January 30, 2021

Result Report | Sector: Capital Goods

Cummins India Ltd

ADD	CMP Rs660	Target Rs720	Upside 9%

Improving earnings visibility; Upgrade to 'ADD'

Cummins India (KKC) reported healthy Q3FY21 performance (26% qoq EBITDA growth) led by demand recovery in power generation (PG) business & strong margins due to favorable sales mix, cost control initiatives & lower employee cost. We believe, Government's thrust on the Road, Rail and Metro projects (National Infra pipeline of ~Rs100trn+) along with new investments into data centre and 5G telecom network will aid in faster demand revival for KKC's products. In addition, mgmt. expects healthy pre-buy demand before implementation of new emission norms. Though KKC reported 16.7% adjusted EBITDAM over Q2-Q3FY21, we expect it to normalize at ~15% owing to likely tilt in sales mix in favor of PG, rollback of few costs & commodity price headwinds. We raise FY22 earnings estimates by 30% to factor in better than expected recovery in earlier estimated sales & margins. Hence, we upgrade KKC to 'ADD' rating with revised TP of Rs720 based on SOTP methodology.

Faster sales recovery led by multiple tailwinds

Domestic demand traction has improved significantly for KKC especially from sectors like Data Center, infra, mining, construction etc., while hospitality, retail, and commercial segments are recovering relatively at slower pace. Export markets like South Asia, MENA & LATAM are also showing good signs of demand recovery while Europe & USA remained weak due to 2nd wave of COVID. KKC is eying for market share gain through customized offerings, & by increasing power density & fuel economy of products. CPCB IV norms implementation can lead to further market share gains. KKC is looking at ideas for the long term, such as merging Cummins Technology India Limited (CTIL unlisted group entity) with itself, but nothing is planned as of now. Mgmt. indicated that hydrogen technologies for rail & construction (where KKC is already present) will remain with the company, which offers high growth potential.

Industrial sales are directly dependent on infra awarding activities, hence pick up in NHAI ordering, roads, rail & metro projects lead to strong sales volumes. Under the National infrastructure pipeline Government has laid out aggressive investment plan of Rs100trn+. Hence, we expect strong growth prospects for KKC's industrial business. Given the large distribution network & large installed base of machines (0.6mn+), demand for spares is expected to remain robust.

Sustainable cost reduction initiatives

Cost optimization measures & VRS scheme coupled with favorable sales mix in terms of higher distribution & exports sales has resulted in adjusted EBITDA margins of 16.7% (excl. impairment of Rs230mn in Q2) during Q2-Q3FY21. KKC provided customized value-added products for data center, which helped in better price realization. We assume 15% EBITDAM in Q4FY21 to factor in rise in raw material prices & roll back of few expenses as guided by management. The Company is planning to take price hike in Q1FY22 to mitigate the impact of adverse commodity prices.

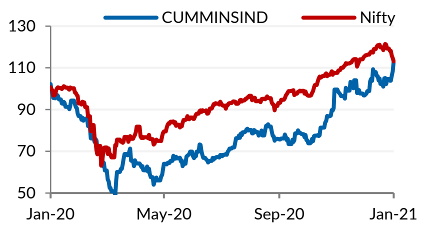
Valuation re-rating on the cards

KKC is at an advantage versus other domestic peers and is ahead with regards to its preparedness, on the back of a global portfolio which is already compliant with the new norms and will need certain modifications to adapt to local conditions. Strong FCF and dividend pay-out caps downside risks for KKC, while pickup in demand can aid earning upsides through operating leverage. The stock is currently trading at 24x/21x FY22/FY23 earnings which is in line with its 15-year avg. 1-yr fwd P/E multiple of 22x. We expect valuation re-rating of the stock with EBITDA CAGR of 17% over FY21-FY23E, improvement in return ratios & better earnings quality (Non-core income 29% of FY23E PBT vs 37% in FY20). Hence, we upgrade KKC to 'ADD' with TP of Rs720.

