

**BUY**

TP: Rs 2,200 | ▲ 29%

**CUMMINS INDIA**

| Capital Goods

| 08 November 2023

**Strong operating performance; maintain BUY**

- Q2 gross/EBITDA margins expand 500bps/320bps YoY on lower input costs, sustained pricing and better product mix
- Demand for CPCB-IV engines and faster inventory correction bode well for H2; longer-term positive outlook intact
- TP revised to Rs 2,200 (vs. Rs 2,110) as we raise FY24/FY25 EPS by 4% each and roll valuations over; maintain BUY

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**Strong operating numbers:** KKC achieved revenue of Rs 19bn in Q2FY24, thanks to robust demand in the industrial and distribution businesses, which grew 23% and 20% YoY respectively, even as the generation business dropped 28%. Exports continued to hold up at Rs 5.1bn, forming 27% of sales. EBITDA margin remained robust at 18% (+320bps YoY), translating into PAT growth of 23% YoY to Rs 3.3bn.

**Margin improves due to trifecta of positives:** Gross margin expanded 500bps YoY to 37.1% in Q2 supported by lower commodity costs as well as a larger share of high-powered products in the mix. Moreover, due to its leadership, KKC was able to hold on to prices despite lower commodity costs, which completed the trifecta behind its buoyant gross margin.

**Rating transition demand surprises positively....:** During H1FY24, KKC received a positive response to its new CPCB-IV engines which formed ~20% of the revenue mix – bettering the company’s own estimate of a 5-10% mix for the new engines.

**...as does channel inventory normalisation:** In Q2, KKC saw a sharp 60-70% YoY drop in low- and medium-horsepower (LHP/MHP) sales due to prebuying in Q1, ahead of the new emission norms. Management now highlighted that channel inventory has already normalised vs. its earlier timeline of Q4, which bodes well for demand in H2.

**Positive long-term outlook:** Management has reiterated revenue growth guidance at 2x GDP for KKC in FY24 and retained its annual EBITDA margin expansion target of 100bps with a focus on cost. It is cautiously optimistic about exports in the near term but bullish in the medium term and is even engineering its new CPCB-IV engines for country-specific needs.

**Maintain BUY:** We see visibility for sustained long-term growth in the domestic power genset market, with KKC best positioned to manage the ongoing transition to new emission norms. Post Q2, we raise our FY24/FY25 EPS estimates by 4% each and roll valuations over to Sep’25E. This causes our TP to rise to Rs 2,200 (vs. Rs 2,110), set at an unchanged 35x P/E – 25% premium to the 5Y mean. BUY.

**Key changes**

Target	Rating
▲	◀ ▶

Ticker/Price	KKC IN/Rs 1,699
Market cap	US\$ 5.7bn
Free float	49%
3M ADV	US\$ 20.7mn
52wk high/low	Rs 1,980/Rs 1,306
Promoter/FPI/DII	51%/10%/25%

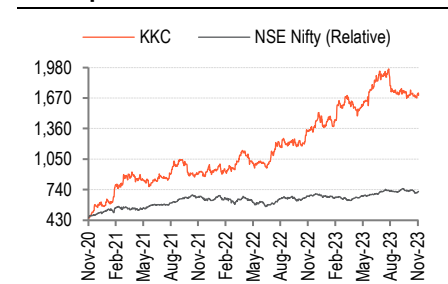
Source: NSE | Price as of 7 Nov 2023

**Key financials**

Y/E 31 Mar	FY23A	FY24E	FY25E
Total revenue (Rs mn)	77,721	87,152	97,675
EBITDA (Rs mn)	12,477	14,000	15,944
Adj. net profit (Rs mn)	12,425	14,342	16,621
Adj. EPS (Rs)	44.8	51.7	60.0
Consensus EPS (Rs)	44.8	48.4	56.8
Adj. ROAE (%)	22.8	23.6	24.5
Adj. P/E (x)	37.9	32.8	28.3
EV/EBITDA (x)	39.4	35.4	31.4
Adj. EPS growth (%)	59.0	15.4	15.9

