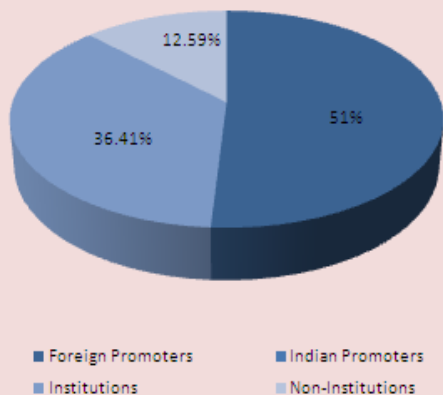


STRONG BUY

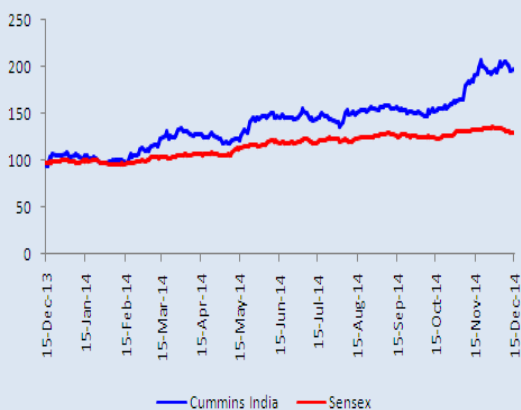
Market Data

| | |
|----------------------------|------------|
| Current Market Price (CMP) | 852.25 |
| Target Price | 1056 |
| Upside Potential | 23.89% |
| 52 Week High Low | 418/952.45 |
| Market Cap (INR in Crores) | 23,624.37 |



Stock Scan

| | |
|--------------------------------|-------------------|
| Scrip ID | Cummins India Ltd |
| Scrip Code (NSE) | CUMMINSIND |
| Scrip Code (BSE) | 500480 |
| Bloomberg Ticker | KKC IN |
| Reuters Ticker | CUMM.BO |
| Industry | Capital Goods |
| Face Value | INR2.00 per Share |
| Equity Share Capital (INR Cr) | 55.44 |
| Avg 5 years P/E | 22.94 |
| Avg daily volume (Last 1 Year) | 29,221 |
| Beta Vs Sensex | 0.87 |
| Dividend Pay Out Ratio % | 60.06% |
| PEG Ratio | NA |



Analyst: Anik Das
Email id: adas4@microsec.in

Cummins India Ltd

Sector – Capital Goods

We recommend Cummins India Ltd (KKC) a **“STRONG BUY”**. We had earlier recommended Cummins India Ltd a “BUY” at INR462 in our report dated 6th May, 2013 with a Target price of INR556. The stock had surpassed our target price of INR556. We are re-initiating the stock at current level on account of strong growth in domestic revenue supported by powergen business and recovery in industrial business, exponential growth in exports, volume growth due to pre-buying on change of emission norms, ~15-20% price hike post emission norms, and stable margins due to its cost control efficiencies. At the current price of INR873, the stock is trading at adjusted P/E of 34x its FY15e EPS and 29x its FY16e EPS. We believe that KKC will continue to enjoy premium valuations due to its dominant market positioning, impressive long-term growth outlook, healthy balance-sheet, strong ROE as compared to its peers and dividend yield of ~2.83%.

Investment Rationale

Cummins India likely to post an exponential export growth rate over the next 2-3 years- A trigger for the stock-Cummins India exports ~41% of sales in value terms. Over the last few years, a large portion of incremental volumes of Cummins India has been driven by exports. A large part of exports are driven by cost reduction and a falling INR Vs USD. Management has guided ramping up LHP exports from INR3.5 bn in FY14 to INR15-20 bn by FY19-20E. For KKC, sustainability of exports drives being a single sourcing hub for the low HP segment and also some production shift from plants in the UK to its India facilities.

Diesel engines – A good proxy for investment cycle, kick-starting of the new investment cycle will power domestic revenue growth for KKC-KKC’s product caters every segment of country’s capex. KKC’s industrial segment went through a weak phase in the last three years, given the dwindling economic growth. We believe within the next ~3-4 quarters, India will revive its investment cycle and genset demand will come from all segments. We believe that the country needs substantial investment in new diesel engines for road construction, mines, oil rigs, commercial vehicles, rail engines, defense ships, water pumps, etc.

Debt free balance sheet with surplus cash, high return ratio, in the next three years provides an attractive investment opportunity- KKC likely to post revenue and an EBITDA CAGR of ~19.8% & ~18.8% respectively over the next 3 years. The company is likely to maintain an EBITDA margin of ~17-18% on the back of favorable product mix, price hike in selected product and higher indigenization, which will guide a PAT CAGR of ~16.1%. Furthermore, KKC is a debt-free company with a free cash flow of INR436 Crore. Also, ROE of ~24% in FY14 is expected to improve to ~25% in FY17E on higher earnings. Therefore, the above mentioned rationale provides an attractive investment opportunity for the long term investors.

Key Financials Highlights (Figure in INR CR)

| Particulars (INR IN Cr) | FY2012A | FY2013A | FY2014A | FY2015E | FY2016E | FY2017E |
|-------------------------|---------|---------|---------|---------|---------|---------|
| Net Sales | 4117.2 | 4589.4 | 3976.7 | 4584.5 | 5745.1 | 6836.7 |
| Growth (%) | 41.8% | 11.5% | -13.4% | 15.3% | 25.3% | 19.0% |
| EBITDA | 697.3 | 834.9 | 696.7 | 795.5 | 1017.3 | 1233.9 |
| EBITDA Margin (%) | 16.9% | 18.2% | 17.5% | 17.4% | 17.7% | 18.0% |
| Net Profit | 539.8 | 702.5 | 600.0 | 691.4 | 810.9 | 939.2 |
| Net Profit Margin (%) | 13.1% | 15.3% | 15.1% | 15.1% | 14.1% | 13.7% |
| Net Profit Growth(%) | 92.3% | 30.1% | -14.6% | 15.2% | 17.3% | 15.8% |
| EPS | 21.3 | 27.6 | 21.6 | 24.9 | 29.3 | 33.9 |
| Adj. EPS* | 19.5 | 25.3 | 21.6 | 24.9 | 29.3 | 33.9 |
| Adj. P/E(x)* | 25.5 | 19.6 | 27.5 | 34.2 | 29.1 | 25.2 |
| Adj. P/BV(x)* | 6.7 | 5.8 | 6.4 | 7.6 | 6.8 | 6.0 |
| ROE(%) | 30.7% | 34.5% | 24.2% | 24.4% | 24.6% | 25.3% |
| EV/EBITDA(x) | 15.9 | 16.5 | 12.9 | 29.5 | 23.0 | 19.0 |

Source: Company Data, Microsec Research

Quarterly Result Update

| Particulars | Quarterly Snapshot | | | | | Half-Yearly | | |
|--|--------------------|--------------|---------------|----------------|-----------------|---------------|---------------|----------------|
| | Q2FY15A | Q2FY14A | Q1FY14A | YoY | QoQ | FY2015A | FY2014A | % Change |
| Net Sales | 1117.1 | 913.8 | 1032.7 | 22.3% | 8.2% | 2149.8 | 1942.5 | 10.7% |
| Other Operating Income | 26.9 | 18.9 | 12.4 | | | 39.4 | 39.5 | |
| Total Operating Income | 1144.1 | 932.7 | 1045.1 | 22.7% | 9.5% | 2189.2 | 1982.0 | 10.5% |
| Total Expenditure | 954.1 | 780.1 | 865.3 | | | 1819.4 | 1653.8 | |
| EBITDA | 189.9 | 152.6 | 179.9 | 24.4% | 5.6% | 369.8 | 328.2 | 12.7% |
| <i>EBITDA Margin (%)</i> | <i>16.6%</i> | <i>16.4%</i> | <i>17.2%</i> | <i>24 Bps</i> | <i>(61)Bps</i> | <i>16.9%</i> | <i>16.6%</i> | <i>33 Bps</i> |
| Other Income | 72.6 | 55.8 | 106.7 | 30.1% | -31.9% | 179.4 | 122.6 | 46.3% |
| Operating Profit | 262.6 | 208.5 | 286.6 | 25.9% | -8.4% | 549.1 | 450.9 | 21.8% |
| Depreciation | 20.4 | 13.1 | 18.6 | | | 39.0 | 24.9 | |
| PBIT | 242.2 | 195.4 | 268.0 | 24.0% | -9.6% | 510.1 | 426.0 | 19.7% |
| PBT | 241.2 | 194.4 | 266.7 | 24.0% | -9.6% | 507.9 | 423.9 | 19.8% |
| Tax | 38.8 | 49.6 | 54.7 | | | 93.5 | 112.9 | |
| PAT | 202.4 | 144.8 | 212.0 | | | 414.4 | 311.0 | |
| Consolidated PAT | 202.4 | 144.8 | 212.0 | 39.8% | -4.5% | 414.4 | 311.0 | 33.2% |
| <i>PAT Margin (%)</i> | <i>17.7%</i> | <i>15.5%</i> | <i>20.3%</i> | <i>217 Bps</i> | <i>(259)Bps</i> | <i>18.9%</i> | <i>15.7%</i> | <i>324 Bps</i> |
| PAT excl exceptional items | 202.4 | 144.8 | 212.0 | 39.8% | -4.5% | 414.4 | 311.0 | 33.2% |
| <i>PAT Margin excl exceptional items (%)</i> | <i>17.7%</i> | <i>15.5%</i> | <i>20.3%</i> | <i>217 Bps</i> | <i>(259)Bps</i> | <i>18.9%</i> | <i>15.7%</i> | <i>324 Bps</i> |
| EPS | 7.3 | 5.2 | 7.6 | 39.8% | -4.5% | 14.9 | 11.2 | 33.2% |
| Adjusted EPS | 7.3 | 5.2 | 7.6 | 39.8% | -4.5% | 14.9 | 11.2 | 33.2% |

