

INDUSTRY CAPITAL GOODS

CMP (as on 19 Dec 2017) Rs 856

Target Price Rs 1,016

Nifty	10,463
Sensex	33,837

KEY STOCK DATA

Bloomberg /Reuters	KKC IN
No. of Shares (mn)	277
MCap (Rs bn) / (\$ mn)	237 / 3,704
6m avg traded value (Rs mn)	291

STOCK PERFORMANCE (%)

52 Week high / low	Rs 1,097 / 780		
	3M	6M	12M
Absolute (%)	(8.3)	(8.2)	6.2
Relative (%)	(12.7)	(16.3)	(22.1)

SHAREHOLDING PATTERN (%)

Promoters	51.0
FIs & Local MFs	20.8
FPIs	14.6
Public & Others	13.6

Source : BSE

Sujit Jain
sujit.jain@hdfcsec.com
+91-22-6171-7314

Business as usual

We spoke with the management of Cummins India (KKC) to take stock of the recent developments and the way forward. The key takeaways are as follows:

- **The sudden exit of the Chairman & Managing Director is unlikely to have any impact on KKC given the strong management line up at KKC.** Mr. Patrick Ward, currently the Vice President and CFO of Cummins Inc. will be the interim MD. A new MD is expected to be appointed soon.
- **Exports have bottomed out** (in line with the 2Q concall commentary). The fall in exports at 17% in 2QFY18 was rather steep juxtaposed against a 3/2/3% YoY fall in 1QFY18/FY17/FY16.
- **Despite aggressive competition in HHP segment** (55/40% of domestic Power Gen business/exports), **KKC estimates to have gained ~1% market share.** KKC charges a premium in this segment.
- The domestic sales including distribution had fallen 7% YoY in 2QFY18. The GST impact has been absorbed well. **Power Generation (PG) business is back on 7-8% growth trajectory.**

Financial Summary: Standalone

(Rs mn)	2QFY18	2QFY17	YoY (%)	1QFY18	QoQ (%)	FY16	FY17	FY18E	FY19E	FY20E
Net Sales	11,539	12,790	(10)	13,408	(14)	47,088	50,773	52,583	57,567	63,896
EBITDA	1,675	1,990	(16)	1,953	(14)	7,751	8,018	8,002	9,086	10,545
APAT	1,529	1,969	(22)	1,784	(14)	7,389	7,232	7,191	8,022	9,427
Diluted EPS (Rs)	5.5	7.1	(22)	6.4	(14)	26.7	26.1	25.9	28.9	34.0
P/E (x)						32.1	32.8	33.0	29.6	25.2
EV / EBITDA (x)						30.1	28.9	28.9	25.4	21.8
RoE (%)						22.1	20.0	18.6	19.4	21.2

Source: Company, HDFC sec Inst Research

- The pricing has been stable in the PG business. Given the competitive pressures, it is difficult to raise prices in PG despite the rise in the raw material prices. **KKC has been able to raise price in the industrial segment by ~2%.**
- **The MHP and HHP is the core of KKC:** KKC reiterated that it is a mainly a B2B company. B2C, especially in the LHP segment is not its mainstay in the domestic markets. It has maintained its pole position despite the increased competitive intensity in the MHP and HHP segments.

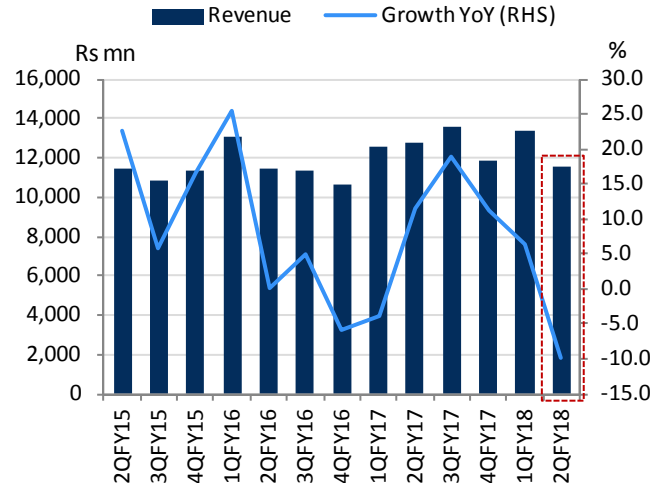
Govt's thrust on Infrastructure would continue to drive KKC's Industrial segment. With all the lead indicators for exports such as China's GDP growth, oil prices, steel and copper prices firming up, we expect KKC to regain traction in export revenues in the ensuing quarters. We maintain our estimates of tepid revenue CAGR of 8% over FY17-20E. With the recent decline in the stock price of KKC, we upgrade KKC to a BUY with a TP of Rs 1,016/sh (31x Dec-19 EPS).

