

October 25, 2019

## Q2FY20 Result Update

Change in Estimates |  Target |  Reco

### Change in Estimates

	Current		Previous	
	FY20E	FY21E	FY20E	FY21E
Rating	HOLD		HOLD	
Target Price	543		655	
Sales (Rs. m)	54,509	57,175	57,960	62,788
% Chng.	(6.0)	(8.9)		
EBITDA (Rs. m)	6,455	6,871	7,818	8,875
% Chng.	(17.4)	(22.6)		
EPS (Rs.)	23.1	24.7	26.1	29.8
% Chng.	(11.3)	(17.1)		

### Key Financials - Standalone

Y/e Mar	FY19	FY20E	FY21E	FY22E
Sales (Rs. m)	56,590	54,509	57,175	62,445
EBITDA (Rs. m)	8,641	6,455	6,871	8,046
Margin (%)	15.3	11.8	12.0	12.9
PAT (Rs. m)	7,226	6,411	6,840	7,995
EPS (Rs.)	26.1	23.1	24.7	28.8
Gr. (%)	1.9	(11.3)	6.7	16.9
DPS (Rs.)	17.0	17.5	18.5	20.0
Yield (%)	3.1	3.2	3.4	3.7
RoE (%)	17.8	15.2	15.8	18.0
RoCE (%)	17.3	11.6	11.9	13.8
EV/Sales (x)	2.5	2.6	2.5	2.3
EV/EBITDA (x)	16.6	22.3	21.1	18.1
PE (x)	20.7	23.4	21.9	18.7
P/BV (x)	3.6	3.5	3.4	3.3

### Key Data

### CUMM.BO | KKC IN

52-W High / Low	Rs.885 / Rs.532
Sensex / Nifty	39,058 / 11,584
Market Cap	Rs.150bn/ \$ 2,111m
Shares Outstanding	277m
3M Avg. Daily Value	Rs.696.98m

### Shareholding Pattern (%)

Promoter's	51.00
Foreign	8.27
Domestic Institution	29.84
Public & Others	10.89
Promoter Pledge (Rs bn)	-

### Stock Performance (%)

	1M	6M	12M
Absolute	(8.9)	(26.4)	(20.0)
Relative	(10.0)	(27.0)	(31.0)

### Ashwani Sharma

ashwanisharma@plindia.com | 91-22-66322247

### Khushboo Parekh

khushbooparekh@plindia.com | 91-22-66322257

## Lackluster performance continues

Cummins India continued to report weak set of numbers with revenue declined by 12% YoY at Rs13.1 bn (PLe Rs14.9 bn) during 2QFY20. This was mainly due to de-growth in both domestic (-6%YoY) and exports (-25%YoY). EBITDA margin declined 510bps YoY at 11.7% due to unfavorable sales mix and intense pricing pressure. Absolute EBITDA fell 39% YoY at Rs1.5bn. With lower tax rate (due to change in tax policy), PAT came in at Rs1.8 bn (PLe Rs1.6 bn). Within the domestic market, Cummins reported weakness across the segments (Powergen, Industrial, Distribution) on the back of slowdown in the economic activity. On the exports, challenges continued in various geographies with ME and Africa witnessed 50% reduction demand, Brazil -30%, China -20%, Europe -30% and UK -20% YoY. ME and Africa combine contribute 30% of export sales. KKC management has further lowered its overall revenue guidance with domestic revenue growth guidance from 8-10% to 3-5% and de-growth of 20% from 12-15% in exports for FY20. We have cut EPS estimates by FY20/21E by 11%/17% for Cummins on account of a) weak 1HFY20 reported earnings, b) deepening slowdown in the export markets and c) delay in domestic recovery. The stock is currently trading at 24x/22x FY20/21E. We maintain Hold rating with revised TP of Rs543 (22x FY21E).

**Lackluster operating performance:** Sales were down 12% YoY at Rs13.1 bn (PLe Rs14.8 bn) as domestic revenue fell by 6% YoY at Rs9.5 bn and exports were down by 25% YoY at Rs3.4 bn. Gross Margins contracted by 320bps in 2QFY20 impacted by unfavorable mix and forex loss. Going ahead margins are expected to remain at the current level unless there is any improvement in export markets EBITDA margin contracted by 510bps YoY at 11.7% mainly due to sharp de-growth in exports. Other income increased by 18% YoY at Rs926 mn. Tax rate for the quarter came lower at 12.8% (PLe 28%) compared to 29% in Q2FY19. This partially neutralized impact of weak operating performance on PAT, which was down 13% YoY Rs1.8 bn (PLe Rs1.6 bn). Sales for H1FY20 were down by 6% at Rs26.5 bn compared to Rs28.1 bn in H1FY19 where domestic sales were up by 4% YoY at Rs19.4 bn and exports were down by 26% YoY at Rs6.6 bn. EBITDA margins for H1FY20 contracted by 500bps at 11.5% compared to 16.5% in H1FY19 due to contraction in gross margins by 300bps. Tax rate for H1FY20 came lower at 19.7% compared to 28.5% in H1FY19. PAT for H1FY20 declined by 18% YoY at Rs3.2 bn.

