Shift to new norms may dent Cummins' margins

Supply-chain challenges, export demand other concerns for firm: Analysts

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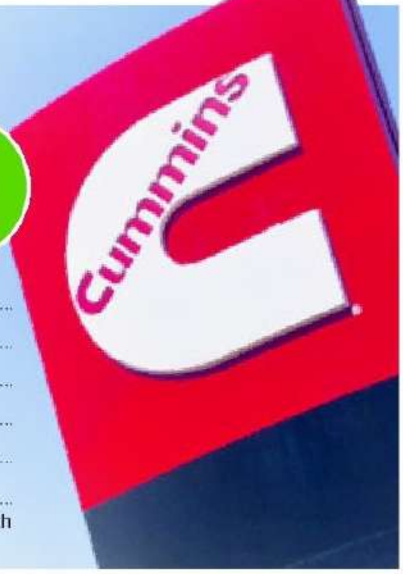
Mumbai, 30 May

STEADY GROWTH

Net sales (in ₹ crore)	7,612	9,076	10,330
	FY23	**FY24E**	**FY25E**
Change (%YoY)	26.3	19.2	13.8
Ebitda	1,242	1,534	1,845
Margin (%)	16.0	16.6	17.6
Adjusted net profit	1,144	1,361	1,605
Change (% YoY)	46.5	19.0	18.0

E: Estimates

Source: JM Financial Research



Over the last three trading sessions, the stock of Cummins India has gained about 9 per cent on strong January-March quarter (Q4) numbers and good near-term prospects.

Its Q4 performance was led by a healthy 29 per cent revenue growth over the year-ago quarter.

This was largely on the back of a 33 per cent jump in domestic revenues while exports witnessed a growth of 17 per cent.

Domestic sales, which accounted for 74 per cent of the company's revenues in the quarter, was aided by pre-bookings prior to the new norms of the Central Pollution Control Board (CPCB). The norms will come into effect from July 1.

While all segments did well, growth was higher in power generation and distribution, which reported 43 per cent and 31 per cent rise, respectively.

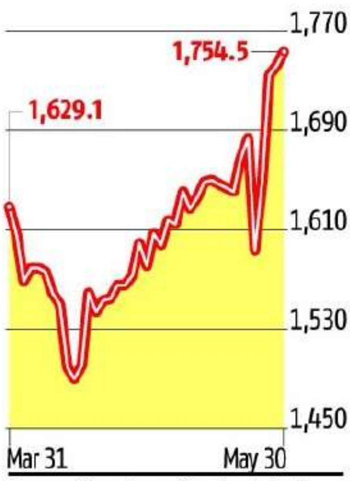
It was due to higher volumes from data centres, pharma, real estate, hospitality and manufacturing.

Demand in the construction segment witnessed a recovery to pre-Covid levels. This, coupled with healthy traction in mining and railways, helped the industrial segment grow by 14 per cent.

The company posted a better-than-expected growth in gross and operating profit margins, with the latter growing 310 basis points (bps) over the year-ago quarter to 16.9 per cent.

On a sequential basis, however, gross margins contracted as sales mix was skewed towards low-margin segments while there was a slower pick up in high-margin segments, such as exports, says JM Financial Research.

WELL DONE IN SHORT RUN*



Source: Bloomberg; *Stock price in ₹
Compiled by BS Research Bureau

For the full year (FY23), the company said it posted record revenues and profits. And, this was driven by strong demand from domestic and exports coupled with pricing actions and prudent cost management.

The company, however, is cautiously optimistic about the short-to-medium term outlook, given the emission changes from July and continued supply-chain challenges, especially for specific electronics and other components. It has thus refrained from giving guidance for FY24.

Analysts, led by Subhadip Mitra of Nuvama Research said, "With no guidance for FY24, we find concerns on sales growth/margins from H2 of FY24 onwards, as new CPCB norms imply costlier products, with chip-supply issues and limited pricing power."

Nomura Research, too, believes that after boosting sales and profitability in the June quarter, volumes and gross margins, in particular, face a sharp squeeze from the second half. This may last for the entire financial year.

Given that there is an overlap of lower-priced CPCB II and CBCB IV product sales from July to December, it will become tough to sell higher-priced CPCB IV products at the same power ratings.

Priyankar Biswas and Neelotpal Sahu of Nomura Research said that under such circumstances, the 30-50 per cent price hikes proposed by the management may be challenging.

It may lead to gross margin contraction by 100 bps year-on-year (YoY) for FY24 to 30.3 per cent. About 80 per cent of power generation segment sales (or 25 per cent of FY23 sales) would be impacted due to the norms, which are applicable on sub-800kW products.

Antique Stock Broking, however, is positive on the company's prospects, going ahead.

It believes that Cummins India can be a beneficiary of the domestic infrastructure capex cycle and CPCB norm changes.

It can also benefit from revival in exports and play a vital role in the global supply chain of Cummins Inc.

Further, the company is well placed to take advantage of business demand recovery, given its preparedness on the technology front and leadership position, said analysts led by Dhirendra Tiwari of the brokerage.

At the current price of ₹1,745, the stock is trading at 34 times its FY25 earnings estimates.

Given the recent rally and uncertainties regarding demand/margins in the second half, investors should await stable trends before considering the stock.