

CUMMINS INDIA

INR 311

Torque-ed

BUY



Cummins India's (KKC) Q4FY07 results surprised us in terms of profitability despite revenue performance being softer than our expectations. For Q4FY07, revenue grew by ~30% Y-o-Y to INR 5 bn, EBITDA grew by ~41% Y-o-Y to INR 823 mn, and net profit grew by ~21% Y-o-Y to INR 657 mn. EBITDA margins expanded by ~130bps Y-o-Y to 16.3% driven by lower other operating and raw material expenses (as a percentage of sales). However, net margins at 13% were lower by ~100bps Y-o-Y due to higher tax rate.

For FY07, on a consolidated basis, revenue grew by ~20% Y-o-Y to INR 21 bn, EBITDA grew by 36% Y-o-Y to INR 3.4 bn, and net profit was up by ~46% Y-o-Y at INR 2.6 bn. EBITDA margins expanded by ~200bps Y-o-Y for the year to 16.3% driven by buoyant demand and pricing scenario. Net margins expanded by ~230bps to 12.6% for the year.

Even though KKC posted strong margins in FY07, the margins outlook for FY08E remains a cause of concern as reduction in import duties, commodity inflation, and exchange rate fluctuations are likely to result in margin pressures. However, we believe that the macro environment is strongly supportive of KKC's growth, going forward, as engines form the core of the capital goods segment and KKC is among the leading manufacturers of diesel engines in India. At our consolidated EPS estimate of INR 16 and INR 20 the stock is trading at a P/E multiple of 20x and 16x for FY08E and FY09E, respectively. We continue to maintain our 'BUY' recommendation.

* Liquidation of services business

KKC has decided to wind up the 'services' business of its subsidiary, Cummins Auto Services Limited (CASL), which was making losses (loss of INR 90 mn in FY06). The 'services' business basically comprised of providing highway solutions through authorized service stations. With this closure, CASL will primarily be in the business of retailing spare parts for commercial vehicles.

* Strong other income on higher treasury income

KKC's other income for Q4FY07 continued to remain high at INR 230 mn, up ~20% Y-o-Y, being driven by scrap sales. For FY07, on a consolidated level, other income was up ~41% at INR 912 mn, driven by treasury income and scrap sales.

* Capacity constraints likely to ease

KKC incurred a capital expenditure of ~INR 700 mn in FY07 as it is undertaking capacity expansion for large and small size engines. The large size engines facility is likely to commence production in November 2007, while the small size engine facility is expected to commence production from October 2007.

Financials

Year to March	Q4FY07	Q4FY06	% change	Q3FY07	% change	FY07	FY08E
Revenues (INR mn)	5,049	3,877	30.2	4,770	5.9	21,228	29,050
EBITDA (INR mn)	823	583	41.1	719	14.6	3,454	4,401
Net profit (INR mn)	657	541	21.4	629	4.4	2,680	3,112
EPS (INR)	3.3	2.7	21.4	3	4.4	13.5	15.7
PE (x)						23.0	19.8
EV/EBITDA (x)						17.2	13.5
ROAE (%)						29.6	29.7

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Market Data

52-week range (INR) : 320 / 150
Share in issue (mn) : 198.0
M cap (INR bn/USD mn) : 61.6 / 1,520.9
Avg. Daily Vol. BSE ('000) : 665.6

Share Holding Pattern (%)

Promoters : 51.0
MFs, FIs & Banks : 20.0
FIIIs : 13.6
Others : 15.4

* Outlook and valuations

Engines form the core of the capital goods segment and KKC is among the leading manufacturers of diesel engines in India. Therefore, we believe that the macro environment is strongly supportive of KKC's growth, going forward. At our consolidated EPS estimates of INR 16 and INR 20 the stock trades at a P/E multiple of 20x and 16x for FY08E and FY09E, respectively. We maintain our 'BUY' recommendation