Stock data (as on Jan 29, 2021)

Sensex:	13,635
52 Week h/l (Rs)	690 / 280
Market cap (Rs/USD mn)	184712 / 2532
Outstanding Shares (mn)	277
6m Avg t/o (Rs mn):	741
Div yield (%):	2.1
Bloomberg code:	KKC IN
NSE code:	CUMMINSIND

Stock performance



	1M	3M	1Y
Absolute return	16%	53%	19%

Shareholding pattern (As of Dec'20 end)

Promoter	51%
FII+DII	35%
Others	14%

Financial Summary (Consolidated)

(Rs mn)	FY20	FY21E	FY22E	FY23E
Revenues	51,915	44,272	51,762	57,971
yoy gr (%)	(8.9)	(14.7)	16.9	12.0
EBITDA	5,892	6,330	7,409	8,672
OPM (%)	11.3	14.3	14.3	15.0
Adj. PAT	7,255	6,555	7,543	8,734
yoy gr (%)	(2.3)	(9.6)	15.1	15.8
EPS (Rs)	26.2	23.6	27.2	31.5
P/E (x)	25.4	28.2	24.5	21.1
P/B (x)	4.2	3.9	3.7	3.4
EV/E (x)	30.1	27.7	23.5	19.8
Net D/E (x)	(0.2)	(0.2)	(0.2)	(0.2)
RoIC (%)	10.7	10.0	11.6	13.2
RoE (%)	16.7	14.4	15.5	16.7

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Exhibit 1: Result table (Consolidated)

(Rs mn)	Q3FY21	Q3FY20	% yoy	Q2FY21	% qoq
Total sales	14,310	14,564	(2)	11,700	22
EBITDA	2,421	2,165	12	1,916	26
EBITDAM (%)	16.92	14.86	205.8	16.38	54
Depreciation	324	300	8	330	(2)
Interest	48	48	0	40	20
Other income	606	629	(4)	580	4
PBT	2,655	2,445	9	2,125	25
Tax	694	582	19	428	62
Adjusted PAT	2,403	2,159	11	1,962	23
Exceptional item	0	161		230	
Reported PAT	2,403	1,999	20	1,732	39
PATM (%)	17	15	197	17	3
EPS (Rs)	8.7	7.8	11	7.1	23

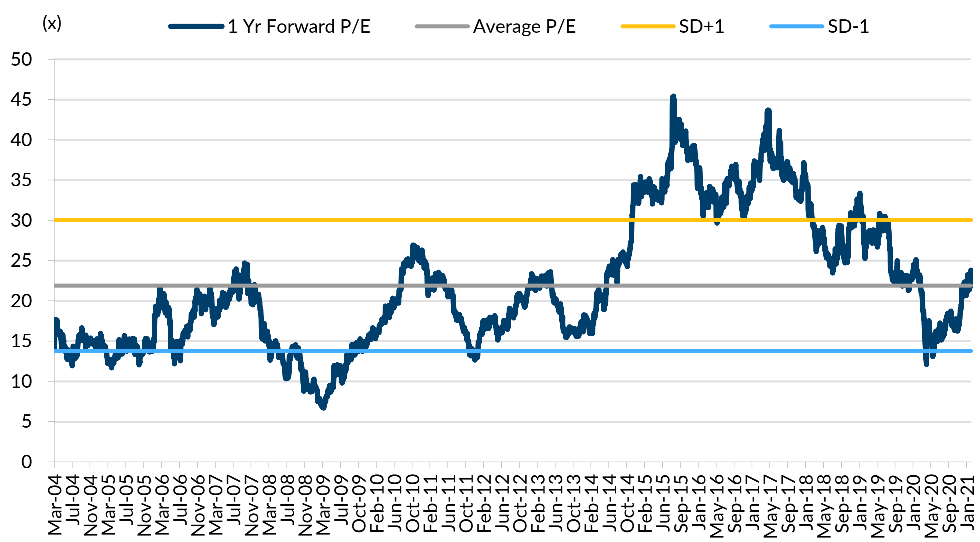
Source: Company, YES Sec – Research

Exhibit 2: Cost analysis (Consolidated)

