Cummins India (KKC IN)

Rating: BUY | CMP: Rs671 | TP: Rs836

August 13, 2018

Q1FY19 Result Update

☑ Change in Estimates | ☑ Target | ■ Reco

Change in Estimates

	Current		Previous	
	FY19E	FY20E	FY19E	FY20E
Rating	**BUY**		**BUY**	
Target Price	**836**		**857**	
Sales (Rs. m)	55,960	61,882	55,960	61,882
% Chng.			-	-
EBITDA (Rs. m)	8,562	9,654	8,282	9,344
% Chng.			*3.4*	*3.3*
EPS (Rs.)	26.8	29.8	27.8	30.6
% Chng.			*(3.6)*	*(2.4)*

Key Financials

	FY17	FY18	FY19E	FY20E
Sales (Rs. m)	50,773	50,825	55,960	61,882
EBITDA (Rs. m)	8,018	7,325	8,562	9,654
Margin (%)	*15.8*	*14.4*	*15.3*	*15.6*
PAT (Rs. m)	7,346	6,524	7,428	8,270
EPS (Rs.)	26.5	23.5	26.8	29.8
Gr. (%)	*(2.3)*	*(11.2)*	*13.9*	*11.3*
DPS (Rs.)	14.0	15.0	16.1	17.9
Yield (%)	*2.1*	*2.2*	*2.4*	*2.7*
RoE (%)	*20.3*	*16.9*	*18.2*	*19.1*
RoCE (%)	*19.2*	*15.6*	*17.6*	*18.9*
EV/Sales (x)	3.6	3.6	3.2	2.9
EV/EBITDA (x)	22.5	24.8	21.2	18.7
PE (x)	25.3	28.5	25.0	22.5
P/BV (x)	5.0	4.7	4.4	4.2

Key Data	CUMM.BO | KKC IN
52-W High / Low	Rs.993 / Rs.612
Sensex / Nifty	37,645 / 11,356
Market Cap	Rs.186bn/ $ 2,660m
Shares Outstanding	277m
3M Avg. Daily Value	Rs.520.13m

Shareholding Pattern (%)

Promoter's	51.24
Foreign	13.17
Domestic Institution	22.90
Public & Others	12.70
Promoter Pledge (Rs bn)	-

Stock Performance (%)

	1M	6M	12M
Absolute	3.6	(20.6)	(24.8)
Relative	0.6	(27.6)	(37.6)

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Exports sales bounces back

Key pointers

- Exports sales up 12% YoY led by strong uptick in Low Horse Power(LHP) engine sales (up 26% YoY).
- Margin beat led by better mix and forex gains.
- Seeing recovery in global markets and expect trend to continue in medium term.
- For FY19 company has guided 8-10% growth in the domestic market and flattish exports sales (conservative given the commentary and Q1 numbers).
- Expects gross margin to improve by 100bps in FY19 led by better mix

Cummins' (KKC's) Q1FY19 PAT was up 10.2%YoY at Rs1.83bn which was in line with our estimates. Domestic sales were down 7% YoY due to high base of last years and supply constraints with few vendors, however KKC expect to recover lost sales during the course of the year. Exports sales were up 12% YoY led by strong bounce back in LHP sales (up 26% YoY). Margin beat was led by better mix.

KKC remains positive on the medium to long term outlook for domestic sales as underlying demand remains positive arising from sustained investments by the government in creating infrastructure for the Indian economy. KKC is seeing recovery taking place in the global economy & commodity markets and believe trend of improvement should continue in the medium term. The company has guided 8-10% growth in the domestic market and flattish exports sales (conservative given the commentary and Q1 numbers) for FY19. KKC also expects gross margin to improve by 100bps in FY19 led by better mix (LHP export recovery/few product action taken in domestic markets) and cost rationalization measures.

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. While we have increased our margin assumption, increase in tax rate has led to earning cut of ~3% for FY19/20. We maintain "BUY" with a revised TP of Rs836.

