

CMP	Rs480
Target 12m	Rs584 (22%)
Market cap (US\$ m)	2,448
Enterprise value (US\$ m)	2,448
Bloomberg	KKC IN
Sector	Capital Goods

22 March 2013

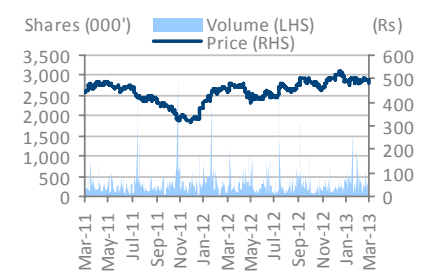
52Wk High/Low (Rs)	550/395
Shares o/s (m)	277
Daily volume (US\$ m)	3
Dividend yield FY13ii (%)	3.1
Free float (%)	49.0

Shareholding pattern (%)

Promoter	51.0
FII	12.9
DII	21.7
Others	14.5

Price performance (%)

	1M	3M	1Y
Cummins India	(2.9)	(5.1)	5.8
Absolute (US\$)	(3.2)	(2.8)	2.1
Rel. to Sensex	0.1	(2.4)	(3.2)
CAGR (%)	3 yrs	5 yrs	
EPS	9.2	17.4	

Stock movement**A bright spot in the power sector mess**

As a market-leading diesel engine supplier, Cummins India (KKC) is relatively immune to the Indian capex cycle. Outlook for gensets delivering prime power improves with diminishing power capex and need for back-up power boosts demand in an upcycle. KKC's brand franchise is difficult to replicate in an industry requiring high after-sales customer engagement. Its leadership position would sustain superior margins and returns. Valuations at 16x FY15ii discount near-term earnings but do not reflect KKC's unique position among cap-goods vendors wherein price is not the main basis of competition.

Structural growth story relatively immune to cycles: KKC is among the few companies that are relatively immune to the current capex slowdown as it benefits from the continued, severe power deficit in India. With multiple issues plaguing the power sector, grid power will continue to be unreliable. This engenders robust demand for diesel generators. KKC, a dominant supplier of diesel engines with industry-leading product offerings and strong distribution network, is well placed to ride the robust demand. Pickup in industrial-capex-led demand will further boost revenue growth for the company.

Strong brand to aid margin improvement: KKC derives strength from the technological leadership of its parent, which enables it to offer a range of superior products. With emission norms becoming stricter, this technological superiority is especially useful. Operating leverage driven by robust demand environment, focus on cost efficiencies, ability to indigenise rapidly, and a stable royalty payment to parent would help KKC improve margins. Prospects of increased competition in the high-margin segments are not particularly high.

Robust fundamentals justify premium valuations: We expect KKC to register 16.5% net profit Cagr over FY12-15 driven by 13.6% revenue Cagr and 100bps Ebitda margin expansion. We expect ROE to improve to 32-33% in FY14-15 despite high capex at the Phaltan megasite. This contrasts with other capital goods vendors such as Siemens, ABB, and Thermax that have little visibility of an improvement in the near term. Key risks to medium-term growth trajectory include: 1) Cummins Inc choosing vehicles other than KKC for launching new products; and 2) investments being strategically important to the group but earning sub-par returns for KKC.

Financial summary (Rs m)

Y/e 31 Mar, Parent	FY11A	FY12A	FY13ii	FY14ii	FY15ii
Revenues (Rs m)	40,425	41,172	45,256	52,017	60,298
Ebitda margins (%)	18.9	16.9	17.4	17.7	18.0
Pre-exceptional PAT (Rs m)	5,910	5,398	6,770	7,576	8,527
Reported PAT (Rs m)	5,910	5,913	6,770	7,576	8,527
Pre-exceptional EPS (Rs)	21.3	19.5	24.4	27.3	30.8
Growth (%)	33.1	(8.7)	25.4	11.9	12.6
PER (x)	22.5	24.6	19.7	17.6	15.6
ROE (%)	35.1	28.0	31.6	32.1	32.8
Net debt/equity (x)	(0.4)	(0.4)	(0.3)	(0.1)	0.0
EV/Ebitda (x)	17.4	19.1	16.9	14.4	12.3
Price/book (x)	7.4	6.5	5.9	5.4	4.9

Source: Company, IIFL Research. Price as at close of business on 22 March 2013.

Gopal Ritolia

gopal.ritolia@iiflcap.com

91 22 4646 4651

Anupam Gupta

anupam.gupta@iiflcap.com

91 22 4646 4641

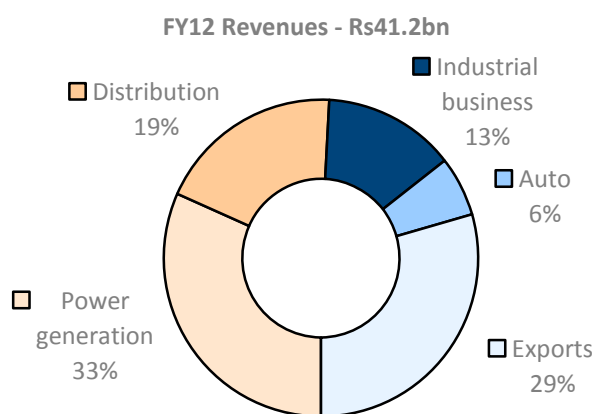
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Company snapshot

Cummins India (KKC) is a 51%-owned subsidiary of Cummins Inc, USA and is the leading manufacturer of diesel engines used in generators in India. KKC has been present in India since 1962 when it started off in partnership with Kirloskar in Pune, Maharashtra. Cummins Inc acquired Kirloskar’s stake in 1997, increasing its stake to 51% and it renamed the company Cummins India Ltd.

KKC has eight manufacturing facilities in Maharashtra and Gujarat. The company produces ~40,000 engines annually for the industrial sector and ~10,000 engines annually for power generation. The product range includes diesel engines from 15kVA to 2,000kVA for various power/industrial uses. The business is organised into five segments: power generation, industrial engines, automotive, distribution, and exports. Power generation and exports contributed ~65% of the total FY12 revenue.

Figure 1: Power generation and exports form ~65% of revenue



Source: Company, IIFL Research

KKC is the leader in the domestic diesel generator market with more than 33% market share by value. Importantly, leadership is driven by dominant share in the medium-to-heavy horsepower engines, which have higher profitability, compared with low HP engines. An extensive distribution and service network of 34 dealers, 250 branches, and 2500 field engineers and technicians supports the company’s leadership position.

KKC is led by Anant Talualicar, who has been MD and CEO of Cummins Inc’s India operations since FY05. KKC’s management team has remained stable, steering the company on a steady growth path.

Figure 2: Key management personal

Person	Designation	Remarks
Anant J Talaulicar	Chairman and MD	Worked with Cummins Inc since 1986 across businesses. MD of KKC since Mar-2004
Rajiv Batra	Chief Financial Officer	CFO since Jul-2004. Prior experience with Xerox and Digital Equipment India
Mahesh Narang	Chief Operating Officer	
Amit Kumar	Head, Power Generation	
Vipul Tandon	Head, Distribution	

Source: Company, IIFL Research

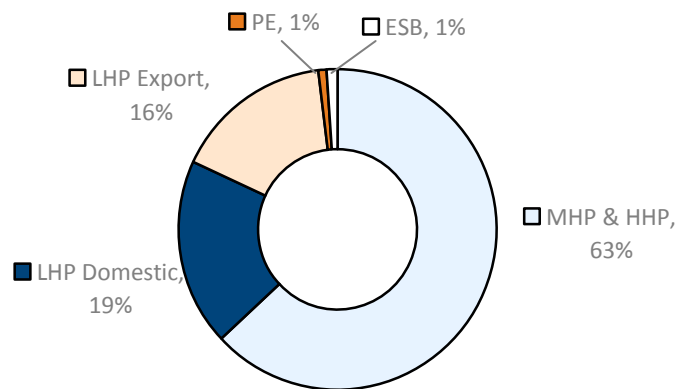
Structural growth story; relatively immune to capex cycles

Cummins India is among the few companies that are immune to the current capex slowdown since it benefits from the continued, severe power deficit in India. With multiple issues plaguing the power sector, grid power will continue to be unreliable. This creates sustained, robust demand for alternative powergen equipment such as diesel generators. KKC, a dominant supplier of diesel engines with a superior product offering and a strong distribution network is well placed to ride on this demand growth. Pickup in industrial-capex-led demand will further boost revenue growth for KKC.

