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Q3FY21 result review
and earnings revision

Capital Goods

Target price: Rs783

Earnings revision

(%)	FY21E	FY22E
Sales	↑ 3.7	↑ 2.4
EBITDA	↑ 36.7	↑ 13.6
PAT	↑ 31.5	↑ 10.9

Target price revision

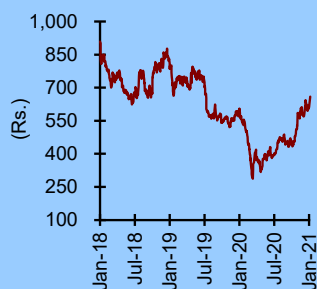
Rs783 from Rs613

Shareholding pattern

	Jun '20	Sep '20	Dec '20
Promoters	51.0	51.0	51.0
Institutional investors	36.2	36.2	35.2
MFs and others	18.6	18.6	17.1
FIs/Banks/Ins	8.7	9.3	9.1
FIs	8.9	8.3	9.0
Others	12.8	12.8	13.8

Source: NSE

Price chart



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Cummins India

BUY

Maintained

Healthy margins, hope of restructuring emerge

Rs660

Cummins India (Cummins) has reported better-than-expected margins, healthy growth under powergen supported revenue beat. Management didn't deny any move towards restructuring of unlisted and listed entities. We believe this is a very positive development which will open up lot more synergies. Growth traction can continue with likely recovery from hospitality and realty segments. Though near-term execution may be volatile, we believe, focus on cashflow, leadership in technology and gradual recovery in export markets augur well for long-term growth. Factoring in better-than-expected margins, FY21E and FY22E earnings by 31.5% and 10.9%, respectively. Given long term structural growth drivers like change in emission norms to CPCB-IV plus and likely restructuring of business, we maintain BUY with a revised SoTP-based target price of Rs783 (previously: Rs613).

- ▶ **Revival of growth under powergen, construction and exports:** HHP powergen witnessed YoY growth post 5 quarters of YoY decline, construction segment grew 102% YoY and exports grew marginally by 1% YoY. Domestic growth outlook is healthy with a gradual revival of economic activity and segments like hospitality and realty may recover from the current slump. Mining has gained traction and railways is also expected to return to normalcy gradually.
- ▶ **Focus on cost control and favourable mix supported margins:** Cummins was able to control cost efficiently, this in addition to favourable mix supported better-than-expected margins. Commodity prices have recently increased and this is expected to impact the overall gross margins going forward.
- ▶ **Stable exports with an optimistic outlook:** Exports witnessed marginal 1% YoY growth despite lockdown in some European markets. We believe the worst is behind and the growth trajectory may revive going forward. Shift towards India from China by most countries for sourcing will also aid in fuelling growth.
- ▶ **Maintain BUY on cashflow and long-term growth:** Factoring in better-than-expected margins, we raise our earnings estimates by 31.5% and 10.9% for FY21E and FY22E, respectively, and introduce FY23E estimates. We believe long-term growth potential is intact with the introduction of CPCB-IV+ norms. We revise our SoTP-based target price to Rs783 (previously: Rs613). Given the strong cashflow, stable margins and synergy benefits from restructuring, we have raise our valuation to 28X for standalone core Sep'22 earnings. Structural improvements in investments towards infrastructure and export recovery are rerating catalysts.

Market Cap	Rs185bn/US\$2.5bn	Year to Mar (Std)	FY20	FY21E	FY22E	FY23E
Reuters/Bloomberg	CUMM.BO/KKC IN	Revenue (Rs mn)	51,577	45,656	53,832	58,101
Shares Outstanding (mn)	277.2	Net Income (Rs mn)	6,432	6,683	7,763	8,257
52-week Range (Rs)	666/287	DEPS (Rs)	23.2	24.1	28.0	29.8
Free Float (%)	49.0	% Chg YoY	(11.0)	3.9	16.2	6.4
FII (%)	9.0	P/E (x)	28.4	27.3	23.5	22.1
Daily Volume (US\$/000)	10,520	CEPS (Rs)	27.0	28.7	32.8	34.9
Absolute Return 3m (%)	53.5	EV/E (x)	29.9	25.3	19.9	18.0
Absolute Return 12m (%)	19.2	Dividend Yield (%)	2.1	2.4	3.0	2.4
Sensex Return 3m (%)	16.9	RoCE (%)	17.2	18.5	20.4	20.9
Sensex Return 12m (%)	15.0	RoE (%)	15.5	15.6	17.2	17.3

Valuation and outlook

Factoring in better operational performance and growth, we raise earnings estimates, though in the near term, margins are expected to be challenging due to higher commodity prices, control over fixed overheads and staff cost will aid in operating leverage. Any likely development regarding the merger of the unlisted group entities will give rise to synergies and thus, weigh favourably towards valuation re-rating. Factoring the same, we have raised our core earnings target multiple to 28x Sep'22E earnings from 25x FY22E earnings.