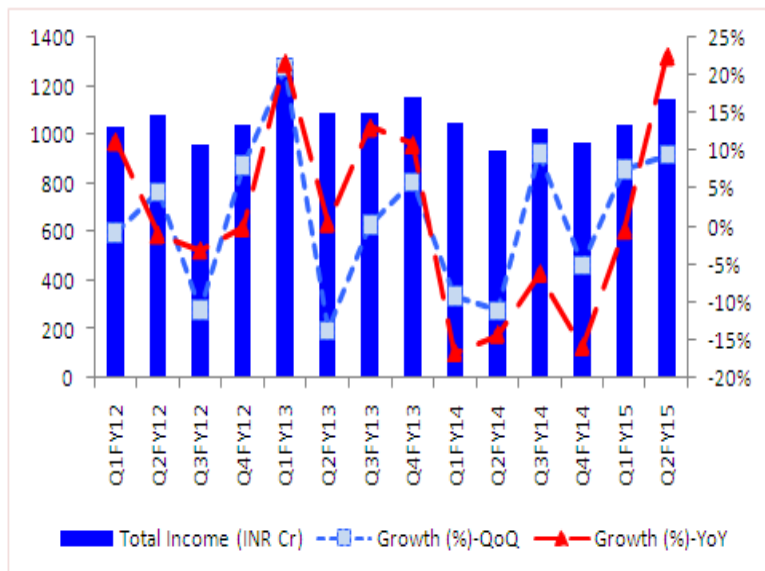
Source: Company Data, Microsec Research. All data in INR crores unless specified.

| Particulars | Quarterly Snapshot | | | | | Half-Yearly | | |
|------------------------------|--------------------|--------------|---------------|--------------|--------------|---------------|---------------|--------------|
| | Q2FY15A | Q2FY14A | Q1FY14A | YoY | QoQ | FY2015A | FY2014A | % Change |
| Segmental Revenue | | | | | | | | |
| PGBU | 259.0 | 240.0 | 288.0 | 7.9% | -10.1% | 547.0 | 570.0 | -4.0% |
| <i>as a % of total sales</i> | <i>22.7%</i> | <i>26.6%</i> | <i>28.1%</i> | | | <i>25.3%</i> | <i>29.7%</i> | |
| IBU | 150.0 | 120.0 | 102.0 | 25.0% | 47.1% | 252.0 | 260.0 | -3.1% |
| <i>as a % of total sales</i> | <i>13.2%</i> | <i>13.3%</i> | <i>10.0%</i> | | | <i>11.7%</i> | <i>13.6%</i> | |
| Auto | 24.0 | 15.0 | 26.0 | 60.0% | -7.7% | 50.0 | 55.0 | -9.1% |
| <i>as a % of total sales</i> | <i>2.1%</i> | <i>1.7%</i> | <i>2.5%</i> | | | <i>2.3%</i> | <i>2.9%</i> | |
| DBU | 236.0 | 227.0 | 218.0 | 4.0% | 8.3% | 454.0 | 457.0 | -0.7% |
| <i>as a % of total sales</i> | <i>20.7%</i> | <i>25.2%</i> | <i>21.3%</i> | | | <i>21.0%</i> | <i>23.8%</i> | |
| Total Domestic Sales | 669.0 | 602.0 | 634.0 | 11.1% | 5.5% | 1303.0 | 1342.0 | -2.9% |
| LHP/Heavy duty/Mid-range | 130.0 | 60.0 | 119.0 | 116.7% | 9.2% | 249.0 | 150.0 | 66.0% |
| <i>as a % of total sales</i> | <i>11.4%</i> | <i>6.7%</i> | <i>11.6%</i> | | | <i>11.5%</i> | <i>7.8%</i> | |
| HHP Exports | 340.0 | 240.0 | 270.9 | 41.7% | 25.5% | 610.9 | 426.0 | 43.4% |
| <i>as a % of total sales</i> | <i>29.9%</i> | <i>26.6%</i> | <i>26.5%</i> | | | <i>28.2%</i> | <i>22.2%</i> | |
| Total Export Sales | 470.0 | 300.0 | 389.9 | 56.7% | 20.5% | 859.9 | 576.0 | 49.3% |
| Total Revenue | 1139.0 | 902.0 | 1023.9 | 26.3% | 11.2% | 2162.9 | 1918.0 | 12.8% |

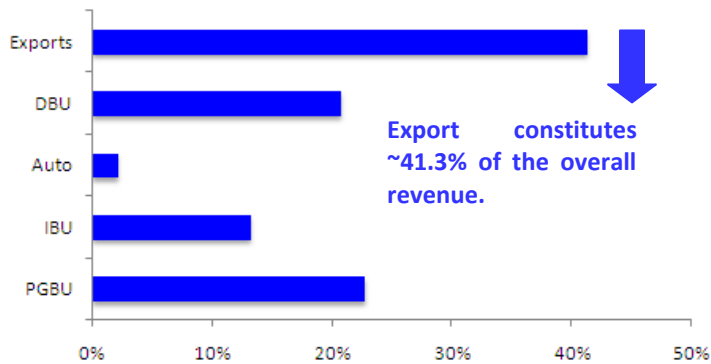
Source: Company Data, Microsec Research. All data in INR crores unless specified.

Solid quarterly numbers, Revenues up by ~23% & ~10% on a QoQ basis

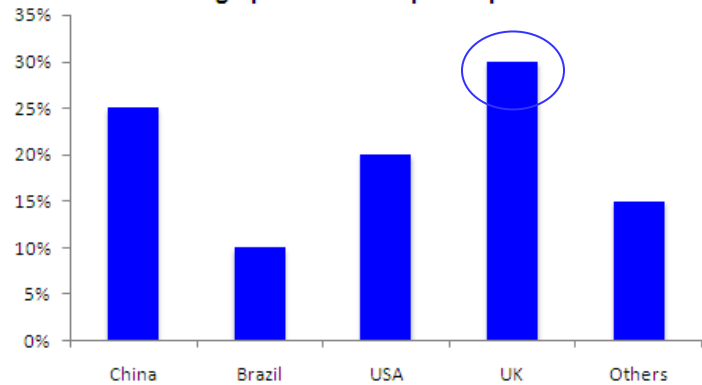
- KKC has posted a good set of numbers for Q2FY15, with revenues increasing by ~23% YoY at INR1144 crore as the company gets benefited from the higher export number (Export up by ~60% YoY).The company's average revenue growth has been 2% over the past ~14 quarters.
- The domestic sales arrived at ~INR669 crores, which constitutes ~58.7% of the overall revenue. The remaining were exports, which brought about ~INR470 crores, up 57% on YoY basis, helped by the ramp up in LHP exports and one time order from China.
- KKC has reported a ~160 bps reduction of gross margin due to (1) higher import content for the CPCB II compliant products (2) 9-10% YoY increase of pig iron prices (3) execution of one time low margin HHP order from China.



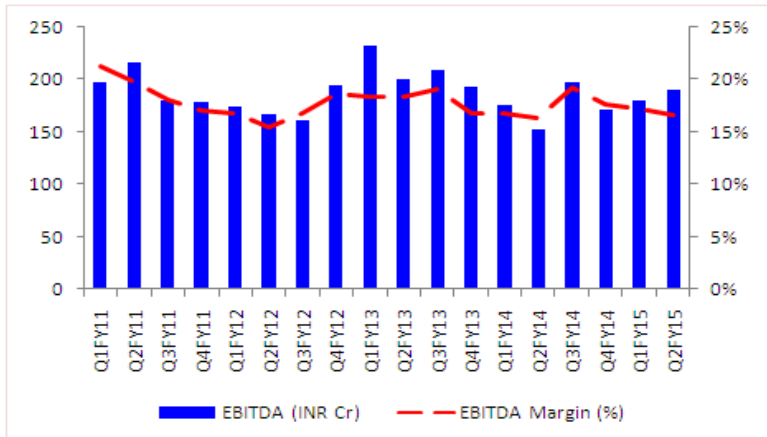
Segmental Break-up of Sales



Geographical Break-up of Exports



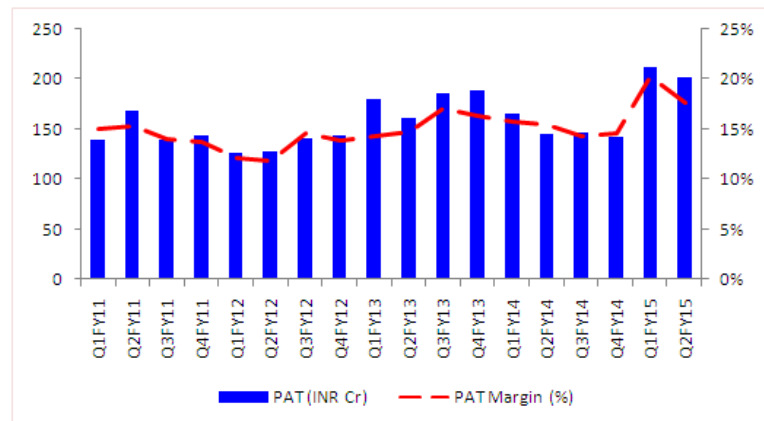
EBITDA grew by ~25% to INR 190 Crore and EBITDA margin expanded by ~24bps on YoY basis



- The EBITDA came at INR189.9 crores, which was up by ~24.4% on YoY basis and ~5.6% on QoQ basis. The reasons for boosted EBITDA were (1) Low expenditure due to its cost reduction processes like six sigma, ACE, etc (2) Improved product mix i.e. higher sales of HHP gensets.
- The EBITDA Margin for the Q2FY14 was ~16.6%, up by ~24bps on YoY basis.