As a % of net sales	Q3 FY21	Q3 FY20	bps yoy	Q2 FY21	bps qoq
COGS	64.0	64.6	(55.0)	61.6	244.1
Employee cost	9.0	10.0	(102.2)	10.5	(150.9)
Other expenses	10.0	10.5	(48.5)	11.5	(147.7)
Total costs	83.1	85.1	(205.8)	83.6	(54.5)

Source: Company, YES Sec – Research

Exhibit 3: Trading at 15-yr average 1-yr forward P/E

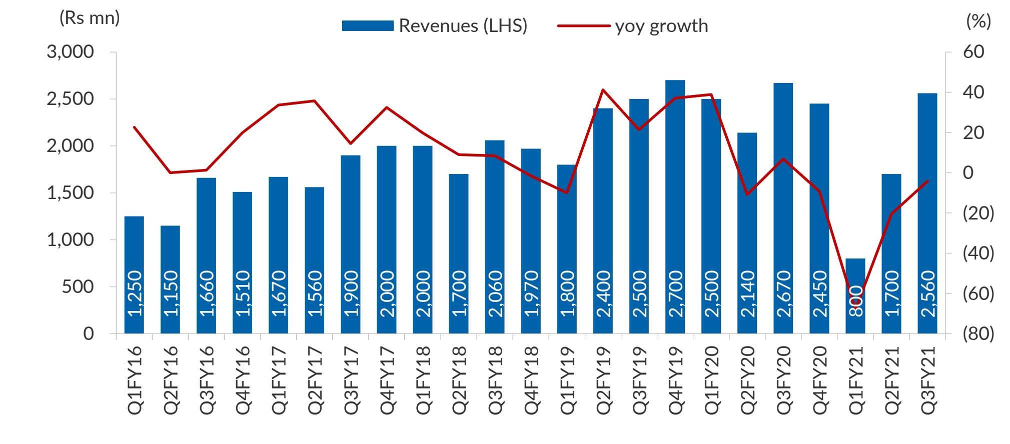


Source: Company, YES Sec – Research

Key highlights from Q3FY21 earnings conference call:

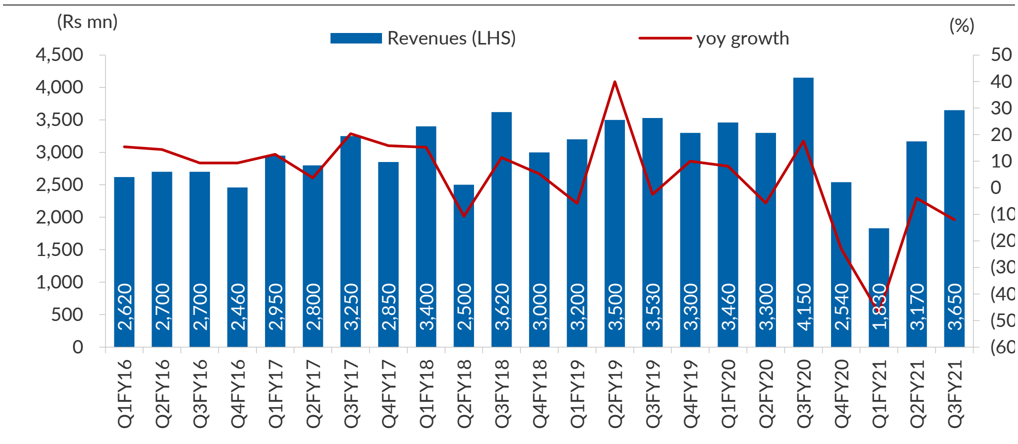
- ✓ Sales Break up segment wise in the domestic market, industrial Rs2.56bn, power gen Rs4.2bn, distribution Rs3.65bn, exports- HHP Rs2.3bn, LHP Rs1.46bn
- ✓ Power gen break up: HHP: Rs2.34bn, MHP Rs950mn, LHP Rs930mn
- ✓ Industrial sales break up: Compressor- Rs250mn, Construction- Rs1,020mn, Mining- Rs470mn, Rail- Rs480mn, Miscellaneous- Rs350mn
- ✓ The distribution business has been able to grow steadily on 6-8% annualized for the last 3-5 years and the company continues to maintain that trend for the future as well
- ✓ Company has not been impacted significantly by the steel commodity price fluctuations. Overall material margins have remained stead
- ✓ Management has not provided FY2021 guidance. Management is seeing gradual recovery over the next two to three months. The company is overall optimistic going ahead. The power generation segment has recovered better than expectations due to strong recovery in end-user segments, data centres, infrastructure, rentals, and industrial. Growth has been slower in medium horse power due to muted demand from hospitality, retail, and commercial segments.
- ✓ Globally, Cummins is the largest player in data centres. High-speed diesel is not available with competitors. Cummins has the right technology to grow in India.
- ✓ The construction segment is expected to remain strong for next 12 months
- ✓ CPCB-IV norms are expected to be delayed for six months (originally during July-August 2021). The new norms are most likely expected in April 2022. The industry has been asking for relief due to COVID-19. Cost of products as per the new norms will be higher. So, selling price is expected to be higher but the price hike cannot be said right now. Although it would be significant compared to other industries.
- ✓ The mining segment has come back strongly, led by demand in coal and metal industries. In marine, the company has introduced new products to capture market share and will grow well.
- ✓ Higher other income is on account of Rs380mn dividend received from its subsidiary, Valvoline Cummins, and exchange gains.
- ✓ Rise in key commodity prices such as copper and steel would be hitting the company in the next quarter. The company would be increasing prices next year depending on products and segments to partially mitigate the impact of commodity rise.

