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Q4FY20 result review
and earnings revision

Capital Goods

Target price: Rs465

Earnings revision

(%)	FY21E	FY22E
Sales	↓ 3.2	↑ 0.2
EBITDA	↓ 12.7	↓ 2.2
PAT	↓ 8.7	↓ 0.5

Target price revision

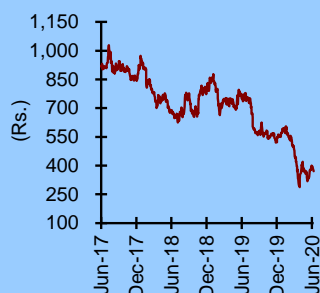
Rs465 from Rs412

Shareholding pattern

	Sep '19	Dec '19	Mar '20
Promoters	51.0	51.0	51.0
Institutional investors	38.1	37.8	37.5
MFs and others	21.5	22.6	20.7
FIs/Banks/Ins	8.4	8.9	9.0
FII	8.2	6.3	7.8
Others	10.9	11.2	11.5

Source: NSE

Price chart



INDIA

ICICI Securities

Cummins India

BUY

Maintained

Rs369

Strong cashflows despite weak execution

Cummins India's (Cummins) export revenues dropped 21% YoY and domestic revenues declined 22% YoY in Q4FY20 in line with expectations. Management is sanguine about recovery from US and China export markets while the Middle East, Europe and South-East Asia continue to be under stress. Company was able to manage net working capital efficiently resulting in healthy cashflows and dividend payout. Though near-term execution is expected to be weak, we believe, focus on cashflows, leadership in technology and gradual recovery in export markets augur well for long-term growth. Factoring-in near-term weakness, we cut FY21E earnings by 9% and marginally tone down FY22E earnings. Given long-term structural growth drivers like change in emission norms to CPCB-IV plus and benign valuation, we maintain BUY with a revised SoTP target of Rs465 (previously: Rs412).

- **Weakness in domestic market accentuated by Covid-19:** Overall domestic sales fell 22% YoY to Rs7.8bn due to decline in all segments. Powergen dropped 33% YoY to Rs2.7bn and distribution declined 23% YoY to Rs2.5bn. Aided by partial support from mining and railways; industrial segment decline was limited to 9% YoY at Rs2.5bn. As per management, after adjusting for lockdown, domestic decline for Q4FY20 would have been 3.7% YoY.
- **Export headwinds continue, green shoots in certain markets visible:** Exports declined 21% YoY in Q4FY20 to Rs2.7bn impacted by a challenging outlook in most of the overseas geographies. There has been recovery in demand from China and US markets, which is likely to support HHP exports. Other geographies are currently under stress and the progress of pandemic containment will be a key determinant of demand.
- **Higher other expenses and material costs impacting margins:** Gross margins are low due to unfavourable product mix and this is likely to continue in the near term till LHP exports recover. Other expenditure was high due to certain forex losses and is likely to normalise going forward.
- **Maintain BUY on cashflows and long-term growth:** Given the continued stress in domestic markets and slower recovery expected in exports, we cut our earnings estimates by 8.7% and 0.5% for FY21E and FY22E respectively. We factor-in gradual improvement in margins and expect exports to recover in FY22E. We believe long-term growth potential is intact with the introduction of CPCB-IV+ norms. We revise our SoTP-based target price to Rs465 (previously Rs412) and roll over our valuation multiple to FY22E given depressed earnings in FY21E due to lockdown.

Market Cap	Rs102bn/US\$1.3bn
Reuters/Bloomberg	CUMM.BO/KKC IN
Shares Outstanding (mn)	277.2
52-week Range (Rs)	779/287
Free Float (%)	49.0
FII (%)	7.8
Daily Volume (US\$/000)	7,886
Absolute Return 3m (%)	(16.3)
Absolute Return 12m (%)	(48.4)
Sensex Return 3m (%)	18.8
Sensex Return 12m (%)	(11.5)

Year to Mar (Std)	FY19	FY20	FY21E	FY22E
Revenue (Rs mn)	56,590	51,577	44,256	49,565
Net Income (Rs mn)	7,226	6,432	4,592	5,606
DEPS (Rs)	26.1	23.2	16.6	20.2
% Chg YoY	8.0	(11.0)	(28.6)	22.1
P/E (x)	14.2	15.9	22.3	18.2
CEPS (Rs)	30.0	27.0	21.1	24.9
EV/E (x)	11.1	16.2	21.4	16.6
Dividend Yield (%)	4.6	3.8	4.3	4.3
RoCE (%)	23.8	17.2	13.2	16.0
RoE (%)	17.8	15.5	11.1	13.6

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Valuation and outlook

The economic damage due to pandemic-related slowdown and stress on MENA market is expected to delay the overall recovery of exports and we believe this is likely to impact overall near-term growth. Demand from the railways continues to be strong. Though near-term growth will be impacted by the export weakness and domestic challenges, we expect things to normalise in FY22E.