PAT grew by ~40% to INR 202 Crore and PAT margin expanded by ~217Bps on YoY basis

- The PAT arrived at INR202.4 crores, which was up by ~40% on YoY basis, supported by a higher other income and a lower marginal tax rate.
- KKC has received a dividend income of INR40 Crores (INR 29 Crore from Valvoline Cummins, balance from Cummins Research and Technology India and Cummins Generator Technologies India).
- KKC has reported a marginal tax rate of ~16.1% Vs normalised rate of ~25-26%. As per the management, the company got tax benefits from its SEZ units and from dividend income.



Key Takeaways from the conference call

- The management has given a revenue guidance of ~5-10%, on the back of 35% growth in exports. As diesel engines are a good proxy for investment cycle, management believes that actual demand will revive after ~3-4 quarters.
- Management indicated that for the power generation segment, demand was down 25-30% QoQ due to pre-buying associated with CPCB II and the resultant price hike.
- Management expects the EBITDA margin to drop by 100bps in FY15 as the company currently requires higher import content in CPCB II compliant engines. For FY16, KKC will increase indigenization in CPCB II compliant engines. Therefore KKC likely to maintain the EBITDA margin at its historical level.
- Capacity utilisation for the company is in the range of 60-65% Vs 50-60% during the year ago quarter.
- Management communicated that company witness demand recovery from industrial and automotive business and distribution business continues to witness growth.
- Average working capital cycle for LHP products is likely to be 100-110 days. Inventory and trade receivable days expanded by 7 & 13 days YoY.

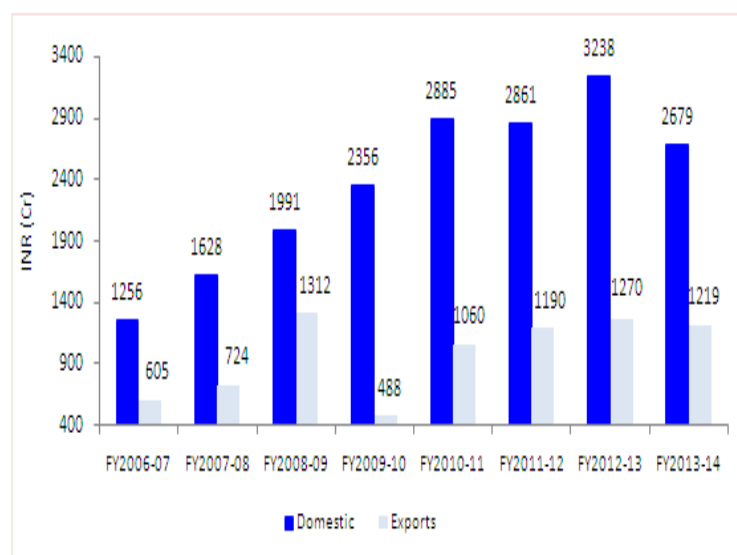
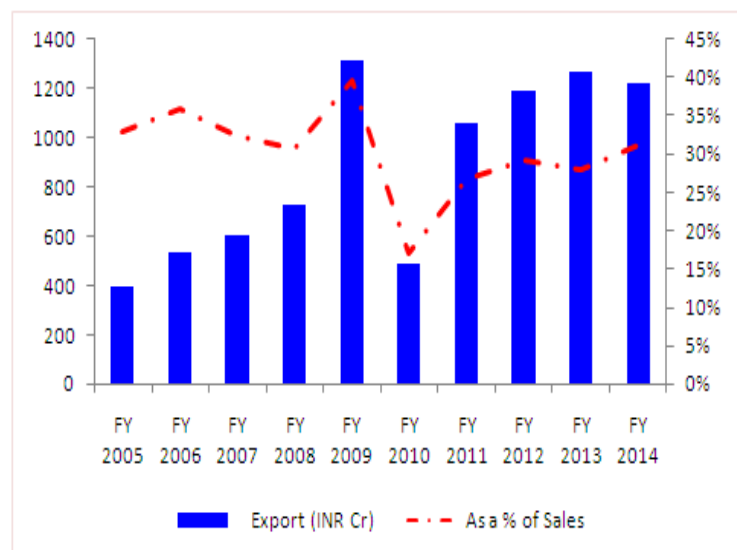
Investment Rationale

Cummins India likely to post an exponential export growth rate over the next 2-3 years- A trigger for the stock-

Cummins India exports ~41% of sales in value terms. Over the last few years, a large portion of incremental volumes of Cummins India has been driven by exports. A large part of exports are driven by cost reduction and a falling INR Vs USD. Management has guided ramping up LHP exports from INR3.5 bn in FY14 to INR15-20 bn by FY19-20E. Management has indicated that KKC will get incremental orders from its parents for LHP verticals as Cummins' shifted export production for some of its products to the India plant. For KKC, sustainability of exports drives being a single sourcing hub for the low HP segment and also some production shift from plants in UK to its India facilities.

Management has indicated that KKC is the single source plant for the parents' operations in the LHP segment. KKC had unveiled a capex plan in FY 2012, where it was catering some of the parent's unlisted India businesses. KKC is ramping up production for its Phaltan facilities which will drive a higher export number. HHP segment remains a large contributor to exports, LHP exports have grown sharply from a low base. Additionally Cummins Inc will shift export production of some of its products to the India plant, which will be the key trigger for the stock, going ahead. KKC currently diversified its export base, developed markets in UK and US account for half the exports.

Key drivers of exports growth would be: (1) scaling up heavy duty exports & low horse power (LHP) exports, (2) parts exports to manufacturing facilities, (3) range expansion in 140-175 KVA categories of gensets.



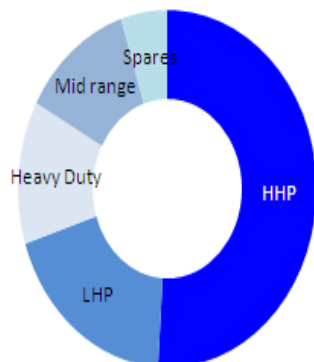
Management expects exports to grow between ~30-40% in FY15e;

Maintained long term growth guidance of 35%: Exports have been growing at a CAGR of ~28.9% for last five years. We expect exports to grow at a CAGR of ~25.6% over FY14-17e. We expect growth in exports to be largely supported by following factors:

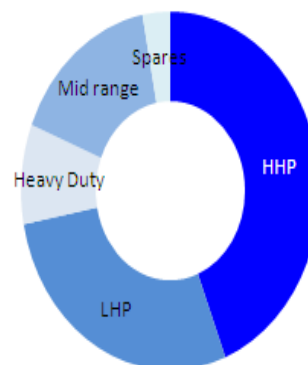
LHP to be the growth driver: We expect growth in LHP (Low Horsepower) segment, which constitutes ~30% of the total exports. In FY14, the LHP was INR578 crore, almost double of INR388 crore in FY13. We expect growth on back of a) demand revival in developing economies like Middle east, South America & Europe b) improvement in ongoing inventory correction at channel partner level c) Production start-up of the new powergen factory (for Urja Gensets) which will be commissioned post HIFY15e, with an initial capacity of ~15,000-20,000 engines p.a. and expected be ramp up to ~50,000 engines in next 2-3 years and d) encouraging response of new gensets launched in the market and e) pick up in market share globally from the current ~5% to ~20% in a span of next 5 years.

Flat growth in HHP (High Horsepower): HHP which constitutes ~60-65% of the total exports is expected to remain flat in FY15e. It is also expected that the new export facility for LHP in Phaltan might replace exports, thus, leading to a decline in HHP in FY16e.

H1 2014- Segment Wise Export Sales Contribution %

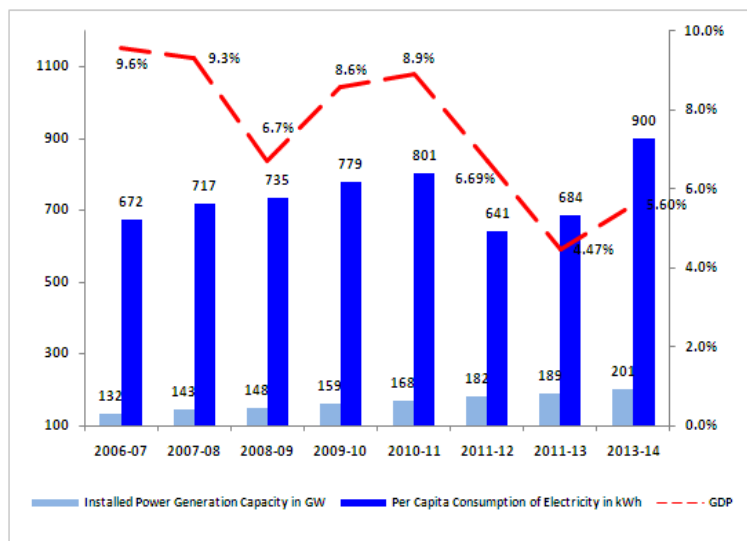


H1 2015- Segment Wise Export Sales Contribution %



Diesel engines – A good proxy for investment cycle, kick-starting of the new investment cycle will power domestic revenue growth for KKC-KKC's product caters every segment of country's capex. KKC's industrial segment went through a weak phase in the last three years, given the dwindling economic growth. We believe within the next ~3-4 quarters, India will revive its investment cycle and genset demand will come from all segments. We believe that the country needs substantial investment in new diesel engines for road construction, mines, oil rigs, commercial vehicles, rail engines, defense ships, water pumps, etc. Furthermore, low-noise gensets are imperative for commercial complex as back-up power.

Domestic Powergen business (~33% of total domestic revenue) to gain ground on continued power: Shortages The domestic powergen business unit (PBU) which accounts for ~33% of the total domestic business of Cummins India is expected to gain ground due to prolonged power shortages in India, particularly southern and northern regions. CEA estimates that power deficits would be averaged at ~19% and ~16% in FY14-15. Apart from this, demand has been strong with deficit rising in eastern region as well to 5% in Q2FY14. In 6MFY14, the southern region contributed ~30% to the domestic gensets volume. The management expects this traction to continue with the peak deficit of at least 8-10% and base deficit of 4-5% to sustain over long period of time. Hence, with other regions like eastern and western regions also joining the race with incremental deficit, we expect domestic powergen business to witness strong demand and grow substantially over next couple of years.