We believe Cummins' long-term structural story is intact given the change in emission norms, technological leadership, testing, 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. Given the strong cashflow, we raise core earnings valuation multiple to 28x Sep'22E from 25x FY22E previously and add back the cash and discount the lease rentals @6% for 10 years. This works out to a target price of Rs783.

Table 1: Earnings revision

(Rs mn)

	FY21E			FY22E		
	Previous	Revised	% chg	Previous	Revised	% chg
Revenues	44,027	45,656	3.7	52,595	53,832	2.4
EBITDA	4,998	6,834	36.7	7,626	8,663	13.6
PAT	5,081	6,683	31.5	6,998	7,763	10.9

Source: Company data, I-Sec research

Table 2: Valuation summary

(Rs mn)

	FY22E	FY23E
PAT	7,763	8,257
Tax rate (%)	24.0	25.0
Interest & dividend income	1,100	1,100
Rental Income	1,241	1,278
Operating PAT	5,984	6,474
P/E (x)	28	28
Value	1,67,550	1,81,262
Cash & Cash Equivalent	15,426	17,100
Gross value	1,82,976	1,98,362
Cummins Standalone value per share (Rs) (A)	660	716
Discounted Lease contribution	11,129	11,129
Lease contribution value per share (Rs) (B)	40	40
Valvoline PAT	1,518	1,557
P/E multiple (x)	20	20
Valvoline Gross value	30,353	31,150
Holding value (50% stake)	15,176	15,575
Valvoline value per share (Rs) (C)	55	56
Total value per share (Rs) (A+B+C)	755	812
Average	783	783

Source: Company data, I-Sec research

Table 3: Result highlights

(Rs mn)	Q3FY20	Q3FY21	YoY(%)	Q2FY21	QoQ(%)	Isec est	Var(%)	9MFY20	9MFY21	YoY(%)
Total Revenue	14,534	14,243	(2.0)	11,602	22.8	13,251	7.5	41,049	30,827	(24.9)
EBITDA	2,158	2,417	12.0	1,674	44.4	1,915	26.2	5,196	4,120	(20.7)
Margin	14.8	17.0	213bps	14.4	254bps	14.5	252bps	12.7	13.4	
Depreciation	296	320	8.2	327	(2.2)	307	4.0	879	949	8.0
Finance Cost	47	46	(1.5)	40	13.9	46	0.5	154	129	(16.0)
Other Income	723	984	36.2	580	69.8	651	51.3	2,418	2,586	6.9
Extraordinary income	(161)	-	-	-	-	-	-	(161)	-	-
PBT	2,378	3,036	27.7	1,887	60.9	2,213	37.2	6,420	5,627	(12.4)
Tax	515	695	34.9	431	61.2	531	30.9	1,310	1,306	(0.3)
tax rate	21.7	22.9	123bps	22.9	5bps	24.0	-110bps	20.4	23.2	
Reported PAT	1,862	2,341	25.7	1,456	60.8	1,682	39.2	5,110	4,322	(15.4)
Adjusted PAT	1,983	2,341	18.1	1,456	60.8	1,682	39.2	5,231	4,322	(17.4)
Margin (%)	13.6	16.4	279bps	12.5	389bps	12.7	374bps	12.7	14.0	
EPS (Rs)	7.2	8.4		5.3		6.1		18.9	15.6	(17.4)

