believe that better product mix, healthy pricing environment, stable commodity prices and continuous cost-cutting initiatives will keep margins strong, going forward.
- **Powerful tailwind; aggressive capacity expansion:** Given quality standards and cost benchmarks that CIL has established, Cummins Inc will enhance the product portfolio that it outsources from India. To meet domestic demand and export requirements, CIL will spend around US$300m at its new mega-site near Pune over the next five years, which will add capacity at 20% CAGR. This is a significant positive for the company's growth.
- **Earnings CAGR at 37%; stock trades at 17x FY12E earnings; Buy:** CIL has exhibited strong 26% earnings CAGR over the last four years, despite uncertain business environment globally. We expect the company to post a robust 37% earnings CAGR over FY10-12. We believe that the stock will command higher valuations due to long-term growth potential and possible upside to earnings expectations in the medium-term. We upgrade the stock to **Buy**, with a target price of Rs840 (20x FY12E earnings).

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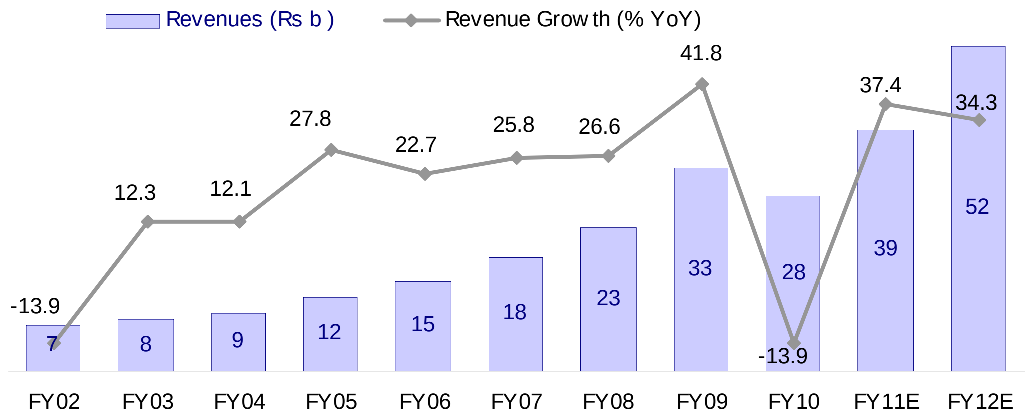
Entering a new growth cycle

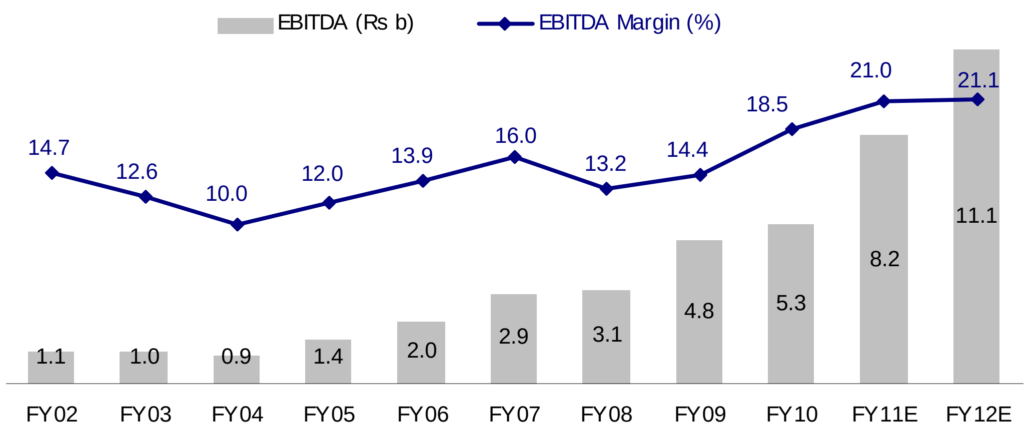
STRONG TAILWIND; TO POST REVENUE CAGR OF 36% OVER FY10-12

Revenues to be driven by 26% CAGR in domestic sales and nearly 3x jump in exports over FY10-12



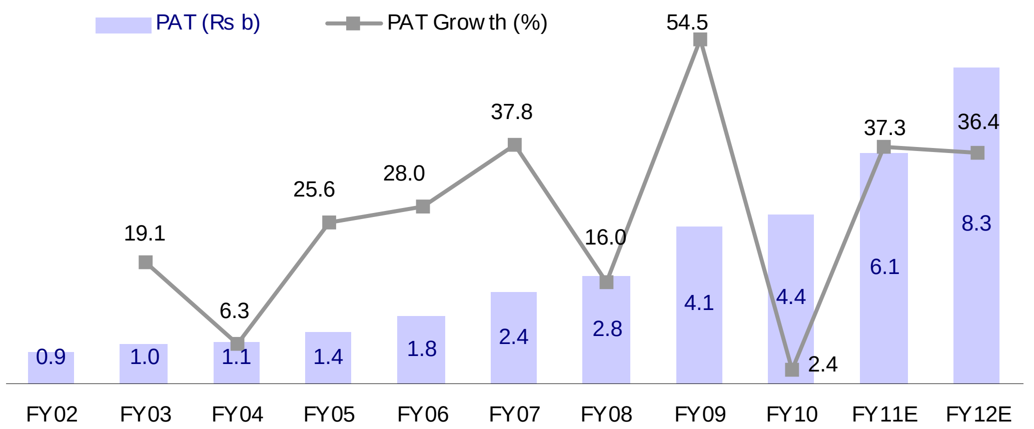
EBITDA MARGIN TO EXPAND 260BP OVER FY10-12