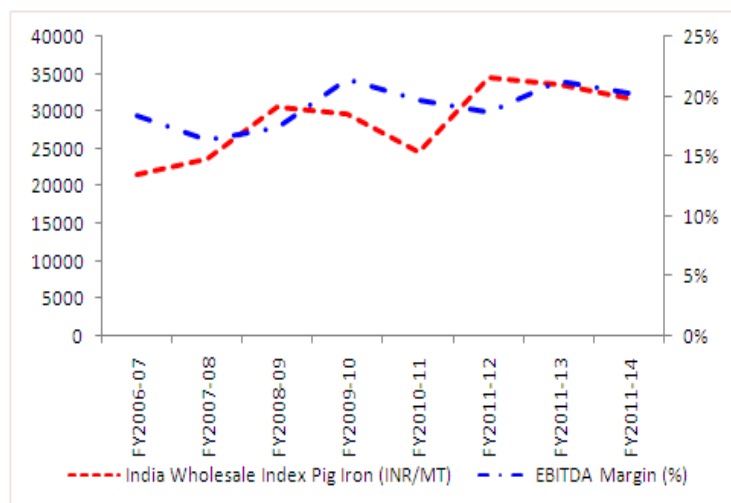
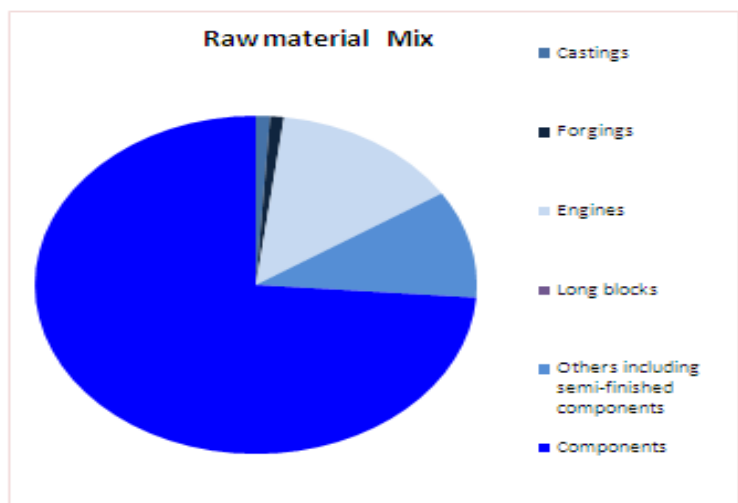
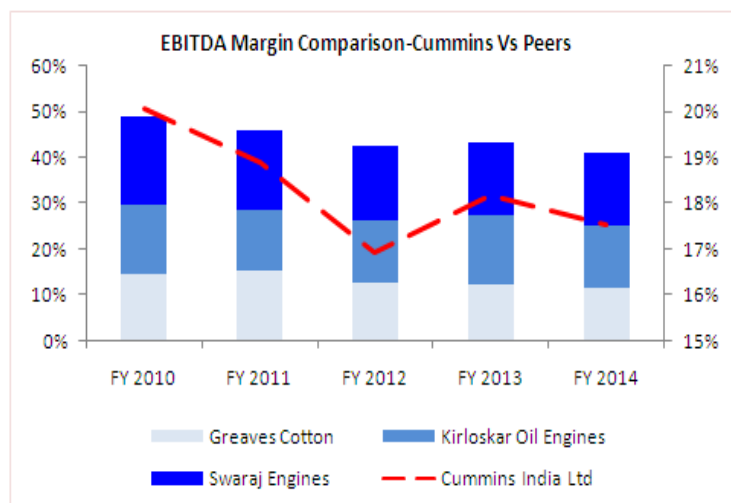
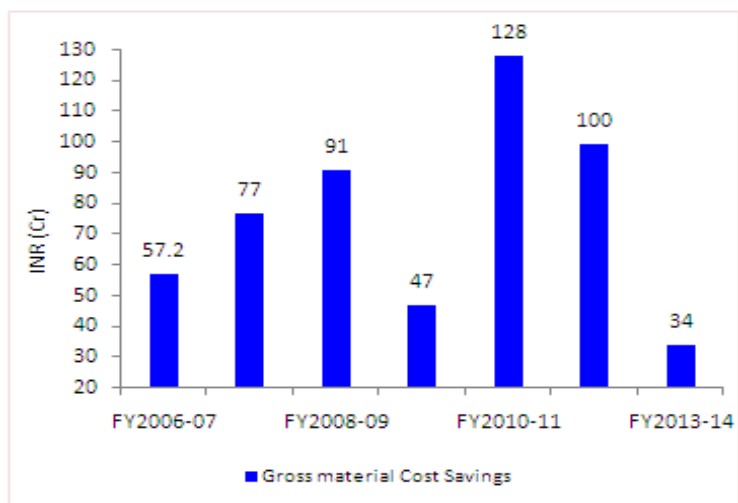


Key triggers like genset price increase post new emission norms (CPCB Norms-II), launch of new products in LHP segment and capacity addition across different sectors augur well for the domestic powergen. The other key triggers which augur well for sustainable growth in domestic power are:

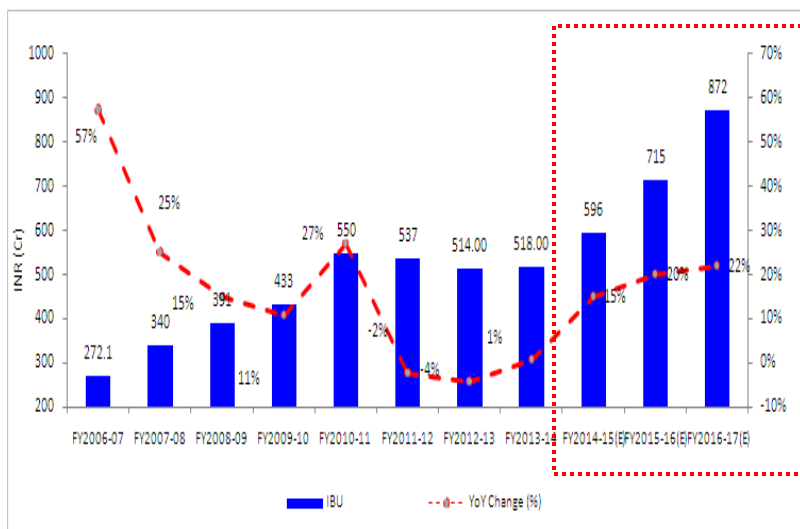
- Launch of new products in LHP segment.
- Company's expectation to maintain its market position in MHP & HHP segment, while expand presence in LHP segment. This would help company improve its LHP volume. Currently, LHP engines constitute ~25% of the total domestic volume with MHP, Heavy duty & HHP accounting for 10%, 10% and 55% respectively.
- Capacity additions across varies sectors like pharma, data centres and textiles, etc.

Cummins India is better placed on EBITDA margin- CPCB – II norms has been effective from 3QFY14 (around 1st January, 2014). The change in emission norms applicable for engines below 800kva, which contribute ~18-20% of the total revenue. As expected, pre-buying of engines ,two quarters before the new CPCB-II norms and ~20-22% higher than the normal demand during that phase. KKC has increased the prices of these diesel engines by ~15-20% post engines post the emission norms due to ~20% rise in the average cost of engines. We believe that FY15e will be play more on volume growth, with consistent price hikes as witnessed in January, 2013 (hike of ~2-3%) because the hike would be a cost-led price increase. However, FY16e sales growth is expected to be more on higher prices post CPCB – II norms. So, change in emission norms would be one of the drivers for the volume growth in FY15e. However, uncertainty with respect to margins may arise from the change in norms as it would be a cost-led price increase. We believe KKC is well equipped to comply with the changing norms and also be the first one to actively launch new emission backed products in the market. Also, the company is not expecting any significant threat from its competitors.

Cummins India has maintained a healthy EBITDA margin even during periods of slowdown. Over the years KKC has been focused on containing costs to improve its margins, KKC currently commands a high EBITDA margin Vs its peers. Management has indicated that as a part of its Accelerated Cost Efficiency (ACE), company going to cut costs by INR230 Crores. The company has a good track record on cost saving, and achieved ~85% of the planned savings during FY06-08 and ~93% during FY09-11 period. Management expects EBITDA margin to drop by ~100bps in FY15 as the company currently requires higher import content in CPCB II compliant engines. For FY16, KKC will increase indigenization in CPCB II compliant engines. Therefore KKC is likely to maintain EBITDA margin at its historical level.



