

# Cummins India Maintain BUY

## A hitch in giddy up!

### Summary

- As against Revenue/EBITDA/PAT expectations of Rs.12bn/Rs.1.9bn/Rs.1.7bn, KKC reported Rs.13bn/Rs.1.9bn/Rs.1.6bn. The exceptional item of Rs.561mn is due to sale of asset in Ahmednagar.
- For FY18, KKC maintains the guidance. While exports may continue to be somewhere between -5% to 0%, domestic may grow only by 5-10%. With high competitive intensity, however, KKC has admitted that gross margins are on slippery slope.
- On improved industrial outlook and change in dividend from subsidiary, we have increased FY19 EPS by 4%. With rich product profile—where competition intensity is low, KKC enjoys too many degrees of freedom that can keep the enviable RoE intact. Maintain BUY.

### Key Highlights and Investment Rationale

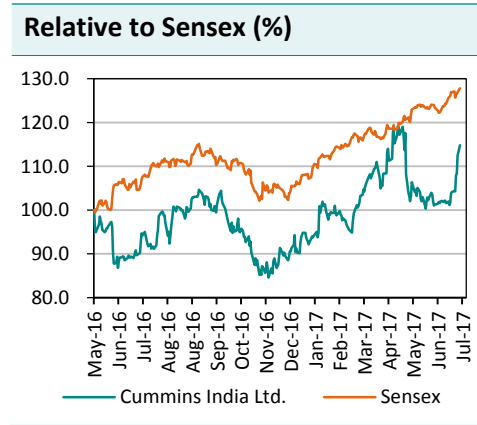
- Employee expenses to clip a similar trend:** The employee expenses advanced 18% YoY to Rs.1.2bn. This includes three factors: First, the annual cycle; second, residual payout accrual; and third, long-term settlement with unions and employees. KKC is experiencing strong tailwind from the government investment in the infrastructure segment. KKC has hinted that construction activity has picked up. Thereby, industrial segment would continue to do well. The proof of the pudding is in eating. In Q1FY18, industrial revenue grew by 21%. This was followed by 18% growth in distribution segment and 12% growth in power generation. Company has reiterated that the dark clouds loom around Africa and Middle-East markets.
- Valuation and Outlook:** We forecast 13% CAGR in revenues till FY19. Further, with cost rationalization and TRIMS, we forecast, in a base-scenario, KKC IN will grow its EBITDA by 22% CAGR over next two fiscals. Notwithstanding the conventional engine market, the benefit for 6B and 6C series engines in marine applications and many more will surprise the street on the upside. Thereby, we think, there are too many wheels that can change the company fortune around. We value this company on 29x FY19E EPS. We maintain the target price of Rs.1,132. We maintain **BUY**.

<b>TP</b>	<b>Rs1,132</b>	
<b>CMP</b>	<b>Rs950</b>	
Potential upside / downside	+19%	
Previous Rating	BUY	
<b>V/s Consensus</b>		
<b>EPS (Rs)</b>	<b>FY18E</b>	<b>FY19E</b>
IDBI Capital	34.3	38.6
Consensus	32.4	39.4
% difference	5.9	(2.0)

<b>Shareholding Pattern (%)</b>	
Promoters	51.0
FII	14.3
DII	21.6
Public	13.1

<b>Price Performance (%)</b>			
	<b>-1m</b>	<b>-3m</b>	<b>-12m</b>
Absolute	4.0	(9.9)	15.0
Rel to Sensex	0.7	(17.7)	(1.4)

<b>Key Stock Data</b>	
Bloomberg/Reuters	KKC IN / CUMM.BO
Sector	Capital Goods
Shares o/s (mn)	277
Market cap. (Rs mn)	263,368
Market cap. (US\$ mn)	4,094
3-m daily average value (Rs mn)	966
52-week high / low	Rs1,096 / 748
Nifty / Sensex	10,014 / 32,238



### Financial snapshot

Year	FY2015	FY2016	FY2017	FY2018E	FY2019E
Revenue	44,058	47,088	50,773	55,836	64,825
EBITDA	6,255	7,713	7,984	9,797	11,969
EBITDA (%)	14.2	16.4	15.7	17.5	18.5
Adj. PAT	7,640	7,627	7,346	9,521	10,700
EPS (Rs)	27.6	27.5	26.5	34.3	38.6
EPS Growth (%)	26.1	(0.2)	(3.7)	29.6	12.4
PE (x)	34.4	34.5	35.8	27.6	24.6
Dividend Yield (%)	1.5	1.5	1.5	1.5	1.5
EV/EBITDA (x)	42.1	34.1	32.9	26.7	21.8
RoE (%)	28.0	24.0	20.3	23.9	23.6
RoCE (%)	14.7	16.6	19.3	21.8	23.8

Source: Company; IDBI Capital Research

Gauging the product mix trend is difficult. From increasing trend in competitive intensity to the traded goods component—there are many factors that has adversely impacted gross margins. Further higher than anticipated employee expenses has led to 149bps erosion in EBITDA margins.

