RESULT REVIEW

BUY
TP: Rs 2,900 | ⮝ 21%

CUMMINS INDIA | Capital Goods | 08 February 2024

Powering ahead; maintain BUY

- **Strong Q3 topline growth of 16% YoY despite lower exports, along with 330bps gross margin expansion as input costs eased**
- **Long-range growth and margin outlook intact; full migration to CPCB-IV+ norms in FY25 a key margin lever**
- **TP revised to Rs 2,900 (vs. Rs 2,200) as we raise FY24-FY26 EPS 9-13% and hike target P/E to 40x (vs. 35x); maintain BUY**

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Strong quarter: KKC posted strong Q3FY24 topline growth of 16% YoY to Rs 25.4bn, with gross and EBITDA margin expansion of 330bps and 240bps YoY to 37.4% and 21.3% respectively. Margin gains came on the back of easing input costs, partly offset by higher other expenses. Exports fell 40% YoY on global uncertainty, but management remains optimistic that domestic demand will fuel growth led by its power genset (powergen) business. The company saw strong traction in the data centre, commercial and residential realty, infrastructure and manufacturing sectors.

Exports to improve: KKC's exports declined 40% YoY due to soft demand from its major markets. The quarter also saw year-end inventory correction in end user markets, which led to lower sales. Management believes this correction has bottomed out and expects exports to revive in coming quarters if the global demand climate improves.

CPCB-IV+ demand continues to surprise positively: KKC observed above-expected demand for CPCB-IV+ engines during Q3. This continues the trend seen in Q2 when demand bettered the company's own estimate for the new engines.

Long-term outlook intact; new engines to enhance margins: KKC reiterated its FY25 revenue growth guidance of 2x GDP growth, accompanied by 100bps operating margin improvement each year, which we believe will be led by the new CPCB-IV+ engines. Although these engines currently earn better realisations than CPCB-II products, the price benefits are not wholly reflected as less than 25% of KKC's capacity is being utilised for these engines. Better pricing clarity will emerge once the market fully transitions to the new engines in Jul'24, which we believe will hold the key to achieving targeted margin accretion in FY25.

Maintain BUY: In our view, KKC is best positioned to manage the ongoing transition to new emission norms and carries a robust outlook going into FY25 when full transition will occur. This leads us to raise FY24/FY25/FY26 earnings estimates by 13%/9%/12% and increase our target P/E multiple to 40x (from 35x), a 25% premium to the 3Y mean. On rolling valuations to Dec'25E, our TP rises to Rs 2,900 (vs. Rs 2,200). BUY.

Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	KKC IN/Rs 2,400
Market cap	US$ 8.1bn
Free float	49%
3M ADV	US$ 13.3mn
52wk high/low	Rs 2,422/Rs 1,445
Promoter/FPI/DII	51%/10%/25%

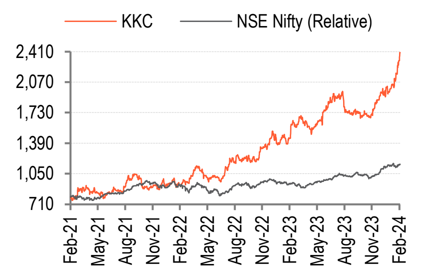
Source: NSE | Price as of 7 Feb 2024

Key financials

Y/E 31 Mar	FY23A	FY24E	FY25E
Total revenue (Rs mn)	77,721	91,010	1,05,479
EBITDA (Rs mn)	12,477	16,826	18,502
Adj. net profit (Rs mn)	12,425	16,230	18,093
Adj. EPS (Rs)	44.8	58.5	65.3
Consensus EPS (Rs)	44.8	48.4	56.8
Adj. ROAE (%)	22.8	26.5	26.2
Adj. P/E (x)	53.6	41.0	36.8
EV/EBITDA (x)	54.9	41.0	37.5
Adj. EPS growth (%)	59.0	30.6	11.5

