

June 07, 2018

Kunal Sheth
kunalsheth@plindia.com
+91-22-66322257

Shreyans Jain
shreyansjain@plindia.com
+91-22-66322256

Rating	BUY
Price	Rs681
Target Price	Rs857
Implied Upside	25.8%
Sensex	35,463
Nifty	10,768

(Prices as on June 07, 2018)

Trading data

Market Cap. (Rs bn)	188.7
Shares o/s (m)	277.2
3M Avg. Daily value (Rs m)	397.1

Major shareholders

Promoters	51.24%
Foreign	14.11%
Domestic Inst.	21.69%
Public & Other	12.96%

Stock Performance

(%)	1M	6M	12M
Absolute	(10.5)	(21.6)	(25.4)
Relative	(11.2)	(29.2)	(38.8)

How we differ from Consensus

EPS (Rs)	PL	Cons.	% Diff.
2019	27.8	28.0	-0.6
2020	30.6	32.2	-5.2

Price Performance (RIC: CUMM.BO, BB: KKC IN)



Source: Bloomberg

We met the management of Cummins India Ltd.(CIL) and came back positive on the medium to long term prospects of the company. Key takeaways from the meet were CIL is focused on driving growth in the core segments, maintaining market share and focus on product improvement/cost cutting initiatives to drive margins.

CIL guided for a CAGR of 9-10% over a 5-year cycle in domestic markets. It aims to garner market share in Indian markets by leveraging its scale, technology leadership and strong distribution network. CIL is also working on new areas like Electrification (battery technology), Renewables (fuel cells), Alternate fuels (gas engines) and advances analytics (Telematics) to prepare for future growth.

CIL guided for a CAGR of 0-5% over a 5-year cycle in export markets. The muted guidance was due to volatility in key exports markets like Middle East and Africa for LHP. Stiff competition in weak market has impacted plans of market share gains in LHP exports.

The management tried to pacify investor concerns by reiterating that CIL will be the entity which will service domestic demand. The decision to manufacture will depend on economic viability based on volumes in the domestic market. CIL also clarified that all its engines have electronic equivalent already available in CIL and hence fears that all electronic engine will be sold through CTIL is unfounded.

We remain positive on KKC, given its strong domestic outlook, gradual likely revival of export markets and strong history of delivering on cost rationalization and healthy cash flows. We have reduced our earnings by 5% for FY20 to factor in lower export guidance. We maintain "BUY" with a revised TP of Rs857 (Previous - Rs928).

Contd...2

Key financials (Y/e March)

	2017	2018	2019E	2020E
Revenues (Rs m)	50,773	50,825	55,960	61,882
Growth (%)	7.5	0.1	10.1	10.6
EBITDA (Rs m)	8,018	7,325	8,282	9,344
PAT (Rs m)	7,346	6,524	7,709	8,475
EPS (Rs)	26.5	23.5	27.8	30.6
Growth (%)	(2.3)	(11.2)	18.2	9.9
Net DPS (Rs)	14.0	15.0	16.7	18.3

Profitability & Valuation

	2017	2018	2019E	2020E
EBITDA margin (%)	15.8	14.4	14.8	15.1
RoE (%)	21.3	16.9	18.8	19.5
RoCE (%)	20.8	16.1	17.8	18.5
EV / sales (x)	3.7	3.7	3.3	3.0
EV / EBITDA (x)	23.7	25.5	22.6	20.1
PE (x)	25.7	28.9	24.5	22.3
P / BV (x)	5.0	4.7	4.5	4.2
Net dividend yield (%)	2.1	2.2	2.5	2.7

