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Rating	BUY
Price	Rs704
Target Price	Rs928
Implied Upside	31.8%
Sensex	34,925
Nifty	10,605

(Prices as on May 25, 2018)

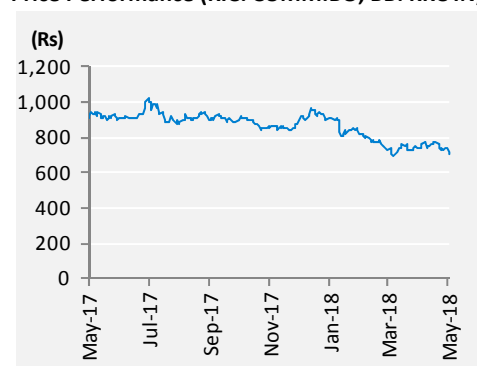
Trading data	
Market Cap. (Rs bn)	195.1
Shares o/s (m)	277.2
3M Avg. Daily value (Rs m)	367.4

Major shareholders	
Promoters	51.24%
Foreign	14.11%
Domestic Inst.	21.69%
Public & Other	12.96%

Stock Performance			
(%)	1M	6M	12M
Absolute	(5.3)	(18.5)	(23.9)
Relative	(6.6)	(22.2)	(37.4)

How we differ from Consensus			
EPS (Rs)	PL	Cons.	% Diff.
2019	27.8	29.4	-5.5
2020	30.9	34.0	-8.9

Price Performance (RIC: CUMM.BO, BB: KKC IN)



Source: Bloomberg

Cummins' (KKC's) Q4FY18 performance was below expectations largely led by weak margins. Export sales were up 30% YoY, however, outlook on export markets remains volatile though some markets are seeing revival; timing of recovery remains uncertain in the near term. Domestic sales were down 5% YoY; however, KKC remains positive on the medium-to-long term outlook as the underlying demand conditions remain positive. The company has guided 8-10% growth in the domestic market and flattish for exports. While the competitive intensity remains high, KKC has been able to maintain/increase market share. We remain positive on KKC, given its strong domestic outlook, gradual likely revival of export markets and strong history of delivering on cost rationalization and healthy cash flows. We have reduced our earnings by 5% for both FY19 and FY20 to factor in lower margins and higher competitive intensity. We maintain "BUY" with a revised TP of Rs928 (Previous - Rs967).

■ **Weak sales trend:** Revenues for the quarter were up 4% YoY at Rs12.3bn (PL: Rs12.9bn). Domestic sales were down 5% YoY to Rs8.16bn, while export sales were up 30% YoY at Rs3.9bn due to low base. EBITDA was up 1.8% YoY to Rs1.7bn and EBITDA margins were down 40bps YoY to 14% (PL: 14.4%). Adj. PAT was up 1.7% YoY to Rs1.6bn (PL: Rs1.6bn).

■ KKC highlighted that high competitive pressure and focus to maintain market share has limited their ability to hike prices. However, it is looking at new product launches and offering system solutions which should help improve margins in the medium term. KKC also continues to focus on profitability, optimizing operational cost and market share improvement.

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Key financials (Y/e March)	2017	2018	2019E	2020E
Revenues (Rs m)	50,773	50,825	55,960	62,712
Growth (%)	7.5	0.1	10.1	12.1
EBITDA (Rs m)	8,018	7,325	8,282	9,470
PAT (Rs m)	7,346	6,524	7,709	8,573
EPS (Rs)	26.5	23.5	27.8	30.9
Growth (%)	(2.3)	(11.2)	18.2	11.2
Net DPS (Rs)	14.0	15.0	16.7	18.6

Profitability & Valuation	2017	2018	2019E	2020E
EBITDA margin (%)	15.8	14.4	14.8	15.1
RoE (%)	21.3	16.9	18.8	19.7
RoCE (%)	20.8	16.1	17.8	18.7
EV / sales (x)	3.9	3.8	3.5	3.1
EV / EBITDA (x)	24.5	26.3	23.4	20.5
PE (x)	26.6	29.9	25.3	22.8
P / BV (x)	5.2	4.9	4.6	4.3
Net dividend yield (%)	2.0	2.1	2.4	2.6

