

# Cummins India (KKC IN)

## Domestic performance shadowed by exports weakness

INDIA | CAPITAL GOODS | Quarterly Update

3 February 2016

### Top takeaways from Q3FY16

- ✖ Weak operational performance; however, PAT (adjusted for inventory write off) was in line with our estimate due to lower tax rate.
- ✖ Exports fell for the second consecutive quarter (-6% yoy) due to weak global demand.
- ✓ The positive surprise was continued growth in domestic sales (+12% yoy) led by 23% yoy growth in its power generation business.

**Key highlights:** Sales growth at 6% yoy was driven by strong performance in power generation (+23% yoy) and distribution and spares (+9% yoy). Export weakness offset strong domestic performance. Gross margins (adjusted for Rs 160mn pertaining to excess inventory provision) were down 100bps yoy to 37.3% due to adverse sales mix. Weak gross margins translated into lower-than-expected EBITDA. However, lower tax rate (13% Q3FY16 against 17% Q2FY16) led to PAT being in line with our estimate.

### Conference call takeaways

- ✓ Management said its domestic power generation business continued to benefit from pick up in infra (particularly roads). It maintained domestic revenue guidance at 10-15%.
- ✓ Over the mid to long term, Cummins India should benefit from its parent Cummins Inc's plans to restructure its sourcing strategy towards low-cost countries. However, no signs of this are visible in the near term.
- ✖ Competitive intensity continues to remain high in the domestic market, especially in the low-kVA segments.
- ✖ Cummins maintained its export revenue guidance of 0-5% with headwinds due to weak global demand. It expects market share gains in exports to lead incremental growth.

### Outlook and valuation

We are enthused by Cummins' above-industry growth in the domestic market and more so by its power-gen business, which reflects on-ground recovery in capacity creation. However, the export outlook remains weak in the light of a weak global environment. We lower our export growth expectation to 7% for FY17 (from 20%), which is still higher than the management's guidance of 0-5%. We introduce FY18 estimates and rollover our multiple to September 2017 EPS and value Cummins at 30x to arrive at our target price of Rs 1050 (unchanged). Current valuations of 26x September 2017 P/E remain expensive for a stock that we expect to deliver 14% CAGR in FY16-18. Hence, we maintain our Neutral rating.

### Neutral (Maintain)

CMP RS 897 / TARGET RS 1050 (+17%)

#### COMPANY DATA

O/S SHARES (MN) :	277
MARKET CAP (RSBN) :	262
MARKET CAP (USDBN) :	3.9
52 - WK HI/LO (RS) :	1247 / 829
LIQUIDITY 3M (USDMN) :	2.3
PAR VALUE (RS) :	2

#### SHARE HOLDING PATTERN, %

	Sep 15	Jun 15	Mar 15
PROMOTERS :	51.0	51.0	51.0
FII / NRI :	17.8	17.4	18.6
FI / MF :	18.1	18.2	17.3
NON PRO :	1.5	1.3	1.4
PUBLIC & OTHERS :	12.4	12.6	12.3

#### Key Financials

Rs mn	FY16E	FY17E	FY18E
Net Sales	49,133	57,126	67,849
EBIDTA	8,184	10,074	12,516
Net Profit	7,992	9,102	10,343
EPS, Rs	28.8	32.8	37.3
PER, x	31.1	27.3	24.0
EV/EBIDTA, x	30.3	24.6	19.8
PBV, x	25.1	25.7	26.2
ROE, %	-	-	-

#### CHANGE IN ESTIMATES

Rs bn	Revised Est.		% Revision	
	FY16E	FY17E	FY16E	FY17E
Revenue	49,133	57,126	-2%	-5%
EBITDA	8,184	10,074	-4%	-8%
Core PAT	7,992	9,102	1.8%	-6.5%
EPS (Rs)	28.8	32.8	1.8%	-6.5%