**Table 1: Financial snapshot**

(Rs mn)

Year-end: Sept.	Q1FY18	Q1FY17	YoY Chg (%)	Q4FY17	QoQ Chg (%)
<b>Net Sales</b>	<b>13,408</b>	<b>12,590</b>	<b>6.5</b>	<b>11,844</b>	<b>13.2</b>
EBIDTA	1,953	2,063	(5.4)	1,700	14.9
Other income	583	416	40.3	511	14.2
<b>PBIDT</b>	<b>2,536</b>	<b>2,479</b>	<b>2.3</b>	<b>2,211</b>	<b>14.7</b>
Depreciation	(208)	(206)	1.2	(208)	0.0
Interest	(42)	(21)	96.3	(49)	(13.4)
<b>PBT (Including Extra)</b>	<b>2,286</b>	<b>2,252</b>	<b>1.5</b>	<b>1,954</b>	<b>17.0</b>
Tax	(625)	(440)	42.1	(369)	69.3
<b>Adjusted PAT</b>	<b>1,660</b>	<b>1,812</b>	<b>(8.4)</b>	<b>1,585</b>	<b>4.8</b>
<b>Reported PAT</b>	<b>2,222</b>	<b>1,812</b>	<b>22.6</b>	<b>1,585</b>	<b>40.2</b>
<b>No. of shares (mn)</b>	<b>277</b>	<b>277</b>		<b>277</b>	
EBIDTA margin (%)	14.6	16.4		14.4	
PBIDT margin (%)	18.9	19.7		18.7	
<b>EPS - annualized (Rs)</b>	<b>24.0</b>	<b>26.1</b>	<b>(8.4)</b>	<b>22.9</b>	<b>4.8</b>

Source: Company; IDBI Capital Research

**Table 2: Actual vs. estimates**

Year to March	Q1FY18	Q1FY18E	Variance (%)
Revenue	13,408	11,911	12.6
EBITDA	1,953	1,912	2.1
EBITDA margin	14.6	16.1	(149)
Adjusted Net Profit	1,660	1,765	(5.9)
Adjusted Net Profit margin	12.4	14.8	(243)

Source: Company; IDBI Capital Research

**Table 3: Change in Estimates**
**(Rs mn)**

Year to March	FY18E			FY19E		
	Revised	Previous	Change (%)	Revised	Previous	Change (%)
Revenue (Rs mn)	55,836	55,806	0.05	64,825	64,791	0.05
EBITDA (Rs mn)	9,797	11,146	(12.10)	11,969	11,957	0.10
EBITDA margin (%)	17.5	20.0	(242.7)	18.5	18.5	0.8
EPS (Rs)	34.3	34.0	1.0	38.6	37.0	4.32

Source: IDBI Capital Research

## Financial Summary

### Profit & Loss Account

(Rs mn)

Year-end: September	FY16	FY17	FY18E	FY19E
<b>Net sales</b>	<b>47,088</b>	<b>50,773</b>	<b>55,836</b>	<b>64,825</b>
<i>Growth (%)</i>	6.9	7.8	10.0	16.1
Operating expenses	(39,375)	(42,790)	(46,039)	(52,856)
<b>EBITDA</b>	<b>7,713</b>	<b>7,984</b>	<b>9,797</b>	<b>11,969</b>
<i>Growth (%)</i>	23.3	3.5	22.7	22.2
Depreciation	(810)	(848)	(988)	(1,172)
<b>EBIT</b>	<b>6,903</b>	<b>7,136</b>	<b>8,809</b>	<b>10,796</b>
Interest paid	(9)	(168)	(190)	(210)
Other income	2,279	2,114	2,582	2,365
<b>Pre-tax profit</b>	<b>9,173</b>	<b>9,082</b>	<b>11,201</b>	<b>12,951</b>
Tax	(1,546)	(1,736)	(1,680)	(2,252)
<i>Effective tax rate (%)</i>	16.9	19.1	15.0	17.4
<b>Reported net profit</b>	<b>7,627</b>	<b>7,346</b>	<b>9,521</b>	<b>10,700</b>
<b>Adjusted net profit</b>	<b>7,627</b>	<b>7,346</b>	<b>9,521</b>	<b>10,700</b>
<i>Growth (%)</i>	(0.2)	(3.7)	29.6	12.4
<i>Shares o/s (mn nos)</i>	277	277	277	277

### Cash Flow Statement

(Rs mn)

