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

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

Rating	BUY
Price	Rs778
Target Price	Rs967
Implied Upside	24.3%
Sensex	33,836
Nifty	10,411

(Prices as on March 14, 2018)

Trading data

Market Cap. (Rs bn)	215.7
Shares o/s (m)	277.2
3M Avg. Daily value (Rs m)	341

Major shareholders

Promoters	51.24%
Foreign	14.60%
Domestic Inst.	21.51%
Public & Other	12.65%

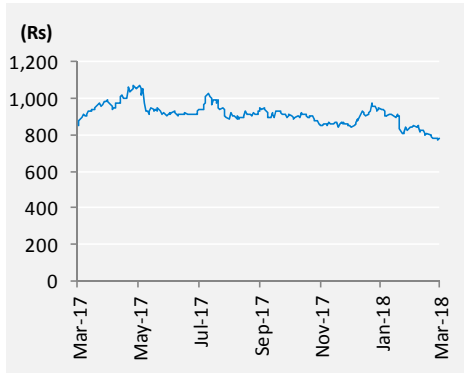
Stock Performance

(%)	1M	6M	12M
Absolute	(7.3)	(17.5)	(8.3)
Relative	(6.4)	(22.5)	(23.2)

How we differ from Consensus

EPS (Rs)	PL	Cons.	% Diff.
2019	28.5	29.7	-4.3
2020	32.2	34.2	-5.8

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



Source: Bloomberg

We met the management of Cummins (KKC). The key take aways from the meet are:

1) In the Powergen segment, HHP is showing signs of an uptick. Data centre, Metro and Large Commercial Real estate are showing traction 2) Manufacturing and Residential real estate market still weak. Recovery in both markets important to return to growth of 12-15% in Powergen 3) Competitive intensity remains high in domestic Powergen markets; KKC has reduced pricing premium with competitors to defend market share 4) Expect distribution business to keep growing at 8-10% 5) Industrial business can double in 3-4 years (FY18 to end with Rs8bn Sales) 6) In LHP exports, Middle East has seen some improvement and Africa continues to be muted. LHP exports bottomed out but timing of recovery is uncertain. HHP exports continue to grow at 6-10% 7) Rental income to be ~Rs1bn per annum 8) Reopened Pirangut plant and have set up projects business of Industrial segment.

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 cut our earnings by ~11% for both FY18 and FY19 to factor in weak margins. We maintain "BUY" with a revised TP of Rs967.

■ **Domestic markets - stable outlook:** Domestic economy continues to grow largely in areas which are positively benefited through continuing government investments in Infrastructure. In the Powergen segment, HHP is showing signs of an uptick. Data centre, Metro and Large Commercial Real estate are showing traction. Manufacturing and Residential real estate markets are still weak; recovery in both these markets is important to return to growth of 12-15% in Powergen market. We expect distribution business to keep growing at 8-10% CAGR. Industrial business can double in 3-4 years (FY18 to end with Rs8bn Sales). KKC remains positive on the medium-to-long-term outlook for domestic sales as the underlying demand conditions remain positive.

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Key financials (Y/e March)	2017	2018E	2019E	2020E
Revenues (Rs m)	50,773	51,960	56,537	63,455
Growth (%)	7.5	2.3	8.8	12.2
EBITDA (Rs m)	8,018	7,659	8,650	9,962
PAT (Rs m)	7,346	6,825	7,890	8,926
EPS (Rs)	26.5	24.6	28.5	32.2
Growth (%)	(2.3)	(7.1)	15.6	13.1
Net DPS (Rs)	13.6	13.6	13.6	13.6

Profitability & Valuation	2017	2018E	2019E	2020E
EBITDA margin (%)	15.8	14.7	15.3	15.7
RoE (%)	21.3	16.8	17.4	18.0
RoCE (%)	20.8	16.1	16.5	17.2
EV / sales (x)	4.3	4.1	3.8	3.4
EV / EBITDA (x)	27.1	27.9	24.8	21.4
PE (x)	29.4	31.6	27.3	24.2
P / BV (x)	5.8	4.9	4.6	4.2
Net dividend yield (%)	1.7	1.7	1.7	1.7

Source: Company Data; PL Research

- The competition intensity continues to be high in Powergen market. KKC has been able to maintain market share in most nodes and increased share in few nodes. KKC has reduced pricing premium with competitors to defend market share. The current market share in HHP is 62% (up 100bps YoY), MHP - 54% (maintained YoY) and LHP - 14% (maintained). While the competitive intensity continues to insert high pressure on margins, KKC continues to focus on profitability and optimizing operational cost to improve margins.
- **Exports volatile:** 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. LHP exports have bottomed out (after long phase of decline), market size in ME and Africa have shrunk significantly from peak. ME has seen minor improvement over the last few months; however, still volatile. HHP exports continue to grow at 6-8% CAGR.
- **Guidance: The company has guided for 0-5% growth domestic sales and reduced exports -5 to -10 for FY18. Based on trends, KKC believes that domestic market could see growth of 5-10% in FY19.** KKC believes it is positioned to outperform the industry and is investing judiciously in new products, increasing customer focus, emphasising on cost reduction and improving productivity and quality, thus, remaining strongly positioned to continue to deliver values to all stakeholders.
- **Other update: 1)** FY19 capex of Rs3.5bn. Capex to dip to Rs2-2.5bn from FY20 **2)** Invested Rs5.6bn in Technical centre. Expecting 8% rental yield **3)** Expecting Rs1bn of Rental income per annum **4)** Reopened Pirangut plant and have set up Projects business of Industrial segment.
- **Outlook and Valuation:** The stock is trading at 24.2x 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.