Source: Company, Bloomberg, BOBCAPS Research

**Stock performance**



Source: NSE

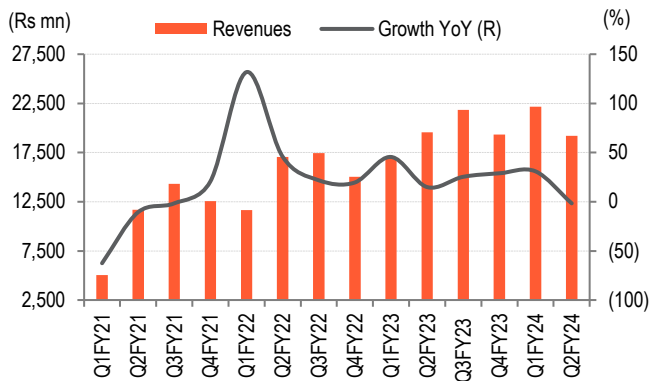


**Fig 1 – Quarterly performance**

Consolidated (Rs mn)	Q2FY24	Q2FY23	YoY (%)	Q1FY24	QoQ (%)	H1FY24	H1FY23	YoY (%)
Revenue	19,216	19,573	(1.8)	22,183	(13.4)	41,398	36,532	13.3
EBITDA	3,462	2,898	19.5	3,425	1.1	6,886	5,045	36.5
EBITDA Margin (%)	18.0	14.8	320bps	15.4	260bps	16.6	13.8	280bps
Depreciation	383	356		363		745	697	
Interest	68	47		78		147	67	
Other Income	896	690		890		1,786	1,359	
PBT	3,907	3,184	22.7	3,874		7,781	5,639	38.0
Tax	996	838		992		1,988	1,488	
Adjusted PAT	3,289	2,673	23.0	3,537	(7.0)	5,793	4,797	20.8
Exceptional item	0	0		0		0	143	
Reported PAT	3,289	2,673	23.0	3,537	(7.0)	6,826	4,654	46.7
Adj. PAT Margin (%)	17.1	13.7	350bps	15.9	120bps	14.0	13.1	90bps
EPS (Rs)	11.9	9.6		12.8	(7.0)	24.6	17.3	