- **Better mix led to margin beat**: Revenues for the quarter were down 1% YoY at Rs13.3bn (PLe: Rs14bn). Domestic sales declined 7% YoY to Rs8.56bn(supply constraint with vendors), while export sales were up 12% YoY at Rs4.41bn (revival in Low Horse Power exports, up 26% YoY). EBITDA was up 10% YoY to Rs2.15bn and EBITDA margins were up 160bps YoY to 16.2% (PLe: 14.2%) due to better mix and forex gain. Adj. PAT was up 10.2% YoY to Rs1.83bn led by a 15% reduction in the Interest cost and a 19% increase in the non-operating income (PLe: Rs1.85bn).

- **Positive trends in domestic markets, exports market improving:** KKC remains positive on the medium to long term outlook for domestic sales as underlying demand remains positive arising from sustained investments by the government in creating infrastructure for the Indian economy. KKC is seeing traction from manufacturing, infrastructure, data centers, IT&ITES etc.

- KKC highlighted that varying degrees of recovery taking place in the global economy, commodity markets and geographies and believe trend of improvement should continue into the medium term. It has seen revival in LHP exports specially in Middle East and Africa which are key markets for LHP product for Cummins.

- ***The company has guided for 8-10% growth in domestic sales and exports to be flat for FY19 and 100bps improvement in gross margins***. KKC believes it is positioned to outperform the industry and is investing judiciously in new products with better margins, increasing customer focus, emphasizing 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 22.5x 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 maintain "BUY" with a TP of Rs836.***

Exhibit 1: **Q1FY19 Result Overview (Rs mn)**

Y/e March	Q1FY19	Q1FY18	YoY gr. (%)	Q4FY18	FY19E	FY18	YoY gr. (%)
Net Sales	**13,280**	**13,408**	***(1.0)***	**12,332**	**55,960**	**50,825**	***10.1***
Expenditure							
Raw Material	8,330	8,722	*(4.5)*	8,031	35,311	32,581	*8.4*
% of Net Sales	*62.7*	*65.1*		*65.1*	*63.1*	*64.1*	
Personnel Cost	1,265	1,226	*3.2*	1,180	5,484	4,979	*10.1*
% of Net Sales	*9.5*	*9.1*		*9.6*	*9.8*	*9.8*	
Others	1,538	1,507	*2.0*	1,391	6,603	5,940	*11.2*
% of Net Sales	*11.6*	*11.2*		*11.3*	*11.8*	*11.7*	
Total Expenditure	11,133	11,455	*(2.8)*	10,602	47,398	43,501	*9.0*
EBITDA	**2,147**	**1,953**	***9.9***	**1,731**	**8,562**	**7,325**	***16.9***
Margin (%)	*16.2*	*14.6*		*14.0*	*15.3*	*14.4*	
Other income	696	583	*19.3*	664	2,598	2,285	*13.7*
Depreciation	271	208	*29.8*	273	1,022	938	*9.0*
EBIT	**2,572**	**2,328**	***10.5***	**2,122**	**10,138**	**8,671**	***16.9***
Interest	36	42	*(15.2)*	34	100	148	*(32.6)*
Extraordinary Item	-	561		-	-	561	
PBT	**2,536**	**2,847**	***(10.9)***	**2,088**	**10,038**	**9,084**	***10.5***
Total Taxes	706	625	*12.9*	475	2,610	2,000	*30.5*
ETR (%)	*27.8*	*22.0*		*22.8*	*26.0*	*22.0*	
PAT	**1,830**	**2,222**	***(17.6)***	**1,612**	**7,428**	**7,085**	***4.8***
Adjusted PAT	**1,830**	**1,660**	***10.2***	**1,612**	**7,428**	**6,524**	***13.9***
Other Comprehensive Income	3	(30)		4	-	12	
Total Comprehensive Income	**1,833**	**2,192**	***(16.4)***	**1,616**	**7,428**	**7,097**	***4.7***