EBITDA margin expansion led by superior product-mix, favorable pricing and cost-cutting programs like ACE and TRIMS



EXPECT EARNINGS CAGR OF 37% OVER FY10-12

Net profit margin to be maintained at 15.6% over the next two years



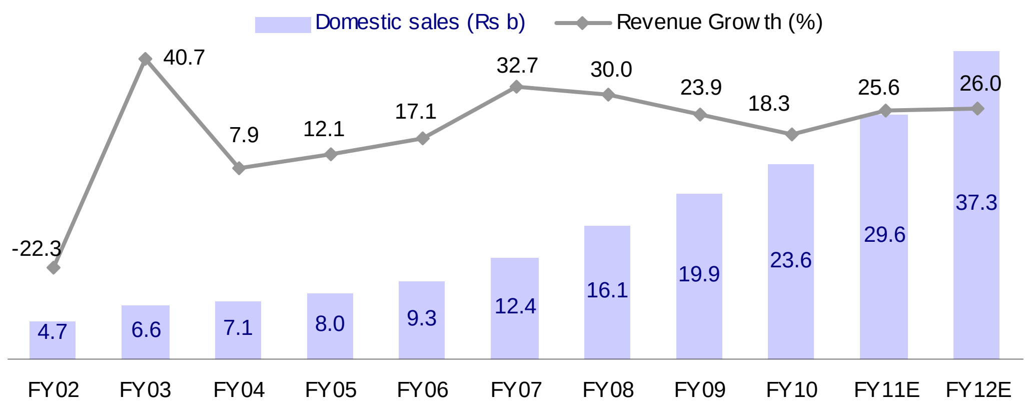
Source: Company/MOSL

Domestic sales to grow at 26% CAGR over FY10-12

Cummins India (CIL) is the largest engine manufacturer in India, with products ranging from 60HP to 3,500HP, operating on diesel, gas and duel-fuel. We expect domestic sales to register a CAGR of 26% over the next two years, supported by momentum in all product segments.

Power-gen sales (45% of total sales) revive strongly in the past two quarters; to sustain momentum in the near term

DOMESTIC SALES TREND: 26% CAGR OVER FY10-12



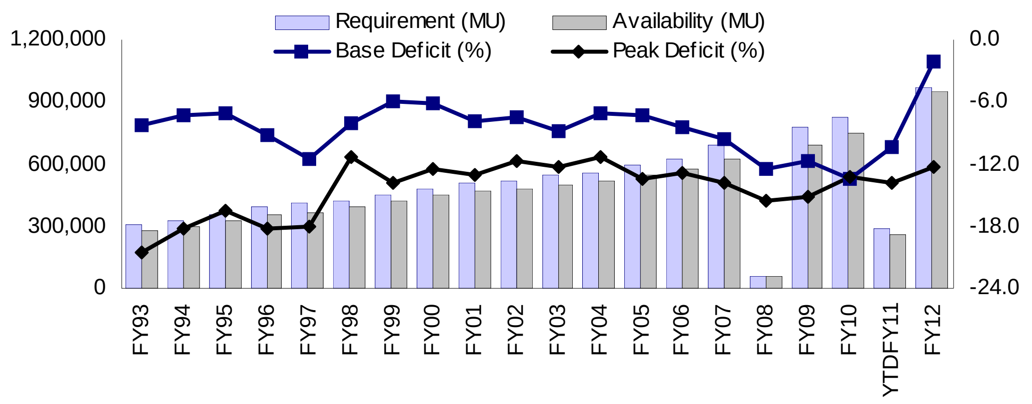
Source: Company/MOSL

#1. Power Generation (45% of sales)

CIL offers power generation solutions to industry, services and real-estate segments. With mounting power deficit, the demand for diesel engines as back-up supply will continue to be strong.

Growing power shortage is driving genset sales for primary usage, apart from standby applications

BASE & PEAK DEFICIT TREND

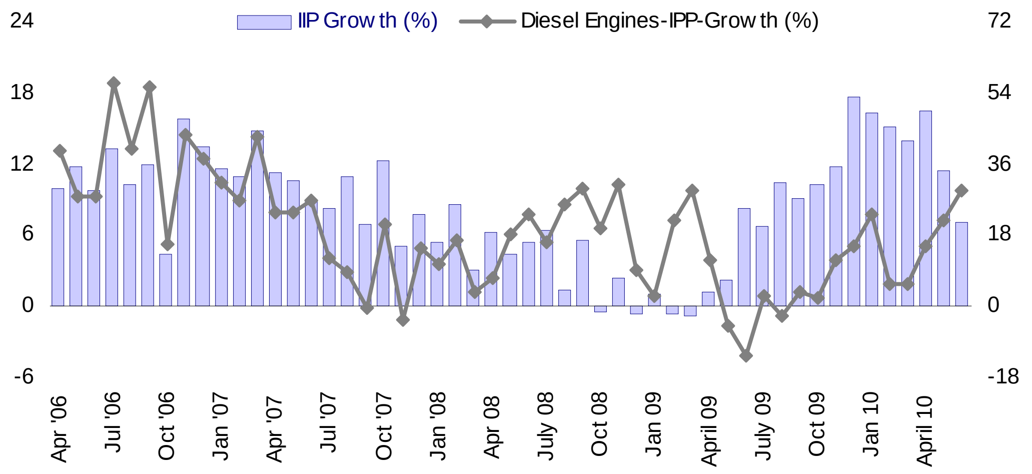


Source: Company/MOSL

#2. Industrial (15% of sales)

- Key user segments include construction, mining, compressors, oilfields, marine, defense, railways and water-well rigs. Infrastructure investment will create strong demand from construction and mining industries.
- India stage-III emission norms based on EU stage-IIIA are likely to be implemented from April 2011 on off-highway wheeled construction equipment. This will provide additional growth opportunity to CIL, as the company offers both mechanical and electronic engines, meeting emission norms.