Segmental Analysis

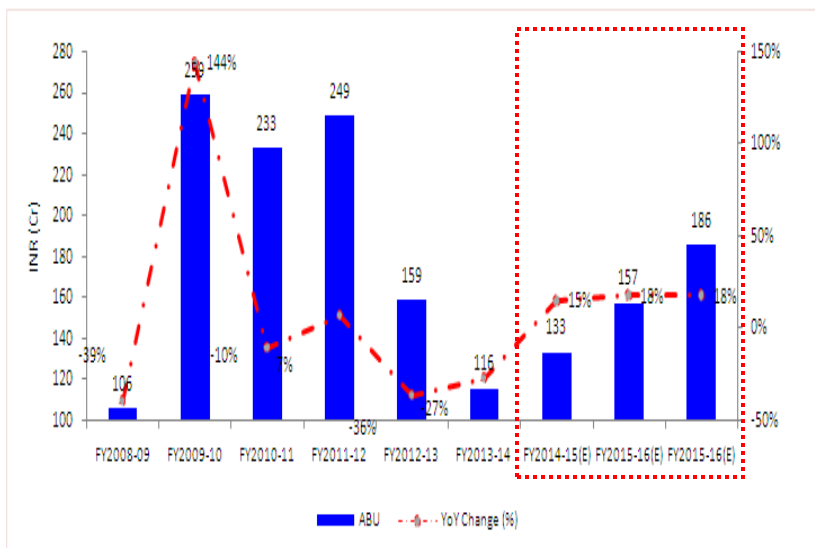
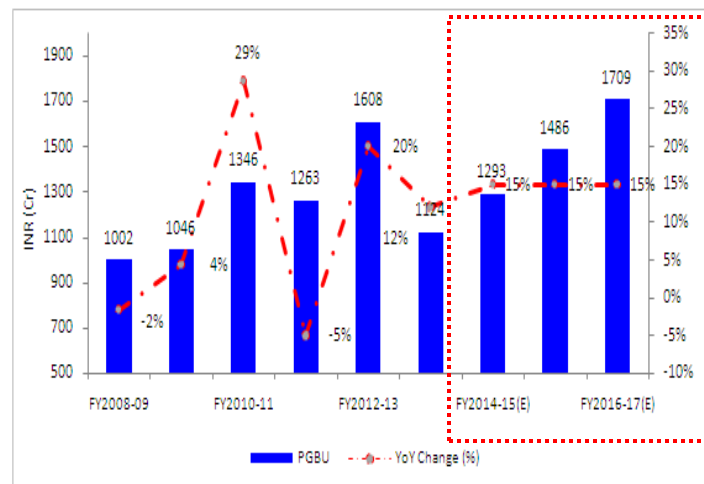


Industrial Business Unit (IBU) -

- The IBU which constitutes almost ~13% of overall revenue is growing at a CAGR of ~4.6% for last 5 years. The IBU constitutes 15% of the domestic business of Cummins.
- IBU segment includes the sector of mining, construction, marine, oil & gas, and defence. The IBU is poised to grow at a CAGR of ~13% in the next 3 years. The growth drivers being 1) the upfit centre at Megasite with an annual capacity of 20,000MW which would cater to the requirements of engines for the construction, compressor, marine & fire pumps markets 3) expected recovery in the economic activity 3) leading position in the market in the off-highway wheeled construction equipments like pavers, wheel loaders etc.

Power Generation Business Unit (PGBU)

- The PGBU which constitutes ~33% of the overall revenue is growing at a CAGR of ~2% for the period of FY2010-2014. The segment is likely to perform well in coming quarters as we expect this segment to pick some momentum keeping in view the increasing demand from sectors like manufacturing, retail and commercial realty.
- The PGBU is likely to grow at CAGR of ~10% for next 3 years on account of 1) the facility at MIDC SEZ which would cater mainly to the exports (~30% of overall revenue); PGBU is ~65%-70% of exports. 2) HHP Rebuild centre which will repair & rebuild gensets & combustion engines 3) Tata Cummins Ltd which will manufacture B series engines & ISB electric engines

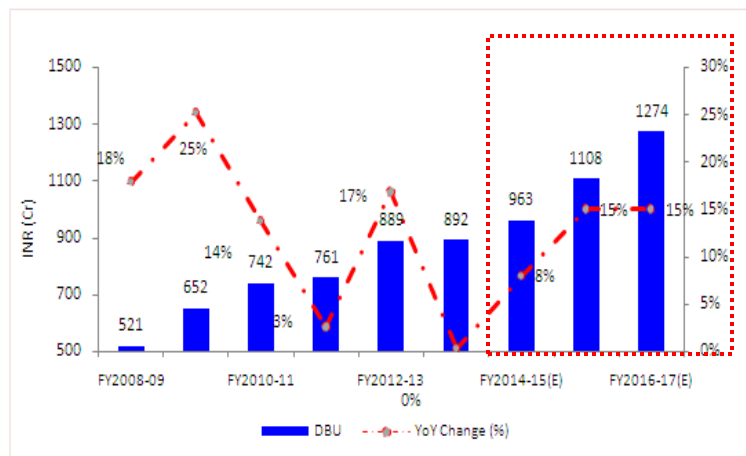


Automotive Business Unit (ABU)-

- The ABU segment contributes ~5% of the total revenue. Cummins has engineered products compliant with emission norms in India. Starting April 2010, BS-IV norms have been implemented in 13 major cities and starting from October 2010, BS-III norms will be implemented across the country. This positioned the company as a preferred supplier to Indian OEMs for their Domestic and Export applications.
- The ABU is likely to grow at CAGR of ~12% in next 3 years. The growth drivers being 1) leading market position in OEM's (Original Equipment Manufacturer) 2) growing demand in market.

Distribution Unit (DBU)-

- The DBU which constitutes around ~20% of the total revenue is growing at a CAGR of ~8% for last 3 years. The distribution business maintains a positive outlook with a CAGR of ~12.6% for next 3 years.
- Distribution business provides a stable chain of revenue as sales are generated from previous years' engine sales and DBU is a high-margin business due to low operating costs.
- The growth drivers are 1) several initiatives launched like inaugurating a 'state of the art' High Horse Power (HHP) Engine Rebuild Centre at the Cummins Megasite in Phaltan for its line of HHP mechanical & electronic engines to cater to the growing demand.



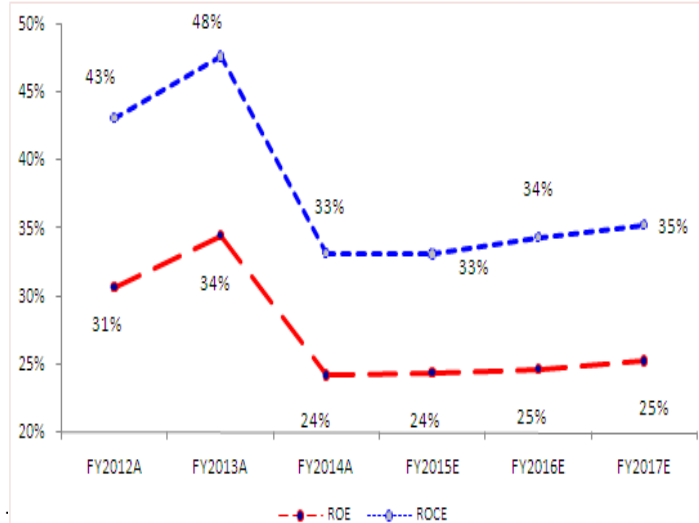
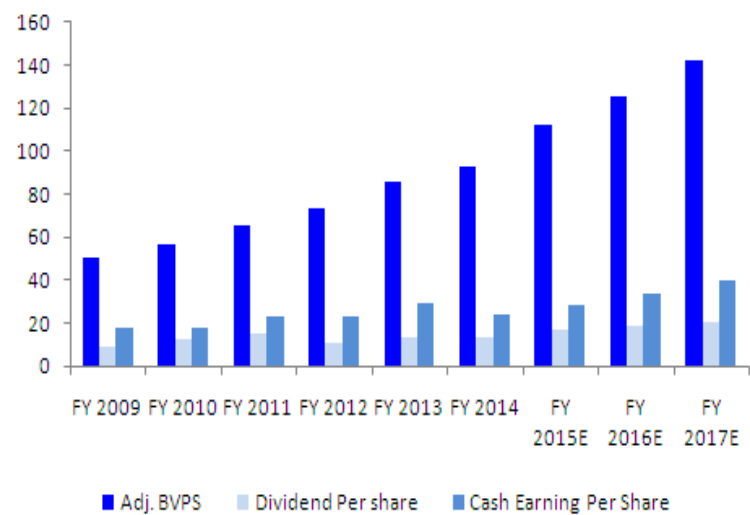
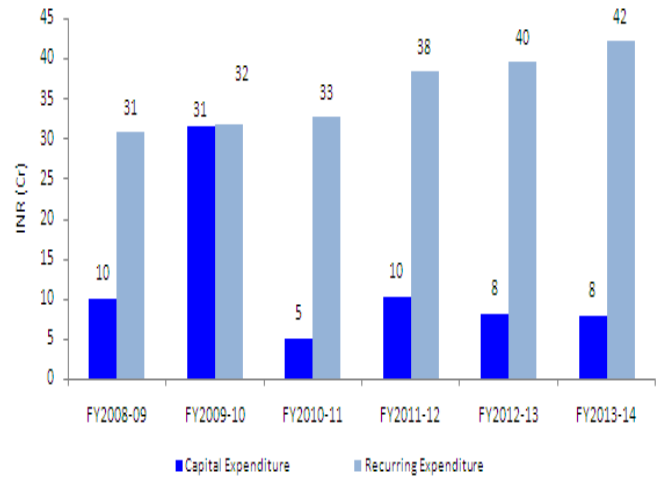
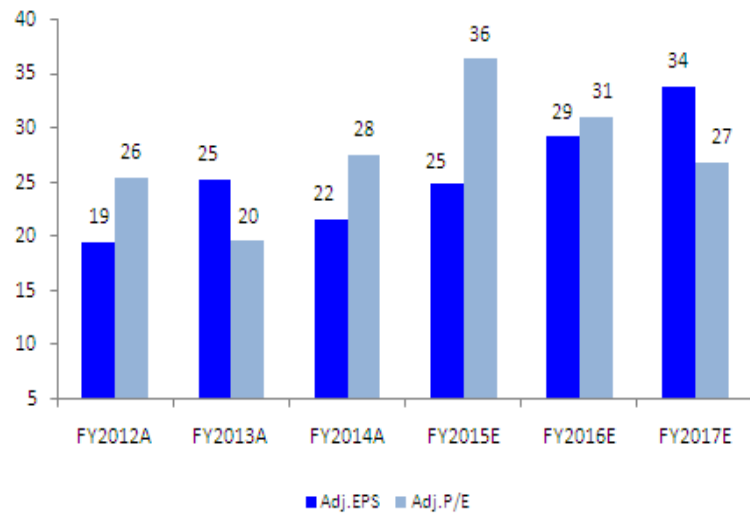
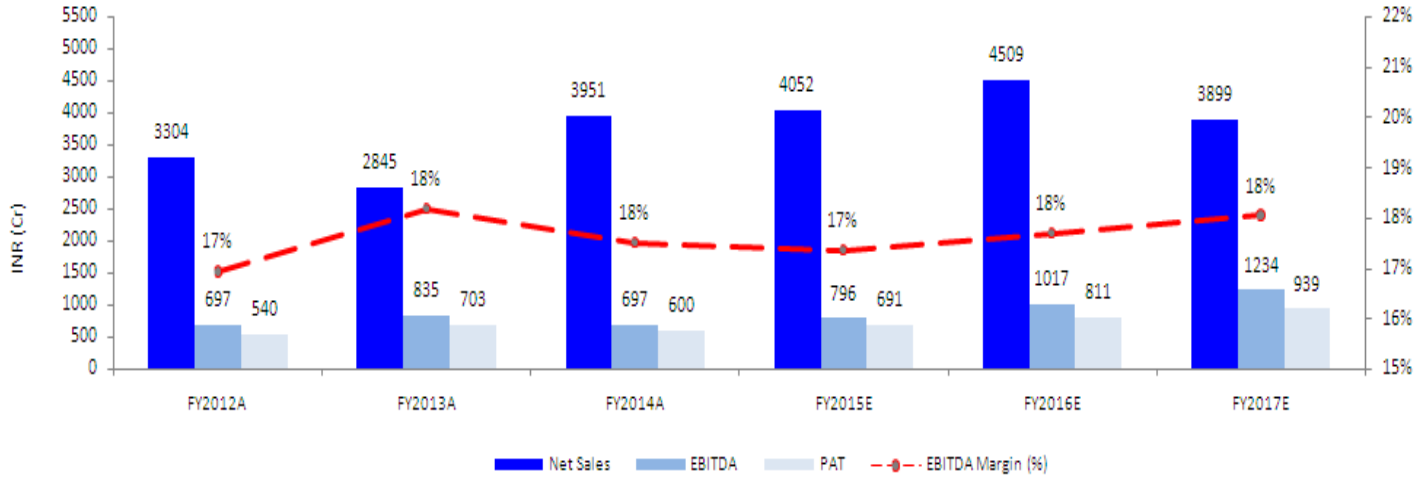
Higher absorption of corporate cross charges seen further at ~2% of revenue; Royalty to remain stable between 2-3% -

