

November 7, 2022

## Q2FY23 Result Update

Change in Estimates |  Target |  Reco

### Change in Estimates

	Current		Previous	
	FY24E	FY25E	FY24E	FY25E
Rating	ACCUMULATE		ACCUMULATE	
Target Price	1,514		1,296	
Sales (Rs. m)	79,975	87,281	73,211	79,902
% Chng.	9.2	9.2		
EBITDA (Rs. m)	12,352	13,790	11,344	12,620
% Chng.	8.9	9.3		
EPS (Rs.)	39.5	43.3	36.0	39.7
% Chng.	9.7	8.9		

### Key Financials - Standalone

Y/e Mar	FY22	FY23E	FY24E	FY25E
Sales (Rs. m)	61,404	73,365	79,975	87,281
EBITDA (Rs. m)	8,851	10,627	12,352	13,790
Margin (%)	14.4	14.5	15.4	15.8
PAT (Rs. m)	7,854	9,555	10,941	11,989
EPS (Rs.)	28.3	34.5	39.5	43.3
Gr. (%)	27.1	21.7	14.5	9.6
DPS (Rs.)	10.5	22.8	26.1	28.5
Yield (%)	0.8	1.7	2.0	2.1
RoE (%)	17.0	19.1	20.4	20.8
RoCE (%)	15.5	16.9	18.6	19.4
EV/Sales (x)	5.8	4.9	4.5	4.1
EV/EBITDA (x)	40.1	33.6	29.0	25.9
PE (x)	47.1	38.7	33.8	30.9
P/BV (x)	7.6	7.1	6.7	6.2

### Key Data

### CUMM.BO | KKC IN

52-W High / Low	Rs.1,373 / Rs.842
Sensex / Nifty	61,185 / 18,203
Market Cap	Rs.370bn/ \$ 4,518m
Shares Outstanding	277m
3M Avg. Daily Value	Rs.851.16m

### Shareholding Pattern (%)

Promoter's	51.00
Foreign	10.36
Domestic Institution	26.74
Public & Others	11.90
Promoter Pledge (Rs bn)	-

### Stock Performance (%)

	1M	6M	12M
Absolute	7.8	32.4	48.4
Relative	2.5	18.6	45.7

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## Healthy performance, margins to improve

### Quick Pointers:

- Exports reported healthy growth of 21% YoY, largely driven from Middle East (up 58% YoY) and Latin America (up 29.8% YoY).
- Gross margins expected to gradually improve on account of price pass through, commodity softening and new product launches.

**Cummins India (KKC) reported healthy quarterly performance with 13% and 14.8% YoY growth in revenue and PAT. Gross margins during the quarter were impacted (down 118bps YoY), due to lag in price pass-through. EBITDA margin remain broadly flat at 14.9%, owing to better absorption of fixed overheads. Going forward, margins are expected to improve (in 18-24 months) owing to price hikes, commodity prices softening, better revenue mix and technology driven new product launches. Export markets continue to grow in geographies of Middle East, Latin America and Asia Pacific, with new tailor made product launches for specific regions, while some lag was witnessed in African markets. Domestic demand outlook continues to remain strong from sectors such as data center, pharmaceuticals, defence, railways, mining etc. Though demand scenario remains strong, supply chain disruptions may cause some impact in the near term. Management expects pre-buying to kick-in by H1CY23, prior to implementation of CPCB-IV norms in Jul'23.**

**We believe KKC is well placed to benefit in the long run given 1) healthy demand outlook, 2) reviving margin profile, 3) continued momentum in exports market, 4) implementation of CPCB-IV and 5) technology driven new product launches. Consequently, we revise upwards our EPS estimates by 10.3/9.7% for FY23/24E. The stock is trading at PE of 38.7x/33.8x/30.9x FY23/24/25E. We roll forward to FY25E and arrive at revised TP of Rs1,514 (Rs1,296 earlier), valuing it at PE of 35x FY25E EPS. Maintain 'Accumulate' rating on stock.**

**Better absorption of fixed cost aids margins:** Standalone sales grew 13% YoY to Rs19.5bn (PL estimate of Rs18.9bn) with domestic/exports at ~72.4%/27.6% of sales. Gross margin contracted 118bps YoY 31.8%, impacted due to commodity inflation and lag in price pass through. EBITDA grew 12.1% YoY to Rs2.9bn (PL estimate of Rs2.7bn) with EBITDA margins remaining broadly flat at 14.9% (vs 15% in Q1FY22), aided by better absorption of fixed overheads. Adj. PAT grew 14.8% YoY to Rs2.5bn, (PL estimate of Rs2.4bn) on account of strong operational performance and higher other income (up 23.1% YoY).