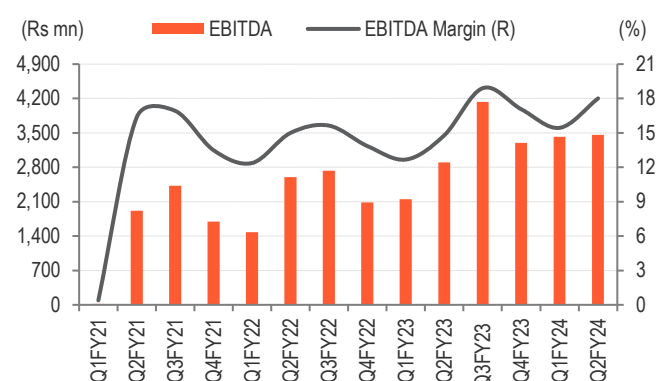
Source: Company, BOBCAPS Research

**Fig 2 – Revenue trend**



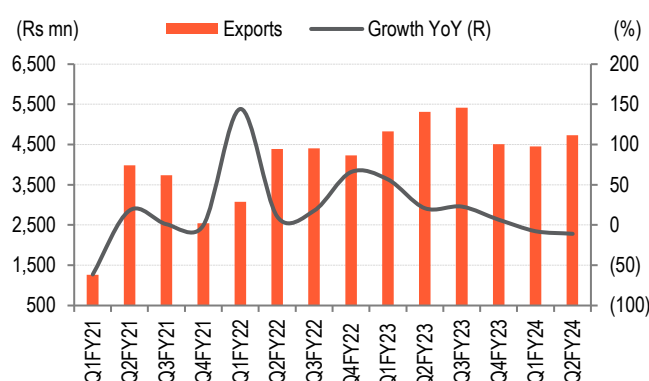
Source: Company, BOBCAPS Research

**Fig 3 – EBITDA growth trend**



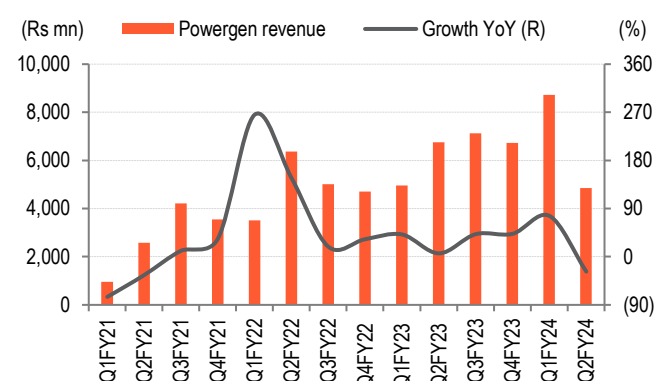
Source: Company, BOBCAPS Research

**Fig 4 – Export trend**



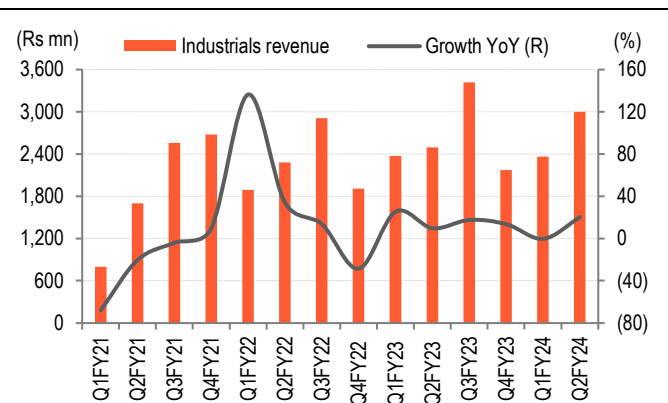
Source: Company, BOBCAPS Research

**Fig 5 – Power genset segment revenue performance**



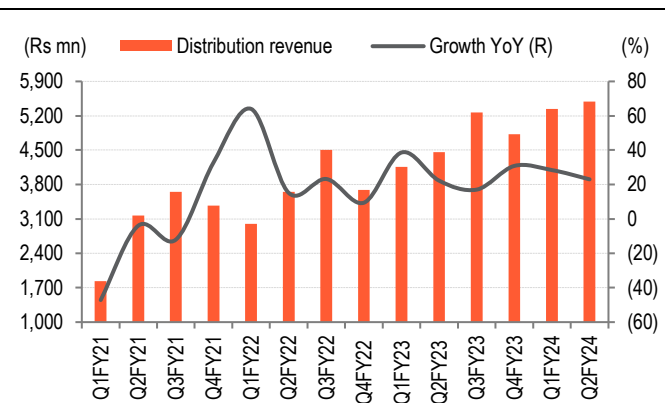
Source: Company, BOBCAPS Research

**Fig 6 – Industrials segment performance**



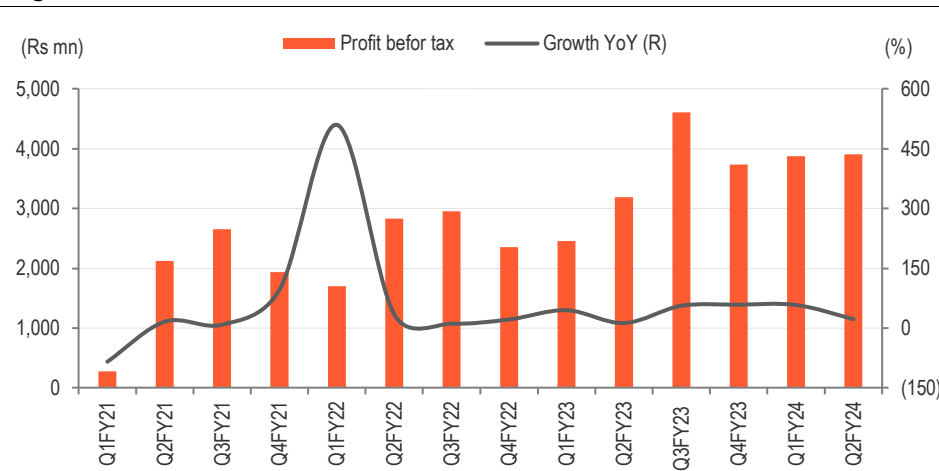
Source: Company, BOBCAPS Research

**Fig 7 – Distribution segment performance**



Source: Company, BOBCAPS Research

**Fig 8 – Profit before tax**



Source: Company, BOBCAPS Research

### Earnings call highlights

- Growth outlook:** India’s GDP is expected to grow in the range of 6.3-6.8% for FY24, and management expects KKC to grow at double this rate (13-14%), as guided earlier.
- Margins:** KKC’s gross margin swelled 500bps YoY to 37.1% in Q2FY24 largely due to a better product mix, operating leverage and a low share of LHP products (lower margin business). Management expects to stay above 32-34% on a gross margin basis in the medium term. It believes the 37.1% margin achieved in Q2 will taper down in H2 as the product mix shifts due to seasonality. Management aims to achieve a 34-35% margin range in the medium term as CPCB-IV engines achieve scale.
- Exports:** The company clocked export revenue of Rs 4.7bn during Q2, of which Rs 1.2bn came from the Asia Pacific, Rs 1.4bn from Latin America, Rs 1.1bn from the Middle East, Rs 630mn from Africa, and Rs 640mn from Europe. Management indicated that the developed markets of Europe and North America posted substantial declines, in excess of 50% YoY, while its other markets of the Asia Pacific, Middle East and South Africa declined at a much lower rate of 5-10%.

Management expects some softness in the short term as geopolitical tensions have an impact on global trade but is extremely bullish on export markets in the mid-to-long term.

- **Industrials segment:** Demand from the construction sector has bounced back on a YoY basis while other businesses such as rail, compressors and defense remain lumpy and erratic in nature. Management expects the healthy demand momentum in construction to continue and pointed to a large number of tenders in coal and steel mining.
