

HOLD

TP: Rs 1,600 | ▲ 1%

CUMMINS INDIA

| Capital Goods

| 09 February 2023

Robust quarter; positives in the price

- Q3 strong with revenue up 25% YoY despite supply chain constraints, as infrastructure-led demand improved; exports grew 23%
- Generator business guided to deliver sustainable long-term growth post absorption of CPCB4-related price hikes
- We raise FY23-FY25 EPS 4-12% and reset to a 35x P/E (vs. 30x) for a new TP of Rs 1,600 (vs. Rs 1,300); retain HOLD as positives priced in

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Strong Q3: Despite supply chain constraints, KKC achieved revenue growth of 25% YoY in Q3FY23 to Rs 21.9bn (Rs 21.1bn est.), thanks to robust demand in both domestic and export markets which grew by 27% and 23% YoY respectively. The infrastructure segment, which had been lagging, showed significant improvement, and exports continued to hold up. The company’s EBITDA margin remained robust at 18.9%, up 330bps YoY, due to healthy pricing power. This translated into higher net profits of Rs 4.1bn (Rs 2.8bn est.), up 66% YoY.

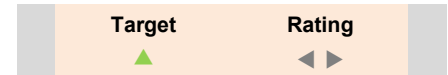
Exports a bright spot: Despite past management commentary on potential headwinds, exports have held up well, rising 23% YoY (+2% QoQ) to Rs 5.4bn in Q3. Notably, sales to Europe – an area where management had previously expressed a cautious outlook – improved by 39% QoQ to reach Rs 970mn.

Positive long-term outlook: KKC expects the implementation of CPCB4 norms in July’23 to drive price hikes of 30-50% on its power generation equipment. While these steep hikes could cause a temporary demand blip for one or two quarters, the company expects to return to a sustainable growth trajectory (at twice the pace of GDP) for the next 2-3 years underpinned by demand from data centres, infrastructure, real estate and hospitality. We note that KKC has recently launched fuel-agnostic engines which addresses a key concern for the power-gen business.

Supply chain still constrained: Supply chain troubles continue to plague the company, marked by shortages of key electronics and components. Management indicated that any uptick in demand from China could further aggravate the situation.

Retain HOLD: Given guidance of sustained long-term growth in the domestic market and with exports holding strong, we raise FY23/FY24/FY25 EPS estimates by 12%/4%/4% and hike our target P/E multiple to 35x from 30x – a 30% premium to the 5Y average. Upon rolling valuations forward to Dec’24E, we reset to a higher TP of Rs 1,600 (vs. Rs 1,300). However, we retain our HOLD rating as the stock has run up 14% over the past 2 months, pricing in the positives and capping upside potential at just 1%.

Key changes



Ticker/Price	KKC IN/Rs 1,578
Market cap	US\$ 5.3bn
Free float	49%
3M ADV	US\$ 11.6mn
52wk high/low	Rs 1,618/Rs 909
Promoter/FPI/DII	51%/10%/25%

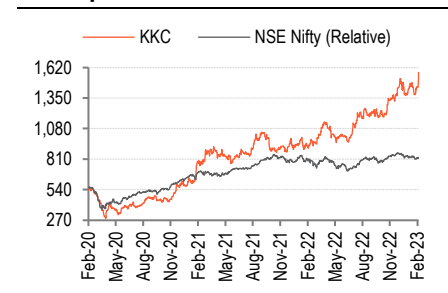
Source: NSE | Price as of 9 Feb 2023

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	61,709	72,950	81,549
EBITDA (Rs mn)	8,681	11,408	11,611
Adj. net profit (Rs mn)	7,814	10,690	11,347
Adj. EPS (Rs)	28.2	38.6	40.9
Consensus EPS (Rs)	28.2	34.5	40.7
Adj. ROAE (%)	16.0	19.9	19.3
Adj. P/E (x)	56.0	40.9	38.6
EV/EBITDA (x)	51.9	40.1	39.6
Adj. EPS growth (%)	25.5	36.8	6.1

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Quarterly performance (Consolidated)