Persistent power deficit drives genset demand

The powergen business contributes 33% of KKC’s revenue. With power deficit remaining high, the segment is a key growth driver. KKC is the market leader in medium-to-high horse power (HP) segment with which contributed 63% of total powergen revenue in 2011.

Figure 3: Medium and High HP are the key segments for KKC in powergen

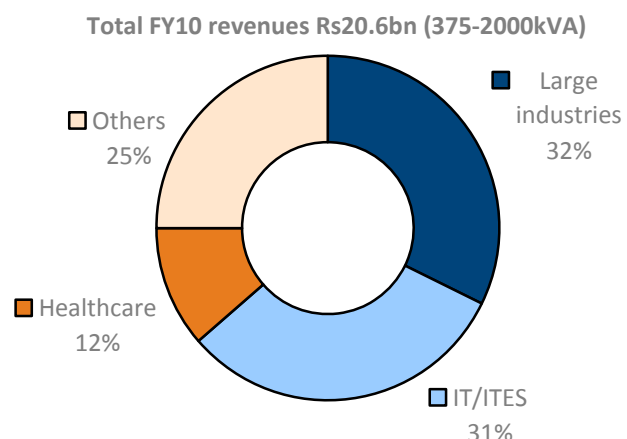


Source: Company, IIFL Research

Need for reliable power drives demand for gensets

Industrial users, IT/ITES and healthcare companies are the largest users of diesel gensets, given the critical need for reliable power for continuity of operations.

Figure 4: Need for reliable power makes industries, IT/ITES and healthcare segments the largest users of diesel generator (DG) sets

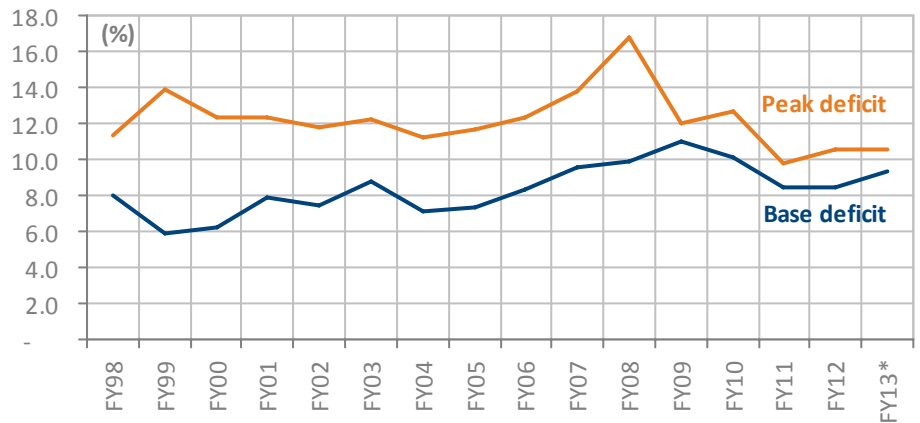


Source: Powerica DRHP, IIFL Research

Power deficit will sustain on slow power capacity addition

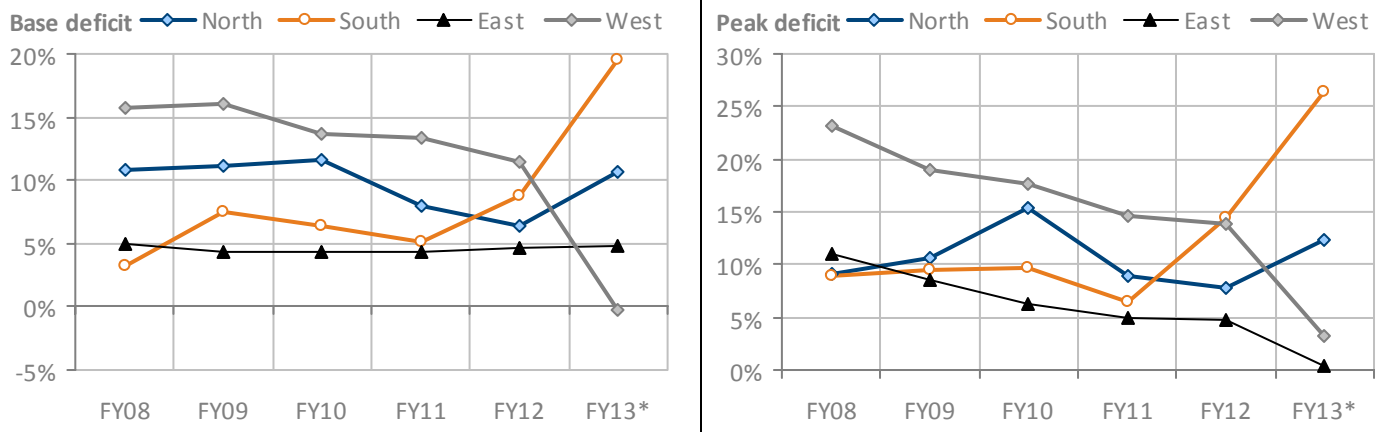
Power capacity addition of 54.9GW during the XI Plan was much higher than the earlier plans. However, it was still much lower than the original XI plan target of ~78GW. Continued shortage of domestic coal and stressed finances of state electricity boards (SEBs) and private utilities mean that power deficit would continue to remain high across regions.

Figure 5: All India power deficit will remain high as capacity addition slows



Source: CEA, IIFL Research *Estimate by CEA

Figure 6: Power deficit is increasing in the northern and southern states



Source: CEA, IIFL Research *Estimate by CEA

Southern states are resorting to large power cuts

The increase in overall power deficit is being driven by the southern and northern regions with all the four key states in the South resorting to increasing power holidays for industries as well as load shedding for urban areas. Moreover, apart from these scheduled power cuts, industries in these and other states also face unscheduled power cuts, making grid supply very unreliable. Loss of production due to abrupt outages and unreliable grid supply strengthens demand for gensets as primary as well as back-up power supply.

Figure 7: Southern states are resorting to severe power cuts for industrial users

	Apr-12	Jul-12	Sep-12	Jan-13
Andhra Pradesh	1-5 day power holiday per week and severe peak hour restrictions	2-3 day power holiday per week and peak hour restrictions	2-3 day power holiday per week and peak hour restrictions	3 day power holiday per week and peak hour restrictions
Tamil Nadu	40% power cut for HT customers; one day holiday apart from Sunday	40% power cut for HT customers; upto 2658MW load shedding	40% power cut for HT customers; upto 4376MW load shedding	40% power cut for HT customers; upto 3327MW load shedding
Kerala	Upto 1100MW load shedding during peak hours	Upto 750MW load shedding during peak hours	Upto 575MW load shedding during peak hours	Upto 500MW load shedding during peak hours
Karnataka	Upto 3450MW load shedding during peak hours	Upto 2200MW load shedding during peak hours	Upto 2400MW load shedding during peak hours	Upto 2500MW load shedding during peak hours
Uttar Pradesh	NA	200-900MW cut for HT/LT industries	900MW cut on HT/LT industries	NA

Source: CEA, IIFL Research

Power capacity addition targets are ambitious

Slowing generation sector capex benefits Cummins

We do not expect the power deficit situation to improve substantially from the current level. Even as power demand continues to increase, slowdown in the pace of power generation capacity addition is the key problem. Planning Commission has set a target of adding 88.5GW of generation capacity during the XII Plan. With ~130GW of coal and lignite-based capacity under construction, the comfort on meeting targets should be high.