IIP GROWTH AND DIESEL ENGINES - IPP GROWTH - MOM (%)



Source: Company/MOSL

Engines sales track IIP, as demand is driven by power shortages and strong industrial production requiring more powered-equipment

#3. Automotive Engines (10% of sales)

CIL supplies 'C' series engines, with 300HP rating to Tata Motors for its Tata Novus series of heavy trucks. Given strong growth in high HP trucks, this segment is expected to post strong growth. From a small base of Rs963m in FY07, auto engines sales have grown to Rs2.6b in FY10, also boosted by demand from the CNG bus segment for Common Wealth Games.

#4. Gas opportunity seen at 1,000MW in the next five years

With new gas discoveries, the gas-based distributed power generation market is estimated at around 200MW per year. Cost of power generation based on gas is significantly lower than that based on diesel. CIL has a strong lean-burn natural gas product line and stands to benefit from the opportunity.

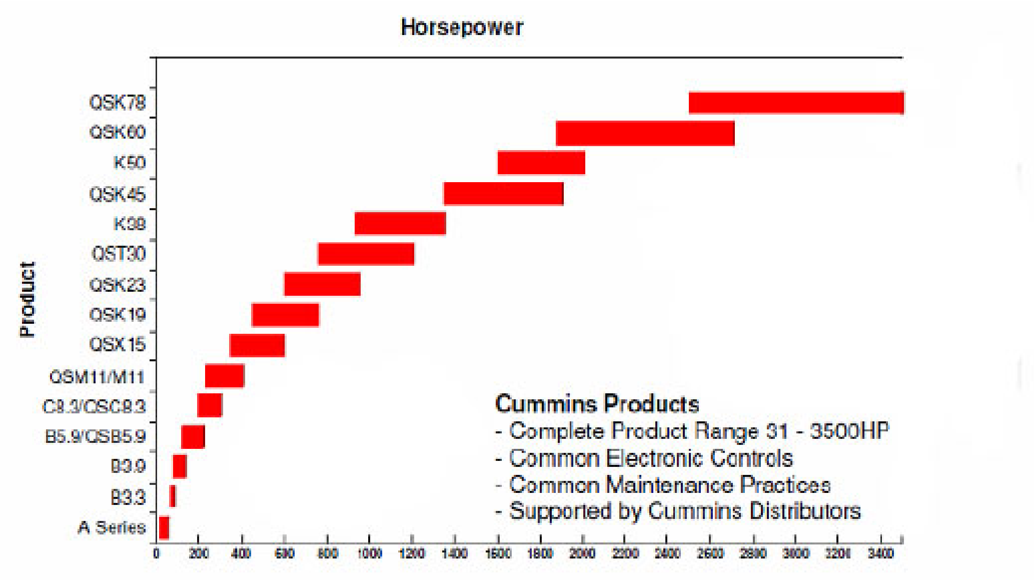
#5. Cummins Sales & Services (CSS)

CSS offers after-sales services for Cummins' engines. It also replaces, repowers and reconditions old engines. The segment has maintained a growth of over 15% in recent years and is expected to grow on similar lines in the next few years. Given the rise in diesel prices, average running hours of large engines is declining. However, increasing engine population provides the required growth stimulus to the segment.

Strong product profile aids steady improvement in market share

Cummins enjoys over 40% market share, aided by a very strong product portfolio, covering a vast range

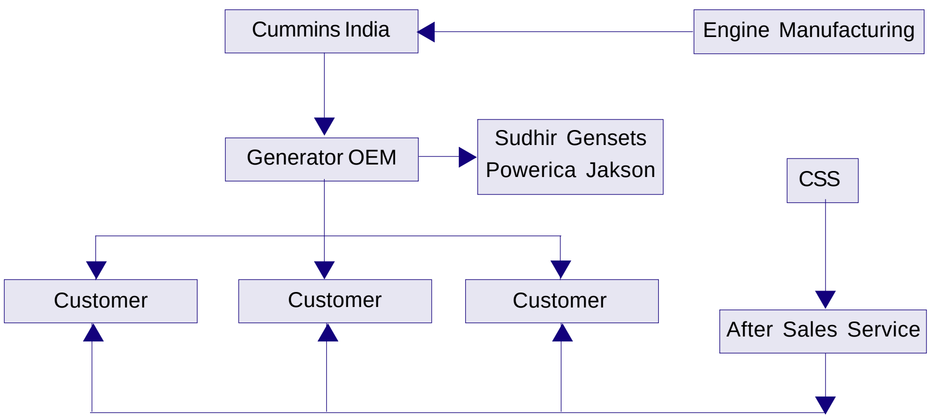
CUMMINS PRODUCT FAMILY



Source: Company/MOSL

Cummins has effectively used third-part assemblers for powergen market, thereby focusing more on technology and manufacturing