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(Rs mn)	Q3FY16	Q3FY15	yoy growth %	Q2FY16	qoq growth %	vs. expectations %	Comments
Sales	11,469	10,831	6%	11,977	-4%	12,091	Sales below estimate due to weak export growth
Gross margin	37.3%	38.4%		37.6%		38.5%	Unfavourable mix led to lower than expected gross margin
EBITDA	1,870	1,894	-1%	2,007	-7%	2,152	
EBITDA margin (%)	16.3%	17.5%		16.8%		17.8%	Lower gross margin also led to weak margins
EBIT (%)	15%	15%		15%		16%	
PBT	2,232	2,075	8%	2,405	-7%	2,422	
Recurring PAT	1,944	1,810	7%	1,986	-2%	1,986	Recurring PAT in line with estimate due to lower tax rate
Reported PAT	1,784	1,810	-1%	1,986	-10%	1,986	
EPS	6.4	6.5	-1%	7.2	-10%		

### Quarterly results

RS MN	Q316	Q315	% CHANGE
<b>Net Sales</b>	<b>11,469</b>	<b>10,831</b>	<b>5.9%</b>
Raw Material	7,191	6,676	7.7%
% of sales	62.7%	61.6%	
Employee cost	1,091	1,018	7.3%
% of sales	9.5%	9.4%	
Other Expenses	1,317	1,244	5.8%
% of sales	11.5%	11.5%	
<b>EBITDA</b>	<b>1,870</b>	<b>1,894</b>	<b>-1.3%</b>
EBITDA margins (%)	16.3%	17.5%	
Depreciation	202	217	-6.9%
<b>EBIT</b>	<b>1,668</b>	<b>1,677</b>	<b>-0.5%</b>
EBIT margins (%)	14.5%	15.5%	
Interest	2	13	-84.3%
Other Income	566	411	37.5%
<b>PBT</b>	<b>2232</b>	<b>2075</b>	<b>7.5%</b>
Tax	288	265	8.8%
<b>PAT</b>	<b>1,944</b>	<b>1,810</b>	<b>7.4%</b>
PAT Margin (%)	16.9%	16.7%	
<b>EPS, (Rs)</b>	<b>7.0</b>	<b>6.5</b>	<b>7.4%</b>

Source: Company, PhillipCapital India Research Estimates

## Financials

### Income Statement

Y/E Mar, Rs mn	FY15	FY16e	FY17e	FY18e
Net sales	43,211	48,074	56,014	66,682
Growth, %	11	11	17	19
<b>Total income</b>	<b>44,058</b>	<b>49,133</b>	<b>57,126</b>	<b>67,849</b>
Raw material expenses	-28,557	-31,740	-36,218	-42,677
Employee expenses	-3,936	-4,296	-4,721	-5,329
Other Operating expenses	-4,215	-4,913	-6,112	-7,328
<b>EBITDA (Core)</b>	<b>7,351</b>	<b>8,184</b>	<b>10,074</b>	<b>12,516</b>
Growth, %	5.5	11.3	23.1	24.2
Margin, %	17.0	17.0	18.0	18.8
Depreciation	-797	-834	-936	-1,018
<b>EBIT</b>	<b>6,553</b>	<b>7,350</b>	<b>9,138</b>	<b>11,498</b>
Growth, %	1.8	12.2	24.3	25.8
Margin, %	15.2	15.3	16.3	17.2
Interest paid	-45	-21	-21	-21
Other Non-Operating Income	1,735	2,299	2,260	2,313
<b>Pre-tax profit</b>	<b>9,148</b>	<b>9,469</b>	<b>11,377</b>	<b>13,790</b>
Tax provided	-1,289	-1,637	-2,275	-3,448
<b>Net Profit</b>	<b>7,859</b>	<b>7,832</b>	<b>9,102</b>	<b>10,343</b>
Growth, %	20.7	14.9	13.9	13.6
<b>Net Profit (adjusted)</b>	<b>6,954</b>	<b>7,992</b>	<b>9,102</b>	<b>10,343</b>
Wtd avg shares (m)	277	277	277	277