Figure 8: Fuel supply issues will lead to slow capacity addition in XII plan

MW	Hydro	Coal	Lignite	Gas/LNG	Nuclear	Total
Central	6,004	13,800	250	828	5,300	26,182
State	1,608	12,210	-	1,712	-	15,530
Private	3,285	43,270	270	-	-	46,825
Total	10,897	69,280	520	2,540	5,300	88,537

Source: CEA, IIFL Research

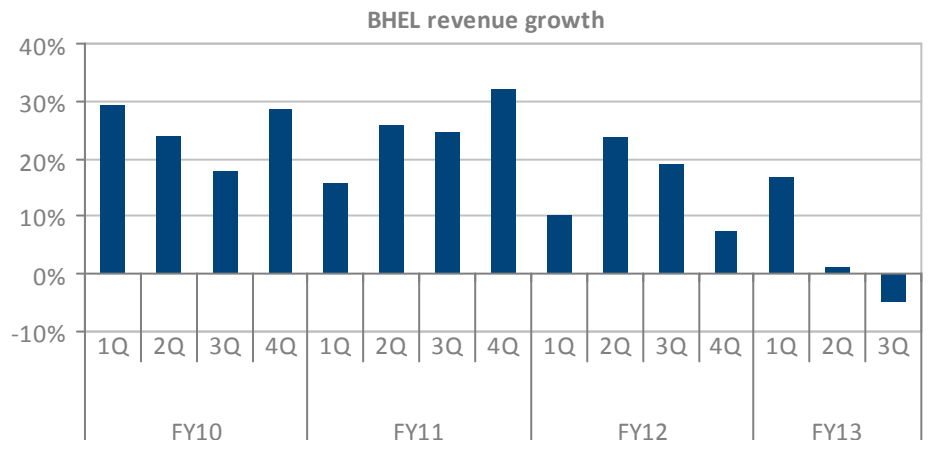
But fuel supply and poor SEB health pose problems

However, majority of the coal-based power plants commissioned recently or those under implementation have yet to sort out fuel supply problems. With domestic coal production growth falling well short of the requirement of the power sector itself, reliance on imports is increasing. However, cash-strapped SEBs have little appetite for costly power based on higher-priced imported coal. There seems little headway in the proposal to circumvent higher import prices of coal through price pooling.

Revenue growth for generation equipment suppliers is slowing

The problems faced by developers are already manifesting in the form of slowing execution. Slowing revenue growth and increasing receivables for BHEL, the largest power equipment vendor is a prime example of slowing execution of projects under development. New project awards in the sector have also slowed down to a trickle due to uncertainty on fuel supply and power offtake issues.

Figure 9: Revenue growth for power equipment suppliers has slowed



Source: Company, IIFL Research

Lack of alternatives to drive demand for diesel gensets

Hence, despite the high per unit cost of diesel based genset power (~Rs13/unit) compared with grid power cost (Rs3.5-4/unit), we expect demand for diesel gensets to remain robust. Ongoing increases in price of diesel would increase the cost of power. However, demand is unlikely to be impacted much, in the absence of alternatives. A few key advantages of diesel generator (DG) sets over other sources of power are:

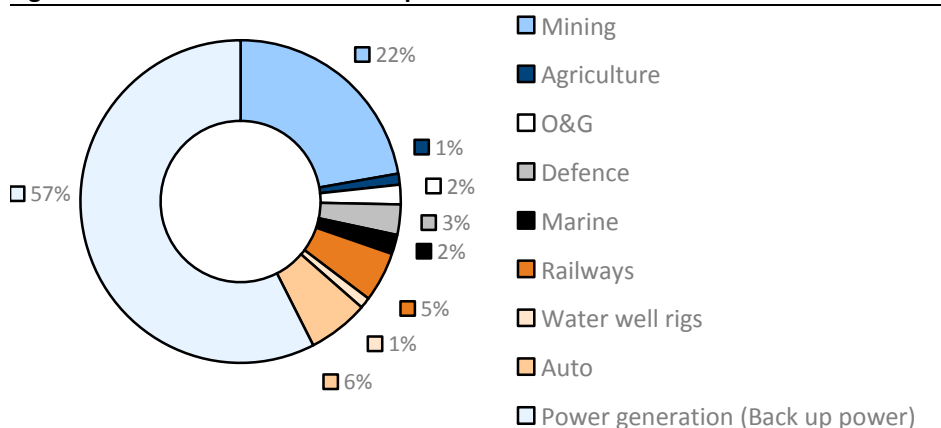
- Diesel availability is not a concern and does not suffer from regulatory interference. Other alternatives such as gas, biogas and agriculture wastes are not available or are seasonal and have logistics issues.
- Lead time for setting up a diesel genset at ~ 12 months is much shorter than lead time of ~36 months for gas-based plants.
- There is no requirement to tap into the transmission network as DG sets are local, unlike other plants that have to be at a different location than the end-use plants.

Increasing base of installed engines drives demand for distribution division

Robust powergen segment to drive growth of the distribution segment as well

Minimal downtime and high reliability are the key requirements for industries as well as commercial genset users. As a result, customers tend to rely on dependable service providers such as KKC for after sales service. KKC’s distribution segment caters to the after sales service and maintenance needs for the large installed base of Cummins engines. KKC currently has an installed base of ~350,000 engines across India, Nepal, and Bhutan.

Figure 10: Sector-wise revenue composition of the Distribution division



Source: Company, IIFL Research

A key offering of the division is the annual maintenance contracts to ensure consistent uptime. KKC also offers an exchange programme where a Cummins engine that is due for overhaul is immediately replaced with another reconditioned engine with no downtime when the original is sent for repair/overhaul. The company also sells engines reconditioned by Cummins Technologies India Ltd (subsidiary of Cummins Inc).

Spare part sales contribute 60% of distribution segment revenues

Currently, sale of spare parts form ~60% of the distribution segment sales. The rest is evenly split between sale of engines to small OEMs, maintenance contracts for generators for companies with a pan-India footprint and the ReCon business.

KKC's focus on maximising customer satisfaction with in its existing base is paying off with such customers driving repeat/referral sales of Cummins engines. The company has also established a new dedicated training centre to expand its base of qualified engineers for this division. KKC has also formed a 50:50 JV with one its dealers (SVAM Power Plants) to focus on sales and service of Cummins engines and generator sets in Northern India.

Demand for after sales will sustain even as power deficits come down

An important aspect of the distribution business is that it is not just driven by increasing sales of new Cummins engines. Given the nature of application of these engines, customers cannot afford unreliable operations from gensets even if grid power reliability increases. Currently, many customers have in-house teams for operation and maintenance of DG sets as these are the prime source of power. As DG sets come to be used as back-up source of power, these in-house teams would be replaced by outsourced teams from Cummins to ensure proper maintenance and reliability of DG sets at lower costs.

Revival in mining capex will help improve industrial segment demand

The industrial business division caters to engine requirements for sectors such as mining, construction equipment and compressors, marine engines, rail locomotives, and the oil & gas sectors. Key product offerings include diesel engines in the 18-3,500 HP range.