Given the depressed earnings in FY21E due to Covid-19 related lockdown, we roll over our valuation multiple to FY22E earnings. We believe, Cummins' long-term structural story is intact given the change in emission norms and technological leadership and the testing and other preparedness and investments done by the company.

Taking account of Cummins India's higher other income due to lease rentals and high cash position, we value its core earnings and lease rental income separately and add back the cash. We value core earnings at 22x FY22E core earnings, add back the cash and discount the lease rentals @6% for 10 years. This works out to a target price of Rs465.

Table 1: Earnings revision

(Rs mn)	FY21E			FY22E		
	Previous	Revised	% chg	Previous	Revised	% chg
Revenues	45,699	44,256	(3.2)	49,455	49,565	0.2
EBITDA	5,161	4,504	(12.7)	5,925	5,794	(2.2)
PAT	5,030	4,592	(8.7)	5,637	5,606	(0.5)

Source: Company data, I-Sec research

Table 2: Valuation summary

(Rs mn)	FY19	FY20	FY21E	FY22E
PAT (X)	7,226	6,432	4,592	5,606
Tax rate (%)	29.9	17.1	24.0	24.0
Interest & dividend income (Y)	1,106	1,435	1,100	1,100
Rental Income (Z)	1,174	1,180	1,204	1,240
Operating PAT (P=X-Y-Z) (Y and Z adjusted for tax)	5,626	4,264	2,841	3,827
P/E multiple (Q)				22
Value (R=P*Q)				84,203
Cash & Cash Equivalent (S)				11,036
Gross value (R+S)				95,239
Cummins Standalone value per share (Rs) (A)				344
Discounted Lease contribution				10,993
Lease contribution value per share (Rs) (B)				40
Valvoline PAT				1,516
P/E multiple (x)				30
Valvoline Gross value				45,485
Holding value (50% stake)				22,742
Valvoline value per share (Rs) (C)				82
Total value per share (Rs) (A+B+C)				465

Source: Company data, I-Sec research

Table 3: Result highlights

(Rs mn)	Q4FY19	Q4FY20	YoY(%)	Q3FY20	QoQ(%)	I-Sec est	Var(%)	FY19	FY20	YoY(%)
Total Revenue	13,404	10,528	(21.5)	14,534	(27.6)	10,045	4.8	56,590	51,577	(8.9)
EBITDA	1,718	667	(61.2)	2,158	(69.1)	412	61.7	8,641	5,863	(32.2)
Margin	12.8	6.3	-648bps	14.8	-851bps	4.1	223bps	15.3	11.4	
Depreciation	280	308	9.9	296	4.1	290	5.9	1,103	1,187	7.6
Finance Cost	45	49	8.2	47	5.2	46	5.4	162	203	25.0
Other Income	692	898	29.7	723	24.2	402	123.1	2,928	3,315	13.2
Extraordinary income	-	(38)		(161)		(160)		-	(199)	
PBT	2,085	1,170	(43.9)	2,378	(50.8)	318	268.0	10,304	7,591	(26.3)
Tax	676	(13)	(101.9)	515	(102.5)	265	(104.9)	3,078	1,297	(57.9)
tax rate	32.4	(1.1)	-3352bps	21.7	-2278bps	83.5	-8459bps	29.9	17.1	
Reported PAT	1,409	1,183	(16.0)	1,862	(36.5)	52	2,153.8	7,226	6,293	(12.9)
Adjusted PAT	1,409	1,212	(14.0)	1,983	(38.9)	172	602.4	7,226	6,442	(10.8)
Margin (%)	10.5	11.5	99bps	13.6	-213bps	1.7	979bps	12.8	12.5	
EPS (Rs)	5.1	4.4		7.2		0.6		26.1	23.2	(10.8)