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



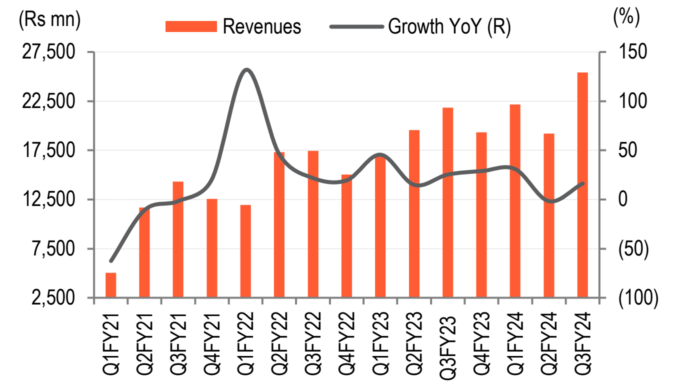
Source: NSE

Fig 1 – Quarterly performance

Consolidated (Rs mn)	Q3FY24	Q3FY23	YoY (%)	Q2FY24	QoQ (%)	9MFY24	9MFY23	YoY (%)
Revenue	25,414	21,850	16.3	19,216	32.3	66,812	58,382	14.4
EBITDA	5,425	4,131	31.3	3,462	56.7	12,312	9,176	34.2
EBITDA Margin (%)	21.3	18.9	240bps	18.0	330bps	18.4	15.7	270bps
Depreciation	423	347		383		1,168	1,044	
Interest	65	28		68		211	96	
Other Income	994	849		898		2,782	2,207	
PBT	5,932	4,604	28.8	3,909		13,714	10,243	33.9
Tax	1,479	1,189		996		3,466	2,677	
Adjusted PAT	5,006	4,138	21.0	3,291	52.1	10,248	8,935	14.7
Exceptional item	17	0		0		17	143	
Reported PAT	4,989	4,138	20.6	3,291	51.6	11,817	8,792	34.4
Adj. PAT Margin (%)	19.7	18.9	80bps	17.1	260bps	15.3	15.3	0bps
EPS (Rs)	18.1	14.9		11.9	52.1	42.7	32.2	