Cummins Inc. as the parent company incurs certain expenses on its subsidiary companies for activities like marketing or products etc. The management had indicated that some pressure is being imposed on US- based companies from the US tax authorities on benefitting there overseas subsidiaries for the services rendered by them. With this regards, the management has indicated that it doesn't expect any meaningful increase in the royalty payments, but can see a higher absorption of corporate cross charges for the services the parent provide. Furthermore, we expect that there could be marginal increase in cross charges because of upgradation of the product offering post the new CPCB emission, taking the cross charges to ~3-4% of the revenue from current rate of ~3.60% in FY14.

Capex to spend INR400-500 crores both in FY14e and FY15e at Megasite, Technical Centre and India Office Campus

Cummins India (KKC) is moving in a smooth pace in setting up its integrated manufacturing called "Megasite" at Phaltan in Maharashtra. The group is investing ~INR7000 crores for setting up 10 facilities representing almost all Cummins group companies present in India in one location. At present, four plants are operational viz. **1.** Tata Cummins plant for the B series engines, **2.**High horsepower rebuild centre, **3.**Recon plant to re-manufacture parts and engines and **4.**Parts distribution center. The facility for power generation business to manufacture generator sets and generator drive engines in medium and low horse power range for export market with annual capacity of ~51,000units recently started production. The production is expected to be ~15-20,000 per annum initially and will be increased to full capacity over next three to four years. Cummins had spent an amount of INR226 crores in FY13 as capital expenditure. Out of this, INR82 crores was spent at the megasite, INR50 crores being the biggest on Low horsepower plant, INR87 crores on India Office Campus and rest among other categories. Management expects to spend INR350-400 crores both in FY14e and FY15e because of Corporate Office which is likely to be ready by 2014 and others like technical centre, Low horsepower plant and some tactical projects in High Horsepower manufacturing in Kothrud.

Key Financials



Peer Comparison

| Particulars | CMP | Mcap | TTM Net Sales | TTM EBITDA | TTM EBITDA Margin | TTM PAT | TTM PAT Margin | TTM EPS | Cash | BVPS | D/E |
|-----------------------|-----|-------|---------------|------------|-------------------|---------|----------------|---------|-------|-------|-----|
| Greaves Cotton | 134 | 3276 | 1892.6 | 197 | 10.4% | 145 | 7.7% | 6.0 | 34.2 | 33.6 | 0.0 |
| Kirloskar Oil Engines | 260 | 3754 | 2446.2 | 301 | 12.3% | 178 | 7.3% | 12.3 | 52.4 | 87.6 | 0.0 |
| Cummins India Ltd | 852 | 23624 | 4106.4 | 738 | 18.0% | 703 | 17.1% | 25.4 | 86.5 | 92.5 | 0.0 |
| Swaraj Engines | 886 | 1100 | 638.8 | 95 | 14.9% | 68 | 10.7% | 55.0 | 109.5 | 169.0 | 0.1 |

| Particulars | P/E | | | EV/EBITDA | | | P/BV | | | ROE | | |
|-----------------------|------------|------------|------------|------------------|------------------|------------------|-------------|-------------|-------------|------------|------------|------------|
| | FY 15E P/E | FY 16E P/E | FY 17E P/E | FY 15E EV/EBITDA | FY 16E EV/EBITDA | FY 17E EV/EBITDA | FY 15E P/BV | FY 16E P/BV | FY 17E P/BV | FY 15E ROE | FY 16E ROE | FY 17E ROE |
| Greaves Cotton | 21.9 | 16.8 | 13.5 | 12.7 | 10.0 | 8.5 | 3.6 | 3.1 | 2.6 | 16.9% | 19.2% | 20.5% |
| Kirloskar Oil Engines | 20.1 | 17.0 | 13.0 | 8.3 | 9.9 | 8.6 | 2.9 | 2.6 | 2.4 | 14.6% | 16.1% | 19.2% |
| Cummins India Ltd | 35.0 | 29.9 | 25.8 | 30.3 | 23.6 | 19.5 | 7.8 | 7.0 | 6.1 | 24.4% | 24.6% | 25.3% |
| Swaraj Engines | 14.9 | 12.3 | 11.4 | 9.2 | 7.8 | 7.0 | 4.4 | 3.8 | 3.3 | 30.4% | 29.8% | 30.3% |

Source: Company data, Microsec Research, Bloomberg estimates. (All figures in INR crores except % and per share data)

Valuation

We are re-initiating the stock a **"STRONG BUY"** at current level on account of strong growth in domestic revenue supported by powergen business and recovery in industrial business, growth in exports, volume growth due to pre-buying on change of emission norms, ~15-20% price hike post emission norms, and stable margins due to its cost control efficiencies. At the current price of INR852, the stock is trading at adjusted P/E of 34.17x its FY15e EPS and 29.13x its FY16e EPS. We believe that KKC will continue to enjoy premium valuations due to its dominant market positioning, impressive long-term growth outlook, healthy balance-sheet, strong ROE as compared to its peers and dividend yield of ~2.83%. We have used the discounted cash flow (DCF) method to value KKC. **We have assigned a WACC of 11.38% and assumed a terminal growth rate of 3%. Our DCF based price target is INR 1056 which shows an upside potential of 24% from the current market price of INR 852. Hence we recommend a "STRONG BUY" for the stock from long term perspective.**

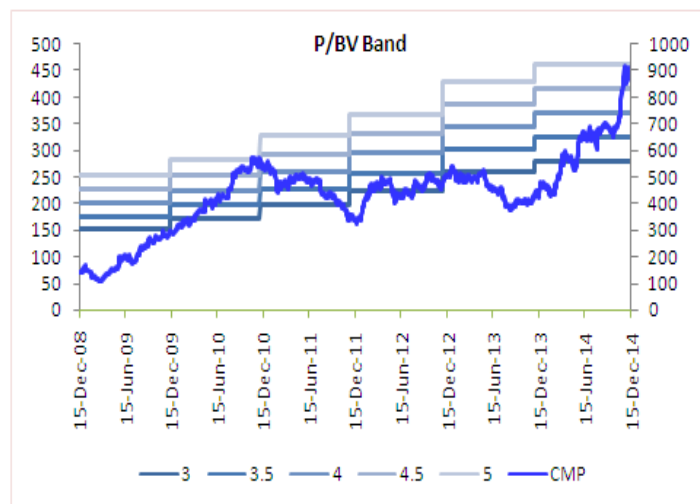
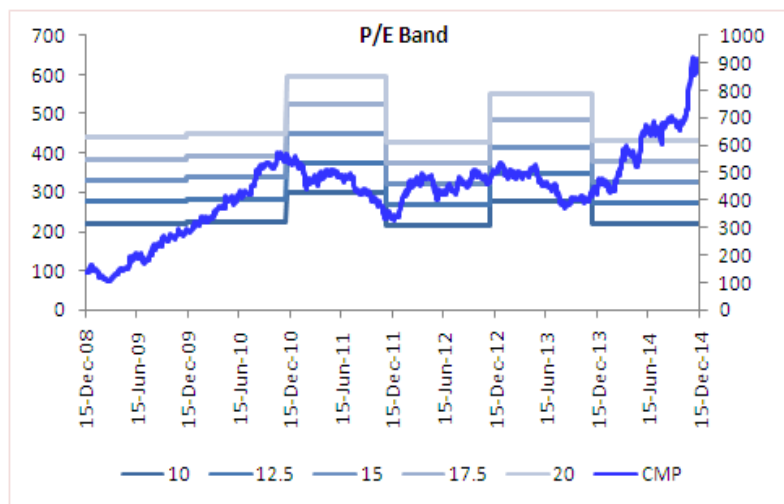
Key DCF Assumptions

| Parameters | |
|-----------------------|---------------|
| Risk Free Rate | 7.87% |
| Return on Market | 11.91% |
| Market Risk Premium | 3.51% |
| Beta | 0.87 |
| Cost of Equity | 11.38% |
| Cost of Debt | 7.80% |
| Tax Rate | 26.00% |
| Post-Tax cost of Debt | 5.77% |
| Debt-to-Equity Ratio | 0.00 |
| WACC | 11.38% |