Financials snapshot						(INR mn)		
Year to March	Q4FY07	Q4FY06	% change	Q3FY07	% change	FY06	FY07	FY08E
Revenues (net)	5,049	3,877	30.2	4,770	5.9	17,751	21,228	29,050
Raw material	3,330	2,596	28.3	3,194	4.3	11,729	13,885	18,747
Staff cost	348	255	36.6	296	17.6	1,395	1,541	2,270
Other operating expenses	548	443	23.7	562	(2.5)	2,084	2,348	3,631
Total expenditure	4,226	3,293	28.3	4,051	4.3	15,208	17,774	24,649
EBITDA	823	583	41.1	719	14.6	2,543	3,454	4,401
Depreciation	74	82	(10.6)	77	(4.7)	400	381	502
EBIT	750	501	49.6	641	16.9	2,143	3,073	3,899
Interest	11	5	138.9	2	500.0	45	65	53
Other income	236	197	19.9	260	(9.0)	645	912	762
Extraordinary items			NM	-	-	5	-	-
PBT	975	694	40.5	899	8.4	2,738	3,920	4,608
Tax	318	153	108.5	270	17.7	902	1,241	1,497
Adjusted net profit	657	541	21.4	629	4.4	1,836	2,680	3,112
Reported net profit	657	541	21.4	629	4.4	1,841	2,680	3,112
Equity capital(FV:INR2)	396	396	-	396	-	396	396	396
# of shares (mn)	198	198	-	198	-	198	198	198
EPS (INR)	3.3	2.7	21.4	3.2	4.4	9.3	13.5	15.7
Market cap. (INR mn)						61,628	61,628	61,628
PE (x)						33.5	23.0	19.8
EV/EBITDA (x)						23.3	17.2	13.5
Market cap / Revenues (x)						3.5	2.9	2.1
as % of net revenues								
Raw material	66.0	67.0	(1.5)	67.0	(1.5)	66.1	65.4	64.5
Other operating expenses	10.9	11.4	(5.0)	11.8	(7.9)	11.7	11.1	12.5
EBITDA	16.3	15.0	8.4	15.1	8.2	14.3	16.3	15.1
Adjusted net profit	13.0	14.0	(6.8)	13.2	(1.4)	10.3	12.6	10.7
Tax rate	32.6	22.0	48.3	30.0	8.6	32.9	31.6	32.5

*Annual numbers are consolidated

Company Description

KKC is a subsidiary of Cummins Inc., US, which holds 51% stake in the company. Cummins is a leading manufacturer of medium-high HP range of diesel engines in India with manufacturing facilities in Pune and Daman.

Investment Theme

KKC is a play on the multiple segments of power requirement, rising mobile penetration across rural and suburban geographies, strong coal requirement (driving demand in mining), and continued growth in automobile sales on the back of large potential in environment-friendly natural gas fuel-based engines. We expect Cummins to benefit from growth in the above segments.

Key Risks

Any slowdown in the economy is bound to have an impact on the capital goods industry. By nature, capital goods industry is the first to be affected by an economic slowdown and the last to benefit from an economic upturn. Besides, since exports form a major chunk of the revenue mix, global economic slowdown is likely to affect Cummins adversely, in our estimates.

Financial Statements (consolidated)

Income statement					(INR mn)
Year to March	FY05	FY06	FY07	FY08E	FY09E
Income from operations	14,711	17,751	21,228	29,050	36,179
Direct costs	9,908	11,729	13,885	18,747	23,292
Employee costs	1,157	1,395	1,541	2,270	2,894
Other expenses	1,852	2,084	2,348	3,631	4,522
Total operating expenses	12,917	15,208	17,774	24,649	30,709
EBITDA	1,794	2,543	3,454	4,401	5,470
Depreciation and amortisation	414	400	381	502	562
EBIT	1,380	2,143	3,073	3,899	4,909
Interest expenses	41	45	65	53	39
Other income	671	645	912	762	925
Profit before tax	2,010	2,743	3,920	4,608	5,795
Provision for tax	653	902	1,241	1,497	1,845
Extraordinary items	23	5	-	-	-
Reported profit	1,334	1,836	2,680	3,112	3,950
Adjusted net profit	1,357	1,841	2,680	3,112	3,950
Shares outstanding	198	198	198	198	198
Dividend per share	4.0	4.0	5.3	5.5	5.6
Dividend payout (%)	58.4	43.0	39.4	34.7	28.3

Common size metrics- as % of net revenues

Year to March	FY05	FY06	FY07	FY08E	FY09E
Operating expenses	87.8	85.7	83.7	84.9	84.9
Depreciation	2.8	2.3	1.8	1.7	1.6
Interest expenditure	0.3	0.3	0.3	0.2	0.1
EBITDA margins	12.2	14.3	16.3	15.1	15.1
Net profit margins (adjusted)	9.2	10.4	12.6	10.7	10.9