### Slowdown in economic activity impacts demand across the markets:

Domestic markets plunged by 6% YoY due to weak economic activity on the back of lower demand, tight liquidity situation and slowdown in infrastructure projects. Industrial/Distribution/Powergen declined 10%/6%/4% YoY. Exports plunged 26% YoY due to slow down in most of the geographies. According to management, Middle East and Africa declined 50%, Brazil 40%, China 20% and Europe by 25-30% and UK by 20%. Mexico grey by 200% YoY due to lower base in 2QFY19. Middle East and Africa account for 30% of total export revenues.

**Growth guidance cut for both domestic and export markets:** The company has further lowered its guidance for growth in domestic sales to 3-5% from 8-10% and exports to be negative 20% from negative 12-15% for FY20. Margins would remain at current levels until exports market improve. KKC is confident on the medium to long term outlook on domestic sales, especially from the infrastructure sectors is high, once the fund allocations from the fiscal union budget, start to positively impact this sector. KKC will continue to invest in products (essential) and innovations and curtail investments in non-essential products. Focus is also reducing the overheads (Travels, headcounts, Maintenance, Material cost etc) to improve the profitability.

**Exhibit 1: Q2FY20 Result Overview (Rs mn)**

Y/e March	2QFY20	2QFY19	YoY gr. (%)	1QFY20	QoQ (%)	H1FY20	H1FY19	YoY gr. (%)
<b>Net Revenue</b>	<b>13,084</b>	<b>14,869</b>	<b>(12.0)</b>	<b>13,430</b>	<b>(2.6)</b>	<b>26,515</b>	<b>28,149</b>	<b>(5.8)</b>
<b>EBITDA</b>	<b>1,525</b>	<b>2,509</b>	<b>(39.2)</b>	<b>1,514</b>	<b>0.7</b>	<b>3,039</b>	<b>4,656</b>	<b>(34.7)</b>
<i>EBITDA Margin (%)</i>	<i>11.7</i>	<i>16.9</i>		<i>11.3</i>		<i>11.5</i>	<i>16.5</i>	
Other Income	926	785	18.0	769	20.4	1,695	1,480	14.5
Depreciation	293	274	7.1	291	0.8	584	544	7.3
Interest	55	40		52	6.4	107	75	
<b>Profit before Tax</b>	<b>2,102</b>	<b>2,980</b>	<b>(29.5)</b>	<b>1,940</b>	<b>8.3</b>	<b>4,043</b>	<b>5,516</b>	<b>(26.7)</b>
Tax	269	865		525		795	1,571	
<b>Reported PAT</b>	<b>1,833</b>	<b>2,116</b>	<b>(13.4)</b>	<b>1,415</b>	<b>29.5</b>	<b>3,248</b>	<b>3,946</b>	<b>(17.7)</b>
<b>Adjusted PAT</b>	<b>1,833</b>	<b>2,116</b>	<b>(13.4)</b>	<b>1,415</b>	<b>29.5</b>	<b>3,248</b>	<b>3,946</b>	<b>(17.7)</b>
<i>Net Margin (%)</i>	<i>14.0</i>	<i>14.2</i>		<i>10.5</i>		<i>12.2</i>	<i>14.0</i>	
<b>Adjusted EPS</b>	<b>6.6</b>	<b>7.6</b>		<b>5.1</b>		<b>11.7</b>	<b>14.2</b>	

Source: Company, PL

### Other Con-call highlights:

**1) Capex-** Capex is need based mainly in Powergen and Construction sector due to frequent changes in BS norms.

**2) Segmental performance-** Infrastructure and Manufacturing are the segments which are bleeding in the domestic market. Distribution also has been slow due to weakness in the Powergen and Industrial business.

**3) Data Centre-**Data center, Large retail continue to go ahead with the projects which are in pipeline. Data Centre market is ~Rs750-800 mn annually for KKC, growing at a CAGR 10-12% over the last few years and is expected to grow at 10-15% going ahead. Domestic Data Centre market size was Rs1000- 1250 mn.

**4) LHP** is the most competitive business with intense pricing which also have impacted the margins during the quarter.