Source: Company data, I-Sec research

Table 4: Quarterly segmental trend

(Rs mn)	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21	YoY (%)
Revenues						
Powergen	3,800	2,670	960	2,570	4,220	11.1
Distribution	4,150	2,540	1,825	3,170	3,650	(12.0)
Industrial	2,670	2,450	795	1,700	2,560	(4.1)
Domestic	10,585	7,746	3,581	7,433	10,258	(3.1)
% YoY	4%	-22%	-64%	-22%	-3%	
Exports	3,700	2,576	1,260	3,980	3,740	1.1
% YoY	-16%	-20%	-61%	18%	1%	
Total	14,285	10,322	4,841	11,413	13,998	(2.0)
Powergen Domestic						
LHP (till 62.5kva)	900	260	40	300	930	3.3
MHP (82.5-250kva)	1100	670	210	670	940	(14.5)
Heavy Duty (320-380kva)	100	390	130	550	590	490.0
HHP (500kva+)	1700	1450	590	1070	1750	2.9
Total	3800	2770	970	2590	4210	10.8
Industrial Segment						
Compressors	390	373	120	280	250	(35.9)
Construction	720	755	100	450	1020	41.7
Mining	260	290	150	230	470	80.8
Rail	1030	1020	350	530	480	(53.4)
Others	260	23	60	0	0	(100.0)
Total	2660	2460	820	1690	2570	(3.4)
Exports						
LHP			210			
Midrange			360			
Total LHP	1440	970	570	1560	1460	1.4
Heavy duty			140			
HHP	2080	1450	410	2130	2010	
Total HHP	2080	1450	550	2130	2010	(3.4)
spare parts	180	186	140	290	270	50.0
Total	3700	2606	1260	3980	3740	1.1

Source: Company data, I-Sec research

Table 5: Key assumptions

(Rs mn)	FY18	FY19	FY20	FY21E	FY22E	FY23E
PowerGen	13,946	16,000	14,350	12,054	14,465	15,043
% YoY	3.0	14.7	(10.3)	(16.0)	20.0	4.0
Industrial	7,730	9,230	9,960	7,769	9,323	10,068
% YoY	8.0	19.4	7.9	(22.0)	20.0	8.0
Distribution	12,620	13,500	13,400	12,328	14,177	15,311
% YoY	9.7	7.0	(0.7)	(8.0)	15.0	8.0
Domestic	34,296	38,730	37,710	32,151	37,965	40,423
% YoY	(7.6)	12.9	(2.6)	(14.7)	18.1	6.5
Exports	16,007	16,527	12,906	12,648	14,924	16,715
% YoY	0.2	3.2	(21.9)	(2.0)	18.0	12.0
Total	50,303	55,257	50,616	44,799	52,889	57,139

Source: Company data, I-Sec research

Key concall takeaways:

- In the domestic segment, despite overall revenue decline of 3% YoY, powergen witnessed strong 11% YoY growth led by HHP and heavy duty.
- Industrial segment declined 4% YoY due to muted performance by railways; however, the construction segment has recovered with healthy growth outlook.
- Commodity price inflation will adversely impact the margins in Q4FY21. Company will take price hikes (tactical) in order to compensate for the same. Sequential decline in margin in Q3 was largely related to adverse mix (lower export and one-time large order execution). Product mix will be more balanced going forward.
- There has been faster than expected recovery in some of key end-markets like data centres, industrial and rentals. Markets witnessing relatively slow recovery include commercial realty, hospital, etc., which largely use MHP. Residential realty has shown green shoots of recovery, but commercial realty has not picked up strongly yet. In industrial segment, construction will remain buoyant for at least a year. Demand from mining is coming back strongly with rising demand for coal and iron ore, etc. Recovery in compressor segment has not yet happened as it remains a cyclical business. There is strong demand from agriculture sector.
- Export business is holding on and is slightly better than in the same period last year, but declined sequentially due to soft end-market demand.
- Commodity price impact and absence of certain high-margin mix execution is likely to bring EBITDA margins to normalised levels.
- Other income was high due to Rs380mn of higher dividends from Valvoline subsidiary. Lower 'other expenses' YoY mainly reflect one-time impairment charge of Rs230mn in the base quarter. There was no MEIS-related provisioning in Q3FY21.
- CPCB-IV+ is likely to be implemented around Apr'22. The entire structure of the product will be reset post this implementation.
- Company did not deny the rumors regarding restructuring and merger of unlisted entities in the group.
- In powergen, management foresees demand from hospitality and residential realty coming back. Data centre and infrastructure segments are doing well.