DCF - Sensitivity Analysis

| Terminal Growth Rate | WACC | | | | | | | |
|----------------------|------|------|-------|-------|-------|-------|-------|-------|
| | 1056 | 9.9% | 10.4% | 10.9% | 11.4% | 11.9% | 12.4% | 12.9% |
| 1.5% | 1131 | 1079 | 1031 | 987 | 946 | 909 | 874 | |
| 2.0% | 1162 | 1105 | 1054 | 1007 | 964 | 925 | 888 | |
| 2.5% | 1197 | 1136 | 1080 | 1030 | 985 | 943 | 905 | |
| 3.0% | 1237 | 1170 | 1110 | 1056 | 1008 | 963 | 922 | |
| 3.5% | 1283 | 1209 | 1144 | 1085 | 1033 | 985 | 942 | |
| 4.0% | 1337 | 1255 | 1182 | 1118 | 1062 | 1010 | 964 | |
| 4.5% | 1401 | 1308 | 1227 | 1156 | 1094 | 1038 | 988 | |

Valuation Charts



Risks & Concerns

- The risks due to interest rates being hiked to curb rising inflation, could dampen industrial activity. Rising commodity prices could also put pressure on Company margins.
- Key international players are making their foray into India. Private players are also entering so-called Government domains like mining and exploration. This will see the intensity of the competitive landscape rising to new levels.

Recommendation History

| Report Type | Recommended date | CMP | Target Price | Total return generated | Report Links |
|----------------------|------------------|-----|--------------|------------------------|---|
| ICR | 29th March'12 | 462 | 537 | 16% | http://www.microsec.in/Static/Pdf/Cummins%20India%20ICR.pdf |
| Re-Initiate | 6th May'13 | 459 | 556 | 21% | http://www.microsec.in/Static/Pdf/Cummins%20India.pdf |
| Q1FY14 Result Update | 22nd Aug'13 | 374 | 451 | 20% | http://www.microsec.in/Static/Pdf/Cummins%20India%20Q1FY14%20Result%20Update.pdf |

Income Statement

Figures in INR Cr

| Particulars | FY2012A | FY2013A | FY2014A | FY2015E | FY2016E | FY2017E |
|---|---------------|---------------|----------------|---------------|---------------|---------------|
| INCOME | | | | | | |
| Net Sales | 4052.17 | 4509.00 | 3899.11 | 4483.98 | 5604.97 | 6669.92 |
| Growth in sales (%) - YoY | 2.56% | 11.27% | -13.53% | 15% | 25% | 19% |
| Other Operating Income | 65.05 | 80.38 | 77.56 | 100.50 | 140.12 | 166.75 |
| as % of sales | 1.61% | 1.78% | 1.99% | 2.50% | 2.50% | 2.50% |
| Total Income from Operation | 4117.22 | 4589.38 | 3976.67 | 4584.48 | 5745.09 | 6836.66 |
| Growth (%) - YoY | 1.85% | 11.47% | -13.35% | 15.28% | 25.32% | 19.00% |
| TOTAL EXPENDITURE | 3419.97 | 3754.50 | 3279.94 | 3788.96 | 4727.79 | 5602.73 |
| as % of sales | 84.40% | 83.27% | 84.12% | 84.50% | 84.35% | 84.00% |
| EBITDA Margin (%) | 16.93% | 18.19% | 17.52% | 17.35% | 17.71% | 18.05% |
| EBITDA | 697.25 | 834.88 | 696.73 | 795.52 | 1017.30 | 1233.93 |
| Growth (%) | -8.66% | 19.74% | -16.55% | 14.18% | 27.88% | 21.29% |
| Depreciation | 41.98 | 47.25 | 52.75 | 86.64 | 125.54 | 153.47 |
| EBIT Margin (%) | 16.17% | 17.47% | 16.52% | 15.81% | 15.91% | 16.20% |
| EBIT | 655.27 | 787.63 | 643.98 | 708.88 | 891.76 | 1080.46 |
| Interest | 5.41 | 4.61 | 4.18 | 4.50 | 5.50 | 6.00 |
| Other Income | 123.33 | 206.72 | 177.71 | 230 | 240 | 230 |
| PBT before exceptional items | 773.19 | 989.74 | 817.51 | 934.38 | 1126.26 | 1304.46 |
| exceptional items | 51.44 | 61.59 | 0 | 0 | 0 | 0 |
| PBT Margin (%) | 20.35% | 23.32% | 20.97% | 20.84% | 20.09% | 19.56% |
| PBT after exceptional items | 824.63 | 1051.33 | 817.51 | 934.38 | 1126.26 | 1304.46 |
| Tax | 233.36 | 287.22 | 217.49 | 242.94 | 315.35 | 365.25 |
| Tax (%) | 28.30% | 27.32% | 26.60% | 26% | 28% | 28% |
| PAT before extraordinary items | 591.27 | 764.11 | 600.02 | 691.44 | 810.91 | 939.21 |
| Extraordinary item | 51.44 | 61.59 | 0 | 0 | 0 | 0 |
| PAT after extraordinary items | 539.83 | 702.52 | 600.02 | 691.44 | 810.91 | 939.21 |
| Share in profit of associates | 0 | 0 | 0 | 0 | 0 | 0 |
| PAT Margin (%) | 13.32% | 15.58% | 15.39% | 15.42% | 14.47% | 14.08% |
| PAT after minority interest & shrs in associates | 539.83 | 702.52 | 600.02 | 691.44 | 810.91 | 939.21 |
| Paid -up Equity Share Capital (Face Value of Rs.2.00) | 55.44 | 55.44 | 55.44 | 55.44 | 55.44 | 55.44 |
| EPS* | 21.33 | 27.57 | 21.65 | 24.94 | 29.25 | 33.88 |
| Adjusted EPS | 19.47 | 25.34 | 21.65 | 24.94 | 29.25 | 33.88 |

*In Q1FY12, the company issued Bonus Shares in the proportion of 2 (two) Bonus equity shares of Rs. 2/- each for every 5 (five) existing equity shares of Rs. 2/- each fully paid up by capitalization of reserves of the Company.

Balance Sheet

Figures in INR Cr

| Particulars | FY 2012A | FY 2013A | FY 2014A | FY 2015E | FY 2016E | FY 2017E |
|---|----------------|----------------|----------------|----------------|----------------|----------------|
| SOURCES OF FUNDS: | | | | | | |
| Share Capital | 55.44 | 55.44 | 55.44 | 55.44 | 55.44 | 55.44 |
| Reserves & Surplus | 1987.71 | 2331.29 | 2509.71 | 3050.59 | 3421.72 | 3898.01 |
| Shareholder's Funds | 2043.15 | 2386.73 | 2565.15 | 3106.03 | 3477.16 | 3953.45 |
| Loan Funds | 0 | 0 | 0 | 0 | 0 | 0 |
| Deferred tax liabilities (Net) | -6.95 | 32.78 | 46.51 | 46.51 | 46.51 | 46.51 |
| Other long term liabilities | 14.70 | 19.14 | 20.19 | 21.20 | 22.20 | 22.20 |
| Long-term provisions | 100.65 | 129.35 | 117.09 | 118.06 | 118.09 | 118.09 |
| Total Non-current liabilities | 108.40 | 181.27 | 183.79 | 185.77 | 186.80 | 186.80 |
| Trade payables | 516.62 | 549.34 | 485.11 | 530.80 | 631.30 | 711.30 |
| Other current liabilities | 151.65 | 203.46 | 185.67 | 185.00 | 185.00 | 185.00 |
| Short-term provisions | 274.92 | 348.82 | 353.01 | 355.00 | 350.00 | 355.00 |
| Total Current liabilities | 943.19 | 1101.62 | 1023.79 | 1070.80 | 1166.30 | 1251.30 |
| Total | 3094.74 | 3669.62 | 3772.73 | 4362.60 | 4830.26 | 5391.55 |
| APPLICATION OF FUNDS | | | | | | |
| Fixed Assets | | | | | | |
| Gross Block | 970.30 | 1041.47 | 1511.98 | 2053.22 | 2511.22 | 2788.22 |
| (-) Accumulated Depreciation | 505.39 | 548.04 | 592.83 | 679.47 | 805.00 | 958.48 |
| Net block | 464.91 | 493.43 | 919.15 | 1373.75 | 1706.22 | 1829.74 |
| Capital Work in Progress | 49.67 | 120.79 | 95.76 | 90.00 | 90.00 | 90.00 |
| Investments | 597.55 | 627.56 | 495.35 | 395.35 | 295.35 | 295.35 |
| Fixed Assets & Investments | 1112.13 | 1241.78 | 1510.26 | 1859.10 | 2091.57 | 2215.09 |
| Inventories | 567.61 | 530.35 | 551.34 | 523.94 | 611.45 | 743.93 |
| Sundry Debtors | 678.34 | 854.99 | 782.03 | 846.03 | 1057.54 | 1258.47 |
| Other Current assets | 4.97 | 9.03 | 2.16 | 9.84 | 9.84 | 9.84 |
| Cash & Bank balance | 223.50 | 354.65 | 86.49 | 148.96 | 220.68 | 177.77 |
| Loans & Advances | 508.19 | 678.82 | 840.45 | 565.88 | 706.23 | 840.41 |
| Total Current Assets, Loans & Advances | 1982.61 | 2427.84 | 2262.47 | 2094.65 | 2605.74 | 3030.42 |
| Net Current Assets | 1982.61 | 2427.84 | 2262.47 | 2094.65 | 2605.74 | 3030.42 |
| TOTAL | 3094.74 | 3669.62 | 3772.73 | 4362.60 | 4830.26 | 5391.55 |