Source: Company data, I-Sec research

Table 4: Quarterly segmental trend

(Rs mn)	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	YoY (%)
Revenues						
Powergen	4,000	3,930	3,940	3,800	2,670	(33.3)
Distribution	3,300	3,460	3,300	4,150	2,540	(23.0)
Industrial	2,700	2,500	2,140	2,670	2,450	(9.3)
Domestic	9,917	9,893	9,477	10,585	7,756	(21.8)
% YoY	20%	16%	-6%	4%	-22%	
Exports	3,227	3,270	3,370	3,700	2,566	(20.5)
% YoY	-17%	-26%	-25%	-16%	-20%	
Total	13,144	13,163	12,847	14,285	10,322	(21.5)
Powergen Domestic						
LHP (till 62.5kva)	800	450	400	900	260	(67.5)
MHP (82.5-250kva)	1200	1100	1300	1100	670	(44.2)
Heavy Duty (320-380kva)	100	350	600	100	390	290.0
HHP (500kva+)	1900	2150	1650	1700	1450	(23.7)
Total	4000	4050	3950	3800	2770	(30.8)
Industrial Segment						
Compressors	500	450	250	390	373	(25.5)
Construction	1100	900	550	720	755	(31.4)
Mining	150	100	130	260	290	93.3
Rail	800	850	1000	1030	1020	27.5
Others	150	200	200	260	23	(85.0)
Total	2700	2500	2130	2660	2460	(8.9)
Exports						
LHP	500	500	550			
Midrange	800	800	600			
Total LHP	1300	1300	1150	1440	970	(25.4)
Heavy duty	300	300	250			
HHP	1400	1400	1750	2080	1450	
Total HHP	1700	1700	2000	2080	1450	(14.7)
spare parts	220	250	200	180	186	(15.5)
Total	3220	3250	3350	3700	2606	(19.1)

Source: Company data, I-Sec research

Key concall takeaways:

- Rs1.9 of revenues were lost in Q4FY20 due to Covid-19 by way of impact from not being able to ship in the last 15 days of March. Excluding the impact of lockdown, revenues declined 7% YoY for the quarter.
- Operations resumed from 1st June and the facilities are running at 35-40% utilisation levels as of now. Timeline for getting back to pre Covid-19 utilisation levels of 60% cannot be ascertained, given that the major three suppliers are in hot Covid-19 zones – Tamil Nadu, Maharashtra and Delhi.
- Distribution is expected to revive faster than industrial and powergen. The export part of powergen has started seeing activity led by sectors like hospital, data centres and IT infra where power is required for critical applications. Revival of powergen in non-critical areas like commercial/residential will be relatively slower.
- In industrial segment, compressor business is expected to remain weak due to cyclicity. Activity in construction and marine will be dependent on government capex pickup. Railways has started ramping up quickly and mining has not been impacted much by Covid-19.
- Exports declined 20.5% YoY to Rs2.6bn due to weakness in all markets with America declining 1% YoY, Africa 40% YoY, Europe 41% YoY, Middle East 42% YoY, Rest of Asia 46% YoY and Mexico 20% YoY. Remaining markets were up 21% YoY.
- Top five exports markets constitute Europe, Middle East, Africa, South-East Asia and China, contributing 70% of export sales
- In exports, China, US, Vietnam and Indonesia have revived the earliest while all other geographies continue to lag. Pickup in recovery is dependent on how exports market have opened up, e.g. China bounced back the most.
- HHP market recovery is expected to be faster given their use in critical applications. LHP and MHP, which are mostly used in industry and consumer applications, will have relatively slower recovery.
- Management estimates 24-25% long-term tax rate and Q4FY20 had a one-time impact due to shift to new tax regime.
- Other expenditure grew 6% YoY despite 22% YoY decline in revenues due to forex impact of Rs20mn-25mn
- Management sees minimal risk to rental income as most of the real estate properties are rented out internally

Table 5: Key assumptions

(Rs mn).

	FY17	FY18	FY19	FY20	FY21E	FY22E
PowerGen	13,540	13,946	16,000	14,350	12,628	14,143
% YoY	8.3	3.0	14.7	(10.3)	(12.0)	12.0
Industrial	7,160	7,730	9,230	9,960	9,163	10,263
% YoY	27.9	8.0	19.4	7.9	(8.0)	12.0
Distribution	11,500	12,620	13,500	13,400	12,328	13,561
% YoY	16.8	9.7	7.0	(0.7)	(8.0)	10.0
Domestic	37,114	34,296	38,730	37,710	34,119	37,967
% YoY	11.8	(7.6)	12.9	(2.6)	(9.5)	11.3
Exports	15,981	16,007	16,527	12,906	9,680	11,131
% YoY	(3.0)	0.2	3.2	(21.9)	(25.0)	15.0
Total	53,095	50,303	55,257	50,616	43,799	49,098

Source: Company data, I-Sec research

Financial summary

Table 6: Profit & loss statement

(Rs mn, year ending March 31)

	FY19	FY20	FY21E	FY22E
Total Income	56,590	51,577	44,256	49,565
Operating Expenses	47,949	45,715	39,752	43,771
EBITDA	8,641	5,863	4,504	5,794
% margins	15.3	11.4	10.2	11.7
Depreciation & Amortisation	1,103	1,187	1,246	1,308
EBIT	7,538	4,676	3,258	4,486
Gross Interest	162	203	170	150
Other Income	2,928	3,315	2,954	3,040
PBT before exceptionals	10,304	7,789	6,042	7,376
Add:				
Extraordinaries/Exceptionals	-	(199)	-	-
Add: Share in associates				
PBT	10,304	7,591	6,042	7,376
Less: Taxes	3,078	1,297	1,450	1,770
Less: Minority Interests				
Net Income (Reported)	7,226	6,293	4,592	5,606
Adjusted Net Income	7,226	6,432	4,592	5,606