Near-term outlook: GST impact on sales has reversed in 2H. Also, worst in exports may be behind KKC. BUY.

With GST impact of ~Rs 800/200mn in distribution and PG segments, 2Q revenues declined 9.8% YoY.

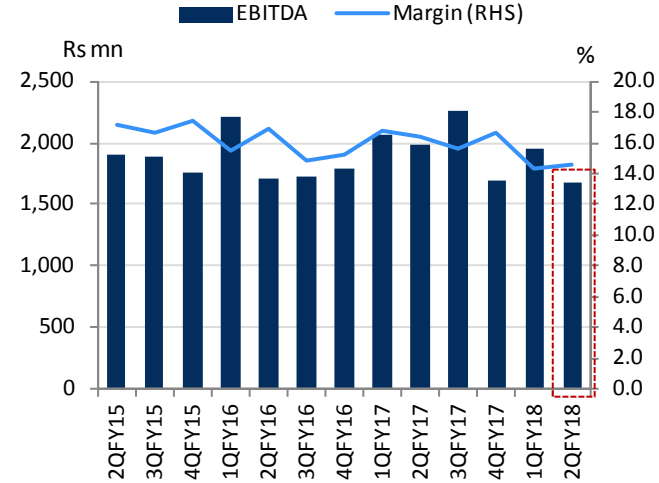
In the Power Gen segment, demand in HHP and MHP was affected by GST transition.

Revenue Trajectory



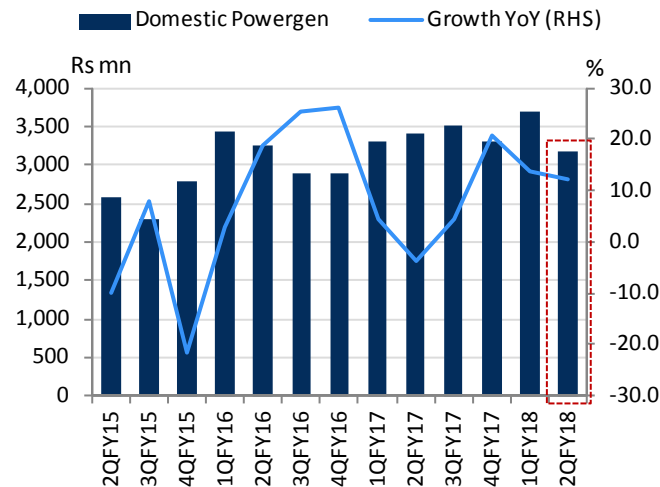
Source : Company, HDFC sec Inst Research

EBITDA And EBITDA Margin



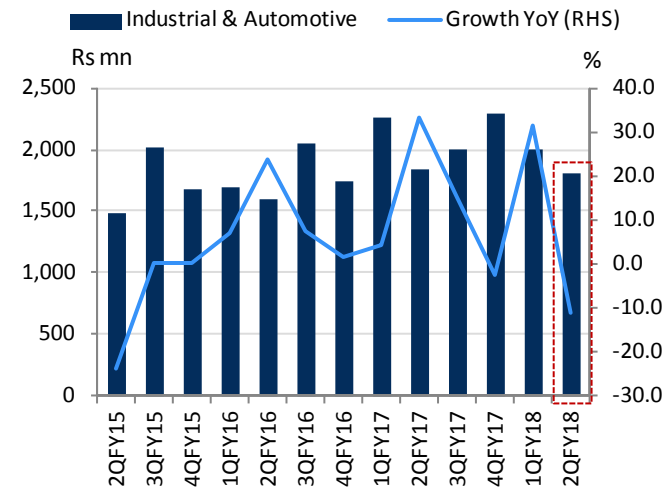
Source : Company, HDFC sec Inst Research