**5) KKC** doesn't see any significant change related to new investments in capacity or supply chain due to new tax regime in the domestic market.

**6) Tax rate-** For 2QFY20 witnessed reversal of deferred tax. From 3QFY20 onwards, 25.2% will be taken on full year basis. There would Rs300-400 mn of benefit on annual basis.

## Financials

### Income Statement (Rs m)

Y/e Mar	FY19	FY20E	FY21E	FY22E
<b>Net Revenues</b>	<b>56,590</b>	<b>54,509</b>	<b>57,175</b>	<b>62,445</b>
YoY gr. (%)	11.3	(3.7)	4.9	9.2
Cost of Goods Sold	36,135	35,703	37,450	40,902
Gross Profit	20,455	18,806	19,725	21,544
Margin (%)	36.1	34.5	34.5	34.5
Employee Cost	5,458	5,676	5,847	6,139
Other Expenses	6,356	6,674	7,008	7,358
<b>EBITDA</b>	<b>8,641</b>	<b>6,455</b>	<b>6,871</b>	<b>8,046</b>
YoY gr. (%)	18.0	(25.3)	6.4	17.1
Margin (%)	15.3	11.8	12.0	12.9
Depreciation and Amortization	1,103	1,158	1,216	1,277
<b>EBIT</b>	<b>7,538</b>	<b>5,297</b>	<b>5,655</b>	<b>6,769</b>
Margin (%)	13.3	9.7	9.9	10.8
Net Interest	162	170	179	188
Other Income	2,928	3,308	3,705	4,150
<b>Profit Before Tax</b>	<b>10,304</b>	<b>8,435</b>	<b>9,181</b>	<b>10,732</b>
Margin (%)	18.2	15.5	16.1	17.2
Total Tax	3,078	2,024	2,341	2,737
Effective tax rate (%)	29.9	24.0	25.5	25.5
<b>Profit after tax</b>	<b>7,226</b>	<b>6,411</b>	<b>6,840</b>	<b>7,995</b>
Minority interest	-	-	-	-
Share Profit from Associate	-	-	-	-
<b>Adjusted PAT</b>	<b>7,226</b>	<b>6,411</b>	<b>6,840</b>	<b>7,995</b>
YoY gr. (%)	2.0	(11.3)	6.7	16.9
Margin (%)	12.8	11.8	12.0	12.8
Extra Ord. Income / (Exp)	-	-	-	-
<b>Reported PAT</b>	<b>7,226</b>	<b>6,411</b>	<b>6,840</b>	<b>7,995</b>
YoY gr. (%)	2.0	(11.3)	6.7	16.9
Margin (%)	12.8	11.8	12.0	12.8
Other Comprehensive Income	-	-	-	-
Total Comprehensive Income	7,226	6,411	6,840	7,995
<b>Equity Shares O/s (m)</b>	<b>277</b>	<b>277</b>	<b>277</b>	<b>277</b>
<b>EPS (Rs)</b>	<b>26.1</b>	<b>23.1</b>	<b>24.7</b>	<b>28.8</b>

Source: Company Data, PL Research

### Balance Sheet Abstract (Rs m)

Y/e Mar	FY19	FY20E	FY21E	FY22E
<b>Non-Current Assets</b>				
<b>Gross Block</b>	<b>21,298</b>	<b>24,843</b>	<b>27,343</b>	<b>29,843</b>
Tangibles	21,273	24,773	27,273	29,773
Intangibles	25	70	70	70
<b>Acc: Dep / Amortization</b>	<b>8,450</b>	<b>9,644</b>	<b>10,994</b>	<b>12,473</b>
Tangibles	8,450	9,644	10,994	12,473
Intangibles	-	-	-	-
<b>Net fixed assets</b>	<b>12,848</b>	<b>15,199</b>	<b>16,349</b>	<b>17,370</b>
Tangibles	12,823	15,129	16,279	17,300
Intangibles	25	70	70	70
Capital Work In Progress	8,865	8,965	9,065	9,165
Goodwill	-	-	-	-
Non-Current Investments	2,742	3,026	3,226	3,226
Net Deferred tax assets	(988)	(988)	(988)	(988)
Other Non-Current Assets	-	-	-	-
<b>Current Assets</b>				
Investments	2,427	2,427	2,427	2,427
Inventories	6,254	6,024	6,318	6,901
Trade receivables	12,727	12,259	12,545	13,359
Cash & Bank Balance	7,379	7,088	6,572	6,533
Other Current Assets	1,660	1,599	1,677	1,831
<b>Total Assets</b>	<b>58,536</b>	<b>60,089</b>	<b>61,851</b>	<b>64,819</b>
<b>Equity</b>				
Equity Share Capital	555	555	555	555
Other Equity	40,750	42,269	43,109	44,618
<b>Total Network</b>	<b>41,305</b>	<b>42,824</b>	<b>43,664</b>	<b>45,172</b>
<b>Non-Current Liabilities</b>				
Long Term borrowings	268	325	325	325
Provisions	727	500	500	500
Other non current liabilities	-	-	-	-
<b>Current Liabilities</b>				
ST Debt / Current of LT Debt	3,092	3,592	4,092	4,592
Trade payables	8,251	7,798	8,180	8,934
Other current liabilities	3,886	4,042	4,083	4,288
<b>Total Equity &amp; Liabilities</b>	<b>58,536</b>	<b>60,089</b>	<b>61,852</b>	<b>64,819</b>