Source: Company, PL

Financials

Income Statement (Rs m)

Y/e Mar	FY17	FY18	FY19E	FY20E
Net Revenues	**50,773**	**50,825**	**55,960**	**61,882**
YoY gr. (%)	*7.5*	*0.1*	*10.1*	*10.6*
Cost of Goods Sold	32,745	32,581	35,311	38,986
Gross Profit	18,029	18,244	20,649	22,896
Margin (%)	*35.5*	*35.9*	*36.9*	*37.0*
Employee Cost	4,334	4,979	5,484	5,817
Other Expenses	5,677	5,940	6,603	7,426
EBITDA	**8,018**	**7,325**	**8,562**	**9,654**
YoY gr. (%)	*5.4*	*(8.7)*	*16.9*	*12.8*
Margin (%)	*15.8*	*14.4*	*15.3*	*15.6*
Depreciation and Amortization	848	938	1,022	1,102
EBIT	**7,170**	**6,387**	**7,540**	**8,552**
Margin (%)	*14.1*	*12.6*	*13.5*	*13.8*
Net Interest	168	148	100	100
Other Income	2,080	2,285	2,598	2,723
Profit Before Tax	**9,082**	**8,523**	**10,038**	**11,175**
Margin (%)	*17.9*	*16.8*	*17.9*	*18.1*
Total Tax	1,736	2,000	2,610	2,906
Effective tax rate (%)	*19.1*	*23.5*	*26.0*	*26.0*
Profit after tax	**7,346**	**6,524**	**7,428**	**8,270**
Minority interest	-	-	-	-
Share Profit from Associate	-	-	-	-
Adjusted PAT	**7,346**	**6,524**	**7,428**	**8,270**
YoY gr. (%)	*(2.3)*	*(11.2)*	*13.9*	*11.3*
Margin (%)	*14.5*	*12.8*	*13.3*	*13.4*
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	**7,346**	**6,524**	**7,428**	**8,270**
YoY gr. (%)	*(2.3)*	*(11.2)*	*13.9*	*11.3*
Margin (%)	*14.5*	*12.8*	*13.3*	*13.4*
Other Comprehensive Income	-	-	-	-
Total Comprehensive Income	7,346	6,524	7,428	8,270
Equity Shares O/s (m)	**277**	**277**	**277**	**277**
EPS (Rs)	**26.5**	**23.5**	**26.8**	**29.8**

Source: Company Data, PL Research

Balance Sheet Abstract (Rs m)

Y/e Mar	FY17	FY18	FY19E	FY20E
Non-Current Assets				
Gross Block	**22,678**	**25,678**	**28,678**	**30,678**
Tangibles	22,228	25,228	28,228	30,228
Intangibles	450	450	450	450
Acc: Dep / Amortization	**7,677**	**8,615**	**9,637**	**10,739**
Tangibles	7,309	8,247	9,269	10,371
Intangibles	367	367	367	367
Net fixed assets	**15,001**	**17,063**	**19,041**	**19,939**
Tangibles	14,919	16,981	18,959	19,857
Intangibles	82	82	82	82
Capital Work In Progress	4,631	4,631	4,631	4,631
Goodwill	-	-	-	-
Non-Current Investments	1,846	1,846	1,846	1,846
Net Deferred tax assets	777	777	777	777
Other Non-Current Assets	1,417	1,275	1,339	1,473
Current Assets				
Investments	6,632	5,632	5,632	5,632
Inventories	5,621	6,266	6,899	7,629
Trade receivables	9,557	10,026	11,039	11,868
Cash & Bank Balance	1,291	885	728	1,592
Other Current Assets	2,673	2,940	3,087	3,396
Total Assets	**50,409**	**52,305**	**55,983**	**59,747**
Equity				
Equity Share Capital	554	554	554	554
Other Equity	36,867	39,174	41,476	44,040
Total Networth	**37,422**	**39,728**	**42,031**	**44,594**
Non-Current Liabilities				
Long Term borrowings	-	-	-	-
Provisions	557	640	705	780
Other non current liabilities	27	-	-	-
Current Liabilities				
ST Debt / Current of LT Debt	2,508	2,000	2,000	2,000
Trade payables	6,082	6,684	7,666	8,477
Other current liabilities	3,486	3,457	3,768	4,049
Total Equity & Liabilities	**50,409**	**52,305**	**55,983**	**59,748**