Revenue Trajectory: Domestic Powergen



Source : Company, HDFC sec Inst Research

Revenue Trajectory: Industrial And Automotive

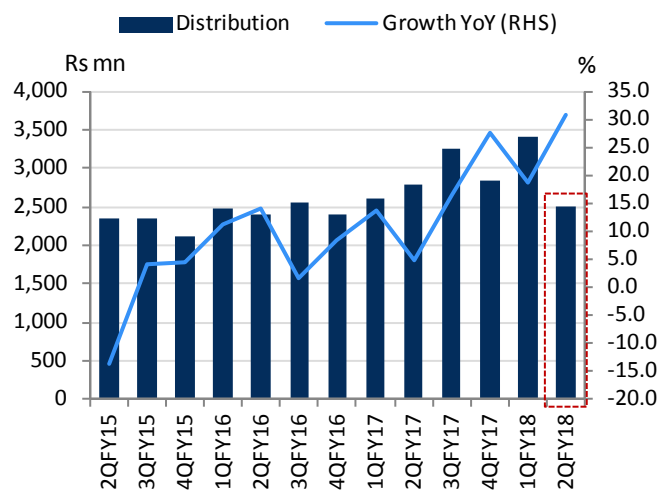


Source : Company, HDFC sec Inst Research

With all the lead indicators for exports such as China's GDP growth, oil prices, steel and copper prices firming up, we expect KKC to regain traction in export revenues in the ensuing quarters.

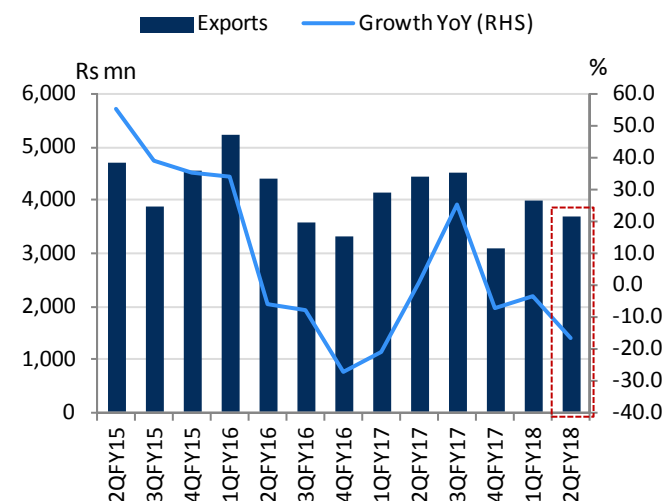
Increase in crude prices and pickup in private capex in domestic geographies could provide an upside to our revenue estimates.

Revenue Trajectory: Distribution Business



Source : Company, HDFC sec Inst Research

Revenue Trajectory: Exports



Source : Company, HDFC sec Inst Research

Key Assumptions And Estimates: Standalone

Revenue (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Domestic Business					
Power Gen	12,477	13,500	14,580	16,038	17,642
YoY (%)	18.8%	8.2%	8.0%	10.0%	10.0%
Industrial	5,555	7,160	8,234	9,881	11,857
YoY (%)	9.6%	28.9%	15.0%	20.0%	20.0%
Automotives & others	1,538	1,234	400	440	484
YoY (%)	3.2%	-19.8%	-67.6%	10.0%	10.0%
Domestic Engine Business	19,570	21,894	23,214	26,359	29,983
Distribution	9,738	11,492	13,158	15,001	17,101
YoY (%)	7.4%	18.0%	14.5%	14.0%	14.0%
Export Business (Only Engines)	16,568	16,195	14,927	14,803	15,254
YoY (%)	-3.0%	-2.2%	-7.8%	-0.8%	3.0%
Other operating income	1,212	1,192	1,283	1,404	1,558
YoY (%)	43.1%	-1.7%	7.6%	9.5%	11.0%
Total revenue	47,088	50,773	52,583	57,567	63,896

Source: Company, HDFC sec Inst Research

Income Statement: Standalone

(Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Net Revenues	47,088	50,773	52,583	57,567	63,896
Growth (%)	6.9	7.8	3.6	9.5	11.0
Material Expenses	29,622	32,745	33,653	36,958	41,149
Employee Expenses	4,156	4,334	4,854	5,145	5,505
SG&A Expenses	5,559	5,677	6,074	6,378	6,697
Total Expenses	39,337	42,755	44,581	48,481	53,351
EBITDA	7,751	8,018	8,002	9,086	10,545
EBITDA Margin (%)	16.5	15.8	15.2	15.8	16.5
EBITDA Growth (%)	5.4	3.4	(0.2)	13.6	16.1
Depreciation	810	848	980	1,114	1,192
EBIT	6,941	7,170	7,022	7,973	9,353
Other Income (Including EO Items)	2,259	2,080	2,790	2,452	2,746
Interest	96	168	225	180	60
PBT	9,104	9,082	9,587	10,245	12,040
Tax (Incl Deferred)	1,561	1,736	1,959	2,223	2,613
RPAT	7,543	7,346	7,628	8,022	9,427
EO (Loss) / Profit (Net Of Tax)	154	114	438	-	-
APAT	7,389	7,232	7,191	8,022	9,427
APAT Growth (%)	4.8	(2.1)	(0.6)	11.6	17.5
Adjusted EPS (Rs)	26.7	26.1	25.9	28.9	34.0
EPS Growth (%)	4.8	(2.1)	(0.6)	11.6	17.5