Source: Company Data; PL Research

- **Growth in core segments:** KKC targets to grow its core segments by 1) Gaining market share in segments like Construction, Commercial Realty, Hospitality and Data Centres 2) New product innovations like CPCB 3, BS-VI for Future Emission Technologies, Telematics, Electrification, Renewables Alternative Fuels and Advanced Analytics. BS-VI technology to have zero emissions. 3) Content Growth (offering more solutions to a customer instead of just the genset in Railways and Marine)
- **Key Capabilities:** KKC highlighted that it has four key capabilities to address growth concerns – Technological Leadership, Scale advantage due to market share, Best-in-class manufacturing facilities and a Strong customer and a Distribution base.
- **Looking at cost optimization to improve Gross margins:** KKC has been able to maintain market share and is confident of holding on to it despite aggressive competitive pricing. Programmes like ACE, Six Sigma, AmaZe and ASCent to help cost optimization and the management ruled out any price hikes in the near future.
- **KKC management has clarified that all Engines (QSK30 and QSK50) will be sold by CIL to CTIL and not vice versa as was the concern.**
- **Positive trends in domestic markets, exports market volatile:** The domestic economy continues to grow largely in areas which are positively benefited through continuing government investments in Infrastructure. KKC remains positive on the medium-to-long term outlook for domestic sales as the underlying demand conditions remain positive. While data centre market is growing fast, KKC expects Construction and Railways to be the key growth drivers.
- In export market, a clear trend is yet to emerge on account of prevailing uncertainties in various economies through the world. KKC believes there are varying degrees of recovery taking place in the global economy, commodity markets and geographies. This trend, however, is likely to only play out in the medium term. KKC is optimistic on the African and the Middle East markets due to favourable oil prices.
- **The company has guided for 9-11% and 0-5% 5-year CAGR growth in domestic sales and exports.** KKC believes it is positioned to outperform the industry and is investing judiciously in new products with better margins, increasing customer focus, emphasising on cost reduction and improving productivity and quality, thus, remaining strongly positioned to continue delivering values to all stakeholders.
- **Outlook and Valuation:** The stock is trading at 22.2x FY20E earnings. We remain positive on KKC's medium/long-term potential in the domestic market, driven by structural factors like revival in Infrastructure/Industrial demand, unreliable quality of power in India and lack of creditable options for power back-up. We have cut our earnings by 5% for FY20 to factor in lower export guidance. We have also reduced our multiple to 28x from 30x to factor in weak export outlook ([Refer our Q4 Update](#)).

Exhibit 1: Growth Strategy

CORE		CAPABILITIES	GROWTH PLATFORMS	
Engine	Power Systems	Technology Leadership	Build on our strength in Powertrain	Leverage our Global Distribution Channel
		Scale Advantage		
Components	Distribution	Distribution Network	Data-Enabled Services	Increase Participation in Attractive Markets
		Partnerships & Customers		
NEW TECHNOLOGIES				

Source: Company Data, PL Research

Exhibit 2: Growth Platforms

CORE		CAPABILITIES	GROWTH PLATFORMS	
Power Generation	Industrial	Technology Leadership	Core	New
		Scale Advantage	Market Share Growth	Telematics
Distribution	Export	Distribution Network	Content Growth	Electrification
		Partnerships & Customers	New Products	Renewables
CONTINUOUS IMPROVEMENT INITIATIVES (ACE, AMaZe, aSCent)				