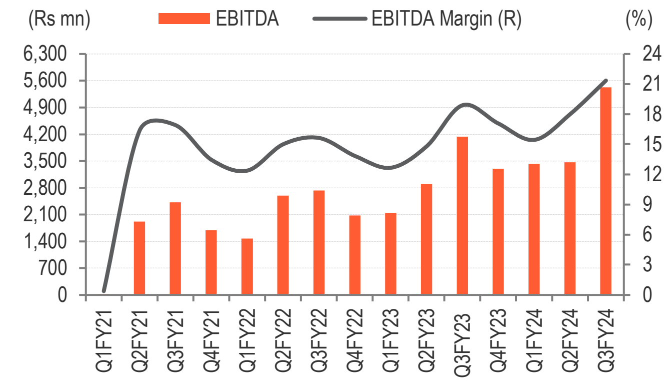
Source: Company, BOBCAPS Research

Fig 2 – Revenue trend



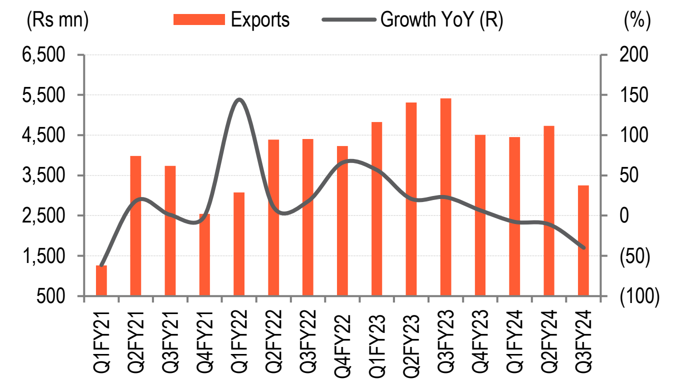
Source: Company, BOBCAPS Research

Fig 3 – EBITDA trend



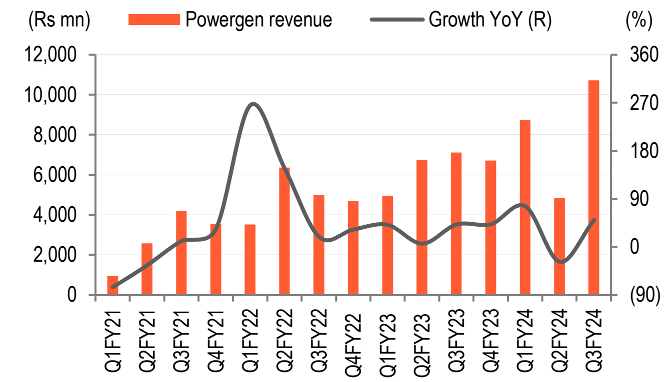
Source: Company, BOBCAPS Research

Fig 4 – Export trend



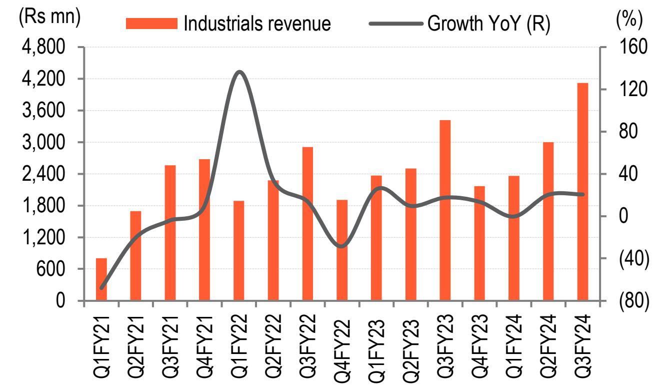
Source: Company, BOBCAPS Research

Fig 5 – Powergen segment performance



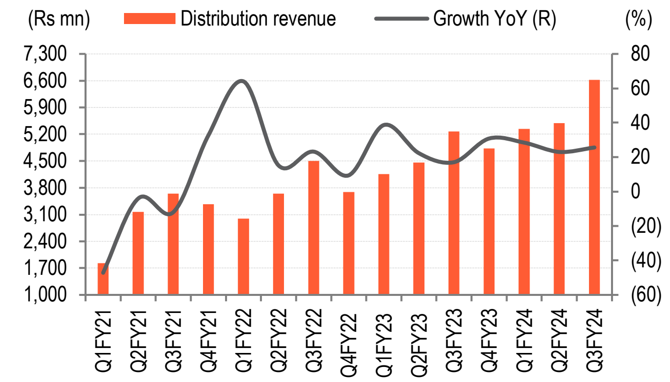
Source: Company, BOBCAPS Research

Fig 6 – Industrials segment performance



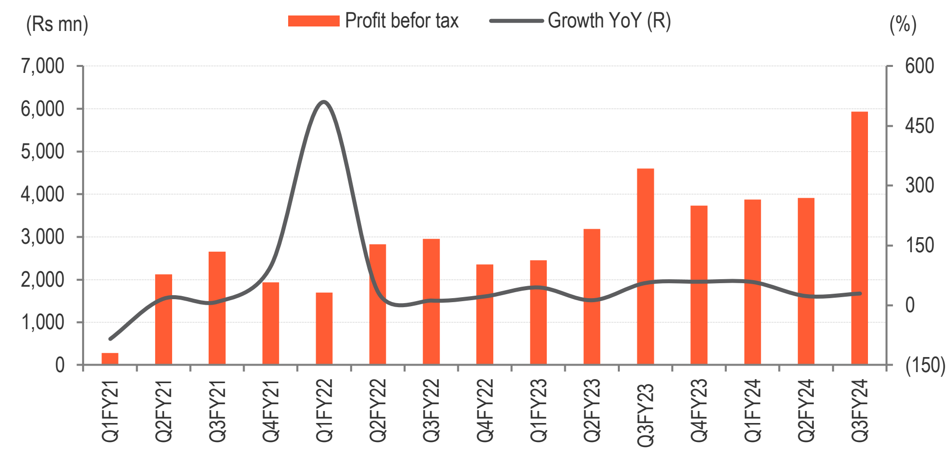
Source: Company, BOBCAPS Research

Fig 7 – Distribution segment performance



Source: Company, BOBCAPS Research

Fig 8 – Profit before tax



Source: Company, BOBCAPS Research

Earnings call highlights

Powergen business

- **Performance:** KKC's powergen segment grew 29% YoY in 9MFY24 to Rs 24.3bn, with volume growth in excess of 20%. Management expects demand globally to be driven by internal combustion engines in the short and medium term.
- **Revenue split:** The segmental topline of Rs 10.7bn can be broken down into Rs 7.7bn for high-horsepower products, Rs 1.3bn for heavy-duty, Rs 1.3bn for mid-range, and Rs 430mn for low-horsepower products. The company has added market share in the high-horsepower segment and sees immense opportunities in the low-power segment, which is one of the largest product categories in the market.
- **Data centres:** Delivery of a large data centre order during the quarter, which management had earlier anticipated would end by Q1FY25, was a major catalyst for growth in the segment. Per KKC, this was one of the biggest data centre orders in the country so far. Management expects the business to remain lumpy in nature, with an opportunity size of Rs 5bn per year for KKC.

- **CPCB-IV+:** KKC has sold 3,000 CPCB-IV gensets during Q3FY24. In general, these offer higher realisations for the company than CPCB-II (older emission-standard) products. Currently, CPCB-IV products account for less than 25% of total genset sales for KKC and use less than 25% of its manufacturing capacity. Hence, management expects to get a clearer picture of the cost structure as the product category ramps up.

- **CPCB-II:** CPCB-IV products are expected to gain traction during the upcoming April-June quarter as the sale of CPCB-II gensets has been disallowed after Jun'24. KKC has been selling the new engines in some regions of India where the regulation has already been implemented but expects older CPCB-II products to continue to dominate the powergen business in Q4FY24.