CIL'S BUSINESS MODEL



Source: Company/MOSL

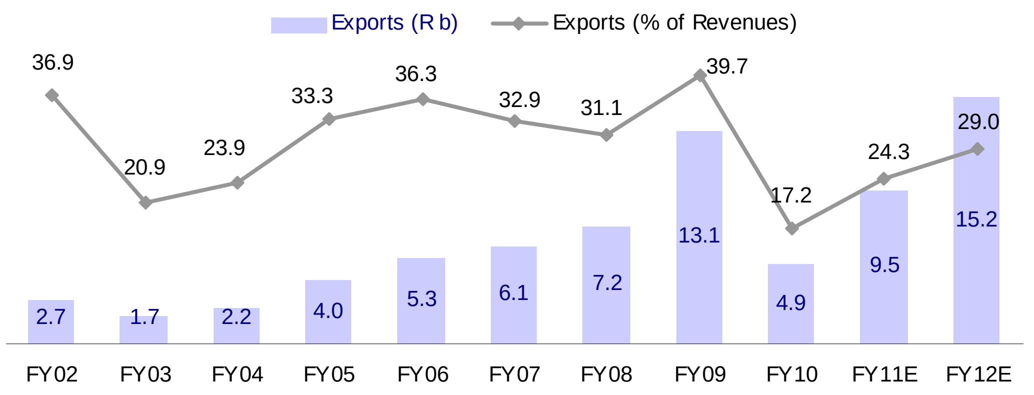
Exports to increase 3x by FY12; parent raises guidance

Growing product basket for exports is the biggest growth driver for Cummins

- Cummins Inc has identified India as a key outsourcing destination for its global markets. Power-generation applications constitute the bulk of CIL's exports. The company supplies K, N series engines of various displacements like 28, 38, 50litres. It also supplies gensets to its parent.
- Exports declined sharply in FY10, due to global slowdown. However, in the past six months, CIL has posted over 125% YoY growth in exports. We expect exports to grow to over Rs15b by FY12. Growth will be driven by exiting portfolio as well as new products.
- In a new development, CIL will also supply <200 KVA DG sets to meet its parent's global requirement. The company is spending Rs1.5b to set up a new factory in the SEZ part of the Phaltan mega-site (Pune) for this product. The eventual capacity at the facility will be 40,000 units by FY13. Initial capacity, to be commissioned by FY11, will be 15,000 units. This will provide further fillip to exports.
- We believe that new product addition will be a key growth driver. New products may include engines for industrial applications, apart from power-generation applications.

EXPORTS: TO INCREASE 3X BY FY12 OVER FY10

Exports to cross Rs15b by FY12

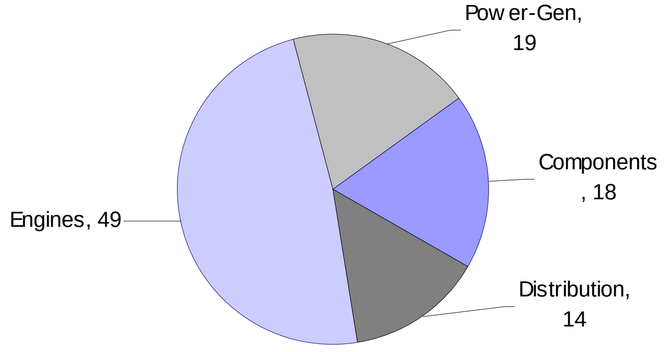


Source: Company/MOSL

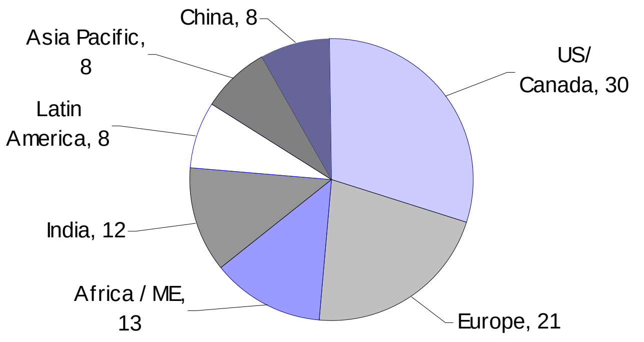
Cummins Inc raises guidance; positive for Cummins India

Columbus, Indiana-based Cummins Inc is among the world's largest engine manufacturers, with an extensive product portfolio, both for on and off-highway applications. CIL meets part of its parent's global demand in the power generation segment.

CUMMINS INC. SALES MIX (%)



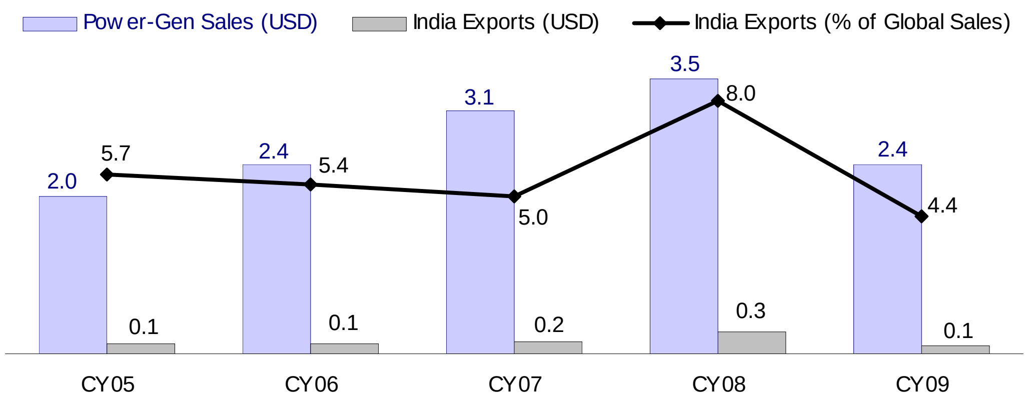
GEOGRAPHY MIX (POWER GENERATION, %)