Source: Company data, I-Sec research

Table 7: Balance sheet

(Rs mn, year ending March 31)

	FY19	FY20	FY21E	FY22E
Assets				
Total Current Assets	34,081	33,611	30,348	31,949
of which cash & cash eqv.	9,807	12,353	10,948	11,036
Total Current Liabilities & Provisions	13,152	12,137	10,217	11,686
Net Current Assets	20,929	21,474	20,132	20,263
Investments	7,706	10,792	10,792	10,792
Other Non-Current Assets	2,316	2,334	2,380	2,429
Net Fixed Assets	14,433	12,805	13,458	13,650
Goodwill				
Total Assets	45,384	47,404	46,762	47,134
Liabilities				
Borrowings	3,092	4,854	4,854	4,854
Deferred Tax Liability	988	800	800	800
Minority Interest				
Equity Share Capital	554	554	554	554
Face Value per share (Rs)	2.00	2.00	2.00	2.00
Reserves & Surplus	40,750	41,195	40,553	40,925
Net Worth	41,305	41,750	41,108	41,480
Total Liabilities	45,384	47,404	46,762	47,134

Source: Company data, I-Sec research

Table 8: Cashflow statement

(Rs mn, year ending March 31)

	FY19	FY20	FY21E	FY22E
Operating Cashflow	7,032	4,204	6,008	7,064
Working Capital Changes	(1,532)	1,984	(109)	(92)
Capital Commitments	(1,685)	(2,644)	(1,900)	(1,500)
Free Cashflow	3,815	3,544	3,999	5,472
Cashflow from Investing Activities	1,854	510	(391)	(1,641)
Issue of Share Capital				
Buyback of shares				
Inc (Dec) in Borrowings	576	1,762	-	-
Interest paid	162	203	170	150
Dividend paid	(5,561)	(4,579)	(5,234)	(5,234)
Extraordinary Items/Others	(809)	1,108	51	1,341
Chg. in Cash & Bank balance	38	2,546	(1,405)	88

Source: Company data, I-Sec research

Table 9: Key ratios

(Year ending March 31)

	FY19	FY20	FY21E	FY22E
Per Share Data (in Rs.)				
Diluted adjusted EPS	26.1	23.2	16.6	20.2
Recurring Cash EPS	30.0	27.0	21.1	24.9
Dividend per share (DPS)	17.0	14.0	16.0	16.0
Book Value per share (BV)	149.0	150.6	148.3	149.6
Growth Ratios (%)				
Operating Income	9.6	(8.9)	(14.2)	12.0
EBITDA	18.0	(32.2)	(23.2)	28.6
Recurring Net Income	8.0	(11.0)	(28.6)	22.1
Diluted adjusted EPS	8.0	(11.0)	(28.6)	22.1
Diluted Recurring CEPS	3.8	(10.2)	(22.0)	18.4
Valuation Ratios				
P/E	14.2	15.9	22.3	18.2
P/CEPS	12.3	13.7	17.5	14.8
P/BV	2.5	2.5	2.5	2.5
EV / EBITDA	11.1	16.2	21.4	16.6
EV / Operating Income	1.7	1.8	2.2	1.9
EV / Operating FCF (pre -Capex)	17.4	15.3	16.3	13.8
Operating Ratios				
Raw Material/Sales (%)	63.9	65.3	64.3	64.2
SG&A/Sales (%)	9.8	11.0	11.9	11.2
Other Income / PBT (%)	28.4	42.6	48.9	41.2
Effective Tax Rate (%)	29.9	16.7	24.0	24.0
NWC / Total Assets (%)	20.7	17.7	18.0	17.5
Inventory Turnover (days)	41.3	41.3	45.5	45.4
Receivables (days)	82.1	80.1	80.0	80.0
Payables (days)	53.2	49.3	49.3	52.0
Net D/E Ratio (x)	(0.2)	(0.2)	(0.1)	(0.1)
Return/Profitability Ratios (%)				
Recurring Net Income Margins	12.8	12.5	10.4	11.3
RoCE	23.8	17.2	13.2	16.0
RoNW	17.8	15.5	11.1	13.6
Dividend Payout Ratio	65.2	60.3	96.6	79.1
Dividend Yield (%)	4.6	3.8	4.3	4.3
EBITDA Margins	15.3	11.4	10.2	11.7

Source: Company data, I-Sec research

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