Source: Company Data, PL Research

Cash Flow (Rs m)

Y/e Mar	FY17	FY18	FY19E	FY20E
PBT	9,082	8,523	10,038	11,175
Add. Depreciation	848	938	1,022	1,102
Add. Interest	168	148	100	100
Less Financial Other Income	2,080	2,285	2,598	2,723
Add. Other	(1,111)	-	-	-
Op. profit before WC changes	8,988	9,609	11,160	12,377
Net Changes-WC	371	(581)	(482)	(801)
Direct tax	(1,867)	(2,000)	(2,610)	(2,906)
Net cash from Op. activities	**7,492**	**7,029**	**8,068**	**8,671**
Capital expenditures	(2,315)	(3,000)	(3,000)	(2,000)
Interest / Dividend Income	1,110	-	-	-
Others	(3,655)	1,000	-	-
Net Cash from Invt. activities	**(4,860)**	**(2,000)**	**(3,000)**	**(2,000)**
Issue of share cap. / premium	-	-	-	-
Debt changes	2,508	(508)	-	-
Dividend paid	(4,663)	(4,778)	(5,125)	(5,706)
Interest paid	(90)	(148)	(100)	(100)
Others	-	-	-	-
Net cash from Fin. activities	**(2,245)**	**(5,435)**	**(5,225)**	**(5,806)**
Net change in cash	**386**	**(406)**	**(157)**	**865**
Free Cash Flow	5,046	4,029	5,068	6,671

Source: Company Data, PL Research

Key Financial Metrics

Y/e Mar	FY17	FY18	FY19E	FY20E
Per Share(Rs)				
EPS	26.5	23.5	26.8	29.8
CEPS	29.6	26.9	30.5	33.8
BVPS	135.0	143.3	151.6	160.9
FCF	18.2	14.5	18.3	24.1
DPS	14.0	15.0	16.1	17.9
Return Ratio(%)				
RoCE	19.2	15.6	17.6	18.9
ROIC	19.7	14.2	15.3	16.6
RoE	20.3	16.9	18.2	19.1
Balance Sheet				
Net Debt : Equity (x)	(0.1)	(0.1)	(0.1)	(0.1)
Net Working Capital (Days)	65	69	67	65
Valuation(x)				
PER	25.3	28.5	25.0	22.5
P/B	5.0	4.7	4.4	4.2
P/CEPS	30.6	27.9	31.6	35.0
EV/EBITDA	22.5	24.8	21.2	18.7
EV/Sales	3.6	3.6	3.2	2.9
Dividend Yield (%)	2.1	2.2	2.4	2.7

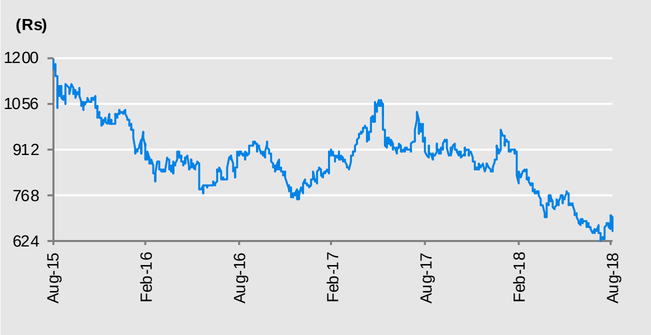
Source: Company Data, PL Research

Quarterly Financials (Rs m)