Source: Company/MOSL

CUMMINS (INDIA EXPORTS AS % OF GLOBAL POWER-GEN REVENUES)

Cummins India exports engines for powergen applications; is a meaningful contributor to global powergen sales

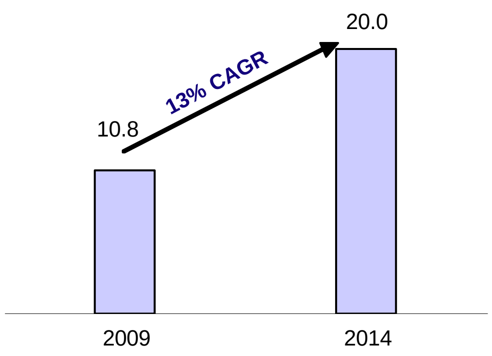


Source: Company/MOSL

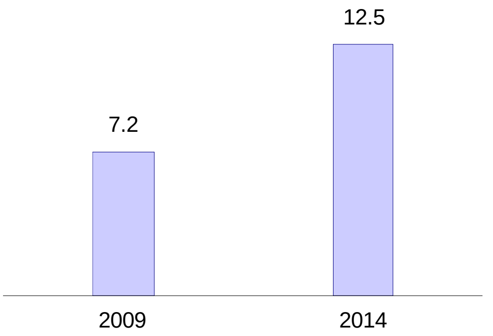
Cummins Inc has also raised its guidance and targets to end CY10 with sales of US$13b and margin expansion. To achieve these targets, the company aims at leveraging its manufacturing base in developing countries like India. This augurs well for exports from India. Cummins Inc expects India to grow by nearly 50% during the year.

Cummins Inc guides 13% CAGR in revenues till 2014, along with margin expansion

CUMMINS INC. SALES (US$ B)



CUMMINS INC. EBIT MARGINS (%)



Source: Company/MOSL

Margins to expand, led by improving product mix and cost-optimization strategies

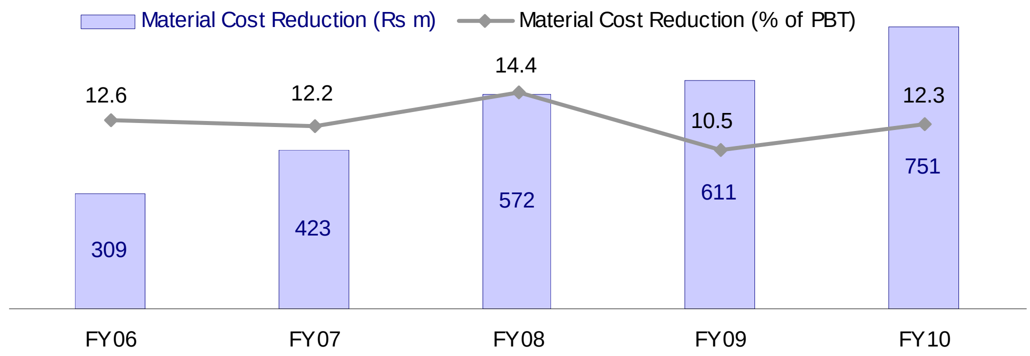
CIL's margins have expanded significantly over the years. Despite a 14% drop in sales in FY10, EBITDA margin expanded 410bp. We expect CIL's EBITDA margin to expand by a further 246bp during FY11 and sustain at that level in FY12.

Key arguments in favor of strong margin outlook

Cost-cutting programs like ACE and TRIMs have had desired impact on overall margins

- **Cost cutting programs:** CIL initiated an accelerated cost-cutting exercise (ACE) in 2005. Apart from other targets, it aimed at cutting direct material spends by 30% in three years. After the successful completion of the exercise, the company has stared another cost-cutting program called TRIMS to reduce total cost of ownership. It targets to bring down indirect material spend and services cost by 30% in three years. We expect CIL to achieve substantial savings, particularly in direct material costs.

MATERIAL COST SAVING AIDING PROFITABILITY



Source: Company/MOSL

- **Favorable pricing environment:** While the business is competitive, the pricing environment continues to be favorable in the mid and high HP segments.
- **Value per engine to increase, with migration to new emission norms:** Migration to higher emission norms requires significant addition to the value of components per engine. With the introduction of new emission norms for off-highway wheeled equipment in April 2011, we expect CIL to increase its value-add to engines for industrial and infrastructure equipment. This will help achieve higher margins.

Strong capex program - to spend US$300m, indicating good growth outlook

Capex programme: Capacity addition of over 20% CAGR to drive long-term growth

CIL will spend US$300m on its new mega-site at Phaltan near Pune. During FY11, it will commission four facilities, including a parts distribution center and reconditioning factory at the mega-site, which it began work on over two years ago.

