

Cummins India Ltd

Margins continue to surprise

Cummins India's (KKC) Q1FY11 results have beaten our and street estimates by a significant margin. More importantly, however, the management has meaningfully upgraded its estimates for revenue and margin growth; the scaled up revenue guidance for FY11 now stands doubled to 40% YoY from 20% earlier. According to the management, the upgrades in guidance are driven by: 1) greater robustness in the domestic and exports businesses, 2) higher operating leverage, and 3) increased productivity to limit margin decline. To factor in the improvement in KKC's business dynamics, we increase our revenue estimates by 16%/26.1% and EPS estimates by 20.8%/31% for FY11E and FY12E respectively. This leads us to upgrade our March '11 target price to Rs 750 (from Rs 575 earlier). While the company's RoCE and growth profile has exceeded our expectations, the recent run up in the stock leaves little room for a valuation upside. Maintain Hold.

Exports rebound, drive growth: During Q1FY11, KKC's revenues surged 45.5% YoY to Rs 91bn, driven by a growth of 130% YoY in exports and 31% in domestic sales. EBITDA margin too expanded 316bps YoY to 19.7% on lower raw material and staff costs (as a % of sales) even as other expenses jumped 103.4% YoY during the quarter. Re-classification of expenses related to warranties under 'other expenses' increased other expenses by Rs 150mn YoY.

Operating leverage enhances margins: According to the management, a 316bps YoY expansion in the EBITDA margin was contributed by the following: 1) Operating leverage (+150bps), 2) cost reduction and productivity related improvements (+50bps), and 3) improvement in the product mix (around +100bps). Commodity price inflation, however, had a negative impact on margins.

Supply chain improvements, the next lever: The management stated that after having successfully undertaken initiatives related to productivity and cost improvement over the last few years, KKC will increasingly focus on productivity improvement and capacity expansion across the supply chain. Over the long term, the management intends to reduce the total cost of ownership for customers by 20% through improvement on the supply chain front.

Focus on capacity expansion: On the capacity expansion front, KKC has undertaken the following projects at the Cummins mega site at Phaltan: 1) Set up heavy duty engines for exports, 2) deployed 200kVA generators for exports, 3) set up capacity for rebuilding and refurbishing engines, and 4) build a state-of-the-art spare parts distribution centre. The outlay for the above projects would be to the tune of Rs 1bn in FY11E.

Financial highlights

(Rs mn)	FY10E	FY11E	FY12E	FY13E
Revenue	28,125	39,548	49,590	60,485
Growth (%)	(14.1)	40.6	25.4	22.0
Adj net income	4,438	5,880	7,110	8,549
Growth (%)	7.1	32.5	20.9	20.2
FDEPS (Rs)	22.4	29.7	35.9	43.2
Growth (%)	7.1	32.5	20.9	20.2

Profitability and return ratios

(%)	FY10E	FY11E	FY12E	FY13E
EBITDA margin	18.8	18.8	18.4	18.3
EBIT margin	17.5	17.5	17.2	17.2
Adj PAT margin	15.8	14.9	14.3	14.1
ROE	30.0	34.3	34.0	33.0
ROIC	32.9	40.1	40.7	40.1
ROCE	29.8	34.1	33.9	32.9

What's New? Target Rating Estimates

CMP	TARGET	RATING	RISK
Rs 672	Rs 750	HOLD	HIGH

BSE	NSE	BLOOMBERG
500480	CUMMINSIND	KKC IN

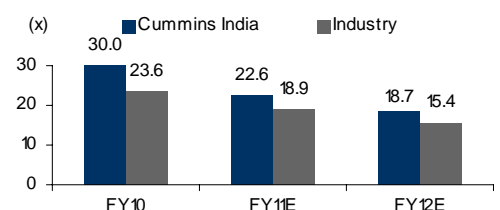
Company data

Market cap (Rs mn / US\$ mn)	133,066/2,569
Outstanding equity shares (mn)	198
Free float (%)	41.0
Dividend yield (%)	1.3
52-week high/low (Rs)	682 / 307
2-month average daily volume	217,725

Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
Cummins India	672	11.5	16.7	46.0
BSECG	14,690	(1.5)	9.1	13.0
Sensex	18,167	1.0	5.2	12.5

P/E comparison



Valuation matrix

(x)	FY10	FY11E	FY12E	FY13E
P/E @ CMP	30.0	22.6	18.7	15.6
P/E @ Target	33.5	25.3	20.9	17.4
EV/EBITDA @ CMP	25.2	17.9	14.6	12.0





Result highlights

Fig 1 - Actual vs estimated performance

(Rs mn)	Actual	Estimate	% Variance
Revenue	9,100	6,729	35.2
EBITDA	1,796	1,104	62.7
Adj net income	1,402	921	52.3
FDEPS (Rs)	7.1	4.7	52.3

Source: RCML Research

Fig 2 - Quarterly performance

(Rs mn)	Q1FY11	Q1FY10	% Chg YoY	Q4FY10	% Chg QoQ
Net sales	9,100	6,256	45.5	7,883	15.4
Less: Direct Cost	5,726	4,190	36.7	5,034	13.8
Staff Cost	530	514	3.1	509	4.0
Other Expenses	1,049	516	103.4	731	43.6
Expenditure	7,305	5,220	39.9	6,274	16.4
Operating profit	1,796	1,037	73.2	1,609	11.6
Other income	276	304	(9.3)	138	100.4
Interest	4	6	(25.5)	3	20.6
Depreciation	93	89	5.0	98	(4.6)
PBT	1,974	1,247	58.3	1,646	19.9
Tax	572	350	63.6	463	23.6
Reported PAT	1,402	897	56.3	1,183	18.5
Adj. PAT	1,402	897	56.3	1,183	18.5
EBITDA margin (%)	19.7%	16.6%	316	20.4%	(68)
EPS (Rs)	7.1	4.5	56.3	6.0	18.5

Source: Company, RCML Research

Fig 3 - Revised estimates

Key parameters (Rs mn)	FY11E			FY12E		
	Old	New	% Chg	Old	New	% Chg
Revenue	34,098	39,548	16.0	39,326	49,590	26.1
EBITDA margin (%)	18.7	18.8	5.7	18.6	18.4	-19.7
Net profit	4,867	5,880	20.8	5,428	7,110	31.0
FDEPS (Rs)	24.6	29.7	20.8	27.4	35.9	31.0

Source: RCML Research



Consolidated financials

Profit and Loss statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Revenues	28,125	39,548	49,590	60,485
<i>Growth (%)</i>	<i>(14.1)</i>	<i>40.6</i>	<i>25.4</i>	<i>22.0</i>
EBITDA	5,275	7,434	9,116	11,060
<i>Growth (%)</i>	<i>10.5</i>	<i>40.9</i>	<i>22.6</i>	<i>21.3</i>
Depreciation & amortisation	361	516	572	629
EBIT	4,914	6,918	8,544	10,432
<i>Growth (%)</i>	<i>13.8</i>	<i>40.8</i>	<i>23.5</i>	<i>22.1</i>
Interest	21	10	7	11
Other income	1,216	1,259	1,338	1,452
EBT	6,109	8,167	9,875	11,874
Income taxes	1,670	2,287	2,765	3,325
Effective tax rate (%)	27.3	28.0	28.0	28.0
Extraordinary items	-	-	-	-
Min into / inc from associates				
Reported net income	4,438	5,880	7,110	8,549
Adjustments	-	-	-	-
Adjusted net income	4,438	5,880	7,110	8,549
<i>Growth (%)</i>	<i>7.1</i>	<i>32.5</i>	<i>20.9</i>	<i>20.2</i>
Shares outstanding (mn)	198.0	198.0	198.0	198.0
FDEPS (Rs) (adj)	22.4	29.7	35.9	43.2
<i>Growth (%)</i>	<i>7.1</i>	<i>32.5</i>	<i>20.9</i>	<i>20.2</i>
DPS (Rs)	12.0	12.0	12.0	12.0