Exhibit 4: Industrial revenues declined by 4% yoy in Q3FY21



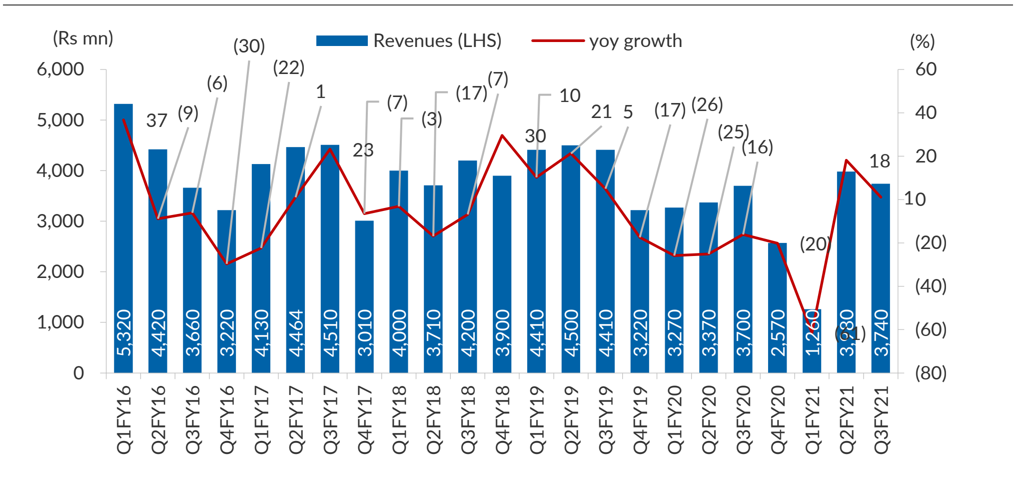
Source: Company, YES Sec – Research

Exhibit 5: Distribution revenues declined by 12% yoy in Q3FY21



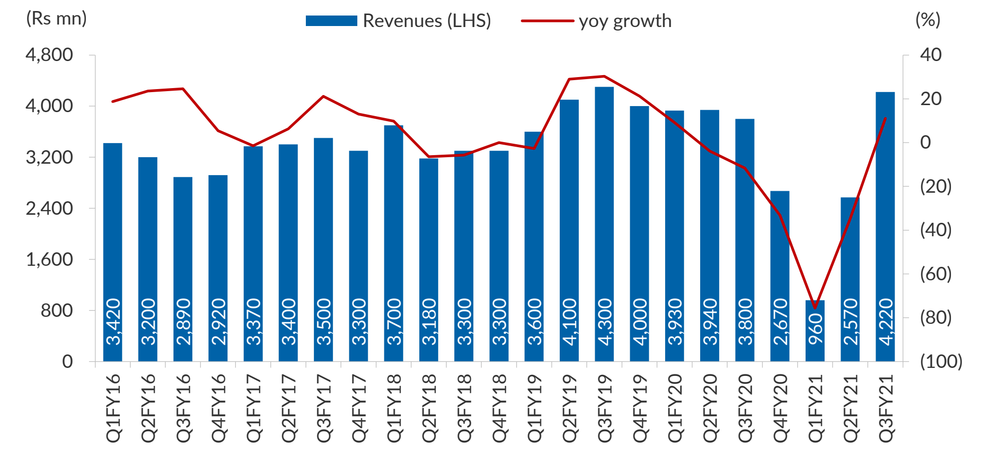
Source: Company, YES Sec – Research

Exhibit 6: Exports revenues grew by 1% yoy in Q3FY21



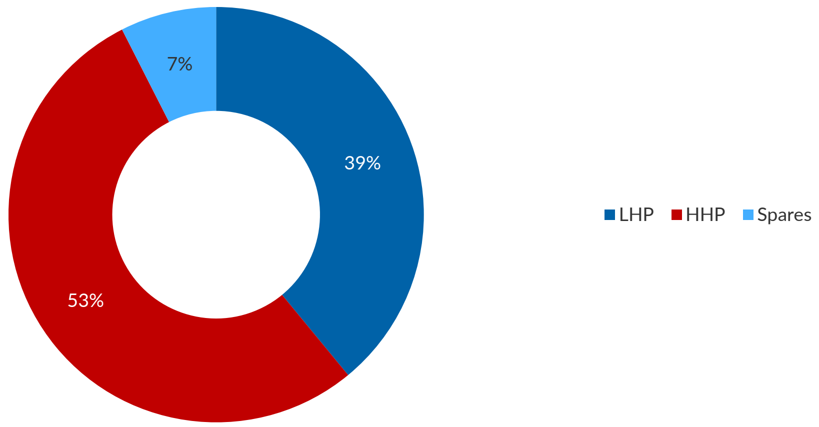
Source: Company, YES Sec – Research

Exhibit 7: Powergen revenue grew by 11% in Q3FY21



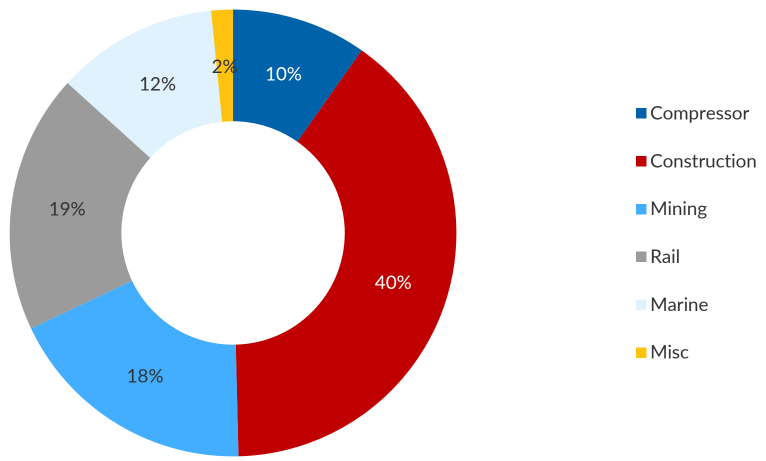
Source: Company, YES Sec – Research

Exhibit 8: Within exports, growth driven by HHP



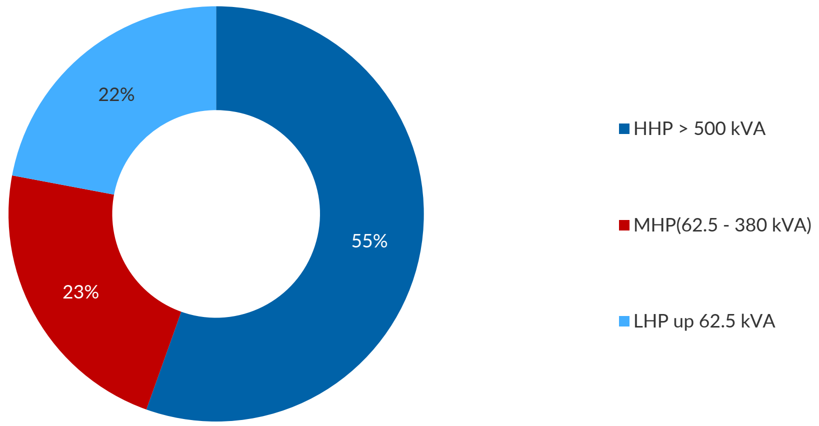