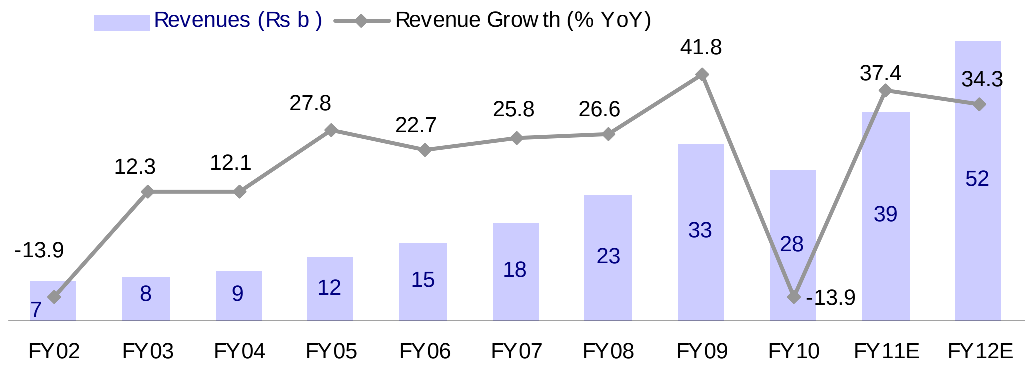
The company will also spend about Rs1.5b on a new facility to manufacture generators with capacities of 200kVA (kilovolt-ampere) and below. This plant will have a capacity of 40,000 units per annum by 2013. The investment will be done in three phases, the first of which will be completed by April 2011. In phase-I, the plant will have a capacity of 10,000-15,000 units. CIL's existing generator facility at Pirangut near Pune has a capacity to produce 15,000 units a year. The facility will be in the SEZ part of the project and will be entirely for export markets.

Expect earnings CAGR of 37% over FY10-12

36% revenue growth and 260bp margin improvement will boost earnings growth

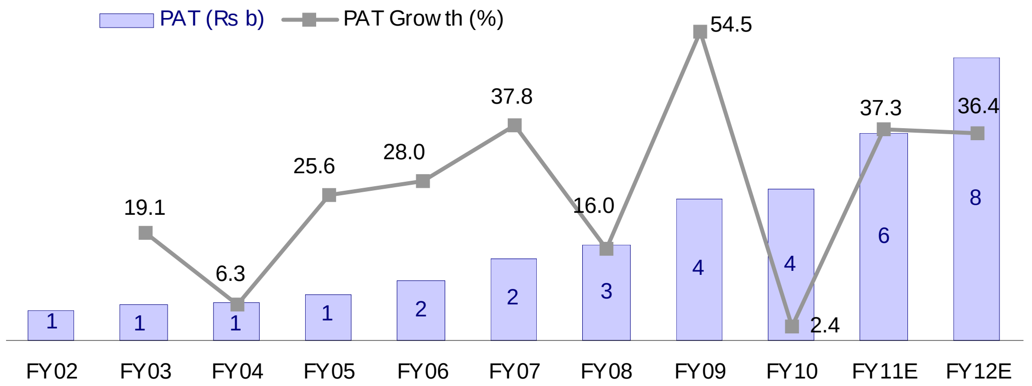
- We expect CIL to post earnings CAGR of 37% over FY10-12, following 26% earnings CAGR over the past four years. Earnings will be driven by strong revenue growth and 260bp margin expansion.
- Revenues are likely to grow at a CAGR of 36% over FY10-12. Exports, which are likely to grow at a CAGR of 76%, will drive revenue growth. Domestic sales would grow at a CAGR of 26%.
- Working capital remains under control. CIL continues to generate healthy cash from operations. Cash and investments stood at Rs8b as at March 2010, up 82%.
- RoCE and RoE stood at 39.5% and 30%, respectively in FY10. We expect RoCE and RoE to further improve to 50% and 39%, respectively by FY12.

REVENUES TO GROW AT 36% CAGR OVER FY10-12



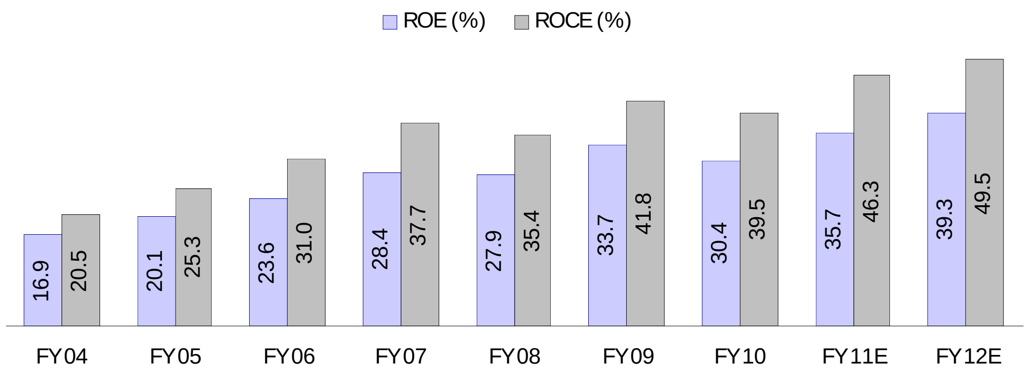
PAT margins to be maintained at around 15.6%