Source: Company Data, PL Research

**Cash Flow (Rs m)**

Y/e Mar	FY19	FY20E	FY21E	FY22E
PBT	10,304	8,435	9,181	10,732
Add. Depreciation	1,103	1,158	1,216	1,277
Add. Interest	162	170	179	188
Less Financial Other Income	2,928	3,308	3,705	4,150
Add. Other	(1,367)	(3,308)	(3,705)	(4,150)
Op. profit before WC changes	10,202	6,455	6,871	8,046
Net Changes-WC	(2,381)	594	(406)	(927)
Direct tax	(2,361)	(2,024)	(2,341)	(2,737)
<b>Net cash from Op. activities</b>	<b>5,460</b>	<b>5,025</b>	<b>4,124</b>	<b>4,383</b>
Capital expenditures	(2,734)	(3,610)	(2,467)	(2,398)
Interest / Dividend Income	947	3,308	3,705	4,150
Others	1,956	(284)	(200)	-
<b>Net Cash from Inv. activities</b>	<b>169</b>	<b>(585)</b>	<b>1,039</b>	<b>1,752</b>
Issue of share cap. / premium	-	-	-	-
Debt changes	576	331	500	500
Dividend paid	(5,641)	(4,891)	(6,000)	(6,486)
Interest paid	(121)	(170)	(179)	(188)
Others	-	-	-	-
<b>Net cash from Fin. activities</b>	<b>(5,186)</b>	<b>(4,731)</b>	<b>(5,679)</b>	<b>(6,174)</b>
<b>Net change in cash</b>	<b>443</b>	<b>(291)</b>	<b>(516)</b>	<b>(39)</b>
Free Cash Flow	5,460	5,025	4,124	4,383

Source: Company Data, PL Research

**Key Financial Metrics**

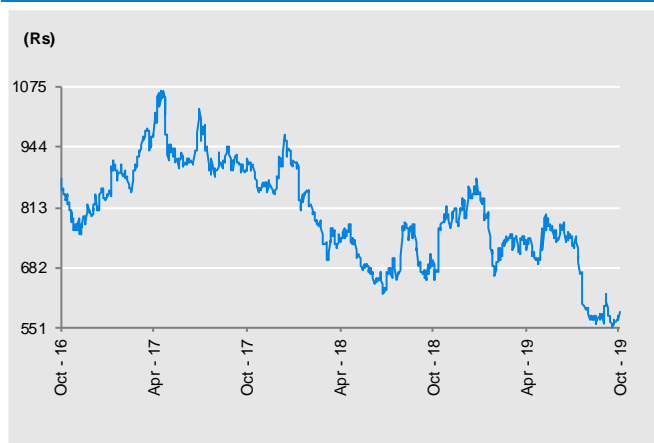
Y/e Mar	FY19	FY20E	FY21E	FY22E
<b>Per Share(Rs)</b>				
EPS	26.1	23.1	24.7	28.8
CEPS	30.0	27.3	29.0	33.4
BVPS	148.9	154.4	157.4	162.9
FCF	19.7	18.1	14.9	15.8
DPS	17.0	17.5	18.5	20.0
<b>Return Ratio(%)</b>				
RoCE	17.3	11.6	11.9	13.8
ROIC	15.6	11.1	11.0	12.6
RoE	17.8	15.2	15.8	18.0
<b>Balance Sheet</b>				
Net Debt : Equity (x)	(0.2)	(0.1)	(0.1)	(0.1)
Net Working Capital (Days)	69	70	68	66
<b>Valuation(x)</b>				
PER	20.7	23.4	21.9	18.7
P/B	3.6	3.5	3.4	3.3
P/CEPS	18.0	19.8	18.6	16.2
EV/EBITDA	16.6	22.3	21.1	18.1
EV/Sales	2.5	2.6	2.5	2.3
Dividend Yield (%)	3.1	3.2	3.4	3.7