- **CPCB:** CPCB volumes accounted for ~20% of KKC's power segment sales and ~30% of these comprised CPCB-IV engines. The company has been lagging in supply to some areas as it misestimated demand and is expanding capacities to plug the gap. Management indicated a shift from CPCB-II to CPCB-IV in bigger cities despite the pricing differential as consumers are willing to pay more for the enhanced engine quality. While KKC's competitor has launched a product, no significant data is available yet to indicate comparative growth.
- **Inventory:** Q1FY24 saw pre-buying due to a change in power norms, but management indicated that inventories have returned to normal and that Q3-Q4 should see a return to growth as usual (13-14%). Globally, the parent has seen sharp inventory correction, and management expects this to be an important factor for softness in the short term.
- **Capex:** KKC incurred capex of ~Rs 1.6bn in H1FY24 and has guided for Rs 3bn-4bn in FY24. The company expects capex to grow only marginally in the next two years, largely for launching and upgrading products and for maintenance purposes.
- **Hydrogen:** Through its JV with Tata, KKC is looking at hydrogen ICE (internal combustion engines) for automotive applications, that can use grey and green hydrogen, but this model requires scale to be successful. The plant is expected to be set up in Jharkhand and will supply to nearby areas.
- **Data centres:** Data centre demand is growing apace for KKC and is one of its top 10 segments. Management expects the strong growth trend to continue for at least 3-4 years.

## Valuation methodology

We see visibility for sustained long-term growth in the domestic power genset market (and for strong exports), with KKC best positioned to manage the ongoing transition to new emission norms. Post Q2, we raise our FY24/FY25 EPS estimates by 4% each and roll valuations over to Sep'25E. This causes our TP to rise to Rs 2,200 (vs. Rs 2,110), set at an unchanged 35x P/E – 25% premium to the five-year mean. Maintain BUY

**Fig 9 – Revised estimates**

Particulars (Rs mn)	New		Old		Change (%)	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Sales	87,152	97,675	87,152	97,675	0.0	0.0
EBITDA	14,000	15,944	13,299	15,245	5.3	4.6
PAT	14,342	16,621	13,815	16,001	3.8	3.9
EPS (Rs)	51.7	60.0	49.8	57.7	3.8	3.9
EBITDA Margin (%)	16.1	16.3	15.3	15.6	80bps	70bps

Source: Company, BOBCAPS Research

## Key risks

Key downside risks to our estimates are:

- prolonged supply chain constraints,
- delay in demand recovery after CBCB-IV norms kick in, and
- slowdown in exports.

## Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
ABB India	ABB IN	10.9	4,209	4,400	HOLD
AIA Engineering	AIAE IN	4.1	3,552	4,200	BUY
Cummins India	KKC IN	5.7	1,699	2,200	BUY
Hitachi Energy	POWERIND IN	2.4	4,571	4,200	HOLD
KEC International	KECI IN	1.8	560	670	HOLD
Larsen & Toubro	LT IN	50.6	2,961	3,500	BUY
Siemens India	SIEM IN	14.5	3,348	3,900	HOLD
Thermax	TMX IN	4.2	2,879	3,000	HOLD