Source: Company, HDFC sec Inst Research

Balance Sheet: Standalone

(Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
SOURCES OF FUNDS					
Share Capital	554	554	554	554	554
Reserves	34,259	36,867	39,491	42,175	45,596
Total Shareholders' Funds	34,813	37,422	40,046	42,729	46,151
Long Term Debt	-	-	-	-	-
Short Term Debt	-	2,508	2,000	1,000	(0)
Total Debt	-	2,508	2,000	1,000	(0)
Net Deferred Taxes	128	24	24	24	24
Other Non-current Liabilities & Provns	1,021	887	1,173	1,275	1,403
TOTAL SOURCES OF FUNDS	35,962	40,841	43,242	45,028	47,578
APPLICATION OF FUNDS					
Net Block	12,894	15,001	18,903	19,789	20,598
CWIP	5,582	4,882	2,000	2,000	2,500
Investments	1,781	1,728	1,728	1,728	1,728
Other Non-current Assets	3,176	3,371	2,417	2,779	3,084
Total Non-current Assets	23,434	24,982	25,049	26,296	27,910
Inventories	6,003	5,621	5,993	6,582	7,328
Debtors	9,381	9,557	10,576	11,579	12,852
Other Current Assets	2,349	2,326	3,626	4,168	4,627
Cash & equivalents	3,738	7,924	8,428	7,746	7,344
Total Current Assets	21,471	25,426	28,624	30,075	32,150
Creditors	5,566	6,082	6,718	7,305	8,039
Other Current Liabilities & Provns	3,377	3,486	3,713	4,038	4,443
Total Current Liabilities	8,943	9,568	10,431	11,343	12,483
Net Current Assets	12,528	15,858	18,193	18,731	19,668
TOTAL APPLICATION OF FUNDS	35,962	40,841	43,242	45,028	47,578

Source: Company, HDFC sec Inst Research

Cash Flow: Standalone

(Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Reported PBT	9,104	9,082	9,587	10,245	12,040
Non-operating & EO items	(2,259)	(2,080)	(2,790)	(2,452)	(2,746)
Interest Expenses	96	168	225	180	60
Depreciation	810	848	980	1,114	1,192
Working capital change	(267)	526	(591)	(1,480)	(1,516)
Tax Paid	(1,561)	(1,736)	(1,959)	(2,223)	(2,613)
Other operating items	(425)	(365)	-	-	-
OPERATING CASH FLOW (a)	5,498	6,443	5,452	5,383	6,417
Capex	(4,246)	(2,061)	(2,000)	(2,000)	(2,500)
Free Cash Flow	1,253	4,383	3,452	3,383	3,917
Investments	(48)	53	-	-	-
Non-operating Income	2,259	2,080	2,790	2,452	2,746
INVESTING CASH FLOW (b)	(2,035)	72	790	452	246
Debt Issuance/(Repaid)	-	2,508	(508)	(1,000)	(1,000)
Interest	(96)	(168)	(225)	(180)	(60)
FCFE	1,157	6,723	2,719	2,203	2,857
Share Capital Issuance	-	-	-	-	-
Dividend	(4,624)	(4,671)	(5,005)	(5,338)	(6,005)
FINANCING CASH FLOW (c)	(4,720)	(2,331)	(5,738)	(6,518)	(7,065)
NET CASH FLOW (a+b+c)	(1,257)	4,185	505	(683)	(402)
Closing Cash & Equivalents	3,738	7,923	8,428	7,746	7,344