Year-end: September	FY16	FY17	FY18E	FY19E
Pre-tax profit	9,173	9,082	11,201	12,951
Depreciation	532	654	988	1,172
Tax paid	(2,049)	(1,840)	(1,680)	(2,252)
Chg in working capital	(2,512)	3,497	(2,044)	(1,256)
Other operating activities	1,773	(3,937)	-	-
<b>Cash flow from operations (a)</b>	<b>6,918</b>	<b>7,456</b>	<b>8,465</b>	<b>10,616</b>
Capital expenditure	(4,573)	479	(4,091)	(4,500)
Chg in investments	19,451	(6,473)	-	-
Other investing activities	(17,000)	1,133	-	-
<b>Cash flow from investing (b)</b>	<b>(2,121)</b>	<b>(4,860)</b>	<b>(4,091)</b>	<b>(4,500)</b>
Debt raised/(repaid)	(229)	(183)	(732)	-
Dividend (incl. tax)	(4,657)	(4,657)	(4,657)	(4,657)
Other financing activities	208	2,595	-	-
<b>Cash flow from financing (c)</b>	<b>(4,677)</b>	<b>(2,245)</b>	<b>(5,389)</b>	<b>(4,657)</b>
<b>Net chg in cash (a+b+c)</b>	<b>119</b>	<b>350</b>	<b>(1,015)</b>	<b>1,459</b>

**Balance Sheet**

(Rs mn)

Year-end: September	FY16	FY17	FY18E	FY19E
Net fixed assets	18,086	16,954	20,056	23,384
Investments	6,902	13,375	13,375	13,375
Other non-curr assets	(128)	(24)	(24)	(24)
<b>Current assets</b>	<b>19,917</b>	<b>20,081</b>	<b>22,293</b>	<b>27,151</b>
Inventories	6,003	5,621	8,414	9,768
Sundry Debtors	9,381	9,557	10,708	12,432
Cash and Bank	897	1,291	1,182	2,641
Loans and advances	2,814	2,657	1,989	2,309
<b>Total assets</b>	<b>44,777</b>	<b>50,385</b>	<b>55,700</b>	<b>63,886</b>
<b>Shareholders' funds</b>	<b>34,813</b>	<b>37,422</b>	<b>42,286</b>	<b>48,329</b>
Share capital	554	554	554	554
Reserves & surplus	34,259	36,867	41,731	47,774
Total Debt	915	732	-	-
Unsecured loans	915	732	-	-
Other liabilities	105	105	105	105
<b>CurrLiab &amp; prov</b>	<b>8,943</b>	<b>12,076</b>	<b>13,309</b>	<b>15,451</b>
Current liabilities	7,822	10,657	8,720	10,123
Provisions	1,121	1,419	4,589	5,328
<b>Total liabilities</b>	<b>9,964</b>	<b>12,914</b>	<b>13,414</b>	<b>15,557</b>
<b>Total equity &amp; liabilities</b>	<b>44,777</b>	<b>50,335</b>	<b>55,700</b>	<b>63,886</b>
<b>Book Value (Rs)</b>	<b>126</b>	<b>135</b>	<b>153</b>	<b>174</b>

Source: Company; IDBI Capital Research

**Financial Ratios**

Year-end: March	FY16	FY17	FY18E	FY19E
Adj. EPS (Rs)	27.5	26.5	34.3	38.6
Adj. EPS growth (%)	(0.2)	(3.7)	29.6	12.4
EBITDA margin (%)	16.4	15.7	17.5	18.5
Pre-tax margin (%)	19.5	17.9	20.1	20.0
ROE (%)	24.0	20.3	23.9	23.6
ROCE (%)	16.6	19.3	21.8	23.8
<b>Turnover &amp; Leverage ratios (x)</b>				
Asset turnover (x)	0.9	1.1	1.1	1.1
Leverage factor (x)	1.6	1.3	1.3	1.3
Net margin (%)	16.2	14.5	17.1	16.5
Net Debt/Equity (x)	0.0	0.0	0.0	-0.1
<b>Working Capital &amp; Liquidity ratio</b>				
Inventory days	47	40	55	55
Receivable days	73	69	70	70
Payable days	73	91	69	70

**Valuation**

Year-end: September	FY16	FY17	FY18E	FY19E
PER (x)	34.5	35.8	27.6	24.6
Price / Book value (x)	7.6	7.0	6.2	5.4
PCE (x)	31.2	32.1	25.0	22.2
EV / Net sales (x)	5.6	5.2	4.7	4.0
EV / EBITDA (x)	34.1	32.9	26.7	21.8
Dividend Yield (%)	1.5	1.5	1.5	1.5



# Notes

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**BUY:** Absolute return of 15% and above; **ACCUMULATE:** 5% to 15%; **HOLD:** Upto ±5%; **REDUCE:** -5% to -15%; **SELL:** -15% and below.

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