Source: Company, YES Sec – Research

Exhibit 9: Industrial growth driven by construction, rail & mining segments



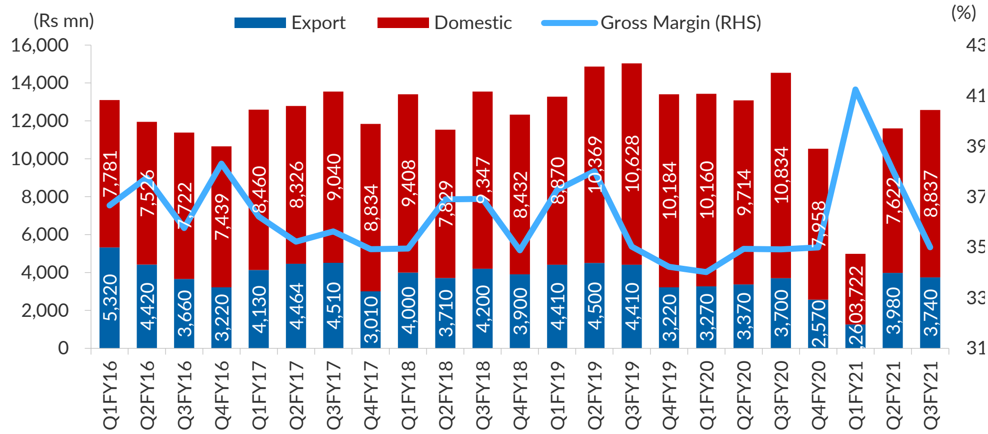
Source: Company, YES Sec – Research

Exhibit 10: Powergen revenues driven by HHP market



Source: Company, YES Sec – Research

Exhibit 11: Encouraging margins due to favorable sales mix



Source: Company, YES Sec – Research

FINANCIALS

Exhibit 12: Income statement

Y/e 30 Mar (Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
Total revenues	56,973	51,915	44,272	51,762	57,971
Growth (%)	11.5	(8.9)	(14.7)	16.9	12.0
EBITDA	8,691	5,892	6,330	7,409	8,672
EBITDA margin (%)	15.3	11.3	14.3	14.3	15.0
Growth (%)	18.6	(32.2)	7.4	17.0	17.0
Depreciation	1,111	1,206	1,290	1,380	1,480
EBIT	7,580	4,686	5,040	6,029	7,192
EBIT margin (%)	13.3	9.0	11.4	11.6	12.4
Interest	168	210	180	190	200
Other income	2,351	2,575	2,400	2,592	2,799
Profit before tax	9,763	7,051	7,260	8,431	9,791
Tax	3,263	1,019	1,829	2,125	2,467
Associate income	926	1,223	1,125	1,237	1,410
Minority interest	0	0	0	0	0
Adj. PAT	7,426	7,255	6,555	7,543	8,734
Extraordinary	0	199	(126)	0	0
Reported PAT	7,426	7,056	6,681	7,543	8,734
Adj. PAT margin (%)	13.0	14.0	14.8	14.6	15.1
Diluted EPS (Rs)	26.8	26.2	23.6	27.2	31.5
Growth (%)	11.1	(2.3)	(9.6)	15.1	15.8