Source: BOBCAPS Research, NSE | Price as of 7 Nov 2023

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
<b>Total revenue</b>	<b>61,709</b>	<b>77,721</b>	<b>87,152</b>	<b>97,675</b>	<b>109,319</b>
EBITDA	8,681	12,477	14,000	15,944	17,785
Depreciation	1,356	1,420	1,514	1,547	1,577
EBIT	7,324	11,057	12,486	14,397	16,207
Net interest inc./(exp.)	122	162	192	150	150
Other inc./(exp.)	2,432	3,082	3,544	3,969	4,366
Exceptional items	0	0	0	0	0
EBT	9,635	13,976	15,838	18,216	20,423
Income taxes	2,732	3,631	3,991	4,590	5,147
Extraordinary items	(1,324)	143	0	0	0
Min. int./Inc. from assoc.	912	2,080	2,496	2,995	3,594
<b>Reported net profit</b>	<b>9,137</b>	<b>12,282</b>	<b>14,342</b>	<b>16,621</b>	<b>18,871</b>
Adjustments	(1,324)	143	0	0	0
<b>Adjusted net profit</b>	<b>7,814</b>	<b>12,425</b>	<b>14,342</b>	<b>16,621</b>	<b>18,871</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Accounts payables	9,997	11,539	14,804	17,394	19,468
Other current liabilities	3,502	3,864	8,357	9,366	10,483
Provisions	0	0	0	0	0
Debt funds	3,947	3,500	3,200	3,000	3,000
Other liabilities	2,224	2,701	3,028	3,394	3,798
Equity capital	554	554	554	554	554
Reserves & surplus	50,895	57,028	63,482	70,961	79,453
Shareholders' fund	51,450	57,582	64,037	71,516	80,007
<b>Total liab. and equities</b>	<b>71,120</b>	<b>79,186</b>	<b>93,426</b>	<b>104,670</b>	<b>116,756</b>
Cash and cash eq.	20,043	24,342	28,917	36,270	42,546
Accounts receivables	12,581	15,971	19,579	21,408	23,960
Inventories	7,375	9,037	10,029	10,704	11,980
Other current assets	4,135	1,635	5,492	5,620	6,290
Investments	3,255	4,218	4,729	5,300	5,932
Net fixed assets	21,891	22,258	22,745	23,198	23,620
CWIP	804	413	463	519	581
Intangible assets	0	0	0	0	0
Deferred tax assets, net	0	0	0	0	0
Other assets	1,037	1,313	1,472	1,650	1,847
<b>Total assets</b>	<b>71,120</b>	<b>79,186</b>	<b>93,426</b>	<b>104,670</b>	<b>116,756</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
<b>Cash flow from operations</b>	<b>7,119</b>	<b>8,197</b>	<b>15,157</b>	<b>19,134</b>	<b>19,140</b>
Capital expenditures	706	(1,543)	(2,000)	(2,000)	(2,000)
Change in investments	(7,597)	1,858	(562)	(627)	(694)
Other investing cash flows	1,029	376	168	188	208
<b>Cash flow from investing</b>	<b>(5,863)</b>	<b>691</b>	<b>(2,394)</b>	<b>(2,439)</b>	<b>(2,486)</b>
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	3,745	(446)	(300)	(200)	0
Interest expenses	0	0	0	0	0
Dividends paid	0	0	0	0	0
Other financing cash flows	(4,567)	(6,427)	(7,888)	(9,141)	(10,379)
<b>Cash flow from financing</b>	<b>(823)</b>	<b>(6,873)</b>	<b>(8,189)</b>	<b>(9,341)</b>	<b>(10,379)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>434</b>	<b>2,015</b>	<b>4,575</b>	<b>7,354</b>	<b>6,275</b>
<b>Closing cash &amp; cash eq.</b>	<b>20,043</b>	<b>24,342</b>	<b>28,917</b>	<b>36,270</b>	<b>42,546</b>

### Per Share

Y/E 31 Mar (Rs)	FY22A	FY23A	FY24E	FY25E	FY26E
Reported EPS	33.0	44.3	51.7	60.0	68.1
Adjusted EPS	28.2	44.8	51.7	60.0	68.1
Dividend per share	18.5	25.0	28.5	33.0	37.4
Book value per share	185.6	207.7	231.0	258.0	288.6