Figure 11: KKC has a comprehensive product offering for industrial use

Mining	Construction and Compressors	Light construction	Marine	Rail	O&G
Dumpers	Excavators	Excavators	Defence	Locomotives	Oil rigs
Dozers	Compressors		Marine propulsion	Power car	Gas compression
Surface Miners	Industrial and fire pumps		Commercial marine		

Source: Company, IIFL Research

Figure 12: Large equipment manufacturers rely on KKC for their engine requirements

Equipment	Key OEM customers for Cummins
Dump trucks/Haul trucks	BEML, Telcon (Hitachi-Tata Motor JV), Hitachi, Komatsu, Terex, Liebherr
Excavators/Shovels	JCB India, BEML, Telcon, L&T-Komatsu, Kiebherr, O&K, Pipe Layer, Komatsu, Hitachi
Blast hole rigs & drills	Atlas Copco, Revathi Equipment
Cranes	Telcon
Surface miner/road miller	L&T Komatsu, L&T Roadmiller
Water sprinkler, de-watering pump, gensets	BEML, others
Wheel loaders	JCB India, Komatsu, Letourneau

Source: Company, Industry data, IIFL Research

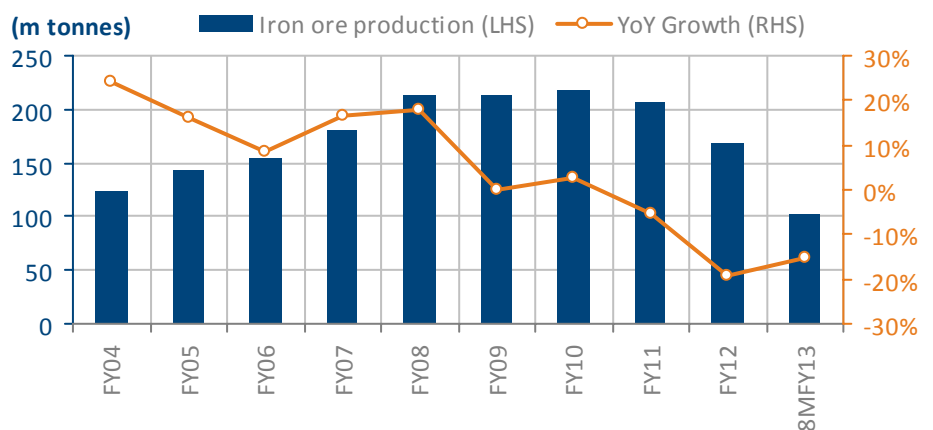
Slowdown in infra and mining capex has impacted industrial segment demand

KKC’s industrial segment sales have been impacted by slowdown in infrastructure projects and mining activity. Delays in securing environment clearances, land acquisition problems, and tight funding positions, have resulted in deferred execution. Mining activity was hit by the export ban on iron ore in Karnataka and Goa.

However, the mining slowdown seems to be bottoming out and this would aid KKC to improve growth in the industrial segment over the next year:

- Intense focus on growth in domestic coal production and rapidly growing demand from power as well as other sectors will drive faster implementation of mining projects that have been allocated /awarded to private as well as PSU miners. Faster regulatory clearance is the key trigger for pickup in coal mining capex.
- Bans in multiple states on iron ore mining had also impacted demand for new equipment that utilise large engines. A gradual lifting of these bans would also spur new equipment capex.
- An offshoot of mining sector capex is the need for transportation of mined coal and other ores. This will also drive demand for shunting and freight locomotives.
- Cummins would also benefit from increasing preference for electronic engines on dozers and excavators as these are more fuel efficient and less polluting.

Figure 13: Domestic iron ore production was impacted by mining ban; gradual removal of these bans will drive demand for KKC powered equipments



Source: Industry, IIFL Research

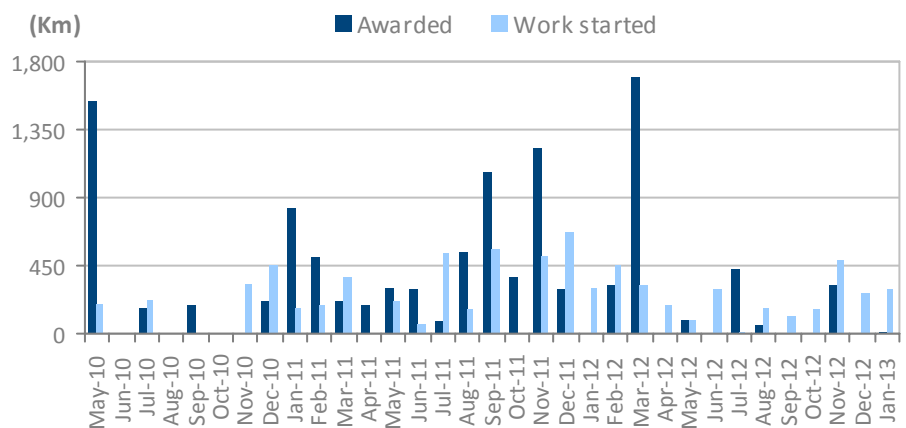
Roads and railways to support up tick in infra capex

Road and railway sector capex to keep construction segment demand steady

Apart from pickup in the mining segment, improvement in infrastructure capex on roads and railway would also aid demand in the construction segment.

- After numerous delays, project awards for the dedicated freight corridor are picking up pace with a large contract awarded on eastern corridor and packages on western corridor to be awarded in the next few months. Expansion of rail links, especially for coal evacuation from mines, is also under focus.
- The other large sector that will drive demand for KKC engines is the road construction sector. While large order inflows in FY12 should have translated into improved construction activity in FY13, delays in securing environment clearances and achieving financial closure have impacted commencement of construction activity. We expect that the backlog of projects awaiting execution to gradually start declining. Steps such as delinking environmental clearance from forest clearance should help. This should help boost construction activity in the sector.

Figure 14: Despite large quantum of road awards in FY12, commencement of construction is only picking up now



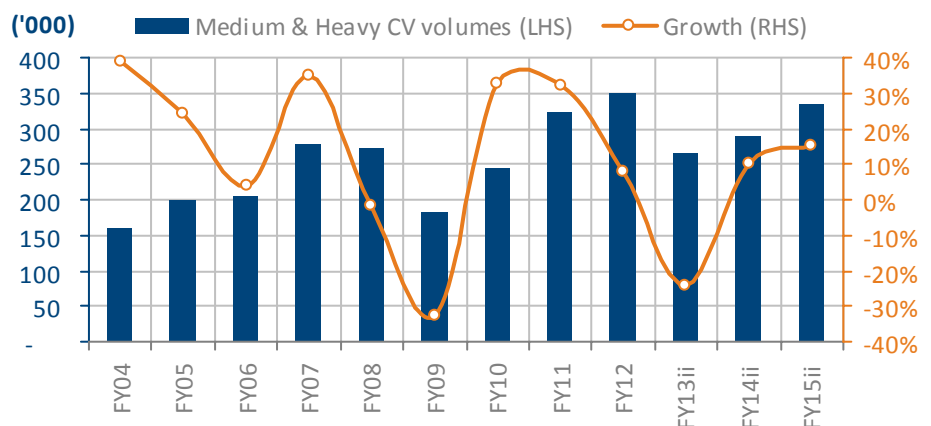
Source: NHAI, IIFL Research

CV volumes declining and we expect a bounce back over FY14-15

Auto sector demand to remain sluggish in the near term

Revenue from the auto sector contributes just 6% to KKC’s overall sales. The company sources diesel and gas-fired engines from TCIL (Tata-Cummins JV) and supplies to original equipment manufacturers of heavy commercial vehicles, except Tata Motors.