Exhibit 13: Balance sheet

Y/e 30 Mar (Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
SOURCE OF FUNDS					
Share capital	554	554	554	554	554
Reserve & Surplus	42,275	43,466	46,472	49,867	53,797
Total shareholder's funds	42,830	44,020	47,027	50,421	54,352
Minority Interest	0	0	0	0	0
Debt	3,126	4,893	4,693	3,693	3,193
Deferred tax liabilities/(assets)	2,432	2,265	2,287	1,808	2,025
TOTAL	48,387	51,178	54,006	55,922	59,570
APPLICATION OF FUNDS					
Fixed assets	29,299	33,053	35,053	37,303	38,803
Less: Depn. and amort.	9,147	10,353	11,643	13,023	14,503
Net block	20,151	22,700	23,410	24,280	24,300
Capital WIP	1,585	800	845	1,299	1,455
Long term investments	4,682	2,559	2,561	2,626	2,941
Other long term assets	2,326	2,077	2,546	2,394	2,681
Inventories	6,329	5,772	5,458	5,956	6,671
Debtors	12,836	12,836	11,523	12,054	13,500
Cash & cash equivalents	7,381	12,353	14,218	14,550	16,127
Loans & advances	5,314	2,863	2,669	3,545	3,971
Total current liabilities	12,215	10,783	9,223	10,783	12,077
Net current assets	19,643	23,042	24,645	25,323	28,192
TOTAL	48,387	51,178	54,006	55,922	59,570

Exhibit 14: Cash flow statement

Y/e 30 Mar (Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
PBT	10,689	8,075	7,260	8,431	9,791
Depreciation	1,111	1,206	1,290	1,380	1,480
Others	(1,545)	(1,783)	1,251	1,237	1,410
Tax Paid	2,374	1,623	1,829	2,125	2,467
Changes in Working Capital	(2,349)	133	261	(346)	(1,292)
Net Cash from Operations	**5,532**	**6,007**	**8,232**	**8,578**	**8,922**
Capex	(2,741)	(2,371)	(2,000)	(2,250)	(1,500)
Change in Investment	670	(1,163)	(47)	(520)	(471)
Others	2,234	1,395	(447)	(327)	(70)
Net Cash from Investing	**162**	**(2,139)**	**(2,493)**	**(3,097)**	**(2,041)**
Change in debt	558	1,767	(200)	(1,000)	(500)
Change in Equity	0	0	0	0	0
Others	(5,808)	(5,890)	(3,675)	(4,149)	(4,804)
Net Cash from Financing	**(5,251)**	**(4,123)**	**(3,875)**	**(5,149)**	**(5,304)**
Net Change in Cash	**444**	**(255)**	**1,865**	**332**	**1,577**
Free cash flow (FCF)	**5,806**	**4,048**	**5,874**	**5,623**	**7,030**

Exhibit 15: Ratio analysis

Y/e 30 Mar (Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
PROFITABILITY RATIOS					
EBITDA Margin (%)	15.3	11.3	14.3	14.3	15.0
Adjusted net margin (%)	13.0	13.6	15.1	14.6	15.1
Return on invested capital (%)	14.0	10.7	10.0	11.6	13.2
Return on equity (%)	17.7	16.7	14.4	15.5	16.7
EFFICIENCY RATIOS					
Asset Turnover	2.6	2.2	1.8	2.0	2.3
Debt to equity	0.1	0.1	0.1	0.1	0.1
Net debt to equity	(0.1)	(0.2)	(0.2)	(0.2)	(0.2)
Interest coverage	45.2	22.3	28.0	31.7	36.0
Debtor days	82.2	90.2	95.0	85.0	85.0
Inventory days	40.5	40.6	45.0	42.0	42.0
Payable days	52.9	49.0	49.0	49.0	49.0
PER SHARE DATA					
Diluted EPS (Rs)	26.8	26.2	23.6	27.2	31.5
Book value per share (Rs)	154.5	158.8	169.6	181.9	196.1
DPS (Rs)	17.0	14.0	11.3	12.7	14.7
VALUATION RATIOS					
P/E	24.9	25.4	28.2	24.5	21.1
P/BV	4.3	4.2	3.9	3.7	3.4
EV/EBITDA	20.8	30.1	27.7	23.5	19.8
Dividend Yield (%)	2.6	2.1	1.7	1.9	2.2

Cummins India Ltd

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