Source: Company Data, PL Research

**Quarterly Financials (Rs m)**

Y/e Mar	Q3FY19	Q4FY19	Q1FY20	Q2FY20
<b>Net Revenue</b>	<b>15,038</b>	<b>13,404</b>	<b>13,430</b>	<b>13,084</b>
YoY gr. (%)	11.0	8.7	1.1	(12.0)
Raw Material Expenses	9,771	8,817	8,862	8,513
Gross Profit	5,267	4,587	4,569	4,571
Margin (%)	35.0	34.2	34.0	34.9
<b>EBITDA</b>	<b>2,267</b>	<b>1,718</b>	<b>1,514</b>	<b>1,525</b>
YoY gr. (%)	15.3	(0.7)	(29.5)	(39.2)
Margin (%)	15.1	12.8	11.3	11.7
Depreciation / Depletion	279	280	291	293
<b>EBIT</b>	<b>1,988</b>	<b>1,438</b>	<b>1,223</b>	<b>1,232</b>
Margin (%)	13.2	10.7	9.1	9.4
Net Interest	41	45	52	55
Other Income	755	692	769	926
<b>Profit before Tax</b>	<b>2,702</b>	<b>2,085</b>	<b>1,940</b>	<b>2,102</b>
Margin (%)	18.0	15.6	14.4	16.1
Total Tax	831	676	525	269
Effective tax rate (%)	30.8	32.4	27.1	12.8
<b>Profit after Tax</b>	<b>1,871</b>	<b>1,409</b>	<b>1,415</b>	<b>1,833</b>
Minority interest	-	-	-	-
Share Profit from Associates	-	-	-	-
<b>Adjusted PAT</b>	<b>1,871</b>	<b>1,409</b>	<b>1,415</b>	<b>1,833</b>
YoY gr. (%)	8.7	(12.6)	(22.7)	(13.4)
Margin (%)	12.4	10.5	10.5	14.0
Extra Ord. Income / (Exp)	-	-	-	-
<b>Reported PAT</b>	<b>1,871</b>	<b>1,409</b>	<b>1,415</b>	<b>1,833</b>
YoY gr. (%)	8.7	(12.6)	(22.7)	(13.4)
Margin (%)	12.4	10.5	10.5	14.0
Other Comprehensive Income	-	-	-	-
<b>Total Comprehensive Income</b>	<b>1,871</b>	<b>1,409</b>	<b>1,415</b>	<b>1,833</b>
Avg. Shares O/s (m)	277	277	277	277
<b>EPS (Rs)</b>	<b>6.7</b>	<b>5.1</b>	<b>5.1</b>	<b>6.6</b>

Source: Company Data, PL Research

**Price Chart**
**Recommendation History**


No.	Date	Rating	TP (Rs.)	Share Price (Rs.)
1	3-Oct-19	Hold	655	560
2	29-Aug-19	Hold	619	570
3	9-Aug-19	Hold	619	604
4	4-Jul-19	BUY	841	760
5	24-May-19	Accumulate	841	757

**Analyst Coverage Universe**

Sr. No.	Company Name	Rating	TP (Rs)	Share Price (Rs)
1	ABB	Reduce	1,442	1,461
2	Apar Industries	Accumulate	814	550
3	Bharat Electronics	Accumulate	128	105
4	BHEL	Hold	63	47
5	Cummins India	Hold	655	560
6	Engineers India	BUY	156	112
7	GE T&D India	Hold	202	184
8	Kalpataru Power Transmission	BUY	704	483
9	KEC International	BUY	352	271
10	Larsen & Toubro	BUY	1,800	1,432
11	Power Grid Corporation of India	BUY	224	199
12	Siemens	BUY	1,722	1,526
13	Thermax	Accumulate	1,300	1,153
14	Triveni Turbine	Accumulate	143	102
15	Voltamp Transformers	BUY	1,601	1,128

**PL's Recommendation Nomenclature (Absolute Performance)**

<b>Buy</b>	: > 15%
<b>Accumulate</b>	: 5% to 15%
<b>Hold</b>	: +5% to -5%
<b>Reduce</b>	: -5% to -15%
<b>Sell</b>	: < -15%
<b>Not Rated (NR)</b>	: No specific call on the stock
<b>Under Review (UR)</b>	: Rating likely to change shortly



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**3rd Floor, Sadhana House, 570, P. B. Marg, Worli, Mumbai-400 018, India | Tel: (91 22) 6632 2222 Fax: (91 22) 6632 2209**

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