- **Competition:** CPCB-IV products are facing some competition from global players who are bringing in products through France, as margin thresholds for these players may be different from those set by KKC. Nevertheless, the company is holding on to its pricing strategy in the current market scenario.

Exports

- **Global markets:** Uncertainty roiling global markets continued to impact KKC's exports, with sales declining in the big demand centres of Europe (-59% YoY), Asia Pacific (-20%), Latin America (-20%), the Middle East (-53%), Africa (-41%), and the US (-47%) due to softer demand.

- **Guidance:** Management believes that the company's performance in export markets has bottomed out, as Q3 is generally a quarter for inventory correction overseas. While recovery in China is still some way off and demand remains weak in Europe, KKC expects exports to revive in coming quarters if the global demand climate improves.

- **Red Sea conflict:** The Red Sea conflict has introduced supply chain disruptions and longer lead times for KKC's operations, with delays in the range of 2-4 weeks. Management expects to bring this issue under control during Q4FY24. In terms of logistics cost, management indicated only a fractional increase due to the conflict.

Other highlights

- **Profitability:** KKC expects to improve EBITDA margins by ~100bps per year from FY25. However, the costs of key commodities such as copper and iron are inching up, so management expects some benefits of the weaker commodity cycle to reverse in the short term.

- **Capacity utilisation and capex:** The company achieved 60-70% utilisation during Q3FY24. Management does not foresee any major capex in the short-to-medium term and is confident of 2x sales potential with the current manufacturing capacity.

- **Rail:** KKC has relatively underperformed in its rail business, generating sales of Rs 2.3bn in FY24 YTD.

- **Channel partners:** Channel partners such as Jakson are increasing their manufacturing capacities. These channel partners are clients exclusively of KKC, and any expansion at their end will only benefit the company going forward.

Valuation methodology

In our view, KKC is best positioned to manage the ongoing transition to new emission norms. Adoption of the new-rated engines has surprised positively over the last two quarters, with an equally robust outlook going into FY25 when full transition will occur. This leads us to raise our FY24/FY25/FY26 earnings estimates by 13%/9%/12% and increase our target P/E multiple to 40x (from 35x), a 25% premium to the stock's three-year mean. On rolling valuations to Dec'25E, our TP rises to Rs 2,900 (vs. Rs 2,200). Maintain BUY.