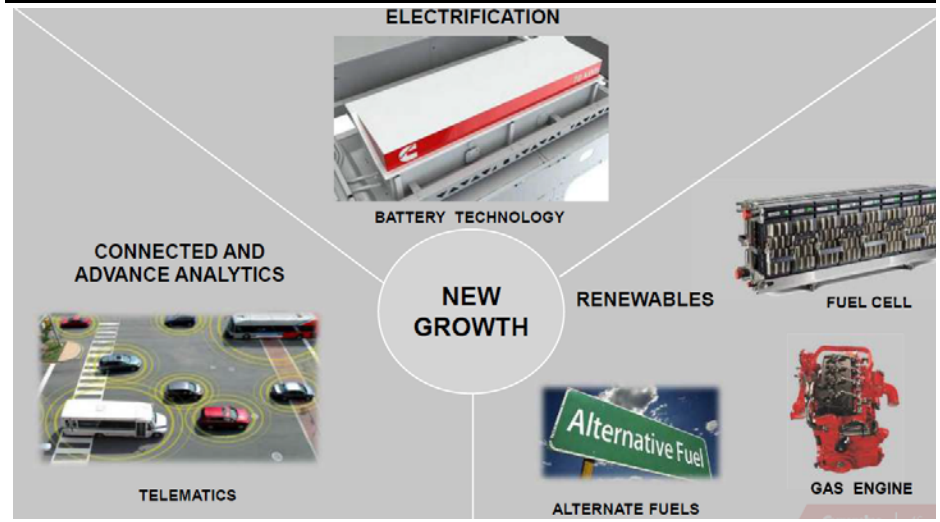
Source: Company Data, PL Research

Exhibit 3: Factors to achieve Core Growth



Source: Company Data, PL Research

Exhibit 4: New Areas to prepare for Future Growth



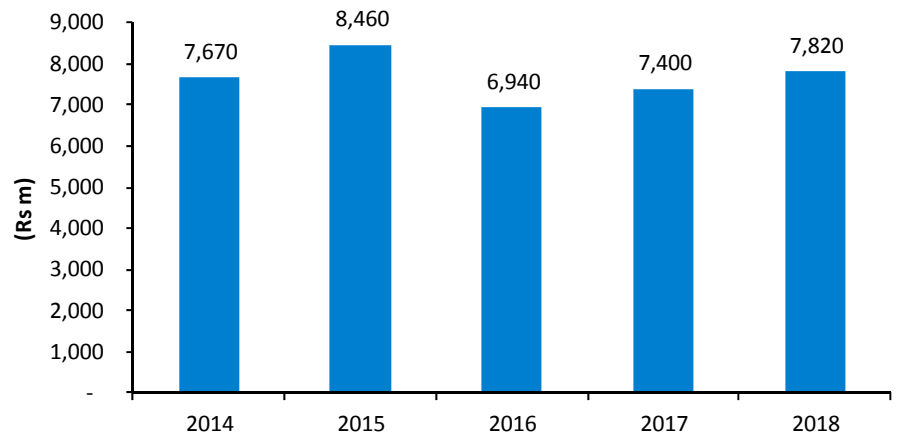
Source: Company Data, PL Research

Exhibit 5: Improvement Initiatives

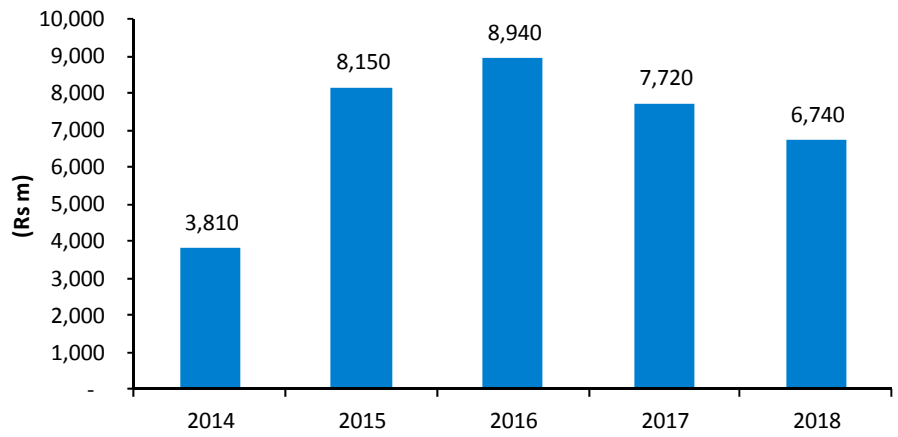


Source: Company Data, PL Research

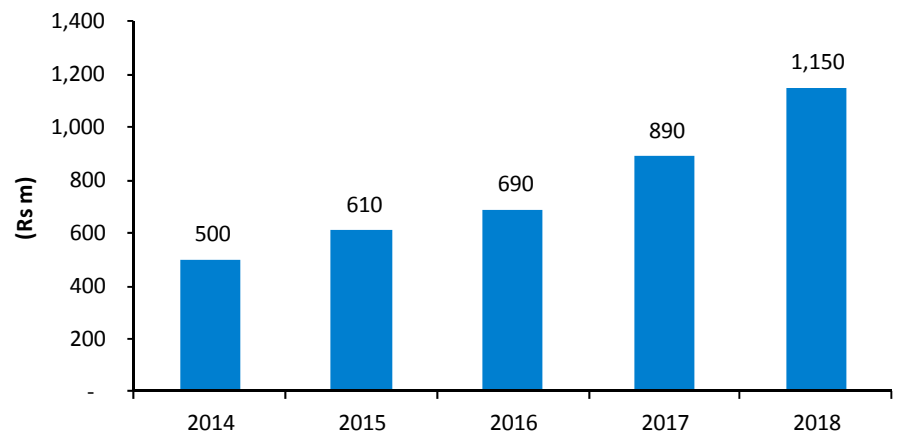
Exhibit 6: Exports - HHP



Source: Company Data, PL Research

Exhibit 7: Exports - LHP

Source: Company Data, PL Research

Exhibit 8: Exports - Spares

Source: Company Data, PL Research

Income Statement (Rs m)