Figure 15: M&HCV volumes have declined but should bounce back in FY14-15ii



Source: SIAM, IIFL Research

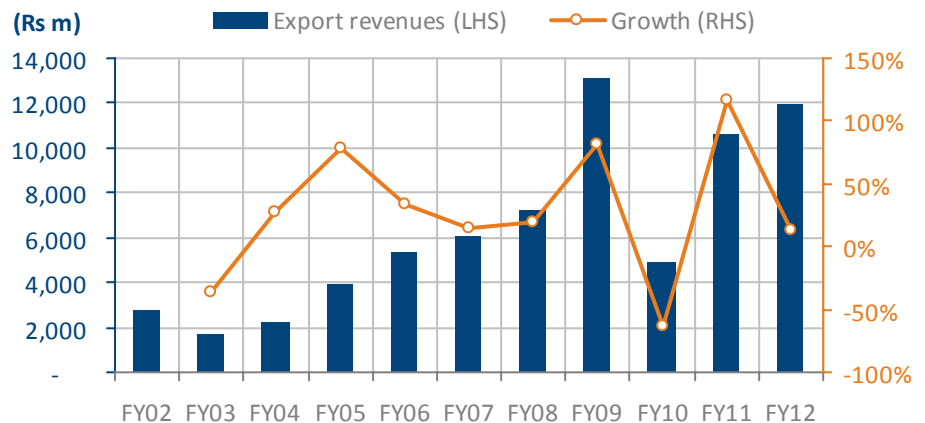
Shift to higher tonnage CVs positive for KKC

With the commercial vehicle segment amid a severe slowdown, we expect revenue of the auto division to remain sluggish. A positive for the division is the shift towards higher-tonnage vehicles in which KKC enjoys a higher market share. The shift to higher-tonnage vehicles will receive a boost on strict implementation of the penalties on overloading of trucks. One of the key provisions of the Motor Vehicle Amendment Bill, which has been passed by Rajya Sabha and is awaiting clearance from the Lok Sabha, is that apart from drivers, even fleet owners would be held responsible for overloading of trucks. It is important to note that a similar ban in FY07 has led to a sharp pickup in demand for trucks. We may see an improvement in truck sales once this bill is approved.

Demand for low HP gensets supporting export revenue growth

Exports: Low HP engines a bright spot amid sluggish demand
 KKC's exports are largely to customers of Cummins Inc and compete with products from other fellow subsidiaries in the UK and China. KKC's products are sold across geographies, including the Americas, Europe, the Middle East, Africa, and Asia. About 60-70% of exports are for the genset market, both engines and complete gensets. Export growth in recent years has been impacted by muted demand for high-HP engines in the developed economies.

Figure 16: Low HP gensets have supported export growth even as medium and high HP demand remains sluggish

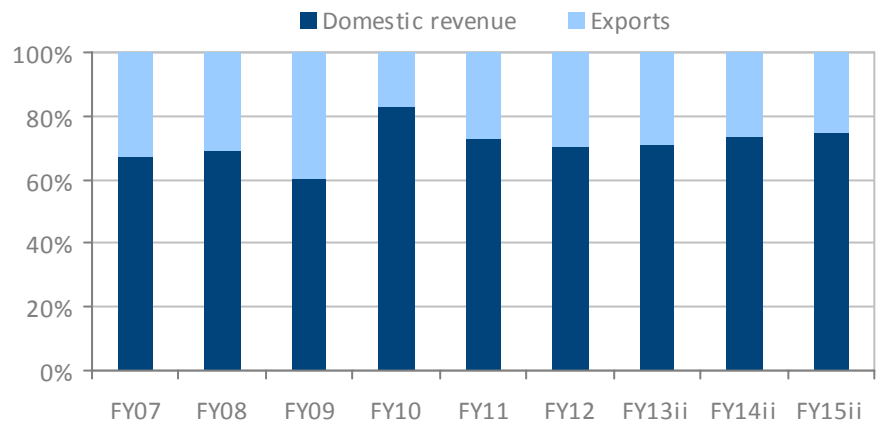


Source: Company, IIFL Research

New dedicated facility for exports of low HP engines a positive

In the next few years, export growth would be supported by the new facility for manufacturing <200kVA diesel generators. The new facility would likely become the global manufacturing hub for low-HP diesel engines for Cummins Inc. The new manufacturing plant at Phaltan (near Pune) will have a capacity of 30,000 engines per annum, which can be scaled up to 50,000 engines, depending on ramp-up in demand. However, given relatively slower growth of the export business vs domestic business, we estimate that share of revenue from exports reduce from 29% in FY12 to 25% by FY15.

Figure 17: Share of exports in total revenues to decline over FY13-15ii



Source: Company, IIFL Research

Strong brand and product offering to keep competition at bay

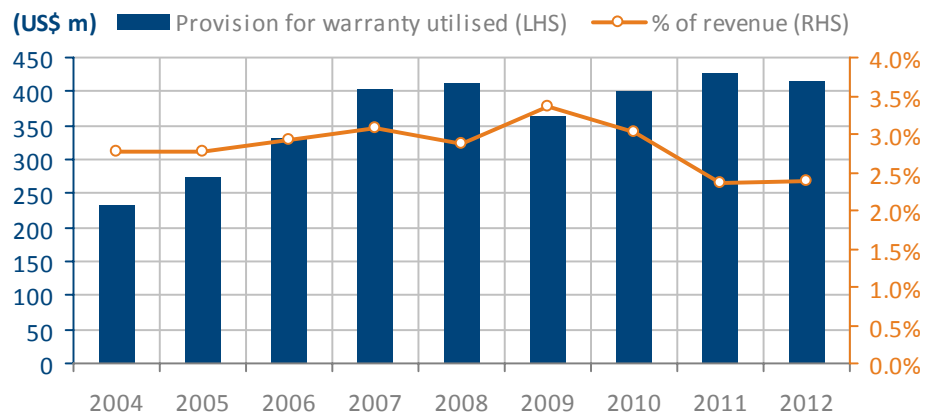
KKC derives strength from the technological leadership of Cummins Inc, its parent, which enables it to offer a range of superior products. With emission norms becoming stricter, this technological superiority is especially useful. In the backdrop of a continued, robust demand environment, focus on cost efficiencies, ability to indigenise quickly and reasonable royalty payment to parent would help KKC improve margins. With utilisation levels close to 50% for the high HP segment, operating leverage will also play a role. Prospects of increased competition in the high-margin segment are not particularly high.

KKC has access to parents leading product portfolio

Access to technology a key differentiator

A big driver of KKC's leadership position in terms of product offering is access to the parent's technological prowess. Cummins Inc is a global leader in design and manufacture of >200HP engines. Cummins Inc has one of the most comprehensive and superior product offerings, reflected in the consistently low warranty expenses.

Figure 18: Warranty provisions utilised has remained stable for Cummins Inc



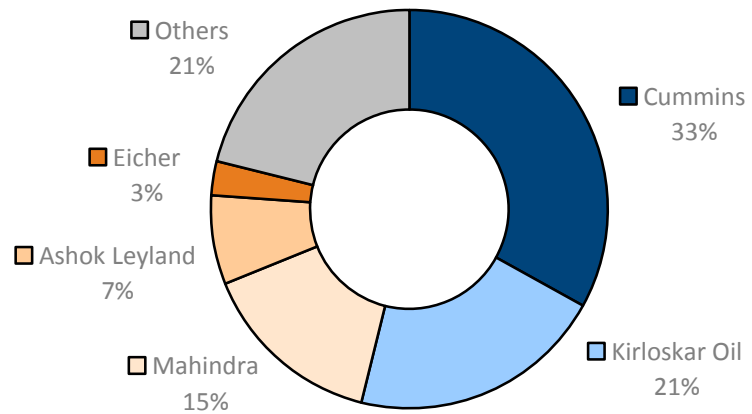
Source: Company, IIFL Research

Globally recognised brand drives customer preference for Cummins

OEMs and consumers consistently exhibit preference for Cummins engines

Global acknowledgement of the Cummins brand as well the product quality is the main reason for higher client preference of KKC's offerings over competitors. For example, when the Russian heavy vehicle manufacturer Kazan entered the Indian market, it offered a choice of own engines and Cummins engines to its customers. Customers overwhelmingly favoured vehicles powered by Cummins engines owing to established product quality and strong brand recognition of Cummins. Boosted by the parent's technological prowess, KKC enjoys leadership position in the mid-to-high range genset market.