### Balance Sheet

Y/E Mar, Rs mn	FY15	FY16e	FY17e	FY18e
Cash & bank	799	689	728	936
Debtors	9,355	10,433	12,130	14,407
Inventory	6,823	7,508	8,628	10,185
Loans & advances	7,471	7,589	7,940	8,445
Other current assets	73	81	95	112
<b>Total current assets</b>	<b>24,521</b>	<b>26,301</b>	<b>29,521</b>	<b>34,086</b>
Investments	4,650	4,450	4,657	4,757
Gross fixed assets	18,830	21,830	23,830	25,830
Less: Depreciation	-6,491	-7,324	-8,260	-9,278
Add: Capital WIP	1,706	1,706	1,706	1,706
<b>Net fixed assets</b>	<b>14,046</b>	<b>16,212</b>	<b>17,276</b>	<b>18,258</b>
<b>Total assets</b>	<b>43,217</b>	<b>46,963</b>	<b>51,454</b>	<b>57,102</b>
Current liabilities	8,520	8,909	9,146	9,997
Provisions	5,202	5,532	6,268	7,067
<b>Total current liabilities</b>	<b>13,721</b>	<b>14,441</b>	<b>15,414</b>	<b>17,064</b>
Non-current liabilities	631	631	631	631
<b>Total liabilities</b>	<b>14,352</b>	<b>15,071</b>	<b>16,044</b>	<b>17,694</b>
Paid-up capital	554	554	554	554
Reserves & surplus	28,311	31,338	34,856	38,853
Shareholders' equity	28,865	31,892	35,410	39,407
<b>Total equity &amp; liabilities</b>	<b>43,217</b>	<b>46,963</b>	<b>51,454</b>	<b>57,102</b>

