August 13, 2020

YES SECURITIES INSTITUTIONAL EQUITIES

Result Report | Sector: Capital Goods

Cummins India Ltd

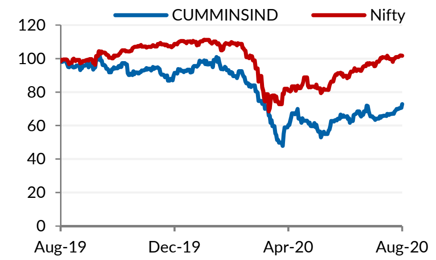
SELL	CMP Rs437	Target Rs332	Downside 24%

HIGHLIGHTS	✓ KKC's PAT came in ahead of est. as higher other income (incl. exceptional gain of Rs357mn due to interest on tax refund) & gross margin expansion negated the sluggish sales performance. ✓ Gross margin expanded by 757bps yoy due to favorable sales mix as distribution business was 37% of sales vs 26% in Q1FY20. KKC expects gross margin to decline to its sustainable level of 35% once other segments witness recovery in demand. ✓ Commercial/ Residential real estate activities expected to remain sluggish & will take longer time to recover, while data centers & healthcare would likely to support powergen biz. Rail & Mining (55% of industrial sales) to lead industrial biz recovery in next 2-3 quarters. Significant demand uncertainties persist in export markets, so recovery would be difficult to predict.
Our View	✓ We think fortunes of KKC's powergen business are primarily dependent on realty & infra segments, which would be facing multiple demand headwind in medium term. Though implementation of CPCB-IV is getting delayed by 2-3 quarters, weak end markets & price cautious customers won't be able to absorb price hikes. Hence, KKC would struggle to maintain double digit growth on a sustainable basis given a structural downtrend in the core business. ✓ We remain highly skeptical on KKC's margin recovery to 11%+ over FY20-FY22 due to, i) Unfavorable product mix (increasing share of industrials within domestic sales, delay in export revival), ii) Pricing pressure in India worse than global levels (LHP/ HHP pricing significantly below inflation levels in domestic market), iii) Competition getting fierce amidst slowing demand and iv) KKC's inability to keep control over fixed costs. We also expect contraction in margins of Export biz in mid-term, foreseeing incremental competition over time.
Valuation	✓ Retain 'SELL' with TP of Rs332 at 17x FY22E EPS. Deteriorating earnings quality (post tax non-core income as % of PAT at 56% in FY22E) & weakening return profile justify our target multiple.
Risk to call	✓ Faster than expected demand & margin recovery.

Stock data (as on August 13, 2020)

Nifty:	11,300
52 Week h/l (Rs)	653 / 280
Market cap (Rs/USD mn)	121067 / 1618
Outstanding Shares	277
6m Avg t/o (Rs mn):	542
Div yield (%):	3.2
Bloomberg code:	KKC IN
NSE code:	CUMMINSIND

Stock performance



	1M	3M	1Y
Absolute return	12.4%	20.4	(25.2)

Shareholding pattern (As of Jun'20 end)

Promoter	51.0%
FII+DII	37.6%
Others	11.2%

∆ in earnings estimates

	FY21e	FY22e
EPS (New)	16.8	19.6
EPS (Old)	15.8	19.6
% change	6%	0%

Exhibit 1: Financial Summary (Consolidated)

Y/e 31 Mar (Rs mn)	FY18	FY19	FY20	FY21E	FY22E
Revenues	51,119	56,973	51,915	41,710	48,967
yoy growth (%)	0.1	11.5	(8.9)	(19.7)	17.4
EBITDA	7,329	8,691	5,892	3,761	4,897
EBITDAM (%)	14.3	15.3	11.3	9.0	10.0
Adjusted PAT	7,118	7,426	7,056	4,652	5,424
yoy growth (%)	(9.2)	11.1	(2.3)	(35.9)	16.6
EPS (Rs)	24.1	26.8	26.2	16.8	19.6
P/E (x)	18.1	16.3	16.7	26.0	22.3
P/BV (x)	2.9	2.8	2.8	2.6	2.5
EV/EBITDA (x)	16.2	13.4	19.3	29.9	22.9
Net D/E (x)	(0.1)	(0.1)	(0.2)	(0.2)	(0.2)
Core ROIC (%)	14.3	13.8	10.6	4.8	6.8
ROE (%)	16.7	17.7	16.7	10.4	11.6