Figure 19: KKC is the dominant player in the USD1.3bn domestic genset market



Source: Industry data, IIFL Research

Stricter emission norms improves leadership position

More importantly, the company is able to advance its lead over competition every time stricter emission control norms are enforced. This is because KKC has the ability to react faster, given its access to existing efficient products of Cummins Inc.

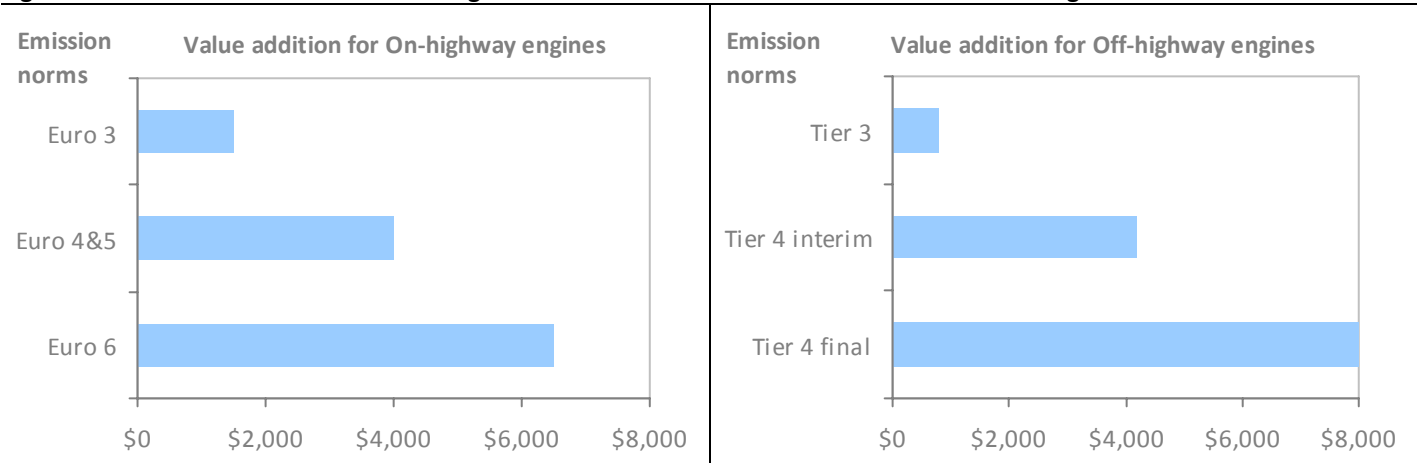
Figure 20: India lags other countries in adoption of stricter emission norms; KKC as a result gets advanced products faster

Market/Application	2010	2011	2012	2013	2014	2015	2016+
US on-highway	EPA10			EPA13	CO ₂		EPA16
Europe on-highway					Euro VI		CO ₂
Brazil on-highway			Euro V				Euro VI
China on-highway				Euro IV			Euro V
India on-highway	Euro IV (major cities)					Euro IV (Countrywide)	Euro V
US off-highway		Tier 4i	Tier 4i		Tier 4F		
Europe off-highway		Stage 3B			Stage 4		

Source: Company, IIFL Research

Stricter emission control norms also benefit KKC due to higher value addition and better realisations. According to the KKC management, the changeover of emission norms for engines below 800KW would result in genset prices increasing by ~20% in India.

Figure 21: Stricter emission norms drive higher value addition and increased content in diesel engines



Source: Company, IIFL Research

Extended product offering of parent is a positive for KKC in India

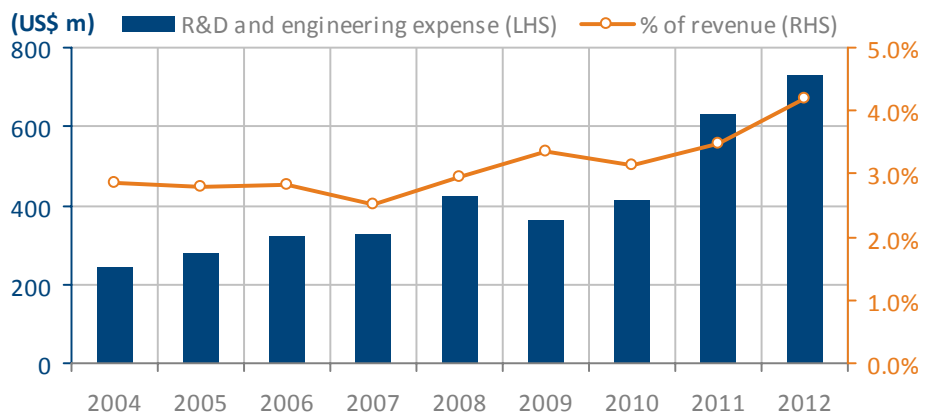
KKC also benefits from the various complementary business activities of Cummins Inc in India. Various other entities (held by the parent) are engaged in design, manufacture, distribution, and servicing of engines and related technologies including fuel systems, controls, air handling, filtration, emission solutions, and electrical power generation systems.

Increasing R&D spends key to maintain technological edge

R&D spends at Cummins Inc to remain strong

Given the continuous movement towards stricter emission control norms worldwide, technological improvement is a necessary condition to survive. Recognising the importance of R&D, Cummins Inc has plans to double R&D spend over the next few years. KKC too would benefit, as these products would be available to it to meet emission control norms in India and would enhance its offerings, compared with competition.

Figure 22: Cummins Inc continues to invest in R&D to maintain its technological edge



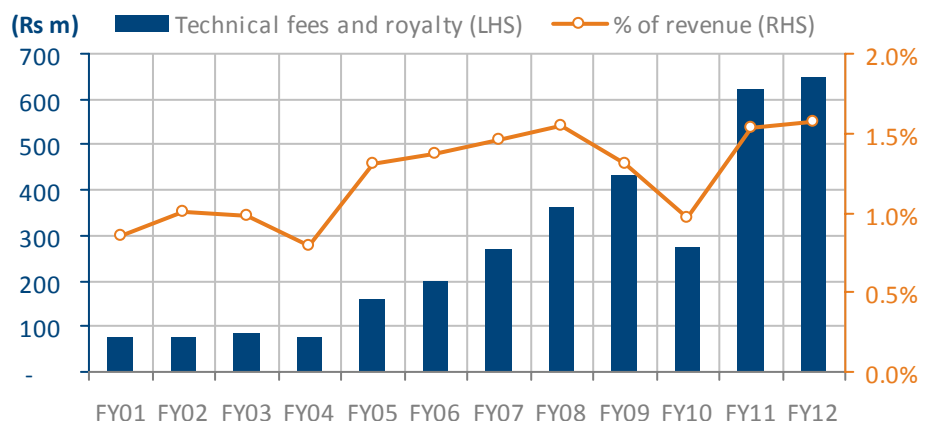
Source: Company, IIFL Research

Royalty payments to parent will remain stable going forward

But KKC’s royalty payments unlikely to jump sharply

In the past many years, despite complete access to parent’s technology and products, KKC’s royalty payments have not seen a substantial jump. KKC’s management continues to highlight that yearly royalty payment will largely remain stable. Furthermore, there would not be a large one-time royalty payment to upgrade the product offering post the new CPCB emission norms kicking in during CY2013.