Growth metrics (%)

Year to March	FY05	FY06	FY07	FY08E	FY09E
Revenues	24.9	20.7	19.6	36.8	24.5
EBITDA	42.0	41.7	35.8	27.4	24.3
PBT	35.4	36.5	42.9	17.6	25.8
Net profit	26.5	35.7	45.5	16.1	27.0
EPS	26.5	35.7	45.5	16.1	27.0

Cash flow statement

Cash flow statement					(INR mn)
Year to March	FY05	FY06	FY07E	FY08E	FY09E
Net profit	1,334	1,836	2,680	3,112	3,950
Add: Depreciation	414	400	381	502	562
Add: E.O.adjustments	23	5	-	-	-
Gross cash flow	1,771	2,241	3,061	3,613	4,512
Less: Dividends	935	947	1,266	1,297	1,341
Less: Changes in W. C.	1,645	322	972	1,608	1,660
Operating cash flow	(809)	972	822	708	1,510
Less: Change in investments	(1,057)	419	(9)	-	-
Less: Capex	515	160	664	871	724
Free cash flow	(268)	393	167	(164)	787

Balance sheet					(INR mn)
As on 31st March	FY05	FY06	FY07E	FY08E	FY09E
Equity capital	396	396	396	396	396
Reserves & surplus	7,241	8,130	9,168	10,984	13,600
Shareholders funds	7,637	8,526	9,564	11,380	13,996
Secured loans	340	108	740	940	840
Unsecured loans	325	323	325	325	0
Borrowings	665	431	1,065	1,265	840
Sources of funds	8,302	8,958	10,630	12,645	14,836
Gross block	5,425	5,589	6,253	7,125	7,848
Accumulated depreciation	3,309	3,669	4,113	4,614	5,176
Total fixed assets	2,116	1,920	2,141	2,511	2,673
Investments	2,313.9	2,732.9	2,723.5	2,723.5	2,723.5
Inventories	2,806	2,784	3,458	4,537	5,650
Sundry debtors	3,363	4,054	5,036	6,606	8,227
Cash and equivalents	107	128	617	655	1,023
Loans and advances	1,164	1,348	1,335	1,751	2,181
Other current assets	94	101	61	80	99
Total current assets	7,534	8,415	10,506	13,627	17,180
Sundry creditors and others	2,600	3,081	3,458	4,537	5,650
Provisions	964	1,021	1,274	1,671	2,081
Total CL & provisions	3,564	4,102	4,732	6,207	7,731
Net current assets	3,970	4,313	5,774	7,420	9,449
Add / (Less) : Defer. tax asset/ Liability	(55)	1	1	1	1
Others	(43)	(10)	(10)	(10)	(10)
Uses of funds	8,302	8,958	10,630	12,645	14,836
Book value per share (BV) (INR)	39	43	48	57	71

Ratios

Year to March	FY05	FY06	FY07E	FY08E	FY09E
ROAE (%)	18.2	22.8	29.6	29.7	31.1
ROACE (%)	17.2	24.8	31.4	33.5	35.7
Current ratio	2.1	2.1	2.2	2.2	2.2
Debtors (days)	83	83	87	83	83
Fixed assets t/o (x)	6.1	7.9	8.3	9.8	11.5
Average working capital t/o (x)	4.6	4.3	4.2	4.4	4.3
Average capital t/o (x)	1.8	2.1	2.2	2.5	2.6
Net debt/equity	(0.2)	(0.3)	(0.2)	(0.2)	(0.2)
Gross debt/equity	0.1	0.1	0.1	0.1	0.1

Valuations parameters

Year to March	FY05	FY06	FY07E	FY08E	FY09E
EPS (INR)	6.9	9.3	13.5	15.7	20.0
Y-o-Y growth (%)	26.5	35.7	45.5	16.1	27.0
CEPS (INR)	8.9	11.3	15.5	18.2	22.8
P/E (x)	45.4	33.5	23.0	19.8	15.6
Price/BV(x)	8.1	7.2	6.4	5.4	4.4
EV/Sales (x)	4.0	3.3	2.8	2.0	1.6
EV/EBITDA (x)	33.1	23.3	17.2	13.5	10.8

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INDIA RESEARCH

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RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	Reduce	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	Sell	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period	Trading Sell	Expected to depreciate more than 10% over a 45-day period

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