Y/e March	2017	2018	2019E	2020E
Net Revenue	50,773	50,825	55,960	61,882
Raw Material Expenses	32,745	32,581	34,919	38,615
Gross Profit	18,029	18,244	21,041	23,268
Employee Cost	4,334	4,979	4,757	5,260
Other Expenses	5,677	5,940	8,002	8,664
EBITDA	8,018	7,325	8,282	9,344
Depr. & Amortization	848	938	1,022	1,102
Net Interest	168	148	100	100
Other Income	2,080	2,285	2,598	2,723
Profit before Tax	9,082	8,523	9,758	10,866
Total Tax	1,736	2,000	2,049	2,390
Profit after Tax	7,346	6,524	7,709	8,475
Ex-Od items / Min. Int.	—	—	—	—
Adj. PAT	7,346	6,524	7,709	8,475
Avg. Shares O/S (m)	277.2	277.2	277.2	277.2
EPS (Rs.)	26.5	23.5	27.8	30.6

Cash Flow Abstract (Rs m)

Y/e March	2017	2018	2019E	2020E
C/F from Operations	7,456	7,658	7,664	7,742
C/F from Investing	(4,860)	(319)	(3,000)	(2,000)
C/F from Financing	(2,209)	(3,869)	(5,419)	(5,948)
Inc. / Dec. in Cash	386	3,471	(755)	(206)
Opening Cash	852	1,238	4,709	3,953
Closing Cash	1,238	4,709	3,953	3,748
FCFF	11,429	5,985	4,564	5,642
FCFE	13,936	5,992	4,564	5,642

Key Financial Metrics

Y/e March	2017	2018	2019E	2020E
Growth				
Revenue (%)	7.5	0.1	10.1	10.6
EBITDA (%)	5.4	(8.7)	13.1	12.8
PAT (%)	(2.3)	(11.2)	18.2	9.9
EPS (%)	(2.3)	(11.2)	18.2	9.9
Profitability				
EBITDA Margin (%)	15.8	14.4	14.8	15.1
PAT Margin (%)	14.5	12.8	13.8	13.7
RoCE (%)	20.8	16.1	17.8	18.5
RoE (%)	21.3	16.9	18.8	19.5
Balance Sheet				
Net Debt : Equity	—	(0.1)	—	—
Net Wrkng Cap. (days)	—	—	—	—
Valuation				
PER (x)	25.7	28.9	24.5	22.3
P / B (x)	5.0	4.7	4.5	4.2
EV / EBITDA (x)	23.7	25.5	22.6	20.1
EV / Sales (x)	3.7	3.7	3.3	3.0
Earnings Quality				
Eff. Tax Rate	19.1	23.5	21.0	22.0
Other Inc / PBT	22.9	26.8	26.6	25.1
Eff. Depr. Rate (%)	4.1	4.2	4.0	4.0
FCFE / PAT	189.7	91.9	59.2	66.6

Source: Company Data, PL Research.

Balance Sheet Abstract (Rs m)

Y/e March	2017	2018	2019E	2020E
Shareholder's Funds	37,422	39,861	42,250	44,878
Total Debt	2,508	2,515	2,515	2,515
Other Liabilities	—	—	—	—
Total Liabilities	39,930	42,376	44,766	47,393
Net Fixed Assets	16,871	13,207	15,185	16,083
Goodwill	82	54	—	—
Investments	9,753	12,798	12,798	12,798
Net Current Assets	13,247	16,616	17,081	18,702
Cash & Equivalents	1,291	4,709	4,007	3,693
Other Current Assets	22,411	24,545	27,050	30,425
Current Liabilities	10,455	12,637	13,975	15,415
Other Assets	(24)	(299)	(299)	(299)
Total Assets	39,930	42,376	44,765	47,285