(Rs mn)	Q3FY23E	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
Revenue	21,850	17,437	25.3	19,573	11.6
EBITDA	4,131	2,725	51.6	2,898	42.5
EBITDA Margin (%)	18.9	15.6	330bps	14.8	410bps
Depreciation	347	353	-	356	-
Interest	28	29	-	47	-
Other Income	849	610	-	690	-
PBT	4,604	2,955	55.8	3,184	-
Tax	1,189	786	-	838	-
Adjusted PAT	4,138	2,495	65.9	2,673	54.8
Exceptional item	-	-	-	-	-
Reported PAT	4,138	2,495	65.9	2,673	54.8
Adj. PAT Margin (%)	18.9	14.3	460bps	13.7	530bps
EPS (Rs)	14.9	9.0	-	9.6	-

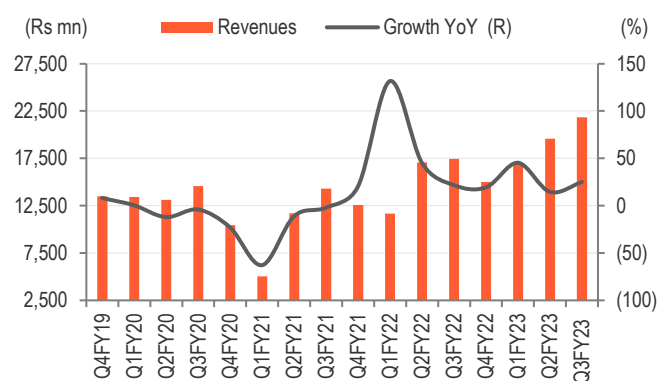
Source: Company, BOBCAPS Research

Fig 2 – Actual vs. Estimates

(Rs mn)	Actual	Estimates	Variance (%)
Revenue	21,850	21,102	3.5
EBITDA	4,131	3,060	35.0
EBITDA Margin (%)	18.9	14.5	440bps
Adj. PAT	4,138	2,846	45.4