**Strong growth in domestic as well as exports market:** Domestic revenue grew 11.3% YoY to Rs13.9bn, driven by growth in distribution (up 22% YoY at Rs4.5bn), Industrial (up 10% YoY at Rs2.5bn) and Powergen (up 6% YoY at Rs6.8bn). Exports grew 21% YoY to Rs5.3bn, driven by Low Horse Power (LHP), up ~48% YoY to Rs2.4bn, while High Horse Power (HHP) declined 3% YoY to Rs2.3bn.

**Exhibit 1: Better absorption of fixed overheads aids margins**

Y/e March (Rs mn)	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	YoY gr. (%)	QoQ gr. (%)	H1FY23	H1FY23	YoY gr. (%)
<b>Revenue</b>	<b>17,274</b>	<b>17,350</b>	<b>14,936</b>	<b>16,867</b>	<b>19,513</b>	<b>13.0</b>	<b>15.7</b>	<b>36,379</b>	<b>29,119</b>	<b>24.9</b>
<b>Total Revenues</b>	<b>17,274</b>	<b>17,350</b>	<b>14,936</b>	<b>16,867</b>	<b>19,513</b>	<b>13.0</b>	<b>15.7</b>	<b>36,379</b>	<b>29,119</b>	<b>24.9</b>
<b>Expenditure</b>	<b>14,682</b>	<b>14,645</b>	<b>12,869</b>	<b>14,728</b>	<b>16,607</b>	<b>13.1</b>	<b>12.8</b>	<b>31,336</b>	<b>25,039</b>	<b>25.1</b>
<i>as % of sales</i>	<i>85.0</i>	<i>84.4</i>	<i>86.2</i>	<i>87.3</i>	<i>85.1</i>			<i>86.1</i>	<i>86.0</i>	
Consumption of RM	11,571	11,573	10,156	11,621	13,300	14.9	14.4	24,922	19,339	28.9
<i>as % of sales</i>	<i>67.0</i>	<i>66.7</i>	<i>68.0</i>	<i>68.9</i>	<i>68.2</i>			<i>68.5</i>	<i>66.4</i>	
Employee Cost	1,569	1,609	1,428	1,513	1,609	2.5	6.3	3,123	2,919	7.0
<i>as % of sales</i>	<i>9.1</i>	<i>9.3</i>	<i>9.6</i>	<i>9.0</i>	<i>8.2</i>			<i>8.6</i>	<i>10.0</i>	
Other expenditure	1,541	1,463	1,285	1,593	1,698	10.2	6.6	3,291	2,781	18.3
<i>as % of sales</i>	<i>8.9</i>	<i>8.4</i>	<i>8.6</i>	<i>9.4</i>	<i>8.7</i>			<i>9.0</i>	<i>9.6</i>	
<b>EBITDA</b>	<b>2,592</b>	<b>2,705</b>	<b>2,067</b>	<b>2,138</b>	<b>2,905</b>	<b>12.1</b>	<b>35.9</b>	<b>5,044</b>	<b>4,080</b>	<b>23.6</b>
Depreciation	336	349	347	337	353	5.1	4.8	689	645	6.9
<b>EBIT</b>	<b>2,256</b>	<b>2,356</b>	<b>1,719</b>	<b>1,802</b>	<b>2,553</b>	<b>13.1</b>	<b>41.7</b>	<b>4,355</b>	<b>3,435</b>	<b>26.8</b>
Other Income	694	866	766	1,001	855	23.1	(14.6)	1,856	1,243	49.3
Interest	22	27	48	19	46	107.7	137.6	66	40	65.0
Extra ordinary items	-	-	-	143	-	-	-	143	(1,324)	-
<b>PBT</b>	<b>2,929</b>	<b>3,195</b>	<b>2,437</b>	<b>2,641</b>	<b>3,362</b>	<b>14.8</b>	<b>27.3</b>	<b>6,002</b>	<b>5,962</b>	<b>0.7</b>
Total Tax	730	786	545	653	838	14.8	28.4	1,490	1,397	6.7
<b>Reported PAT</b>	<b>2,199</b>	<b>2,410</b>	<b>1,892</b>	<b>1,988</b>	<b>2,524</b>	<b>14.8</b>	<b>27.0</b>	<b>4,512</b>	<b>4,565</b>	<b>(1.2)</b>
<b>Adj. PAT</b>	<b>2,199</b>	<b>2,410</b>	<b>1,892</b>	<b>2,096</b>	<b>2,524</b>	<b>14.8</b>	<b>20.4</b>	<b>4,619</b>	<b>3,552</b>	<b>30.1</b>
<b>Adjusted EPS</b>	<b>7.9</b>	<b>8.7</b>	<b>6.8</b>	<b>7.6</b>	<b>9.1</b>	<b>14.8</b>	<b>20.4</b>	<b>16.7</b>	<b>12.7</b>	<b>30.8</b>
<b>Margins (%)</b>	<b>Q2FY22</b>	<b>Q3FY22</b>	<b>Q4FY22</b>	<b>Q1FY23</b>	<b>Q2FY23</b>	<b>bps</b>	<b>bps</b>	<b>H1FY23</b>	<b>H1FY23</b>	<b>bps</b>
EBIDTA	15.0	15.6	13.8	12.7	14.9	(12)	221	13.9	14.0	(15)
EBIT	13.1	13.6	11.5	10.7	13.1	2	240	12.0	11.8	17
EBT	17.0	18.4	16.3	15.7	17.2	27	157	16.5	20.5	(398)
PAT	12.7	13.9	12.7	12.4	12.9	20	51	12.7	12.2	50
Effective Tax rate	24.9	24.6	22.4	24.7	24.9	1	21	24.8	23.4	140