Quarterly Financials (Rs m)

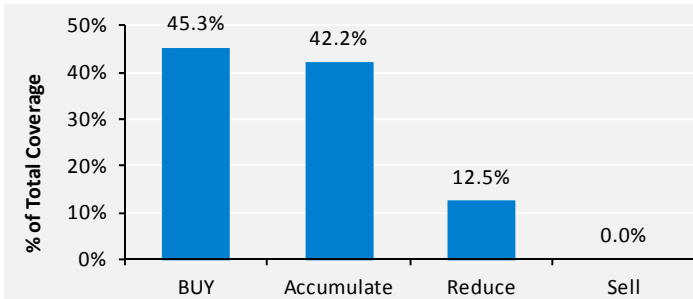
Y/e March	Q1FY18	Q2FY18	Q3FY18	Q4FY18
Net Revenue	13,408	11,539	13,547	12,332
EBITDA	1,953	1,675	1,967	1,731
% of revenue	14.6	14.5	14.5	14.0
Depr. & Amortization	208	220	237	273
Net Interest	42	38	34	34
Other Income	583	536	501	664
Profit before Tax	2,286	1,953	2,197	2,088
Total Tax	625	424	475	475
Profit after Tax	1,660	1,529	1,722	1,612
Adj. PAT	1,660	1,529	1,722	1,612

Source: Company Data, PL Research.

**Prabhudas Lilladher Pvt. Ltd.**

3rd Floor, Sadhana House, 570, P. B. Marg, Worli, Mumbai-400 018, India

Tel: (91 22) 6632 2222 Fax: (91 22) 6632 2209

Rating Distribution of Research Coverage**PL's Recommendation Nomenclature**

BUY	:	Over 15% Outperformance to Sensex over 12-months
Accumulate	:	Outperformance to Sensex over 12-months
Reduce	:	Underperformance to Sensex over 12-months
Sell	:	Over 15% underperformance to Sensex over 12-months
Trading Buy	:	Over 10% absolute upside in 1-month
Trading Sell	:	Over 10% absolute decline in 1-month
Not Rated (NR)	:	No specific call on the stock
Under Review (UR)	:	Rating likely to change shortly

DISCLAIMER/DISCLOSURES**ANALYST CERTIFICATION**

We/I, Mr. Kunal Sheth (MBA), Mr. Shreyans Jain (CA), Research Analysts, authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

Terms & conditions and other disclosures:

Prabhudas Lilladher Pvt. Ltd, Mumbai, India (hereinafter referred to as "PL") is engaged in the business of Stock Broking, Portfolio Manager, Depository Participant and distribution for third party financial products. PL is a subsidiary of Prabhudas Lilladher Advisory Services Pvt Ltd. which has its various subsidiaries engaged in business of commodity broking, investment banking, financial services (margin funding) and distribution of third party financial/other products, details in respect of which are available at www.plindia.com

This document has been prepared by the Research Division of PL and is meant for use by the recipient only as information and is not for circulation. This document is not to be reported or copied or made available to others without prior permission of PL. It should not be considered or taken as an offer to sell or a solicitation to buy or sell any security.

The information contained in this report has been obtained from sources that are considered to be reliable. However, PL has not independently verified the accuracy or completeness of the same. Neither PL nor any of its affiliates, its directors or its employees accepts any responsibility of whatsoever nature for the information, statements and opinion given, made available or expressed herein or for any omission therein.

Recipients of this report should be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The suitability or otherwise of any investments will depend upon the recipient's particular circumstances and, in case of doubt, advice should be sought from an independent expert/advisor.

Either PL or its affiliates or its directors or its representatives or its clients or their relatives may have position(s), make market, act as principal or engage in transactions of securities of companies referred to in this report and they may have used the research material prior to publication.

PL may from time to time solicit or perform investment banking or other services for any company mentioned in this document.

PL is in the process of applying for certificate of registration as Research Analyst under Securities and Exchange Board of India (Research Analysts) Regulations, 2014

PL submits that no material disciplinary action has been taken on us by any Regulatory Authority impacting Equity Research Analysis activities.