Financial summary

Table 6: Profit & loss statement

(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
Total Income	51,577	45,656	53,832	58,101
Operating Expenses	45,715	38,822	45,169	48,613
EBITDA	5,863	6,834	8,663	9,488
% margins	11.4	15.0	16.1	16.3
Depreciation & Amortisation	1,187	1,276	1,339	1,406
EBIT	4,676	5,558	7,324	8,082
Gross Interest	203	170	150	150
Other Income	3,315	3,404	3,041	3,078
PBT before exceptionals	7,789	8,793	10,214	11,009
Add:				
Extraordinaries/Exceptionals	(199)	-	-	-
Add: Share in associates				
PBT	7,591	8,793	10,214	11,009
Less: Taxes	1,297	2,110	2,451	2,752
Less: Minority Interests				
Net Income (Reported)	6,293	6,683	7,763	8,257
Adjusted Net Income	6,432	6,683	7,763	8,257

Source: Company data, I-Sec research

Table 7: Balance sheet

(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
Assets				
Total Current Assets	33,611	34,339	38,139	41,932
of which cash & cash eqv.	12,353	14,325	15,426	17,100
Total Current Liabilities & Provisions	12,137	10,490	12,583	13,499
Net Current Assets	21,474	23,849	25,556	28,432
Investments	10,792	10,792	10,792	10,792
Other Non-Current Assets	2,367	2,415	2,466	2,519
Net Fixed Assets	12,772	12,596	13,056	13,150
Goodwill				
Total Assets	47,404	49,651	51,870	54,893
Liabilities				
Borrowings	4,854	4,854	4,854	4,854
Deferred Tax Liability	800	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	41,195	43,443	45,661	48,685
Net Worth	41,750	43,997	46,216	49,239
Total Liabilities	47,404	49,651	51,870	54,893

Source: Company data, I-Sec research

Table 8: Cashflow statement

(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
Operating Cashflow	4,237	8,128	9,252	9,813
Working Capital Changes	1,951	(451)	(657)	(1,256)
Capital Commitments	(1,175)	(1,100)	(1,800)	(1,500)
Free Cashflow	5,013	6,578	6,795	7,057
Cashflow from Investing Activities	(960)	(391)	(1,641)	(1,969)
Issue of Share Capital				
Buyback of shares				
Inc (Dec) in Borrowings	1,762	-	-	-
Interest paid	203	170	150	150
Dividend paid	(4,579)	(4,435)	(5,544)	(5,234)
Extraordinary Items/Others	1,108	51	1,341	1,669
Chg. in Cash & Bank balance	2,546	1,972	1,101	1,673

Source: Company data, I-Sec research

Table 9: Key ratios

(Year ending March 31)

	FY20	FY21E	FY22E	FY23E
Per Share Data (in Rs.)				
Diluted adjusted EPS	23.2	24.1	28.0	29.8
Recurring Cash EPS	27.0	28.7	32.8	34.9
Dividend per share (DPS)	14.0	16.0	20.0	16.0
Book Value per share (BV)	150.6	158.7	166.7	177.6
Growth Ratios (%)				
Operating Income	(8.9)	(11.5)	17.9	7.9
EBITDA	(32.2)	16.6	26.8	9.5
Recurring Net Income	(11.0)	3.9	16.2	6.4
Diluted adjusted EPS	(11.0)	3.9	16.2	6.4
Diluted Recurring CEPS	(10.2)	6.4	14.4	6.2
Valuation Ratios				
P/E	28.4	27.3	23.5	22.1
P/CEPS	24.4	23.0	20.1	18.9
P/BV	4.4	4.2	4.0	3.7
EV / EBITDA	29.9	25.3	19.9	18.0
EV / Operating Income	3.4	3.8	3.2	2.9
EV / Operating FCF (pre -Capex)	28.3	22.6	20.0	19.9
Operating Ratios				
Raw Material/Sales (%)	65.3	62.5	62.7	63.0
SG&A/Sales (%)	11.1	10.4	9.7	9.5
Other Income / PBT (%)	42.6	38.7	29.8	28.0
Effective Tax Rate (%)	16.7	24.0	24.0	25.0
NWC / Total Assets (%)	17.7	17.6	17.4	18.1
Inventory Turnover (days)	41.3	45.9	45.8	45.8
Receivables (days)	80.1	80.0	80.0	84.0
Payables (days)	49.3	49.3	52.0	52.0
Net D/E Ratio (x)	(0.2)	(0.2)	(0.2)	(0.2)
Return/Profitability Ratios (%)				
Recurring Net Income Margins	12.5	14.6	14.4	14.2
RoCE	17.2	18.5	20.4	20.9
RoNW	15.5	15.6	17.2	17.3
Dividend Payout Ratio	60.3	66.4	71.4	53.7
Dividend Yield (%)	2.1	2.4	3.0	2.4
EBITDA Margins	11.4	15.0	16.1	16.3

Source: Company data, I-Sec research

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