### Valuations Ratios

Y/E 31 Mar (x)	FY22A	FY23A	FY24E	FY25E	FY26E
EV/Sales	7.8	6.3	5.7	5.1	4.6
EV/EBITDA	55.7	39.4	35.4	31.4	28.5
Adjusted P/E	60.3	37.9	32.8	28.3	25.0
P/BV	9.2	8.2	7.4	6.6	5.9

### DuPont Analysis

Y/E 31 Mar (%)	FY22A	FY23A	FY24E	FY25E	FY26E
Tax burden (Net profit/PBT)	81.1	88.9	90.6	91.2	92.4
Interest burden (PBT/EBIT)	131.5	126.4	126.8	126.5	126.0
EBIT margin (EBIT/Revenue)	11.9	14.2	14.3	14.7	14.8
Asset turnover (Rev./Avg TA)	94.4	103.4	101.0	98.6	98.7
Leverage (Avg TA/Avg Equity)	1.3	1.4	1.4	1.5	1.5
Adjusted ROAE	16.0	22.8	23.6	24.5	24.9

### Ratio Analysis

Y/E 31 Mar	FY22A	FY23A	FY24E	FY25E	FY26E
<b>YoY growth (%)</b>					
Revenue	41.5	25.9	12.1	12.1	11.9
EBITDA	43.5	43.7	12.2	13.9	11.5
Adjusted EPS	25.5	59.0	15.4	15.9	13.5
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	14.1	16.1	16.1	16.3	16.3
EBIT margin	11.9	14.2	14.3	14.7	14.8
Adjusted profit margin	12.7	16.0	16.5	17.0	17.3
Adjusted ROAE	16.0	22.8	23.6	24.5	24.9
ROCE	13.6	18.3	18.6	19.2	19.3
<b>Working capital days (days)</b>					
Receivables	74	75	82	80	80
Inventory	44	42	42	40	40
Payables	59	54	62	65	65
<b>Ratios (x)</b>					
Gross asset turnover	1.8	2.1	2.3	2.4	2.6
Current ratio	2.5	2.7	2.4	2.5	2.6
Net interest coverage ratio	60.2	68.1	65.0	96.0	108.0
Adjusted debt/equity	(0.3)	(0.4)	(0.4)	(0.5)	(0.5)

Source: Company, BOBCAPS Research | Note: TA = Total Assets

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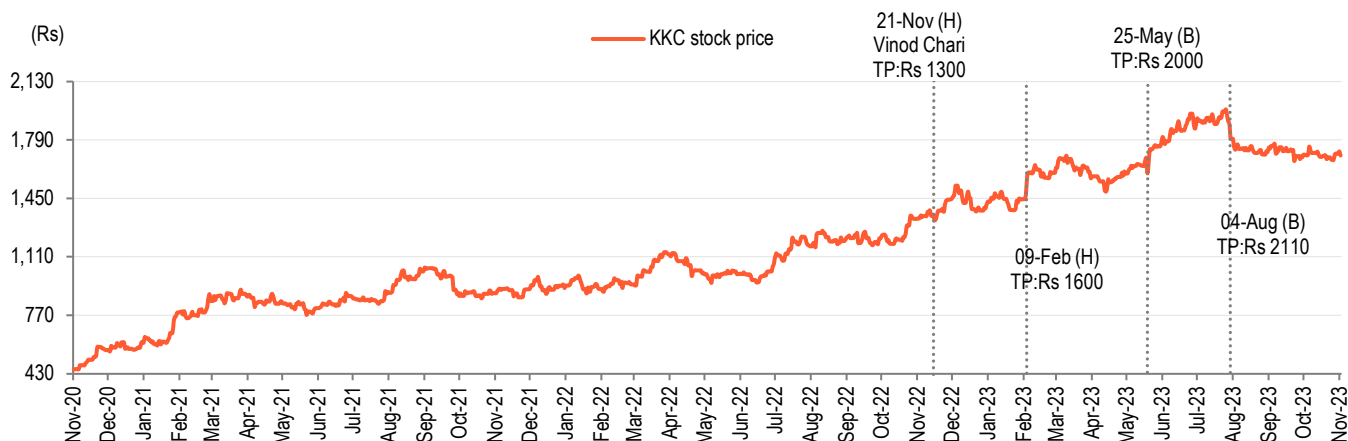
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- BUY** – Expected return >+15%
- HOLD** – Expected return from -6% to +15%
- SELL** – Expected return <-6%

**Note:** Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

### Ratings and Target Price (3-year history): CUMMINS INDIA (KCC IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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