Source: Company, PL

## Conference Call Highlights

- Demand scenario continues to be strong from domestic and exports end user markets and likely to continue with the growth momentum.
- Domestic market grew 11% YoY to Rs13.9bn, while export market grew 21% YoY to Rs5.3bn.
- Supply chain still continues to remain impacted for certain critical components such as electronic, thereby impacting utilization level for the company.
- Capacity utilization level stands at ~70-80% and likely to improve gradually with normalizing supply chain scenario.
- Gross margins were impacted due to commodity price hike and lag in price pass through. Gross margins are likely to reach at a normalised level in next 18-24 months with commodity softening, likely price hikes and new product launches.
- Company over past few years has been focusing on automation to increase operation efficiency.
- Data center continues to witness strong traction and is expected to continue its momentum in near to medium term.
- **Domestic:** Powergen revenue grew 6% YoY to Rs6.8bn, distribution up 22% YoY to Rs4.5bn, Industrial up 10% YoY to Rs2.5bn
  - Industrial segment: Railway is witnessing bounce back and in-line with management expectation. Marine, Mining, Defence are performing better than expected. While construction sector continues to disappoint.
  - Power genset segment growth was driven by segments such as Data center, Pharmaceuticals, Biotechnology and overall manufacturing segment.
  - Distribution segment is witnessing strong growth, due to expanding services offered to clients, adding more products/part and increasing reach.
- **Exports:** Exports: LHP grew 49% YoY to Rs2.4bn, while HHP declined 3% YoY to Rs2.3bn.
  - Exports market such as Latin America, Asia Pacific and Middle East continues to remain strong. Though European market has grown over previous year it now witnessing slowdown sequentially due to geo political tension. While African market is still witnessing slowdown.
- Capex to be in range of Rs2-2.5bn, same compared to last few years, off which majority will be towards maintenance and upgrading capex.
- CPCB-IV norm to be implemented from 1<sup>st</sup> July 2023. Management expect pre-buying of existing product in 1<sup>st</sup> half of 2023. Being more complicated and high technology driven it is likely to be priced higher.