Fig 9 – Revised estimates

Particulars (Rs mn)	New			Old			Change (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Sales	91,010	1,05,479	1,21,303	87,152	97,675	1,09,319	4.4	8.0	11.0
EBITDA	16,826	18,502	21,846	14,000	15,944	17,785	20.2	16.0	22.8
PAT	16,230	18,093	21,135	14,342	16,621	18,871	13.2	8.9	12.0
EPS (Rs)	58.5	65.3	76.2	51.7	60.0	68.1	13.2	8.9	12.0
EBITDA Margin (%)	18.5	17.5	18.0	16.1	16.3	16.3	240bps	120bps	170bps

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	11.8	4,575	4,700	HOLD
AIA Engineering	AIAE IN	4.7	4,129	4,000	HOLD
Cummins India	KKC IN	8.1	2,400	2,900	BUY
Hitachi Energy	POWERIND IN	3.2	6,253	4,200	SELL
KEC International	KECI IN	2.0	653	700	HOLD
Larsen & Toubro	LT IN	58.0	3,395	4,200	BUY
Thermax	TMX IN	4.8	3,285	3,000	HOLD

Source: BOBCAPS Research, NSE | Price as of 7 Feb 2024

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Total revenue	**61,709**	**77,721**	**91,010**	**1,05,479**	**1,21,303**
EBITDA	8,681	12,477	16,826	18,502	21,846
Depreciation	1,356	1,420	1,603	1,631	1,658
EBIT	7,324	11,057	15,223	16,871	20,188
Net interest inc./(exp.)	122	162	282	189	189
Other inc./(exp.)	2,432	3,082	3,698	4,142	4,556
Exceptional items	0	0	0	0	0
EBT	9,635	13,976	18,639	20,824	24,555
Income taxes	2,732	3,631	4,697	5,248	6,188
Extraordinary items	(1,324)	143	0	0	0
Min. int./Inc. from assoc.	912	2,080	2,288	2,517	2,768
Reported net profit	**9,137**	**12,282**	**16,230**	**18,093**	**21,135**
Adjustments	(1,324)	143	0	0	0
Adjusted net profit	**7,814**	**12,425**	**16,230**	**18,093**	**21,135**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Accounts payables	9,997	11,539	15,459	18,784	21,602
Other current liabilities	3,502	3,864	8,727	10,114	11,632
Provisions	0	0	0	0	0
Debt funds	3,947	3,500	3,200	3,000	3,000
Other liabilities	2,224	2,701	3,162	3,665	4,215
Equity capital	554	554	554	554	554
Reserves & surplus	50,895	57,028	64,332	72,473	81,984
Shareholders' fund	51,450	57,582	64,886	73,028	82,538
Total liab. and equities	**71,120**	**79,186**	**95,434**	**1,08,591**	**1,22,987**
Cash and cash eq.	20,043	24,342	29,166	36,754	43,484
Accounts receivables	12,581	15,971	20,446	23,119	26,587
Inventories	7,375	9,037	10,472	11,559	13,294
Other current assets	4,135	1,635	5,735	6,069	6,979
Investments	3,255	4,218	4,939	5,724	6,583
Net fixed assets	21,891	22,258	22,656	23,024	23,367
CWIP	804	413	484	560	644
Intangible assets	0	0	0	0	0
Deferred tax assets, net	0	0	0	0	0
Other assets	1,037	1,313	1,538	1,782	2,049
Total assets	**71,120**	**79,186**	**95,434**	**1,08,591**	**1,22,987**

Cash Flows

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Cash flow from operations	**7,119**	**8,197**	**16,606**	**20,343**	**21,015**
Capital expenditures	706	(1,543)	(2,000)	(2,000)	(2,000)
Change in investments	(7,597)	1,858	(792)	(862)	(943)
Other investing cash flows	1,029	376	237	258	282
Cash flow from investing	**(5,863)**	**691**	**(2,555)**	**(2,604)**	**(2,660)**
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)	(8,927)	(9,951)	(11,624)
Cash flow from financing	**(823)**	**(6,873)**	**(9,227)**	**(10,151)**	**(11,624)**
Chg in cash & cash eq.	**434**	**2,015**	**4,824**	**7,588**	**6,731**
Closing cash & cash eq.	**20,043**	**24,342**	**29,166**	**36,754**	**43,484**

Per Share

Y/E 31 Mar (Rs)	FY22A	FY23A	FY24E	FY25E	FY26E
Reported EPS	33.0	44.3	58.5	65.3	76.2
Adjusted EPS	28.2	44.8	58.5	65.3	76.2
Dividend per share	18.5	25.0	32.2	35.9	41.9
Book value per share	185.6	207.7	234.1	263.4	297.8