EARNINGS TO GROW IN LINE WITH REVENUES AT 37% CAGR



RoE and RoCE to improve further; healthy cash generation expected

STEADY IMPROVEMENT IN ROE AND ROCE



Source: Company/MOSL

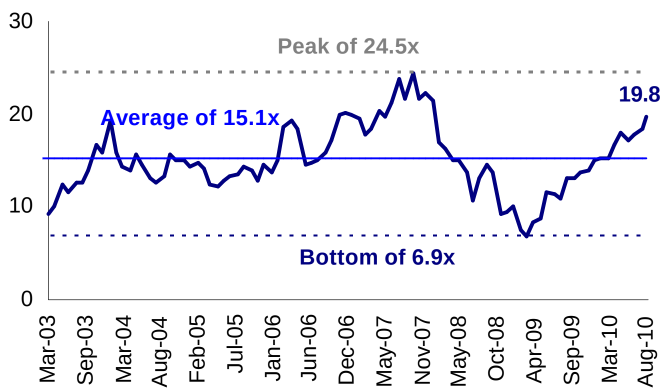
Valuation and view

CIL is among the best performing stocks in the capital goods sector, outperforming the Sensex by 35% over the last six months and by 93% over the last one year. At the current price, stock trades at 23x FY11E and 17x FY12E earnings. Despite the run-up, we believe that the stock offers a good investment opportunity. It is due for a re-rating on account of the following:

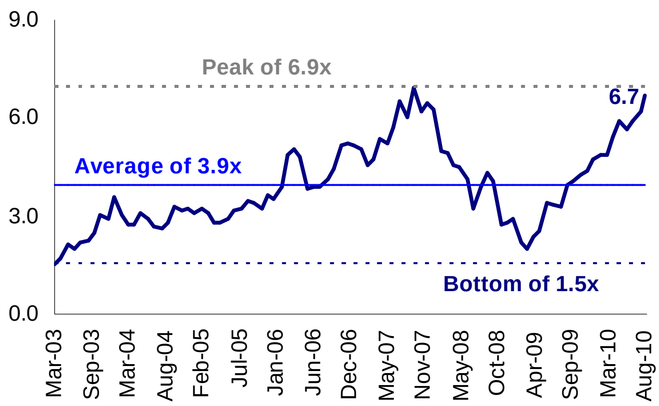
- Strong 37% earnings CAGR over FY10-12E
- Near-term earnings upsides due to possible margin expansion and faster-than expected growth in exports
- Long-term export opportunity due to increasing preference by Cummins Inc for Indian manufacturing base to meet global demand for engines for non-automotive applications

We recommend **Buy**, with a target price of Rs840 (20x FY12E earnings, in line with other large-cap engineering companies like BHEL and L&T).

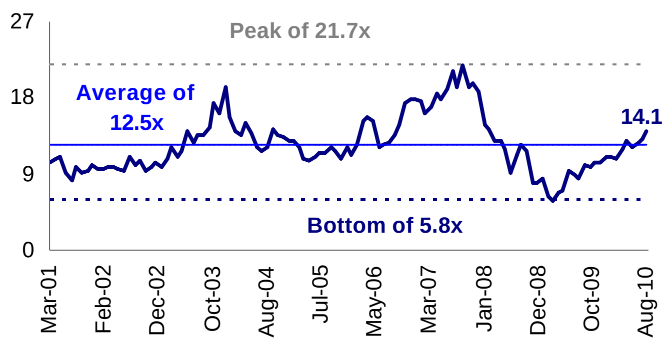
P/E (X)



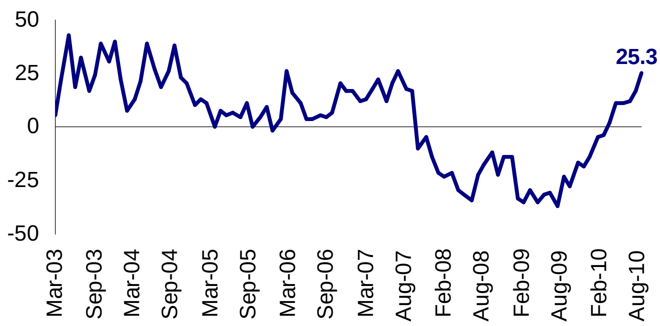
P/BV (X)



EV/EBITDA (X)



RELATIVE TO SENSEX



Source: Company/MOSL

Financials and Valuation

INCOME STATEMENT					(RS MILLION)
Y/E MARCH	2008	2009	2010	2011E	2012E
Total Revenues	**23,507**	**33,043**	**28,449**	**39,095**	**52,499**
Change (%)	*26.4*	*40.6*	*-13.9*	*37.4*	*34.3*
Raw Materials	16,225	22,338	18,552	25,021	33,862
Staff Cost	1,384	2,130	1,953	2,343	2,812
Other Expenses	2,629	3,803	2,670	3,519	4,725
EBITDA	**3,069**	**4,772**	**5,275**	**8,213**	**11,100**
% of Total Revenues	*13.1*	*14.4*	*18.5*	*21.0*	*21.1*
Depreciation	330	456	361	456	587
Other Income	1,227	1,507	1,216	972	1,216
Interest	7	26	21	20	20
PBT	**3,960**	**5,798**	**6,109**	**8,709**	**11,709**
Tax	1,153	1,654	1,670	2,613	3,396
Rate (%)	*29.1*	*28.5*	*27.3*	*30.0*	*29.0*
Adjusted PAT	**2,807**	**4,145**	**4,439**	**6,096**	**8,314**
Extra-ordinary Income (net)	0	192	0	0	0
Reported PAT	**2,807**	**4,337**	**4,439**	**6,096**	**8,314**
Change (%)	*16.0*	*54.5*	*2.4*	*37.3*	*36.4*
Adj. Consolidated PAT	**3,246**	**4,438**	**4,439**	**6,096**	**8,314**
Change (%)	*21.2*	*36.7*	*0.0*	*37.3*	*36.4*