Source: Company, PhillipCapital India Research Estimates

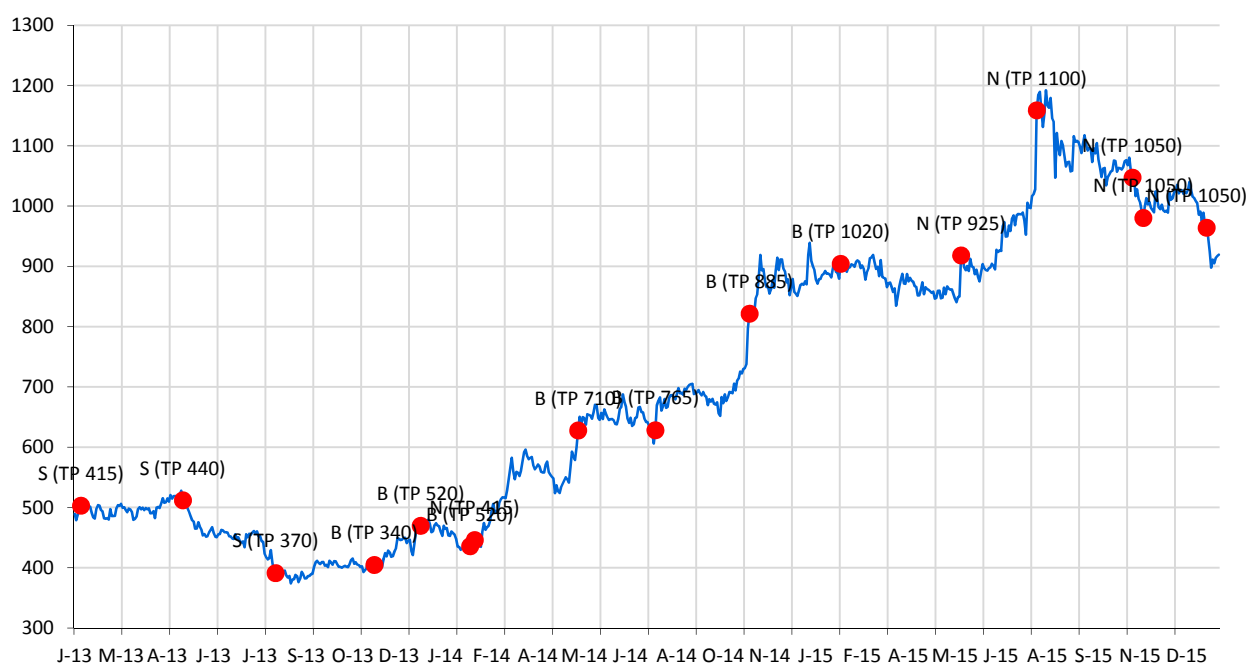
### Cash Flow

	FY15	FY16e	FY17e	FY18e
Pre-tax profit	9,148	9,469	11,377	13,790
Depreciation	797	834	936	1,018
Chg in working capital	279	-1,170	-2,208	-2,707
Total tax paid	-1,124	-1,637	-2,275	-3,448
<b>Cash flow from operating activities</b>	<b>9,101</b>	<b>7,495</b>	<b>7,830</b>	<b>8,654</b>
Capital expenditure	-4,824	-3,000	-2,000	-2,000
Chg in investments	303	200	-207	-100
<b>Cash flow from investing activities</b>	<b>-4,521</b>	<b>-2,800</b>	<b>-2,207</b>	<b>-2,100</b>
Free cash flow	4,579	4,695	5,623	6,554
Equity raised/(repaid)	0	0	0	0
Debt raised/(repaid)	0	0	0	0
Dividend (incl. tax)	-4,517	-4,805	-5,584	-6,345
Other financing activities	-127	0	0	0
<b>Cash flow from financing activities</b>	<b>-4,645</b>	<b>-4,805</b>	<b>-5,584</b>	<b>-6,345</b>
Net chg in cash	-66	-110	39	209

### Valuation Ratios

	FY15	FY16e	FY17e	FY18e
<b>Per Share data</b>				
EPS (INR)	25.1	28.8	32.8	37.3
Growth, %	20.7	14.9	13.9	13.6
Book NAV/share (INR)	104.1	115.1	127.7	142.2
FDEPS (INR)	25.1	28.8	32.8	37.3
CEPS (INR)	24.7	32.4	36.2	41.0
CFPS (INR)	26.6	18.7	20.1	22.9
DPS (INR)	14.0	14.9	17.3	19.7
<b>Return ratios</b>				
Return on assets (%)	19.5	17.4	18.5	19.1
Return on equity (%)	24.1	25.1	25.7	26.2
Return on capital employed (%)	24.1	21.6	22.7	23.2
<b>Turnover ratios</b>				
Asset turnover (x)	1.6	1.5	1.6	1.7
Sales/Total assets (x)	1.1	1.1	1.1	1.2
Sales/Net FA (x)	3.6	3.2	3.3	3.8
Working capital/Sales (x)	0.4	0.3	0.4	0.3
Working capital days	128.4	126.8	128.0	126.7
<b>Liquidity ratios</b>				
Current ratio (x)	2.9	3.0	3.2	3.4
Quick ratio (x)	2.1	2.1	2.3	2.4
Interest cover (x)	145.0	350.0	435.2	547.5
Dividend cover (x)	1.8	1.9	1.9	1.9
Total debt/Equity (%)	-	-	-	-
Net debt/Equity (%)	(2.8)	(2.2)	(2.1)	(2.4)
<b>Valuation</b>				
PER (x)	35.8	31.1	27.3	24.0
Price/Book (x)	8.6	7.8	7.0	6.3
Yield (%)	1.6	1.7	1.9	2.2
EV/Net sales (x)	5.7	5.2	4.4	3.7
EV/EBITDA (x)	33.7	30.3	24.6	19.8
EV/EBIT (x)	37.8	33.7	27.1	21.5

## Stock Price, Price Target and Rating History



## Rating Methodology

We rate stock on absolute return basis. Our target price for the stocks has an investment horizon of one year.

Rating	Criteria	Definition
BUY	$\geq +15\%$	Target price is equal to or more than 15% of current market price
NEUTRAL	$-15\% > \text{to} < +15\%$	Target price is less than +15% but more than -15%
SELL	$\leq -15\%$	Target price is less than or equal to -15%.

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