Y/e Mar	Q2FY18	Q3FY18	Q4FY18	Q1FY19
Net Revenue	**11,539**	**13,547**	**12,332**	**13,280**
YoY gr. (%)	-	-	*4.1*	*(1.0)*
Raw Material Expenses	7,282	8,546	8,031	8,330
Gross Profit	4,257	5,000	4,301	4,950
Margin (%)	*36.9*	*36.9*	*34.9*	*37.3*
EBITDA	**1,675**	**1,967**	**1,731**	**2,147**
YoY gr. (%)	*(14.2)*	*17.4*	*(12.0)*	*24.0*
Margin (%)	*14.5*	*14.5*	*14.0*	*16.2*
Depreciation / Depletion	220	237	273	271
EBIT	**1,454**	**1,730**	**1,458**	**1,876**
Margin (%)	*12.6*	*12.8*	*11.8*	*14.1*
Net Interest	38	34	34	36
Other Income	536	501	664	696
Profit before Tax	**1,953**	**2,197**	**2,088**	**2,536**
Margin (%)	*16.9*	*16.2*	*16.9*	*19.1*
Total Tax	424	475	475	706
Effective tax rate (%)	*21.7*	*21.6*	*22.8*	*27.8*
Profit after Tax	**1,529**	**1,722**	**1,612**	**1,830**
Minority interest	-	-	-	-
Share Profit from Associates	-	-	-	-
Adjusted PAT	**1,529**	**1,722**	**1,612**	**1,830**
YoY gr. (%)	-	-	*1.7*	*10.2*
Margin (%)	*13.3*	*12.7*	*13.1*	*13.8*
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	**1,529**	**1,722**	**1,612**	**1,830**
YoY gr. (%)	-	-	*1.7*	*(17.6)*
Margin (%)	*13.3*	*12.7*	*13.1*	*13.8*
Other Comprehensive Income	34	4	4	3
Total Comprehensive Income	**1,563**	**1,726**	**1,616**	**1,833**
Avg. Shares O/s (m)	-	-	-	-
EPS (Rs)	**-**	**-**	**-**	**-**

Source: Company Data, PL Research

Price Chart



Recommendation History

No.	Date	Rating	TP (Rs.)	Share Price (Rs.)
1	08-Sep-17	BUY	1,096	914
2	09-Oct-17	BUY	1,096	912
3	28-Oct-17	BUY	1,019	907
4	10-Jan-18	BUY	1,019	936
5	02-Feb-18	BUY	961	829
6	15-Mar-18	BUY	967	778
7	13-Apr-18	BUY	961	733
8	25-May-18	BUY	928	704
9	07-Jun-18	BUY	857	681
10	11-Jun-18	BUY	928	850

Analyst Coverage Universe

Sr. No.	CompanyName	Rating	TP (Rs)	Share Price (Rs)
1	ABB	Accumulate	1,415	1,135
2	Ashoka Buildcon	BUY	321	240
3	Bharat Electronics	BUY	150	116
4	BHEL	Reduce	73	72
5	Crompton Greaves Consumer Electricals	BUY	290	240
6	Cummins India	BUY	857	655
7	Engineers India	Accumulate	180	125
8	Havells India	NR	-	535
9	J.Kumar Infraprojects	BUY	365	232
10	Kalpataru Power Transmission	Accumulate	472	369
11	KEC International	BUY	400	328
12	KSB Pumps	Accumulate	925	797
13	Larsen & Toubro	BUY	1,566	1,321
14	Power Grid Corporation of India	Accumulate	229	185
15	RPP Infra Projects	BUY	379	203
16	Sadbhav Engineering	BUY	417	296
17	Siemens	Accumulate	1,401	975
18	Thermax	Hold	1,138	1,105
19	Voltas	Accumulate	658	621

PL's Recommendation Nomenclature (Absolute Performance)

Buy	:	> 15%
Accumulate	:	5% to 15%
Hold	:	+5% to -5%
Reduce	:	-5% to -15%
Sell	:	< -15%
Not Rated (NR)	:	No specific call on the stock
Under Review (UR)	:	Rating likely to change shortly

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