Source: Company Data; PL Research

- **Positive trends in domestic markets, exports market volatile:** The domestic economy continues to grow largely in areas which are positively benefited through continuing government investments in Infrastructure. KKC is seeing traction from manufacturing, infra and data centres. Rental business is also seeing an upward trend. KKC remains positive on the medium-to-long term outlook for domestic sales as the underlying demand conditions remain positive. While the domestic Powergen market margins have been muted, KKC has been able to maintain market share in most nodes and increased share in few nodes. The current market share in HHP is 65% (up 300bps YoY) and is confident of holding on to it despite aggressive competitive pricing. While data centre market is growing fast, KKC expects Construction and Railways to be the key growth drivers.
- In export market, a clear trend is yet to emerge on account of prevailing uncertainties in various economies through the world. KKC believes there are varying degrees of recovery taking place in the global economy, commodity markets and geographies. This trend, however, is likely to only play out in the medium term. KKC is optimistic on the African and the Middle East markets due to favourable oil prices.
- **The company has guided for 8-10% growth in domestic sales and exports to be flat for FY19.** KKC believes it is positioned to outperform the industry and is investing judiciously in new products with better margins, increasing customer focus, emphasising on cost reduction and improving productivity and quality, thus, remaining strongly positioned to continue delivering values to all stakeholders.
- **Outlook and Valuation:** The stock is trading at 22.8x FY20E earnings. We remain positive on KKC's medium/long-term potential in the domestic market, driven by structural factors like revival in Infrastructure/Industrial demand, unreliable quality of power in India and lack of creditable options for power back-up. ***We have cut our earnings by 5% for both FY19 and FY20 to factor in lower margins and higher competitive intensity. We maintain "BUY" with a revised TP of Rs928 (Previous - Rs967).***

Exhibit 1: Q FY18 Result Overview (Rs m)

Y/e March	Q FY18	Q FY17	YoY gr. (%)	Q FY18	FY18	FY17	YoY gr. (%)
Net Sales	12,332	11,844	4.1	13,547	50,825	50,773	0.1
Expenditure							
Raw Material	8,031	7,707	4.2	8,546	32,581	32,745	(0.5)
<i>% of Net Sales</i>	<i>65.1</i>	<i>65.1</i>		<i>63.1</i>	<i>64.1</i>	<i>64.5</i>	
Personnel Cost	1,180	1,069	10.4	1,317	4,979	4,334	14.9
<i>% of Net Sales</i>	<i>9.6</i>	<i>9.0</i>		<i>9.7</i>	<i>9.8</i>	<i>8.5</i>	
Others	1,391	1,368	1.7	1,717	5,940	5,677	4.6
<i>% of Net Sales</i>	<i>11.3</i>	<i>11.5</i>		<i>12.7</i>	<i>11.7</i>	<i>11.2</i>	
Total Expenditure	10,602	10,144	4.5	11,580	43,501	42,755	1.7
EBITDA	1,731	1,700	1.8	1,967	7,325	8,018	(8.7)
<i>Margin (%)</i>	<i>14.0</i>	<i>14.4</i>		<i>14.5</i>	<i>14.4</i>	<i>15.8</i>	
Other income	664	511	30.0	501	2,285	2,080	9.9
Depreciation	273	208	30.9	237	938	848	10.6
EBIT	2,122	2,002	6.0	2,231	8,671	9,250	(6.3)
Interest	34	49	(29.5)	34	148	168	(11.7)
Extraordinary Item	-	-		-	561	-	
PBT	2,088	1,954	6.8	2,197	9,084	9,082	0.0
Total Taxes	475	369	28.7	475	2,000	1,736	15.2
<i>ETR (%)</i>	<i>22.8</i>	<i>18.9</i>		<i>21.6</i>	<i>22.0</i>	<i>19.1</i>	
PAT	1,612	1,585	1.7	1,722	7,085	7,346	(3.6)
Adj. PAT	1,612	1,585	1.7	1,722	6,524	7,346	(11.2)
Other Comprehensive Income	4	(30)		4	12	(80)	
Total Comprehensive Income	1,616	1,555	3.9	1,726	7,097	7,266	(2.3)

Source: Company Data, PL Research

**Income Statement (Rs m)**

Y/e March	2017	2018	2019E	2020E
Net Revenue	50,773	50,825	55,960	62,712
Raw Material Expenses	32,745	32,581	34,919	39,133
Gross Profit	18,029	18,244	21,041	23,580
Employee Cost	4,334	4,979	4,757	5,331
Other Expenses	5,677	5,940	8,002	8,780
EBITDA	8,018	7,325	8,282	9,470
Depr. & Amortization	848	938	1,022	1,102
Net Interest	168	148	100	100
Other Income	2,080	2,285	2,598	2,723
Profit before Tax	9,082	8,523	9,758	10,991
Total Tax	1,736	2,000	2,049	2,418
Profit after Tax	7,346	6,524	7,709	8,573
Ex-Od items / Min. Int.	—	—	—	—
Adj. PAT	7,346	6,524	7,709	8,573
Avg. Shares O/S (m)	277.2	277.2	277.2	277.2
EPS (Rs.)	26.5	23.5	27.8	30.9