Source: Company, YES Sec – Research

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Cummins India Ltd

Exhibit 2: Result table (Consolidated)

(Rs mn)	Q1 FY21	Q1 FY20	% yoy	Q4 FY20	% qoq
Total sales	5,028	13,517	(62.8)	10,625	(52.7)
EBITDA	19	1,516	(98.7)	675	(97.1)
EBITDAM (%)	0.4	11.2	(1,083.2)	6.3	(596.6)
Depreciation	(308)	(296)	4.2	(313)	(1.5)
Interest	(44)	(54)	(17.7)	(51)	(12.8)
Other income	967	630	53.4	670	44.3
PBT	634	1,797	(64.7)	981	(35.4)
Tax	(180)	(579)	(68.8)	469	(138.5)
Share in JVs/MI	76	308	(75.2)	290	(73.6)
Recurring PAT	530	1,526	(65.2)	1,740	(69.5)
Exceptional item	0	0		(38)	
Reported PAT	530	1,526	(65.2)	1,702	(68.9)

Source: Company, YES Sec – Research

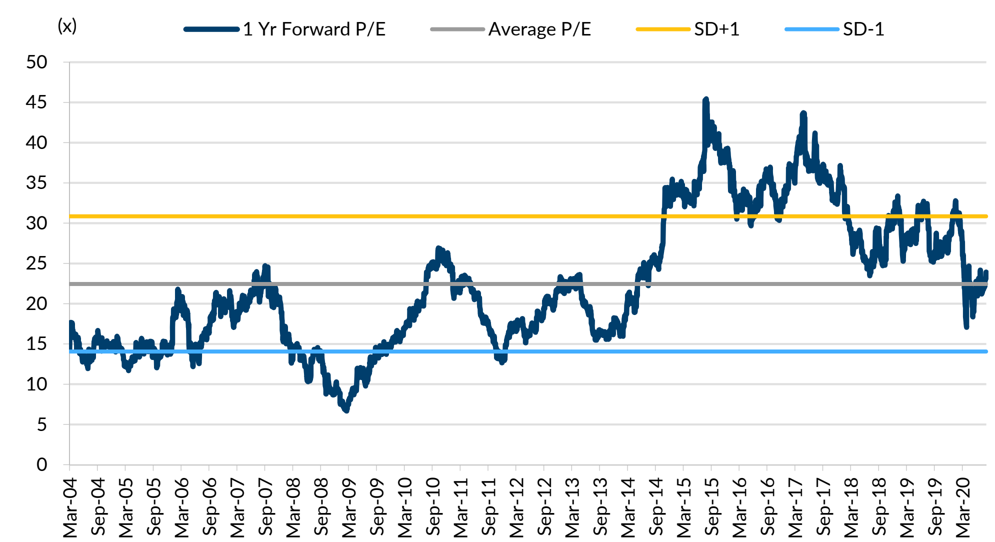
Exhibit 3: Cost analysis (Consolidated)

As a % of net sales	Q1 FY21	Q1 FY20	bps yoy	Q4 FY20	bps qoq
COGS	58.1	65.7	(757.3)	64.7	(653.9)
Employee cost	23.8	10.5	1,327.1	13.6	1,013.1
Other expenses	17.7	12.6	513.4	15.4	237.4
Total costs	99.6	88.8	1,083.2	93.7	596.6

Source: Company, YES Sec – Research

VALUATION CHART

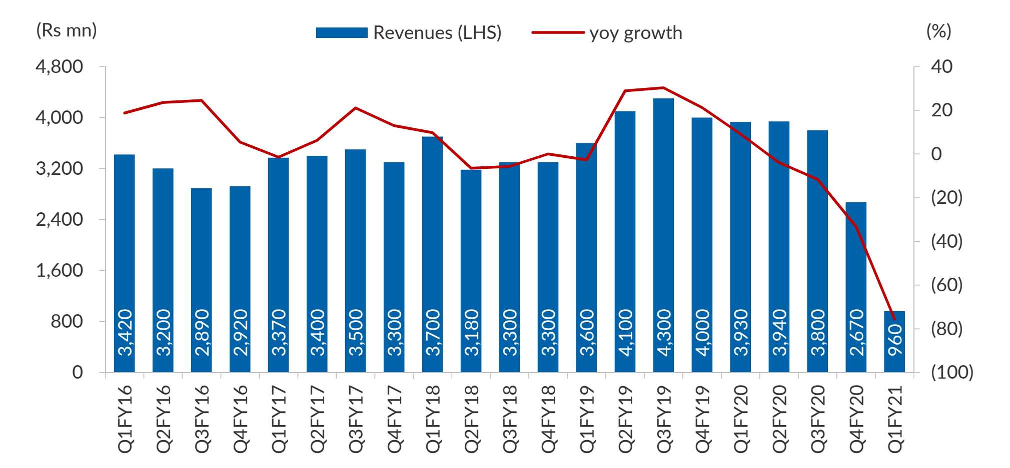
Exhibit 4: Deteriorating earnings/returns deserve Pre-FY14 P/E trajectory