Figure 23: KKC’s royalty payment to the parent has remained stable

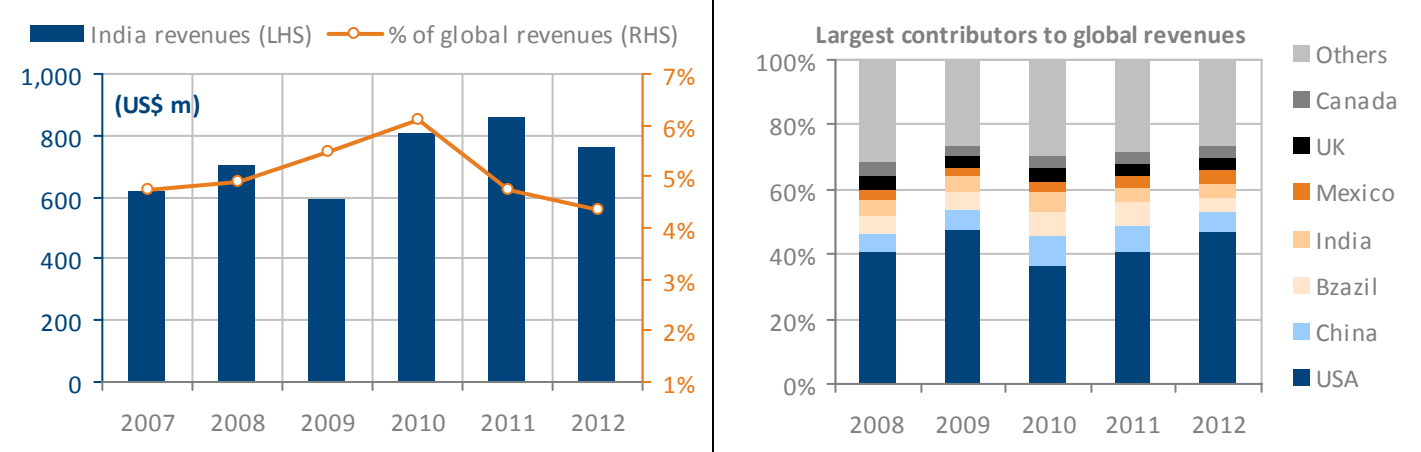


Source: Company, IIFL Research

Support from Cummins Inc to continue, given increasing importance of the Indian operations

With India being one of the faster-growing markets for Cummins Inc, we expect the importance of Indian operations to continue. While the recent INR depreciation has impacted USD denominated contribution to revenues, India remains the fourth largest contributor to global revenues.

Figure 24: India is the 4th largest contributor to Cummins Inc revenues

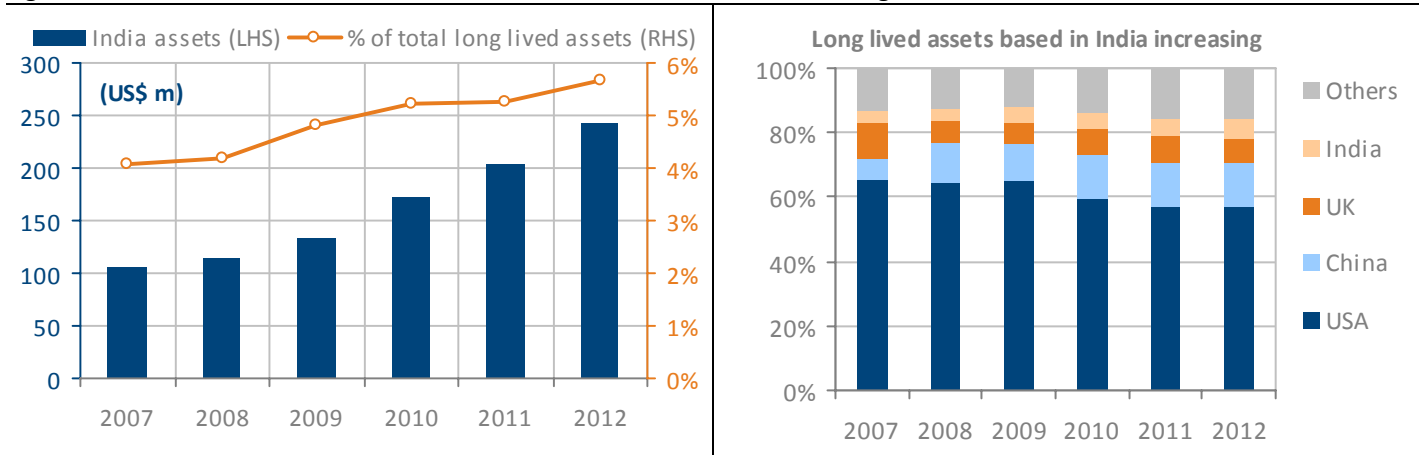


Source: Company, IIFL Research

Cummins Inc is increasing its pace of investment in India

Cummins Inc focus on India is also evident in the increasing share of Cummins Inc's long-term assets base in India. This has gone up from 4.1% in 2007 to 5.7% in 2012 and would further increase post completion of the Phaltan megasite.

Figure 25: Cummins Inc continues to invest in India as is evident from increasing share of India based assets



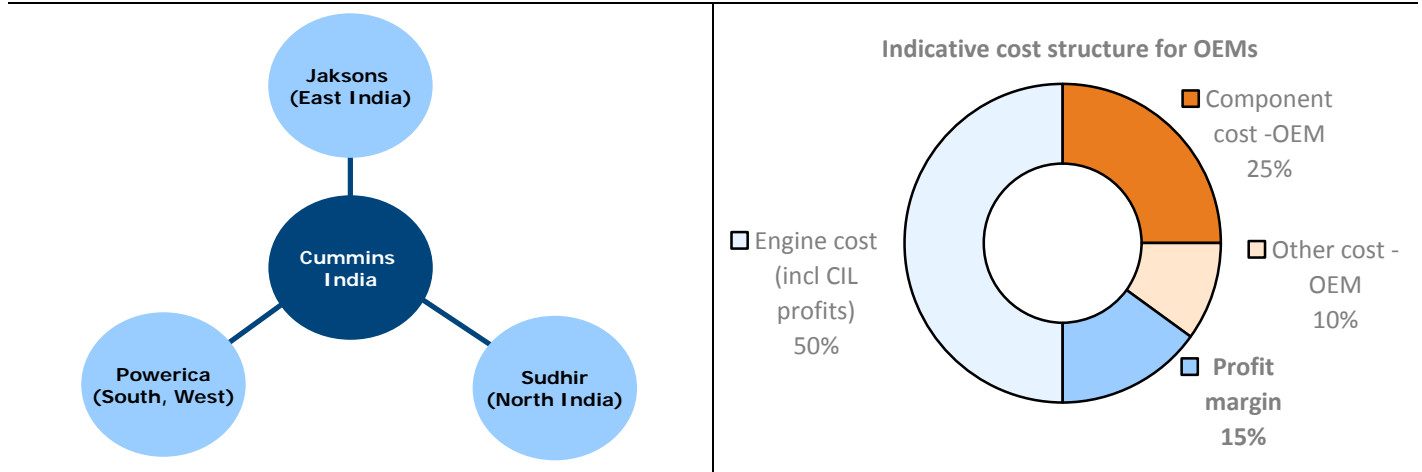
Source: Company, IIFL Research

Extensive domestic distribution network is difficult to replicate

Strong distribution network enhances gains from product portfolio

Over the past many years, Cummins India has established a strong distribution network across the country. The company sells ~70% of its gensets through its dedicated original equipment manufacturers (OEM) such as Jaksons (East India), Sudhir Gensets (North India) and Powerica (South and West India). Having fewer OEMs facilitates better management of channel partners. OEMs add components like casing etc to the core engine and alternators supplied by KKC and sell it as a co-branded product.