Cash flow statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Net income + Depreciation	4,799	6,396	7,682	9,178
Non-cash adjustments	61	-	-	-
Changes in working capital	2,238	(2,343)	(2,767)	(2,061)
Cash flow from operations	7,097	4,053	4,916	7,117
Capital expenditure	(607)	(900)	(900)	(900)
Change in investments	(3,337)	-	-	-
Other investing cash flow	-	-	-	-
Cash flow from investing	(3,944)	(900)	(900)	(900)
Issue of equity	-	-	-	-
Issue/repay debt	(126)	-	-	-
Dividends paid	(2,780)	(2,780)	(2,780)	(2,780)
Other financing cash flow	5	5	5	5
Change in cash & cash eq	253	378	1,240	3,442
Closing cash & cash eq	559	937	2,178	5,619

Economic Value Added (EVA) analysis

Y/E March	FY10E	FY11E	FY12E	FY13E
WACC (%)	11.3	11.3	11.3	11.3
ROIC (%)	32.9	40.1	40.7	40.1
Invested capital (Rs mn)	15,696	18,801	23,136	28,910
EVA (Rs mn)	338,951	541,138	680,713	831,505
EVA spread (%)	21.59	28.78	29.42	28.76

Balance sheet

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Cash and cash eq	559	937	2,178	5,619
Accounts receivable	5,229	7,353	9,220	11,246
Inventories	4,097	5,758	7,256	8,861
Other current assets	2,788	3,890	4,878	5,949
Investments	7,329	7,329	7,329	7,329
Gross fixed assets	7,776	8,676	9,576	10,476
Net fixed assets	3,337	3,721	4,049	4,320
CWIP	-	-	-	-
Intangible assets				
Deferred tax assets, net	170	170	170	170
Other assets	-	-	-	-
Total assets	23,508	29,158	35,080	43,495
Accounts payable	5,178	7,277	9,171	11,200
Other current liabilities				
Provisions	2,634	3,079	2,772	3,385
Debt funds	86	86	86	86
Other liabilities				
Equity capital	396	396	396	396
Reserves & surplus	15,214	18,319	22,654	28,428
Shareholder's funds	15,610	18,715	23,050	28,824
Total liabilities	23,508	29,158	35,080	43,495
BVPS (Rs)	78.8	94.5	116.4	145.6

Financial ratios

Y/E March	FY10	FY11E	FY12E	FY13E
Profitability & Return ratios (%)				
EBITDA margin	18.8	18.8	18.4	18.3
EBIT margin	17.5	17.5	17.2	17.2
Net profit margin	15.8	14.9	14.3	14.1
ROE	30.0	34.3	34.0	33.0
ROCE	29.8	34.1	33.9	32.9
Working Capital & Liquidity ratios				
Receivables (days)	68	68	68	68
Inventory (days)	81	82	83	83
Payables (days)	102	104	104	104
Current ratio (x)	1.6	1.7	2.0	2.2
Quick ratio (x)	1.0	1.1	1.2	1.2
Turnover & Leverage ratios (x)				
Gross asset turnover	3.7	4.8	5.4	6.0
Total asset turnover	1.9	2.3	2.4	2.3
Interest coverage ratio	221.4	570.8	1,053.1	891.0
Adjusted debt/equity	0.0	0.0	0.0	0.0
Valuation ratios (x)				
EV/Sales	4.7	3.4	2.7	2.2
EV/EBITDA	25.2	17.9	14.6	12.0
P/E	30.0	22.6	18.7	15.6
P/BV	8.5	7.1	5.8	4.6



Quarterly trend

Particulars	Q1FY10	Q2FY10	Q3FY10	Q4FY10	Q1FY11
Revenue (Rs mn)	6,256	6,191	8,279	7,883	9,100
YoY growth (%)	(11.5)	(23.4)	7.4	(26.4)	45.5
QoQ growth (%)	(41.6)	(1.1)	33.7	(4.8)	15.4
EBITDA (Rs mn)	948	1,036	1,822	1,512	1,702
EBITDA margin (%)	15.2	16.7	22.0	19.2	18.7
Adj net income (Rs mn)	897	877	1,481	1,183	1,402
YoY growth (%)	1.7	(6.6)	29.8	0.1	56.3
QoQ growth (%)	(24.1)	(2.2)	68.9	(20.1)	18.5