Source: Company, YES Sec – Research

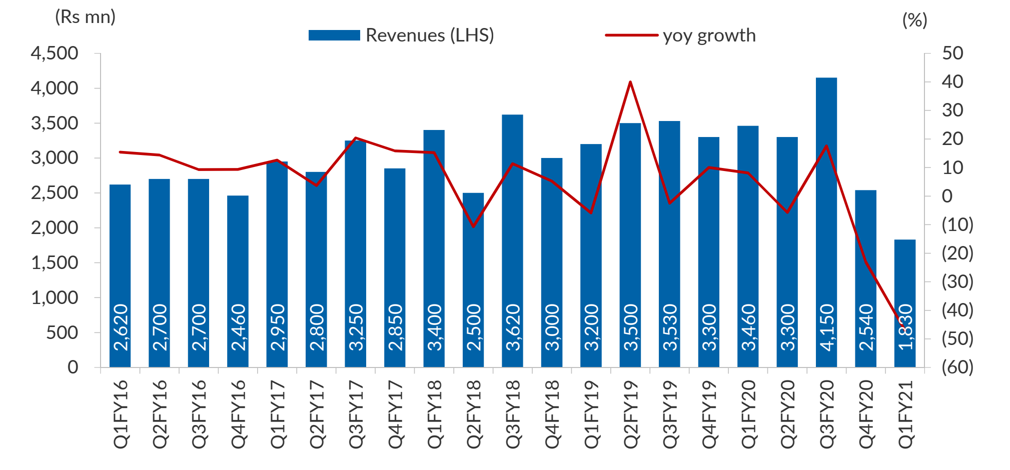
FINANCIAL CHART

Exhibit 5: PG growth revival hinges on real estate recovery



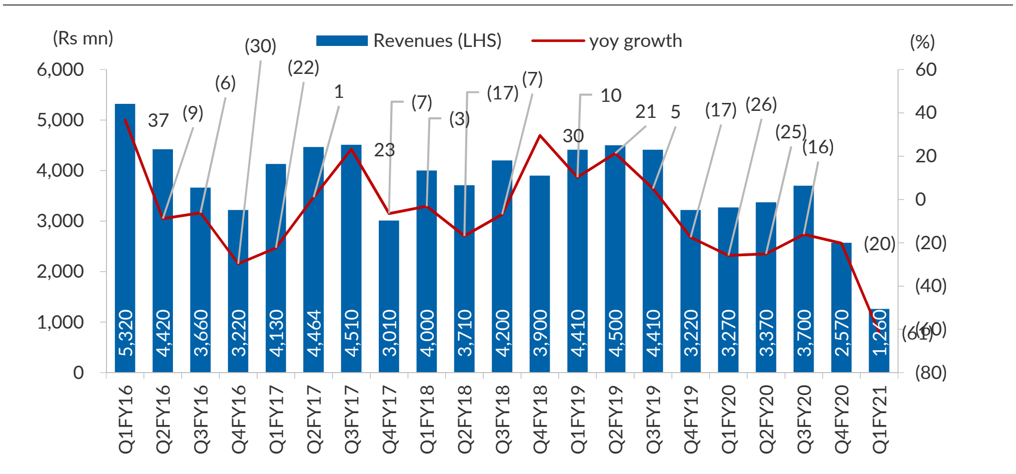
Source: Company, YES Sec – Research

Exhibit 6: Distribution remains only secular growth driver for KKC



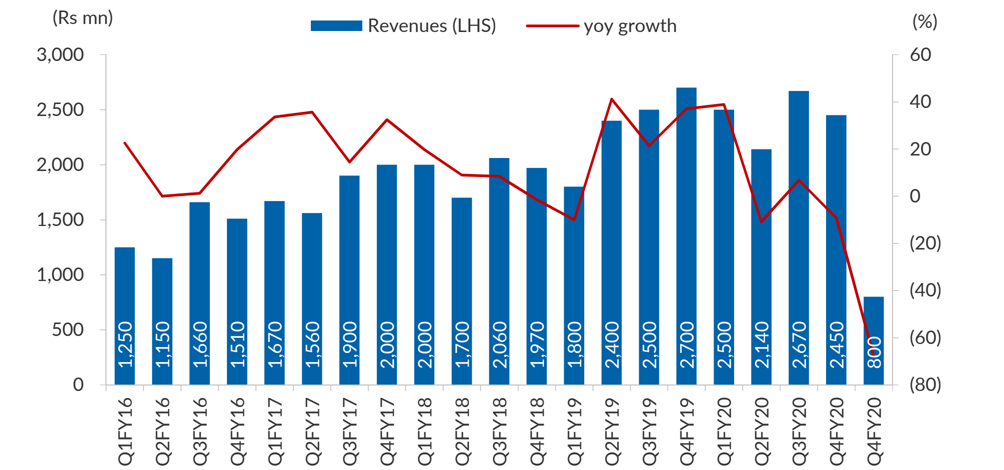
Source: Company, YES Sec – Research

Exhibit 7: Exports recovery likely to be delayed



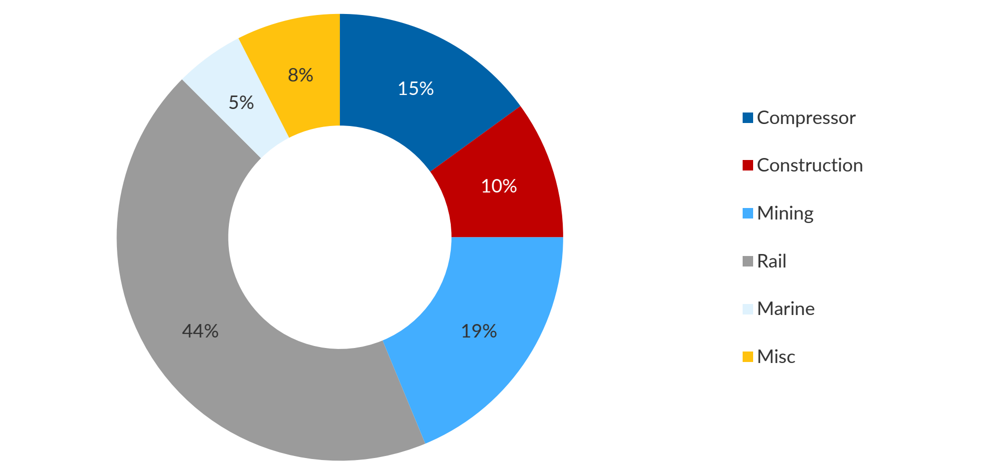