Cash Flow Abstract (Rs m)

Y/e March	2017	2018	2019E	2020E
C/F from Operations	7,456	7,658	7,664	7,701
C/F from Investing	(4,860)	(319)	(3,000)	(2,000)
C/F from Financing	(2,209)	(3,869)	(5,419)	(6,015)
Inc. / Dec. in Cash	386	3,471	(755)	(314)
Opening Cash	852	1,238	4,709	3,953
Closing Cash	1,238	4,709	3,953	3,639
FCFF	11,429	5,985	4,564	5,601
FCFE	13,936	5,992	4,564	5,601

Key Financial Metrics

Y/e March	2017	2018	2019E	2020E
Growth				
Revenue (%)	7.5	0.1	10.1	12.1
EBITDA (%)	5.4	(8.7)	13.1	14.3
PAT (%)	(2.3)	(11.2)	18.2	11.2
EPS (%)	(2.3)	(11.2)	18.2	11.2
Profitability				
EBITDA Margin (%)	15.8	14.4	14.8	15.1
PAT Margin (%)	14.5	12.8	13.8	13.7
RoCE (%)	20.8	16.1	17.8	18.7
RoE (%)	21.3	16.9	18.8	19.7
Balance Sheet				
Net Debt : Equity	—	(0.1)	—	—
Net Wrkng Cap. (days)	—	—	—	—
Valuation				
PER (x)	26.6	29.9	25.3	22.8
P / B (x)	5.2	4.9	4.6	4.3
EV / EBITDA (x)	24.5	26.3	23.4	20.5
EV / Sales (x)	3.9	3.8	3.5	3.1
Earnings Quality				
Eff. Tax Rate	19.1	23.5	21.0	22.0
Other Inc / PBT	22.9	26.8	26.6	24.8
Eff. Depr. Rate (%)	4.1	4.2	4.0	4.0
FCFE / PAT	189.7	91.9	59.2	65.3

Source: Company Data, PL Research.

Balance Sheet Abstract (Rs m)

Y/e March	2017	2018	2019E	2020E
Shareholder's Funds	37,422	39,861	42,250	44,908
Total Debt	2,508	2,515	2,515	2,515
Other Liabilities	—	—	—	—
Total Liabilities	39,930	42,376	44,766	47,423
Net Fixed Assets	16,871	13,207	15,185	16,083
Goodwill	82	54	—	—
Investments	9,753	12,798	12,798	12,798
Net Current Assets	13,247	16,616	17,081	18,841
Cash & Equivalents	1,291	4,709	4,007	3,693
Other Current Assets	22,411	24,545	27,050	30,770
Current Liabilities	10,455	12,637	13,975	15,622
Other Assets	(24)	(299)	(299)	(299)
Total Assets	39,930	42,376	44,765	47,423

Quarterly Financials (Rs m)

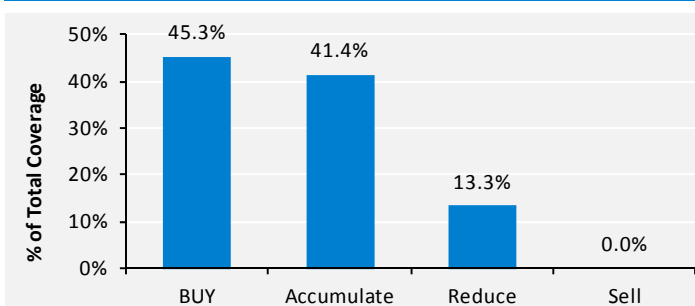
Y/e March	Q1FY18	Q2FY18	Q3FY18	Q4FY18
Net Revenue	13,408	11,539	13,547	12,332
EBITDA	1,953	1,675	1,967	1,731
% of revenue	14.6	14.5	14.5	14.0
Depr. & Amortization	208	220	237	273
Net Interest	42	38	34	34
Other Income	583	536	501	664
Profit before Tax	2,286	1,953	2,197	2,088
Total Tax	625	424	475	475
Profit after Tax	1,660	1,529	1,722	1,612
Adj. PAT	1,660	1,529	1,722	1,612

Source: Company Data, PL Research.

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BUY	: Over 15% Outperformance to Sensex over 12-months
Accumulate	: Outperformance to Sensex over 12-months
Reduce	: Underperformance to Sensex over 12-months
Sell	: Over 15% underperformance to Sensex over 12-months
Trading Buy	: Over 10% absolute upside in 1-month
Trading Sell	: Over 10% absolute decline in 1-month
Not Rated (NR)	: No specific call on the stock
Under Review (UR)	: Rating likely to change shortly

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