DuPont analysis

(%)	FY09	FY10E	FY11E	FY12E	FY13E
Tax burden (Net income/PBT)	71.5	72.7	72.0	72.0	72.0
Interest burden (PBT/EBIT)	134.3	124.3	118.1	115.6	113.8
EBIT margin (EBIT/Revenues)	13.2	17.5	17.5	17.2	17.2
Asset turnover (Revenues/Avg TA)	188.4	229.3	236.5	232.4	226.7
Leverage (Avg TA/Avg equity)	119.5	116.7	122.2	124.6	126.1
Return on equity	33.2	30.0	34.3	34.0	33.0

Company profile

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

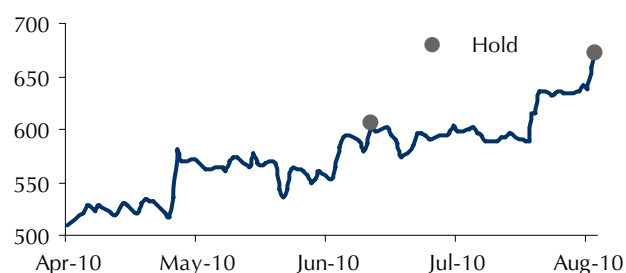
Shareholding pattern

(%)	Sep-09	Dec-09	Mar-10
Promoters	51.0	51.0	51.0
FIs	10.0	10.7	10.8
Banks & FIs	28.8	28.4	28.3
Public	10.2	10.0	9.9

Recommendation history

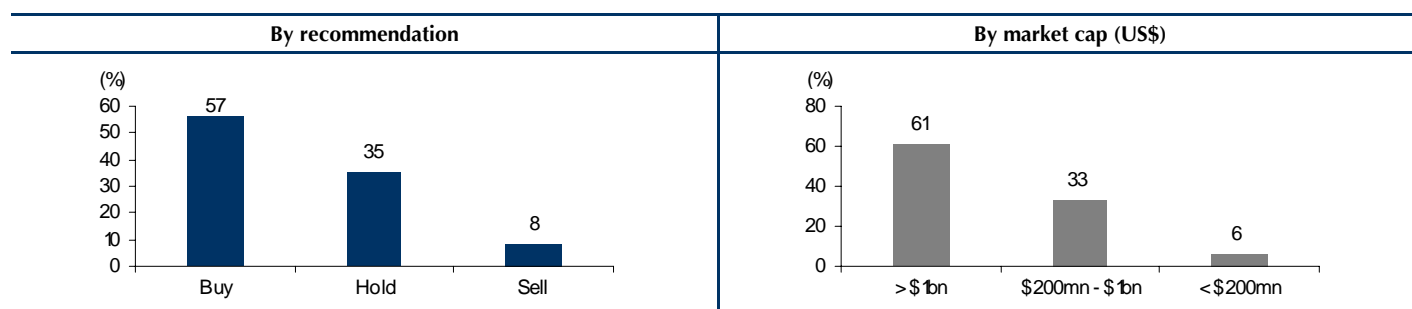
Date	Event	Reco price	Tgt price	Reco
21-Jun-10	Initiating Coverage	607	575	Hold
13-Aug-10	Results Review	672	750	Hold

Stock performance





Coverage Profile



Recommendation interpretation

Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
Hold	Between 15% and -5%
Sell	Less than -5%

Recommendation structure changed with effect from March 1, 2009

Expected absolute returns are based on share price at market close unless otherwise stated. Stock recommendations are based on absolute upside (downside) and have a 12-month horizon. Our target price represents the fair value of the stock based upon the analyst's discretion. We note that future price fluctuations could lead to a temporary mismatch between upside/downside for a stock and our recommendation.

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