Source: Company, YES Sec – Research

Exhibit 8: Industrial growth likely to be supported by rail segment



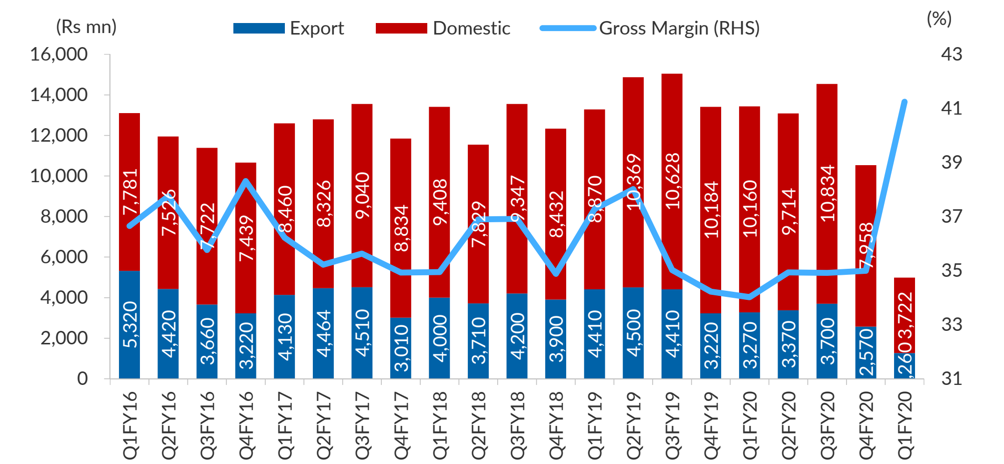
Source: Company, YES Sec – Research

Exhibit 9: Industrial growth driven by rail & marine segments



Source: Company, YES Sec – Research

Exhibit 10: Gross margin expansion in Q1FY21 temporary in nature



Source: Company, YES Sec – Research

FINANCIALS

Exhibit 11: Income statement (Consolidated)