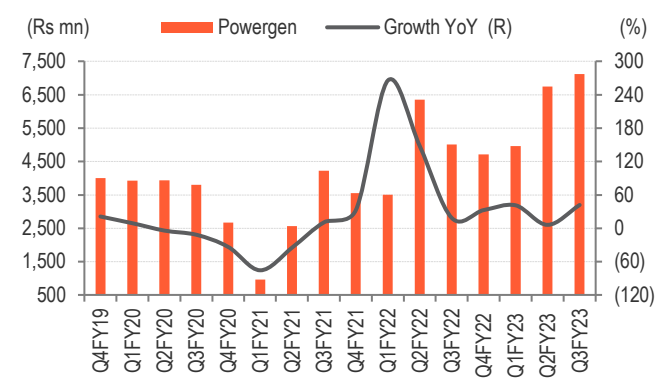
Source: Company, BOBCAPS Research

Fig 3 – Revenue trend



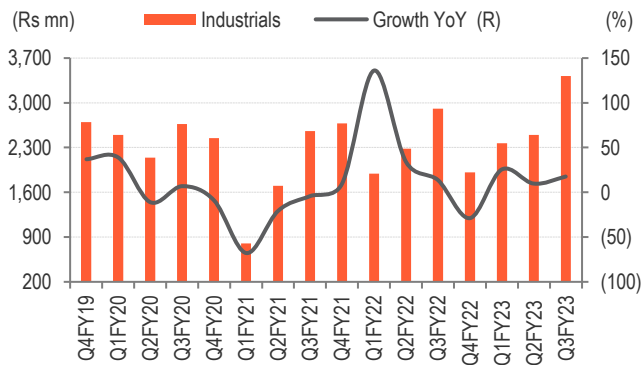
Source: Company, BOBCAPS Research

Fig 4 – Powergen segment revenue



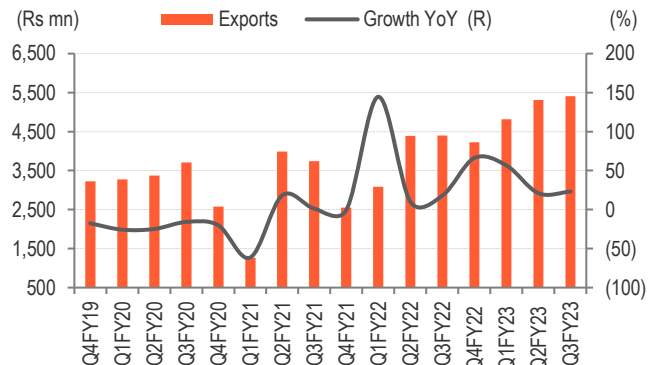
Source: Company, BOBCAPS Research

Fig 5 – Industrial segment revenues



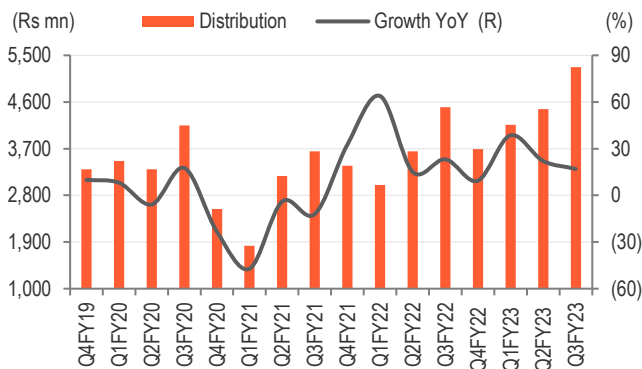
Source: Company, BOBCAPS Research

Fig 6 – Exports



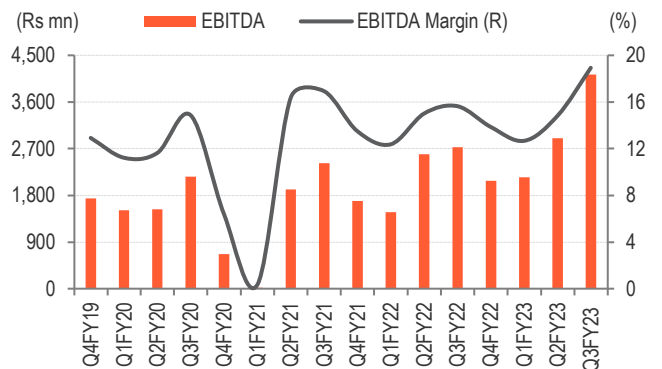
Source: Company, BOBCAPS Research

Fig 7 – Distribution segment revenue



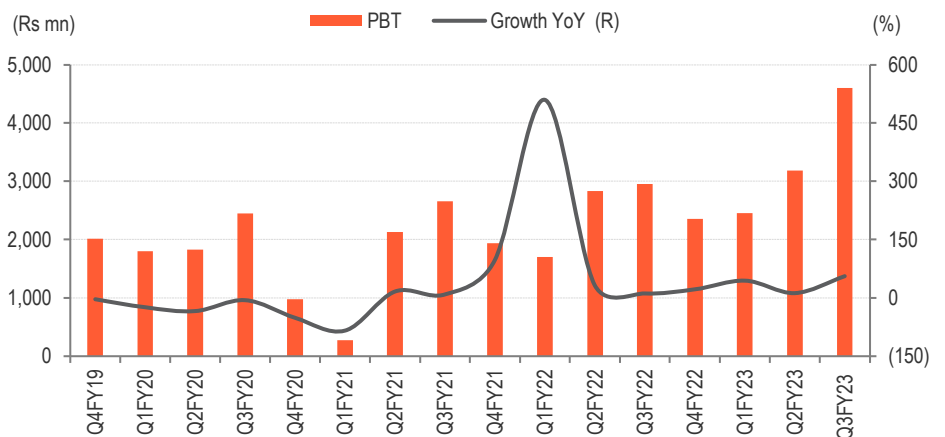
Source: Company, BOBCAPS Research

Fig 8 – EBITDA trend



Source: Company, BOBCAPS Research

Fig 9 – PBT trend



Source: Company, BOBCAPS Research

Earnings call highlights

- KKC's management is confident of delivering sustained growth over the next 2-3 years given rising demand for data centres due to 5G rollout and increased digital media consumption, together with demand from the manufacturing, infrastructure, real estate, and hospitality industries.
- In railways, KKC mainly caters to the rail infrastructure and hotel load infrastructure segments.
- Per management, the marine and construction industries are showing increased demand for KKC's industrial products in the export market. However, the company is facing difficulty supplying these products due to persistent supply chain constraints.
- KKC estimates the CPCB4-related price increase for its product portfolio to be in the range of 30-50%. Management anticipates pre-buying from next quarter, ahead of the norms effective Jul'23.
- GAIL has placed an order for a Proton Exchange Membrane (PEM) Electrolyser with KKC's parent Cummins Inc. KKC is currently evaluating the services and support required for installation.
- Higher growth in the distribution business was attributed to improved product availability, the expansion of distribution channels, and improved reach.
- According to management, the energy mix is likely to shift significantly over the next few decades – to 15% alternative fuels such as CNG, LNG, biofuel and blended ethanol fuel (and 85% diesel) by 2030; to 30% alternatives, including hydrogen, between 2030-40; and an equal split between the two during 2040-50.
- Management indicated that next year's capex will be related to technology investments required to meet CPCB4 regulations. The company's focus will be on growing through new product development, investment in new technologies, and inorganic opportunities.