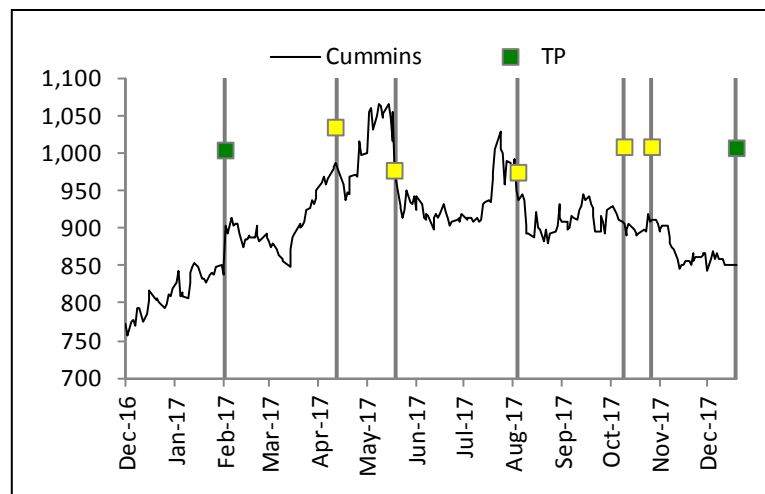
Source: Company, HDFC sec Inst Research

Key Ratios: Standalone

	FY16	FY17	FY18E	FY19E	FY20E
PROFITABILITY %					
GPM	37.1	35.5	36.0	35.8	35.6
EBITDA margin	16.5	15.8	15.2	15.8	16.5
APAT margin	15.7	14.2	13.7	13.9	14.8
RoE	22.1	20.0	18.6	19.4	21.2
Core RoCE (RoIC)	20.2	18.8	17.4	18.2	19.8
RoCE	21.6	19.2	17.5	18.5	20.5
EFFICIENCY					
Tax Rate (%)	17.1	19.1	20.4	21.7	21.7
Fixed Asset Turnover (x)	2.5	2.2	1.9	1.9	2.0
<i>Inventory (days)</i>	<i>46.5</i>	<i>40.4</i>	<i>41.6</i>	<i>41.7</i>	<i>41.9</i>
<i>Debtors (days)</i>	<i>72.7</i>	<i>68.7</i>	<i>73.4</i>	<i>73.4</i>	<i>73.4</i>
<i>Other Current Assets (days)</i>	<i>18.2</i>	<i>16.7</i>	<i>25.2</i>	<i>26.4</i>	<i>26.4</i>
<i>Payables (days)</i>	<i>43.1</i>	<i>43.7</i>	<i>46.6</i>	<i>46.3</i>	<i>45.9</i>
<i>Other Current Liab & Provns (days)</i>	<i>26.2</i>	<i>25.1</i>	<i>25.8</i>	<i>25.6</i>	<i>25.4</i>
<i>Cash Conversion Cycle (days)</i>	<i>68.1</i>	<i>57.0</i>	<i>67.8</i>	<i>69.7</i>	<i>70.4</i>
Debt/EBITDA (x)	-	0.3	0.2	0.1	(0.0)
Net D/E (x)	(0.1)	(0.1)	(0.2)	(0.2)	(0.2)
Interest Coverage (x)	72.5	42.7	31.2	44.3	156.0
PER SHARE DATA (Rs)					
EPS	26.7	26.1	25.9	28.9	34.0
CEPS	29.6	29.1	29.5	33.0	38.3
Dividend	14.0	14.0	15.0	16.0	18.0
Book Value	125.6	135.0	144.5	154.1	166.5
VALUATION					
P/E (x)	32.1	32.8	33.0	29.6	25.2
P/BV (x)	6.8	6.3	5.9	5.6	5.1
EV/EBITDA (x)	30.1	28.9	28.9	25.4	21.8
EV/Revenues (x)	5.0	4.6	4.4	4.0	3.6
OCF/EV (%)	2.4	2.8	2.4	2.3	2.8
FCF/EV (%)	0.5	1.9	1.5	1.5	1.7
FCFE/Mkt Cap (%)	0.5	2.8	1.1	0.9	1.2
Dividend Yield (%)	1.6	1.6	1.8	1.9	2.1

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
2-Feb-17	850	BUY	1,005
12-Apr-17	981	NEU	1,033
20-May-17	973	NEU	977
4-Aug-17	937	NEU	974
10-Oct-17	911	NEU	1,007
27-Oct-17	912	NEU	1,008
19-Dec-17	856	BUY	1,016

Rating Definitions

BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period
NEUTRAL : Where the stock is expected to deliver (-) 10% to 10% returns over the next 12 month period
SELL : Where the stock is expected to deliver less than (-) 10% returns over the next 12 month period

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Compliance Officer: Binkle R. Oza Email: complianceofficer@hdfcsec.com Phone: (022) 3045 3600

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