Y/e 30 Mar (Rs mn)	FY18	FY19	FY20	FY21E	FY22E
Total operating revenues	51,119	56,973	51,915	41,710	48,967
Growth (%)	0.1	11.5	(8.9)	(19.7)	17.4
EBITDA	7,329	8,691	5,892	3,761	4,897
EBITDA margin (%)	14.3	15.3	11.3	9.0	10.0
Growth (%)	(8.9)	18.6	(32.2)	(36.2)	30.2
Depreciation & amortization	944	1,111	1,206	1,288	1,371
EBIT	6,385	7,580	4,686	2,473	3,526
EBIT margin (%)	12.5	13.3	9.0	5.9	7.2
Interest	152	168	210	215	240
Other income	1,613	2,351	2,575	2,812	2,600
Profit before tax	7,847	9,763	7,051	5,070	5,886
Tax	1,818	3,263	1,019	1,298	1,483
Associate income	659	926	1,223	880	1,021
Minority interest	0	0	0	0	0
Adjusted net profit	6,687	7,426	7,255	4,652	5,424
Extraordinary items	(431)	0	199	0	0
Reported net profit	7,118	7,426	7,056	4,652	5,424
Adjusted net margin (%)	13.1	13.0	14.0	11.2	11.1
Diluted EPS (Rs)	24.1	26.8	26.2	16.8	19.6
Growth (%)	(9.2)	11.1	(2.3)	(35.9)	16.6

Exhibit 12: Balance sheet (Consolidated)

Y/e 30 Mar (Rs mn)	FY18	FY19	FY20	FY21E	FY22E
SOURCE OF FUNDS					
Share capital	554	554	554	554	554
Reserve & Surplus	40,632	42,275	43,466	45,282	47,035
Total shareholder's funds	41,186	42,830	44,020	45,836	47,590
Minority Interest	0	0	0	0	0
Debt	2,568	3,126	4,893	5,053	3,549
Deferred tax liabilities/(assets)	1,402	2,432	2,265	2,166	1,670
TOTAL	45,156	48,387	51,178	53,055	52,808
APPLICATION OF FUNDS					
Gross block	28,509	29,299	33,053	35,053	37,285
Less: Depn. and amort.	8,300	9,147	10,353	11,641	13,012
Net block	20,209	20,151	22,700	23,412	24,273
Capital WIP	387	1,585	800	800	1,200
Long term investments	7,085	4,682	2,559	2,425	2,425
Other long term assets	2,226	2,326	2,077	2,411	2,211
Inventories	5,444	6,329	5,772	5,142	5,635
Debtors	13,382	12,836	12,836	10,856	11,403
Cash & cash equivalents	4,709	7,381	12,353	13,818	12,764
Loans & advances	3,706	5,314	2,863	2,879	3,098
Total current liabilities	11,991	12,215	10,783	8,689	10,201
Net current assets	15,249	19,643	23,042	24,006	22,699
TOTAL	45,156	48,387	51,178	53,055	52,808