PL or its research analysts or its associates or his relatives do not have any financial interest in the subject company.

PL or its research analysts or its associates or his relatives do not have actual/beneficial ownership of one per cent or more securities of the subject company at the end of the month immediately preceding the date of publication of the research report.

PL or its research analysts or its associates or his relatives do not have any material conflict of interest at the time of publication of the research report.

PL or its associates might have received compensation from the subject company in the past twelve months.

PL or its associates might have managed or co-managed public offering of securities for the subject company in the past twelve months or mandated by the subject company for any other assignment in the past twelve months.

PL or its associates might have received any compensation for investment banking or merchant banking or brokerage services from the subject company in the past twelve months.

PL or its associates might have received any compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past twelve months

PL or its associates might have received any compensation or other benefits from the subject company or third party in connection with the research report.

PL encourages independence in research report preparation and strives to minimize conflict in preparation of research report. PL or its analysts did not receive any compensation or other benefits from the subject Company or third party in connection with the preparation of the research report. PL or its Research Analysts do not have any material conflict of interest at the time of publication of this report.

It is confirmed that Mr. Kunal Sheth (MBA), Mr. Shreyans Jain (CA), Research Analysts of this report have not received any compensation from the companies mentioned in the report in the preceding twelve months

Compensation of our Research Analysts is not based on any specific merchant banking, investment banking or brokerage service transactions.

The Research analysts for this report certifies that all of the views expressed in this report accurately reflect his or her personal views about the subject company or companies and its or their securities, and no part of his or her compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this report.

The research analysts for this report has not served as an officer, director or employee of the subject company PL or its research analysts have not engaged in market making activity for the subject company

Our sales people, traders, and other professionals or affiliates may provide oral or written market commentary or trading strategies to our clients that reflect opinions that are contrary to the opinions expressed herein, and our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. In reviewing these materials, you should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest.

PL and its associates, their directors and employees may (a) from time to time, have a long or short position in, and buy or sell the securities of the subject company or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as a market maker in the financial instruments of the subject company or act as an advisor or lender/borrower to the subject company or may have any other potential conflict of interests with respect to any recommendation and other related information and opinions.

DISCLAIMER/DISCLOSURES (FOR US CLIENTS)**ANALYST CERTIFICATION**

The research analysts, with respect to each issuer and its securities covered by them in this research report, certify that: All of the views expressed in this research report accurately reflect his or her or their personal views about all of the issuers and their securities; and No part of his or her or their compensation was, is or will be directly related to the specific recommendation or views expressed in this research report

Terms & conditions and other disclosures:

This research report is a product of Prabhudas Lilladher Pvt. Ltd., which is the employer of the research analyst(s) who has prepared the research report. The research analyst(s) preparing the research report is/are resident outside the United States (U.S.) and are not associated persons of any U.S. regulated broker-dealer and therefore the analyst(s) is/are not subject to supervision by a U.S. broker-dealer, and is/are not required to satisfy the regulatory licensing requirements of FINRA or required to otherwise comply with U.S. rules or regulations regarding, among other things, communications with a subject company, public appearances and trading securities held by a research analyst account.

This report is intended for distribution by Prabhudas Lilladher Pvt. Ltd. only to "Major Institutional Investors" as defined by Rule 15a-6(b)(4) of the U.S. Securities and Exchange Act, 1934 (the Exchange Act) and interpretations thereof by U.S. Securities and Exchange Commission (SEC) in reliance on Rule 15a-6(a)(2). If the recipient of this report is not a Major Institutional Investor as specified above, then it should not act upon this report and return the same to the sender. Further, this report may not be copied, duplicated and/or transmitted onward to any U.S. person, which is not the Major Institutional Investor.

In reliance on the exemption from registration provided by Rule 15a-6 of the Exchange Act and interpretations thereof by the SEC in order to conduct certain business with Major Institutional Investors, Prabhudas Lilladher Pvt. Ltd. has entered into an agreement with a U.S. registered broker-dealer, Marco Polo Securities Inc. ("Marco Polo").

Transactions in securities discussed in this research report should be effected through Marco Polo or another U.S. registered broker dealer.