Valuations Ratios

Y/E 31 Mar (x)	FY22A	FY23A	FY24E	FY25E	FY26E
EV/Sales	11.0	8.8	7.6	6.6	5.8
EV/EBITDA	78.1	54.9	41.0	37.5	32.1
Adjusted P/E	85.1	53.6	41.0	36.8	31.5
P/BV	12.9	11.6	10.3	9.1	8.1

DuPont Analysis

Y/E 31 Mar (%)	FY22A	FY23A	FY24E	FY25E	FY26E
Tax burden (Net profit/PBT)	81.1	88.9	87.1	86.9	86.1
Interest burden (PBT/EBIT)	131.5	126.4	122.4	123.4	121.6
EBIT margin (EBIT/Revenue)	11.9	14.2	16.7	16.0	16.6
Asset turnover (Rev./Avg TA)	94.4	103.4	104.2	103.4	104.8
Leverage (Avg TA/Avg Equity)	1.3	1.4	1.4	1.5	1.5
Adjusted ROAE	16.0	22.8	26.5	26.2	27.2

Ratio Analysis

Y/E 31 Mar	FY22A	FY23A	FY24E	FY25E	FY26E
YoY growth (%)					
Revenue	41.5	25.9	17.1	15.9	15.0
EBITDA	43.5	43.7	34.9	10.0	18.1
Adjusted EPS	25.5	59.0	30.6	11.5	16.8
Profitability & Return ratios (%)					
EBITDA margin	14.1	16.1	18.5	17.5	18.0
EBIT margin	11.9	14.2	16.7	16.0	16.6
Adjusted profit margin	12.7	16.0	17.8	17.2	17.4
Adjusted ROAE	16.0	22.8	26.5	26.2	27.2
ROCE	13.6	18.3	22.4	22.0	23.3
Working capital days (days)					
Receivables	74	75	82	80	80
Inventory	44	42	42	40	40
Payables	59	54	62	65	65
Ratios (x)					
Gross asset turnover	1.8	2.1	2.4	2.6	2.8
Current ratio	2.5	2.7	2.4	2.4	2.5
Net interest coverage ratio	60.2	68.1	54.1	89.3	106.8
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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BUY – Expected return >+15%

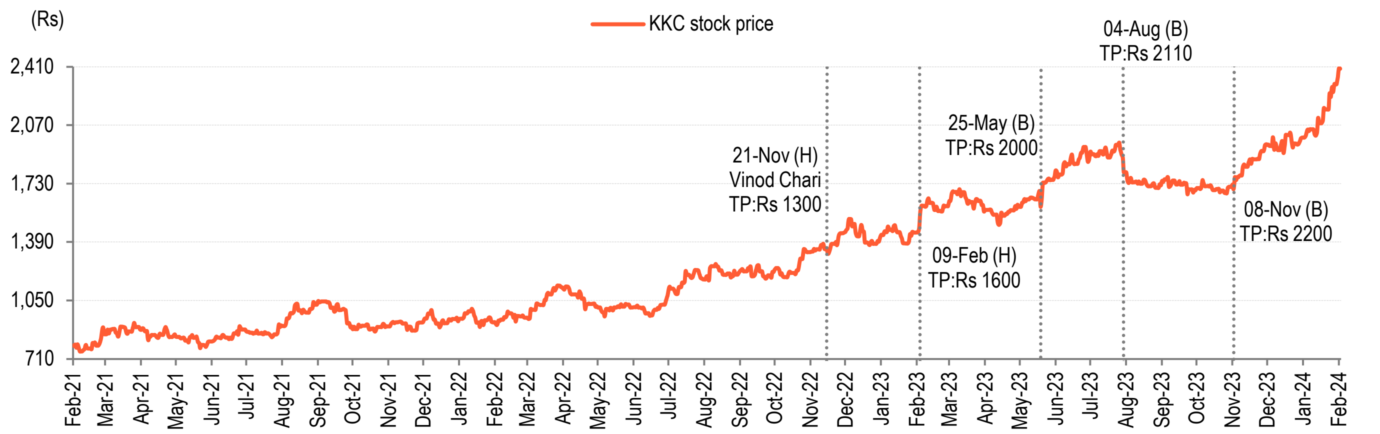
HOLD – Expected return from -6% to +15%

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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