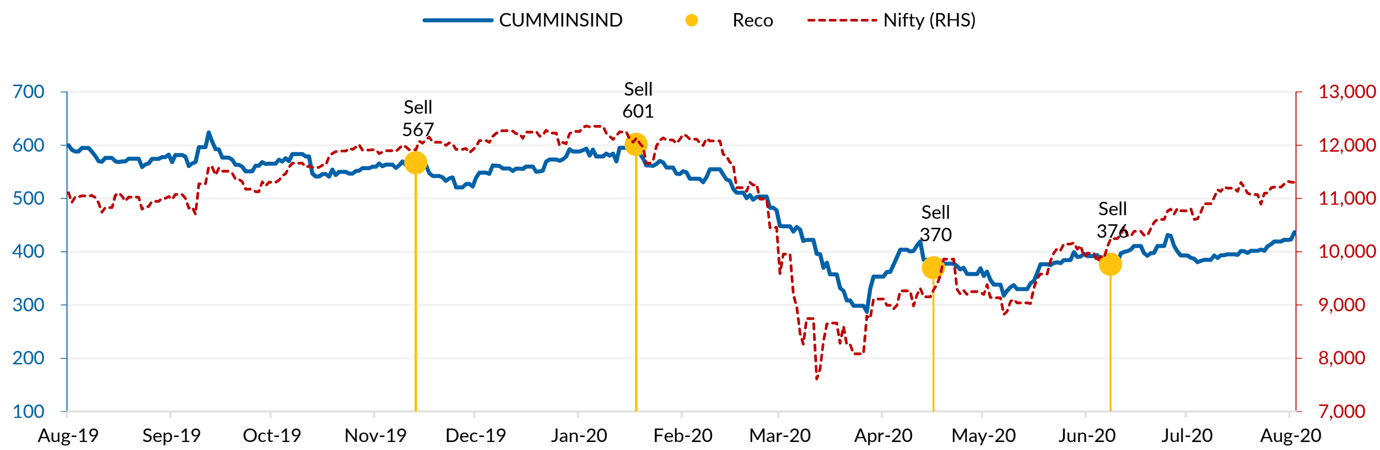
Exhibit 13: Cash flow statement (Consolidated)

Y/e 30 Mar (Rs mn)	FY18	FY19	FY20	FY21E	FY22E
PBT	9,266	10,689	8,075	5,070	5,886
Depreciation	944	1,111	1,206	1,288	1,371
Others	(1,664)	(1,545)	(1,783)	(880)	(1,021)
Tax Paid	(1,835)	(2,374)	(1,623)	(1,298)	(1,483)
Changes in Working Capital	(392)	(2,349)	133	499	254
Net Cash from Operations	**6,319**	**5,532**	**6,007**	**4,679**	**5,006**
Capex	(918)	(2,741)	(2,371)	(2,334)	(2,432)
Change in Investment	1,582	670	(1,163)	134	0
Others	(2,004)	2,234	1,395	0	0
Net Cash from Investing	**(1,340)**	**162**	**(2,139)**	**(2,200)**	**(2,432)**
Change in debt	0	558	1,767	160	(1,504)
Change in Equity	0	0	0	0	0
Others	(4,696)	(5,808)	(5,890)	(1,174)	(2,123)
Net Cash from Financing	**(4,696)**	**(5,251)**	**(4,123)**	(1,014)	(3,628)
Net Change in Cash	**284**	**444**	**(255)**	1,464	(1,054)
Free cash flow (FCF)	**5,096**	**5,806**	**4,048**	**2,639**	**2,754**

Exhibit 14: Ratio analysis (Consolidated)

Y/e 30 Mar (Rs mn)	FY18	FY19	FY20	FY21E	FY22E
PROFITABILITY RATIOS					
EBITDA Margin (%)	14.3	15.3	11.3	9.0	10.0
Adjusted net margin (%)	13.9	13.0	13.6	11.2	11.1
Return on invested capital (%)	14.4	14.0	10.7	4.8	6.8
Return on equity (%)	16.7	17.7	16.7	10.4	11.6
EFFICIENCY RATIOS					
Asset Turnover	2.5	2.6	2.2	1.7	1.9
Debt to equity	0.1	0.1	0.1	0.1	0.1
Net debt to equity	(0.1)	(0.1)	(0.2)	(0.2)	(0.2)
Interest coverage	42.0	45.2	22.3	11.5	14.7
Debtor days	95.5	82.2	90.2	95.0	85.0
Inventory days	38.9	40.5	40.6	45.0	42.0
Payable days	54.2	52.9	49.0	49.0	49.0
PER SHARE DATA					
Diluted EPS (Rs)	24.1	26.8	26.2	16.8	19.6
BVPS (Rs)	148.6	154.5	158.8	165.4	171.7
DPS (Rs)	15.0	17.0	14.0	8.5	11.0
VALUATION RATIOS					
P/E	18.1	16.3	16.7	26.0	22.3
P/BV	2.9	2.8	2.8	2.6	2.5
EV/EBITDA	16.2	13.4	19.3	29.9	22.9
Dividend Yield (%)	3.4	3.9	3.2	1.9	2.5

Recommendation Tracker



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