## Financials

### Income Statement (Rs m)

Y/e Mar	FY22	FY23E	FY24E	FY25E
<b>Net Revenues</b>	<b>61,404</b>	<b>73,365</b>	<b>79,975</b>	<b>87,281</b>
YoY gr. (%)	41.8	19.5	9.0	9.1
Cost of Goods Sold	41,068	48,795	51,824	56,034
Gross Profit	20,336	24,570	28,151	31,247
Margin (%)	33.1	33.5	35.2	35.8
Employee Cost	5,956	6,750	7,598	8,379
Other Expenses	3,028	3,668	3,999	4,451
<b>EBITDA</b>	<b>8,851</b>	<b>10,627</b>	<b>12,352</b>	<b>13,790</b>
YoY gr. (%)	52.7	20.1	16.2	11.6
Margin (%)	14.4	14.5	15.4	15.8
Depreciation and Amortization	1,340	1,404	1,487	1,578
<b>EBIT</b>	<b>7,511</b>	<b>9,222</b>	<b>10,865</b>	<b>12,212</b>
Margin (%)	12.2	12.6	13.6	14.0
Net Interest	115	190	205	242
Other Income	2,875	3,742	3,967	4,059
<b>Profit Before Tax</b>	<b>11,595</b>	<b>12,774</b>	<b>14,627</b>	<b>16,029</b>
Margin (%)	18.9	17.4	18.3	18.4
Total Tax	2,728	3,219	3,686	4,039
Effective tax rate (%)	23.5	25.2	25.2	25.2
<b>Profit after tax</b>	<b>8,867</b>	<b>9,555</b>	<b>10,941</b>	<b>11,989</b>
Minority interest	-	-	-	-
Share Profit from Associate	-	-	-	-
<b>Adjusted PAT</b>	<b>7,854</b>	<b>9,555</b>	<b>10,941</b>	<b>11,989</b>
YoY gr. (%)	27.1	21.7	14.5	9.6
Margin (%)	12.8	13.0	13.7	13.7
Extra Ord. Income / (Exp)	1,012	-	-	-
<b>Reported PAT</b>	<b>8,867</b>	<b>9,555</b>	<b>10,941</b>	<b>11,989</b>
YoY gr. (%)	43.5	7.8	14.5	9.6
Margin (%)	14.4	13.0	13.7	13.7
Other Comprehensive Income	-	-	-	-
Total Comprehensive Income	8,867	9,555	10,941	11,989
<b>Equity Shares O/s (m)</b>	<b>277</b>	<b>277</b>	<b>277</b>	<b>277</b>
<b>EPS (Rs)</b>	<b>28.3</b>	<b>34.5</b>	<b>39.5</b>	<b>43.3</b>