Cash Flow Statement

INR Cr

| Particulars | FY 2012A | FY 2013A | FY 2014A | FY 2015E | FY 2016E | FY 2017E |
|---|----------------|----------------|----------------|----------------|----------------|----------------|
| A. Cash Flow From Operating Activites | | | | | | |
| Net Profit Before Tax | 773.19 | 989.74 | 817.51 | 934.38 | 1126.26 | 1304.46 |
| Depreciation | 41.98 | 47.25 | 52.75 | 86.64 | 125.54 | 153.47 |
| Loss/(Profit) on assets sold or discarded | -0.05 | -11.85 | 0.2 | | | |
| profit on sale of investments | -22.76 | -62.15 | -16.72 | | | |
| Provision for Doubtful debts | 3.54 | 1.47 | 2.07 | 4.07 | 4.07 | 4.07 |
| Interest Expenses | 5.41 | 4.61 | 4.18 | 4.50 | 5.50 | 6.00 |
| Interest Income | -18.02 | -17.6 | -46.05 | -46.05 | -46.05 | -46.05 |
| Dividend Income | -42.87 | -68.86 | -60.1 | -60.1 | -60.1 | -60.1 |
| Operating Profit before WC changes | 740.42 | 882.61 | 753.84 | 923.44 | 1155.22 | 1361.85 |
| (Increase)/Decrease in Inventories | -48.65 | 37.26 | -20.99 | 27.40 | -87.51 | -132.48 |
| (Increase)/Decrease in Sundry Debtors | 36.28 | -178.11 | 70.89 | -64.00 | -211.51 | -200.93 |
| (Increase)/ Decrease in loans and advances | -59.88 | -72.69 | -120.39 | 274.57 | -140.35 | -134.18 |
| Increase/ (Decrease) in Long term liabilities | -5.09 | 4.44 | 1.05 | 0.00 | 0.00 | 0.00 |
| (Increase)/Decrease in Other current liabilities | 40.66 | 51.63 | -18.92 | -7.68 | 0.00 | 0.00 |
| (Increase)/Decrease in Trade Payable | -50.88 | 32.74 | -64.23 | -45.69 | -100.50 | -80.00 |
| (Increase)/Decrease in Provisions | 5.10 | 36.44 | -8.07 | 1.99 | -5.00 | 5.00 |
| Cash generated from operations | 657.96 | 794.32 | 593.18 | 1110.02 | 610.36 | 819.26 |
| Direct taxes paid | 215.48 | 265.71 | 230.81 | 242.94 | 315.35 | 365.25 |
| Net Cash from Operating Activities | 442.48 | 528.61 | 362.37 | 867.08 | 295.00 | 454.01 |
| B. Cash Flow From Investing Activities | | | | | | |
| Purchase of Fixed Assets | -228.82 | -228.82 | -471.79 | -535.48 | -458.00 | -277.00 |
| Net Cash used in Investing Activities | 27.88 | -38.46 | -204.75 | -406.63 | 222.00 | -28.00 |
| C. Cash Flow From Financing Activities | | | | | | |
| Interest Paid | -5.41 | -4.61 | -4.18 | -4.50 | -5.50 | -6.00 |
| Dividend Paid (including tax on dividend) | -345.18 | -354.39 | -421.60 | -393.49 | -439.78 | -462.92 |
| Net Cash from/(Used) in financing activities | -350.59 | -359.00 | -425.78 | -397.99 | -445.28 | -468.92 |
| Net (Increase)/Decrease in cash & cash equivalents | 119.77 | 131.15 | -268.16 | 62.47 | 71.73 | -42.92 |
| Cash & Cash Equivalents at beginning | 103.73 | 223.50 | 354.65 | 86.49 | 148.96 | 220.68 |
| Cash & Cash Equivalents at End | 223.50 | 354.65 | 86.49 | 148.96 | 220.68 | 177.77 |

Financial Ratios

| Particulars | FY 2011 | FY 2012 | FY 2013 | FY 2014 | FY 2015E | FY 2016E | FY 2017E |
|-----------------------------------|---------|---------|---------|---------|----------|----------|----------|
| Profitability Ratios (%) | | | | | | | |
| Return on Assets (ROA) | 22.81% | 18.17% | 20.77% | 16.12% | 17.00% | 17.64% | 18.38% |
| Return on Capital Employed (ROCE) | 47.82% | 43.13% | 47.67% | 33.19% | 33.11% | 34.38% | 35.27% |
| Return on Equity (ROE) | 35.10% | 30.72% | 34.50% | 24.23% | 24.38% | 24.64% | 25.28% |
| Per Share | | | | | | | |
| Earnings Per Share | 29.85 | 21.33 | 27.57 | 21.65 | 24.94 | 29.25 | 33.88 |
| Adj. Earnings Per Share | 21.32 | 19.47 | 25.34 | 21.65 | 24.94 | 29.25 | 33.88 |
| Dividend Per share | 15.00 | 11.00 | 13.00 | 13.00 | 17.00 | 19.00 | 20.00 |
| Cash Earning Per Share | 22.64 | 22.84 | 29.27 | 23.55 | 28.07 | 33.78 | 39.42 |
| BVPS | 91.23 | 73.71 | 86.10 | 94.31 | 114.19 | 127.84 | 145.35 |
| Adj. BVPS | 65.16 | 73.71 | 86.10 | 92.54 | 112.05 | 125.44 | 142.62 |
| Valuation Parameters | | | | | | | |
| Adj. P/E ratio | 22.93 | 25.51 | 19.61 | 27.53 | 34.17 | 29.13 | 25.15 |
| P/CEPS | 21.60 | 21.75 | 16.98 | 25.31 | 30.36 | 25.23 | 21.62 |
| Normalised P/BVPS | 5.36 | 6.74 | 5.77 | 6.32 | 7.46 | 6.67 | 5.86 |
| Adj. P/BVPS | 7.50 | 6.74 | 5.77 | 6.44 | 7.61 | 6.79 | 5.98 |
| Market Cap/Sales | 3.43 | 3.40 | 3.06 | 4.24 | 5.27 | 4.21 | 3.54 |
| EV/EBITDA | 15.60 | 15.94 | 16.51 | 12.89 | 29.51 | 23.01 | 19.00 |
| Liquidity Ratios | | | | | | | |
| Current Ratio | 1.81 | 2.10 | 2.20 | 2.21 | 1.96 | 2.23 | 2.42 |
| Acid Test Ratio | 1.26 | 1.50 | 1.72 | 1.67 | 1.47 | 1.71 | 1.83 |
| Debt-Equity Ratio | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Efficiency Ratios (%) | | | | | | | |
| Asset turnover Ratio | 1.53 | 1.36 | 1.33 | 1.05 | 1.10 | 1.22 | 1.31 |
| Working Capital Turnover Ratio | 3.12 | 2.38 | 2.27 | 1.61 | 1.98 | 2.68 | 2.56 |
| Inventory Turnover Ratio | 8.51 | 7.46 | 8.21 | 7.21 | 8.34 | 9.87 | 9.84 |
| Margin Ratios (%) | | | | | | | |
| EBITDA Margin | 18.88% | 16.93% | 18.19% | 17.52% | 17.35% | 17.71% | 18.05% |
| EBIT Margin | 18.39% | 16.17% | 17.47% | 16.52% | 15.81% | 15.91% | 16.20% |
| PBT Margin | 20.31% | 20.35% | 23.32% | 20.97% | 20.84% | 20.09% | 19.56% |
| Net Profit Margin | 14.96% | 13.32% | 15.58% | 15.39% | 15.42% | 14.47% | 14.08% |

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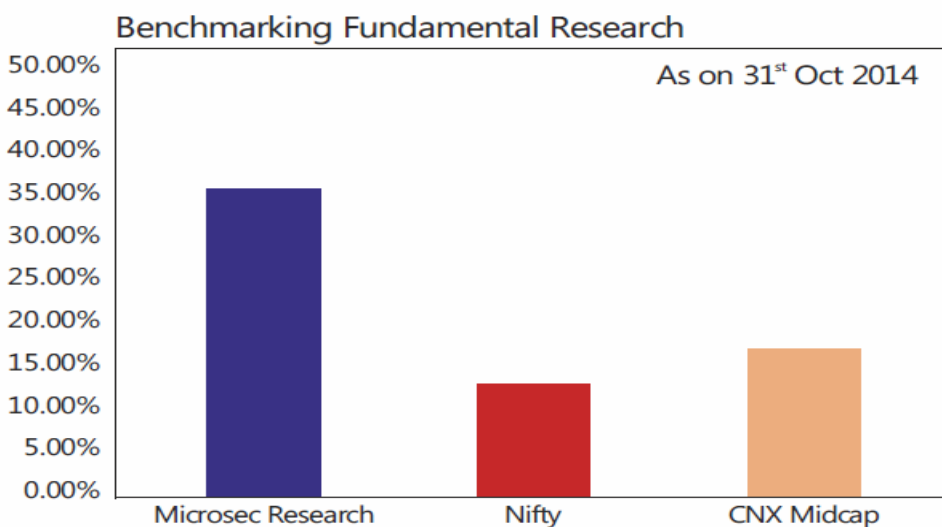
| Fundamental Research | | | |
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| Recommendation | Expected absolute returns (%) over 12 months |
|----------------|--|
| Strong Buy | >20% |
| Buy | between 10% and 20% |
| Hold | between 0% and 10% |
| Underperform | between 0% and -10% |
| Sell | < -10% |

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Research?

Microsec Benchmark its Research



An amount of ₹ 1,00,000 invested individually in all 311 stocks ie, ₹ 3,11,00,000 investment as and when recommended has appreciated to ₹ 4,21,68,697 giving a return of 35.6 percent. On the same basis Nifty has given a return of 14.4 percent and CNXMID CAP has given a return of 16.9 percent.

Microsec benchmark its Research and the same is updated on our website at www.microsec.in. Come, strike the right balance through Benchmarking Research.

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