Valuation methodology

Given guidance of sustained long-term growth in the domestic market and with exports holding strong, we raise FY23/FY24/FY25 EPS estimates by 12%/4%/4% and hike our target P/E multiple to 35x from 30x – a 30% premium to the stock's five-year average. Upon rolling valuations forward to Dec'24E, we reset to a higher TP of Rs 1,600 (vs. Rs 1,300). However, we retain our HOLD rating as the stock has run up 14% over the past 2 months, pricing in the positives and capping upside potential at just 1%

Fig 10 – Revised estimates

(Rs mn)	New			Old			Change (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Sales	72,950	81,549	91,080	72,950	81,549	91,080	0.0	0.0	0.0
EBITDA	11,408	11,611	13,268	10,141	11,425	13,064	12.5	1.6	1.6
PAT	10,690	11,347	13,065	9,564	10,898	12,572	11.8	4.1	3.9
EPS (Rs)	38.6	40.9	47.1	34.5	39.3	45.4	11.8	4.1	3.9
EBITDA Margin (%)	15.6	14.2	14.6	13.9	14.0	14.3	170bps	20bps	20bps

Source: Company, BOBCAPS Research

Key risks

Key risks to our estimates:

Downside risk

- Prolonged supply chain constraints

Upside risk

- Above-expected pick-up in demand from the infrastructure sector

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
ABB India	ABB IN	8.0	3,128	3,100	HOLD
AIA Engineering	AIAE IN	3.2	2,770	3,300	BUY
Cummins India	KKC IN	5.3	1,578	1,600	HOLD
Hitachi Energy	POWERIND IN	1.5	3,002	3,500	BUY
KEC International	KECI IN	1.4	464	500	HOLD
Larsen & Toubro	LT IN	36.5	2,147	2,440	BUY
Siemens India	SIEM IN	13.4	3,104	3,500	BUY
Thermax	TMX IN	3.1	2,119	2,100	HOLD

Source: BOBCAPS Research, NSE | Price as of 9 Feb 2023

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Total revenue	43,601	61,709	72,950	81,549	91,080
EBITDA	6,051	8,681	11,408	11,611	13,268
Depreciation	1,272	1,356	1,313	1,355	1,393
EBIT	4,779	7,324	10,094	10,257	11,875
Net interest inc./(exp.)	168	122	105	112	105
Other inc./(exp.)	2,382	2,432	3,040	3,344	3,678
Exceptional items	0	0	0	0	0
EBT	6,993	9,635	13,029	13,488	15,448
Income taxes	1,900	2,732	3,388	3,399	3,893
Extraordinary items	(126)	(1,324)	143	0	0
Min. int./Inc. from assoc.	1,131	912	1,048	1,258	1,509
Reported net profit	6,350	9,137	10,547	11,347	13,065
Adjustments	(126)	(1,324)	143	0	0
Adjusted net profit	6,224	7,814	10,690	11,347	13,065

Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Accounts payables	7,310	9,997	11,992	13,852	16,220
Other current liabilities	3,574	3,502	6,595	7,820	8,734
Provisions	0	0	0	0	0
Debt funds	202	3,947	3,500	3,200	3,000
Other liabilities	1,962	2,224	2,629	2,939	3,283
Equity capital	554	554	554	554	554
Reserves & surplus	45,959	50,895	55,641	60,748	66,627
Shareholders' fund	46,514	51,450	56,196	61,302	67,181
Total liab. and equities	59,562	71,120	80,912	89,113	98,418
Cash and cash eq.	12,920	20,043	21,733	26,314	31,883
Accounts receivables	10,881	12,581	16,988	18,321	19,963
Inventories	5,642	7,375	8,594	9,384	9,981
Other current assets	3,113	4,135	4,997	5,139	5,240
Investments	2,724	3,255	3,847	4,301	4,804
Net fixed assets	22,367	21,891	22,578	23,223	23,830
CWIP	794	804	950	1,062	1,186
Intangible assets	0	0	0	0	0
Deferred tax assets, net	0	0	0	0	0
Other assets	1,121	1,037	1,226	1,370	1,531
Total assets	59,562	71,120	80,912	89,113	98,418

Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Cash flow from operations	7,887	7,119	10,460	13,522	15,398
Capital expenditures	(758)	706	(2,000)	(2,000)	(2,000)
Change in investments	(75)	(7,597)	(739)	(566)	(627)
Other investing cash flows	988	1,029	216	165	183
Cash flow from investing	155	(5,863)	(2,523)	(2,400)	(2,443)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(4,691)	3,745	(447)	(300)	(200)
Interest expenses	0	0	0	0	0
Dividends paid	0	0	0	0	0
Other financing cash flows	(4,041)	(4,567)	(5,801)	(6,241)	(7,186)
Cash flow from financing	(8,732)	(823)	(6,248)	(6,541)	(7,386)
Chg in cash & cash eq.	(690)	434	1,690	4,581	5,569
Closing cash & cash eq.	12,920	20,043	21,733	26,314	31,883

Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23E	FY24E	FY25E
Reported EPS	22.9	33.0	38.0	40.9	47.1
Adjusted EPS	22.5	28.2	38.6	40.9	47.1
Dividend per share	15.0	18.5	20.9	22.5	25.9
Book value per share	167.8	185.6	202.7	221.1	242.4

Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23E	FY24E	FY25E
EV/Sales	10.3	7.3	6.3	5.6	5.1
EV/EBITDA	74.4	51.9	40.1	39.6	35.0
Adjusted P/E	70.3	56.0	40.9	38.6	33.5
P/BV	9.4	8.5	7.8	7.1	6.5

DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23E	FY24E	FY25E
Tax burden (Net profit/PBT)	89.0	81.1	82.0	84.1	84.6
Interest burden (PBT/EBIT)	146.3	131.5	129.1	131.5	130.1
EBIT margin (EBIT/Revenue)	11.0	11.9	13.8	12.6	13.0
Asset turnover (Rev./Avg TA)	71.8	94.4	96.0	95.9	97.1
Leverage (Avg TA/Avg Equity)	1.3	1.3	1.4	1.4	1.5
Adjusted ROAE	13.8	16.0	19.9	19.3	20.3

Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23E	FY24E	FY25E
YoY growth (%)					
Revenue	(16.0)	41.5	18.2	11.8	11.7
EBITDA	2.7	43.5	31.4	1.8	14.3
Adjusted EPS	(14.2)	25.5	36.8	6.1	15.1
Profitability & Return ratios (%)					
EBITDA margin	13.9	14.1	15.6	14.2	14.6
EBIT margin	11.0	11.9	13.8	12.6	13.0
Adjusted profit margin	14.3	12.7	14.7	13.9	14.3
Adjusted ROAE	13.8	16.0	19.9	19.3	20.3
ROCE	9.9	13.6	17.2	16.0	16.9
Working capital days (days)					
Receivables	91	74	85	82	80
Inventory	47	44	43	42	40
Payables	61	59	60	62	65
Ratios (x)					
Gross asset turnover	1.3	1.8	2.0	2.1	2.2
Current ratio	2.9	2.5	2.4	2.4	2.4
Net interest coverage ratio	28.5	60.2	96.1	91.6	113.1
Adjusted debt/equity	(0.3)	(0.3)	(0.3)	(0.4)	(0.4)

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

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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 (KKC IN)



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

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