Source: Company Data, PL Research

### Balance Sheet Abstract (Rs m)

Y/e Mar	FY22	FY23E	FY24E	FY25E
<b>Non-Current Assets</b>				
<b>Gross Block</b>	<b>20,684</b>	<b>21,884</b>	<b>23,084</b>	<b>24,284</b>
Tangibles	20,684	21,884	23,084	24,284
Intangibles	-	-	-	-
<b>Acc: Dep / Amortization</b>	<b>8,848</b>	<b>10,252</b>	<b>11,739</b>	<b>13,317</b>
Tangibles	8,848	10,252	11,739	13,317
Intangibles	-	-	-	-
<b>Net fixed assets</b>	<b>11,836</b>	<b>11,631</b>	<b>11,345</b>	<b>10,966</b>
Tangibles	11,836	11,631	11,345	10,966
Intangibles	-	-	-	-
Capital Work In Progress	1,226	804	804	804
Goodwill	-	-	-	-
Non-Current Investments	10,263	11,282	12,019	13,165
Net Deferred tax assets	(971)	(971)	(971)	(971)
Other Non-Current Assets	1,219	1,394	2,199	3,011
<b>Current Assets</b>				
Investments	5,775	5,775	5,775	5,775
Inventories	7,288	8,844	9,422	10,282
Trade receivables	12,473	15,408	17,443	19,036
Cash & Bank Balance	13,867	11,559	11,848	12,163
Other Current Assets	1,558	2,201	3,199	3,840
<b>Total Assets</b>	<b>68,051</b>	<b>71,907</b>	<b>77,733</b>	<b>83,407</b>
<b>Equity</b>				
Equity Share Capital	554	554	554	554
Other Equity	47,972	51,221	54,941	59,017
<b>Total Network</b>	<b>48,527</b>	<b>51,775</b>	<b>55,495</b>	<b>59,572</b>
<b>Non-Current Liabilities</b>				
Long Term borrowings	3,972	4,472	4,972	5,472
Provisions	-	-	-	-
Other non current liabilities	-	-	-	-
<b>Current Liabilities</b>				
ST Debt / Current of LT Debt	151	151	151	151
Trade payables	9,973	9,246	10,517	11,478
Other current liabilities	4,457	5,291	5,626	5,763
<b>Total Equity &amp; Liabilities</b>	<b>68,051</b>	<b>71,907</b>	<b>77,733</b>	<b>83,407</b>

Source: Company Data, PL Research

**Cash Flow (Rs m)**

Y/e Mar	FY22	FY23E	FY24E	FY25E
PBT	11,595	12,774	14,627	16,029
Add. Depreciation	1,340	1,404	1,487	1,578
Add. Interest	115	190	205	242
Less Financial Other Income	2,875	3,742	3,967	4,059
Add. Other	(2,753)	-	-	-
Op. profit before WC changes	10,297	14,368	16,319	17,849
Net Changes-WC	(684)	(3,339)	(3,514)	(3,706)
Direct tax	(2,543)	(3,219)	(3,686)	(4,039)
<b>Net cash from Op. activities</b>	<b>7,070</b>	<b>7,811</b>	<b>9,119</b>	<b>10,104</b>
Capital expenditures	705	(1,530)	(1,904)	(2,134)
Interest / Dividend Income	1,030	-	-	-
Others	(7,597)	-	-	-
<b>Net Cash from Inv. activities</b>	<b>(5,862)</b>	<b>(1,530)</b>	<b>(1,904)</b>	<b>(2,134)</b>
Issue of share cap. / premium	-	-	-	-
Debt changes	3,777	500	500	500
Dividend paid	(4,435)	(6,306)	(7,221)	(7,913)
Interest paid	(74)	(190)	(205)	(242)
Others	(42)	-	-	-
<b>Net cash from Fin. activities</b>	<b>(774)</b>	<b>(5,996)</b>	<b>(6,926)</b>	<b>(7,655)</b>
<b>Net change in cash</b>	<b>434</b>	<b>285</b>	<b>289</b>	<b>314</b>
Free Cash Flow	5,552	7,032	7,919	8,904

Source: Company Data, PL Research

**Key Financial Metrics**

Y/e Mar	FY22	FY23E	FY24E	FY25E
<b>Per Share(Rs)</b>				
EPS	28.3	34.5	39.5	43.3
CEPS	33.2	39.5	44.8	48.9
BVPS	175.1	186.8	200.2	214.9
FCF	20.0	25.4	28.6	32.1
DPS	10.5	22.8	26.1	28.5
<b>Return Ratio(%)</b>				
RoCE	15.5	16.9	18.6	19.4
ROIC	19.9	18.5	19.9	20.3
RoE	17.0	19.1	20.4	20.8
<b>Balance Sheet</b>				
Net Debt : Equity (x)	(0.3)	(0.2)	(0.2)	(0.2)
Net Working Capital (Days)	58	75	75	75
<b>Valuation(x)</b>				
PER	47.1	38.7	33.8	30.9
P/B	7.6	7.1	6.7	6.2
P/CEPS	40.3	33.8	29.8	27.3
EV/EBITDA	40.1	33.6	29.0	25.9
EV/Sales	5.8	4.9	4.5	4.1
Dividend Yield (%)	0.8	1.7	2.0	2.1