Income Statement (Rs m)

Y/e March	2017	2018E	2019E	2020E
Net Revenue	50,773	51,960	56,537	63,455
Raw Material Expenses	32,745	32,683	35,279	39,596
Gross Profit	18,029	19,277	21,258	23,859
Employee Cost	4,334	4,417	4,806	5,394
Other Expenses	5,677	7,202	7,802	8,503
EBITDA	8,018	7,659	8,650	9,962
Depr. & Amortization	848	868	958	1,018
Net Interest	168	140	50	50
Other Income	2,080	2,099	2,344	2,549
Profit before Tax	9,082	8,750	9,987	11,444
Total Tax	1,736	1,925	2,097	2,518
Profit after Tax	7,346	6,825	7,890	8,926
Ex-Od items / Min. Int.	—	—	—	—
Adj. PAT	7,346	6,825	7,890	8,926
Avg. Shares O/S (m)	277.2	277.2	277.2	277.2
EPS (Rs.)	26.5	24.6	28.5	32.2

Cash Flow Abstract (Rs m)

Y/e March	2017	2018E	2019E	2020E
C/F from Operations	9,342	7,140	6,696	7,584
C/F from Investing	(3,154)	(3,000)	(3,000)	(2,000)
C/F from Financing	(1,990)	(4,470)	(4,380)	(4,380)
Inc. / Dec. in Cash	4,198	(330)	(684)	1,204
Opening Cash	852	5,050	4,720	4,036
Closing Cash	5,050	4,720	4,036	5,240
FCFF	6,715	4,000	3,646	5,534
FCFE	9,223	4,000	3,646	5,534

Key Financial Metrics

Y/e March	2017	2018E	2019E	2020E
Growth				
Revenue (%)	7.5	2.3	8.8	12.2
EBITDA (%)	5.4	(4.5)	12.9	15.2
PAT (%)	(2.3)	(7.1)	15.6	13.1
EPS (%)	(2.3)	(7.1)	15.6	13.1
Profitability				
EBITDA Margin (%)	15.8	14.7	15.3	15.7
PAT Margin (%)	14.5	13.1	14.0	14.1
RoCE (%)	20.8	16.1	16.5	17.2
RoE (%)	21.3	16.8	17.4	18.0
Balance Sheet				
Net Debt : Equity	—	(0.1)	—	(0.1)
Net Wrkng Cap. (days)	44	33	36	37
Valuation				
PER (x)	29.4	31.6	27.3	24.2
P / B (x)	5.8	4.9	4.6	4.2
EV / EBITDA (x)	27.1	27.9	24.8	21.4
EV / Sales (x)	4.3	4.1	3.8	3.4
Earnings Quality				
Eff. Tax Rate	19.1	22.0	21.0	22.0
Other Inc / PBT	22.9	24.0	23.5	22.3
Eff. Depr. Rate (%)	3.3	3.0	3.0	3.0
FCFE / PAT	125.5	58.6	46.2	62.0

Source: Company Data, PL Research.

Balance Sheet Abstract (Rs m)

Y/e March	2017	2018E	2019E	2020E
Shareholder's Funds	37,422	43,676	47,235	51,832
Total Debt	2,508	2,508	2,508	2,508
Other Liabilities	—	—	—	—
Total Liabilities	39,930	46,184	49,743	54,339
Net Fixed Assets	17,408	19,541	21,583	22,566
Goodwill	—	—	—	—
Investments	9,753	9,753	9,753	9,753
Net Current Assets	12,792	16,914	18,431	22,045
Cash & Equivalents	1,291	4,720	4,036	5,240
Other Current Assets	21,956	25,176	28,454	32,531
Current Liabilities	10,455	12,983	14,060	15,726
Other Assets	(24)	(24)	(24)	(24)
Total Assets	39,930	46,184	49,743	54,339

Quarterly Financials (Rs m)

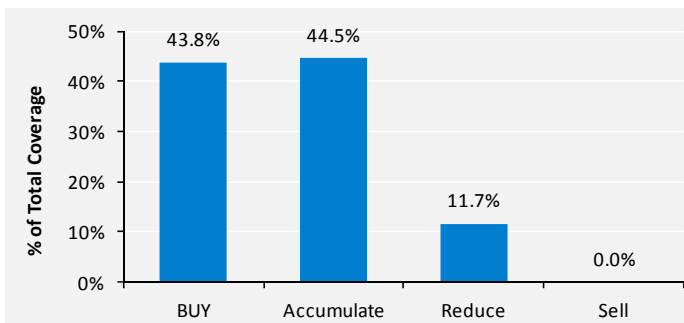
Y/e March	Q4FY17	Q1FY18	Q2FY18	Q3FY18
Net Revenue	11,844	13,408	11,539	13,547
EBITDA	1,700	1,953	1,675	1,967
% of revenue	14.4	14.6	14.5	14.5
Depr. & Amortization	208	208	220	237
Net Interest	49	42	38	34
Other Income	511	583	536	501
Profit before Tax	1,954	2,286	1,953	2,197
Total Tax	369	625	424	475
Profit after Tax	1,585	1,660	1,529	1,722
Adj. PAT	1,585	1,660	1,529	1,722

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

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Accumulate	: Outperformance to Sensex over 12-months
Reduce	: Underperformance to Sensex over 12-months
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Trading Buy	: Over 10% absolute upside in 1-month
Trading Sell	: Over 10% absolute decline in 1-month
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