BALANCE SHEET					(RS MILLION)
Y/E MARCH	2008	2009	2010	2011E	2012E
Share Capital	396	396	396	396	396
Reserves	10,641	13,551	15,214	18,530	23,369
Net Worth	**11,037**	**13,947**	**15,610**	**18,926**	**23,765**
Loans	288	213	87	100	100
Deferred Tax Liability	-134	-231	-170	-170	-170
Capital Employed	**11,191**	**13,945**	**15,527**	**18,856**	**23,695**
Gross Fixed Assets	6,477	7,414	7,776	8,776	9,776
Less: Depreciation	3,929	4,324	4,440	4,896	5,483
Net Fixed Assets	**2,549**	**3,090**	**3,337**	**3,880**	**4,294**
Capital WIP	0	0	0	0	0
Investments	4,321	3,993	7,329	7,329	7,329
Curr. Assets	**10,729**	**14,247**	**12,113**	**17,238**	**22,394**
Inventory	3,215	4,680	4,097	5,891	7,911
Debtors	5,556	6,821	5,229	8,033	10,787
Cash & Bank Balance	123	323	559	2,191	5,500
Loans & Advances	1,935	2,663	2,695	3,213	3,596
Other Assets	24	83	93	100	100
Current Liab. & Prov.	**5,541**	**6,494**	**6,402**	**9,641**	**12,947**
Creditors	4,031	4,762	3,768	5,891	7,911
Other Liabilities	0	0	0	1	2
Provisions	1,510	1,732	2,634	3,749	5,034
Net Current Assets	**4,198**	**6,539**	**4,301**	**5,456**	**6,572**
P&L Account	**0**	**0**	**0**	**0**	**0**
Miscellaneous Expenses	0	0	0	0	0
Application of Funds	**11,191**	**13,945**	**15,526**	**18,856**	**23,695**

E: MOSL Estimates

RATIOS					
Y/E MARCH	2008	2009	2010	2011E	2012E
Basic (Rs)					
Adj EPS	**14.2**	**20.9**	**22.4**	**30.8**	**42.0**
Cash EPS	15.8	23.2	24.2	33.1	45.0
Book Value	55.1	69.3	78.0	94.7	119.2
DPS	4.6	9.0	12.0	12.0	15.0
Valuation (x)					
P/E	49.3	33.4	31.2	22.7	16.6
Cash P/E	44.1	30.1	28.8	21.1	15.6
EV/EBITDA	43.7	28.1	24.8	15.7	11.3
EV/Sales	5.8	4.1	4.6	3.3	2.4
Price/Book Value	12.7	10.1	9.0	7.4	5.9
Dividend Yield (%)	0.7	1.3	1.7	1.7	2.1
Profitability Ratios (%)					
RoE	27.9	33.7	30.4	35.7	39.3
RoCE	35.4	41.8	39.5	46.3	49.5
Turnover Ratios					
Debtors (Days)	87	75	67	75	75
Inventory (Days)	50	52	53	55	55
Creditors. (Days)	63	53	48	55	55
Asset Turnover (x)	3.6	4.5	3.7	4.5	5.4
Leverage Ratio					
Debt/Equity (x)	0.0	0.0	0.0	0.0	0.0

CASHFLOW STATEMENT					(Rs Million)
Y/E MARCH	2008	2009	2010	2011E	2012E
PBT before EO Items	**3,960**	**5,798**	**6,109**	**8,709**	**11,709**
Add : Depreciation	330	456	361	456	587
Interest	7	26	21	20	20
Less : Direct Taxes Paid	1,153	1,654	1,670	2,613	3,396
(Inc)/Dec in WC	(7)	(2,341)	2,238	(1,154)	(1,117)
CF from Operations	**3,136**	**2,286**	**7,057**	**5,418**	**7,803**
EO Income	0	192	0	0	0
CF from Oper. Incl. EO I	**3,136**	**2,478**	**7,057**	**5,418**	**7,803**
(Inc)/Dec in FA	(1,062)	(981)	(623)	(1,000)	(1,000)
(Pur)/Sale of Investments	(1,496)	329	(3,337)	0	0
CF from Investments	**-2,557**	**-652**	**-3,960**	**-1,000**	**-1,000**
(Inc)/Dec in Networth	(35)	578	61	0	0
(Inc)/Dec in Debt	263	-75	-126	13	0
Less : Interest Paid	7	26	21	20	20
Dividend Paid	1,066	2,102	2,775	2,780	3,475
CF from Fin. Activity	**(844)**	**(1,625)**	**(2,861)**	**(2,786)**	**(3,495)**
Inc/Dec of Cash	**(265)**	**200**	**236**	**1,632**	**3,308**
Add: Beginning Balance	388	123	323	559	2,191
Closing Balance	**123**	**323**	**559**	**2,191**	**5,500**

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Disclosure of Interest Statement	Cummins India
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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