Source: Company Data, PL Research

**Quarterly Financials (Rs m)**

Y/e Mar	Q3FY22	Q4FY22	Q1FY23	Q2FY23
<b>Net Revenue</b>	<b>17,350</b>	<b>14,936</b>	<b>16,867</b>	<b>19,513</b>
YoY gr. (%)	21.8	19.8	42.4	13.0
Raw Material Expenses	11,573	10,156	11,621	13,300
Gross Profit	5,777	4,780	5,245	6,212
Margin (%)	33.3	32.0	31.1	31.8
<b>EBITDA</b>	<b>2,705</b>	<b>2,067</b>	<b>2,138</b>	<b>2,905</b>
YoY gr. (%)	11.9	23.4	43.7	12.1
Margin (%)	15.6	13.8	12.7	14.9
Depreciation / Depletion	349	347	337	353
<b>EBIT</b>	<b>2,356</b>	<b>1,719</b>	<b>1,802</b>	<b>2,553</b>
Margin (%)	13.6	11.5	10.7	13.1
Net Interest	27	48	19	46
Other Income	866	766	1,001	855
<b>Profit before Tax</b>	<b>3,195</b>	<b>2,437</b>	<b>2,641</b>	<b>3,362</b>
Margin (%)	18.4	16.3	15.7	17.2
Total Tax	786	545	653	838
Effective tax rate (%)	24.6	22.4	24.7	24.9
<b>Profit after Tax</b>	<b>2,410</b>	<b>1,892</b>	<b>1,988</b>	<b>2,524</b>
Minority interest	-	-	-	-
Share Profit from Associates	-	-	-	-
<b>Adjusted PAT</b>	<b>2,410</b>	<b>1,892</b>	<b>2,096</b>	<b>2,524</b>
YoY gr. (%)	2.9	1.9	57.1	14.8
Margin (%)	13.9	12.7	12.4	12.9
Extra Ord. Income / (Exp)	-	-	(108)	-
<b>Reported PAT</b>	<b>2,410</b>	<b>1,892</b>	<b>1,988</b>	<b>2,524</b>
YoY gr. (%)	2.9	1.9	(16.0)	14.8
Margin (%)	13.9	12.7	11.8	12.9
Other Comprehensive Income	-	-	-	-
<b>Total Comprehensive Income</b>	<b>2,410</b>	<b>1,892</b>	<b>1,988</b>	<b>2,524</b>
Avg. Shares O/s (m)	277	277	277	277
<b>EPS (Rs)</b>	<b>8.7</b>	<b>6.8</b>	<b>7.6</b>	<b>9.1</b>

Source: Company Data, PL Research

**Price Chart**
**Recommendation History**


No.	Date	Rating	TP (Rs.)	Share Price (Rs.)
1	04-Oct-22	Accumulate	1,296	1,214
2	11-Aug-22	Accumulate	1,296	1,238
3	05-Jul-22	Accumulate	1,087	1,052
4	28-May-22	Accumulate	1,087	1,015
5	08-Apr-22	Accumulate	1,032	1,113
6	13-Feb-22	Accumulate	1,069	939
7	11-Jan-22	Accumulate	1,051	952

**Analyst Coverage Universe**

Sr. No.	Company Name	Rating	TP (Rs)	Share Price (Rs)
1	ABB India	Accumulate	3,115	3,100
2	Apar Industries	BUY	1,834	1,464
3	Bharat Electronics	BUY	125	107
4	BHEL	Sell	36	62
5	Cummins India	Accumulate	1,296	1,214
6	Engineers India	BUY	89	65
7	GE T&D India	Hold	102	129
8	Kalpataru Power Transmission	BUY	442	419
9	KEC International	Accumulate	473	440
10	Larsen & Toubro	BUY	2,384	2,023
11	Praj Industries	BUY	520	434
12	Siemens	Accumulate	3,116	2,750
13	Thermax	Accumulate	2,190	2,199
14	Triveni Turbine	BUY	328	283
15	Voltamp Transformers	Hold	2,748	2,616

**PL's Recommendation Nomenclature (Absolute Performance)**

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



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