Figure 26: 70% of sales happen through the three large OEMs



Source: Company, IIFL Research

KKC’s operating model for OEMs

KKC has entered into separate agreements with its three OEMs for distribution of gensets in the domestic market. Each OEM has been assigned a specific geography which is not common with the other OEM. However, an OEM is not the exclusive dealer for Cummins products in these regions and KKC retains the right to appoint additional OEMs for the same territories.

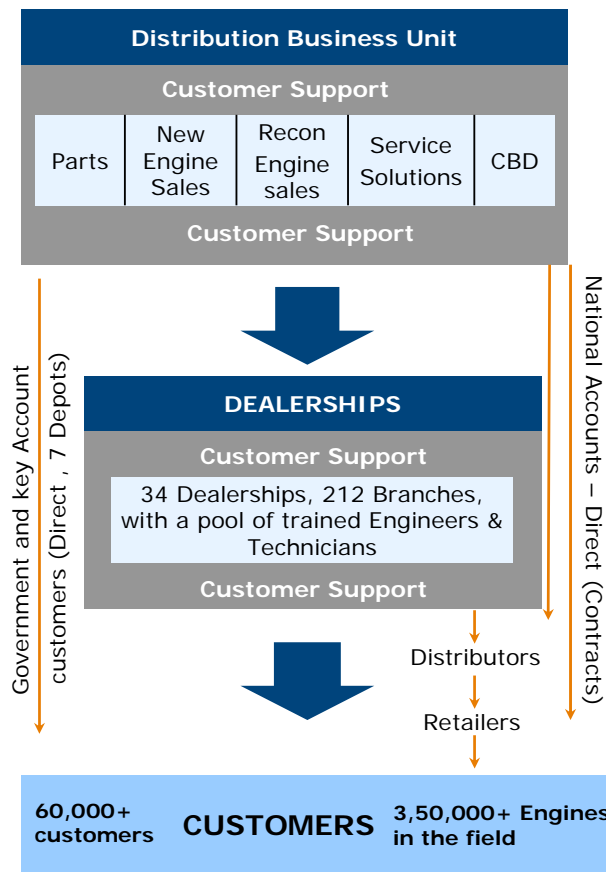
The OEM sources engines and alternators used in diesel generators exclusively from KKC. It then assembles these along with components such as control panels and acoustic boxes manufactured by itself. The genset is sold as a co-branded product. The OEM also carries out the installation services for a few customers and also provides after sales services and sells spare parts for all Cummins diesel gensets.

Although KKC is free to price the engines and alternators sold to OEM, it does not have any control on the end price of gensets sold, except by way of setting the MRP. The OEM is required to pay specific revenue share (1.25% in case of Powerica) from the co-branded products as compensation for KKC’s support. The OEM maintains inventory levels of 45 days, based on annual sales of the previous year and maintains marketing standards as per KKC’s requirements.

Large trained engineer base ensures strong after sales network

Apart from these three OEMs, the company has 34 dealerships, which contribute 20% of total sales. Direct sales to government agencies and large companies comprise 10% of overall sales. KKC also has 212 branches, four zonal offices, 19 area offices, seven depots for spare parts, and two regional repair centres to further manage the distribution. The company has more 2,500 engineers and technicians on the field for these jobs.

Figure 27: The strong distribution network enhances KKC’s competitive position



Source: Company, IIFL Research

Increasing competition not a big concern

In the domestic market, competition from local players and smaller engine makers is strong in the small engines (20HP) segment. Smaller local manufacturers have minimal presence in the medium and high horse power range because it involves complex technology.

Figure 28: Competitive landscape in the diesel engines market

< 30kVA	30-320kVA	320-625kVA	>625kVA
<ul style="list-style-type: none"> • KOEL • Greaves Cotton • Chinese imports • M&M • Ashok Leyland • Smaller local players 	<ul style="list-style-type: none"> • KOEL • Greaves Cotton • Cummins India • Ashok Leyland • Simpson • M&M 	<ul style="list-style-type: none"> • Cummins India • Volvo JV • Greaves Cotton • KOEL 	<ul style="list-style-type: none"> • Cummins India • Wartsila • Caterpillar • KOEL • MAN

Source: Industry, IIFL Research

KKC is the leader the highly profitable medium & high HP segment

KKC is the leader in the mid-and-high horse power range of engines. Of the total diesel generator set market, in FY10, although the company had 15% volume share, revenue share was much higher at 33% as the mid-and-high HP range of DG sets command a much higher price.

An emerging irritant for Cummins would be the new local manufacturing facility that is being set up by Caterpillar. Caterpillar’s subsidiary, Perkins, is setting up a facility for engines in Aurangabad. We do not expect significant pricing pressure on KKC in the near term.

Competition to intensify gradually once Perkins starts local manufacturing

Perkins, a subsidiary of Caterpillar, has announced plans to manufacture the 4000 series of engines in India. Caterpillar will invest US\$150m to set up the manufacturing facility in Shendra Industrial Area in Aurangabad. The facility will have a capacity to manufacture 3,000 engines initially with an option to scale up to 5,000 units, depending on demand. The plant is scheduled to be commissioned by end-2013 or mid-2014. The engines would be distributed through Perkins’ two distributors – GMMCO Power, Chennai and Powerparts Pvt Ltd, New Delhi. Perkins will also export engines from this plant.

Local manufacturing by Perkins unlikely to hurt KKC materially

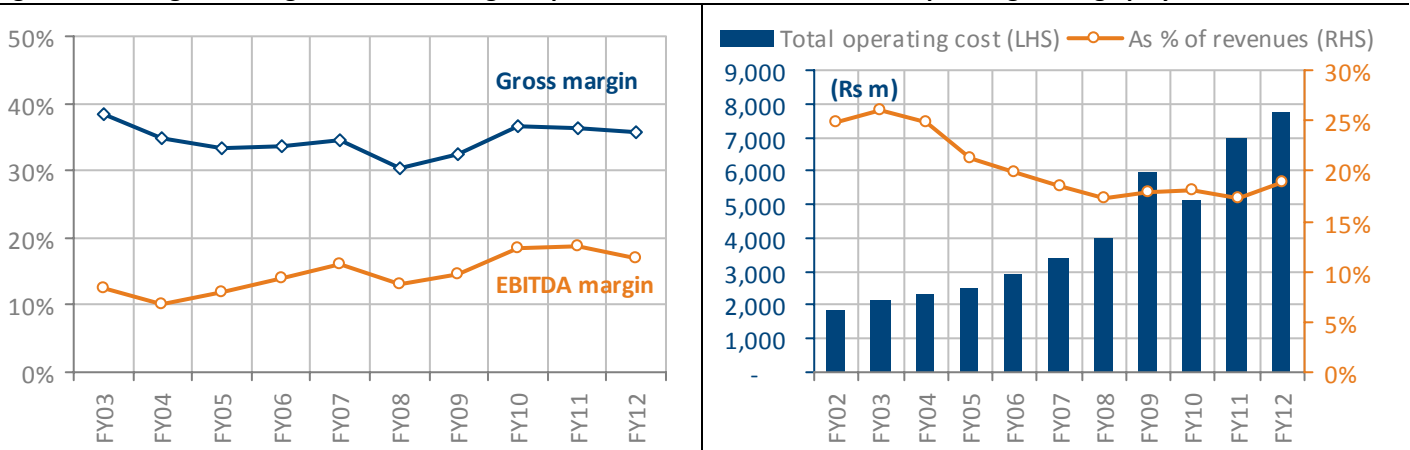
Local manufacturing would lower costs for Perkins. However, Cummins enjoys an edge in terms of distribution network and service capabilities, which are key criteria for users of medium and large HP engines. Hence, we do not expect KKC to substantially lose market share although we have concerns on lower flexibility to increase realisations.

Additionally, any possible pricing pressure may not materialise in the near term as Perkins would take some time to ramp up production and streamline its supply chain network. Cummins, in the mean time, would continue to work on increasing operational efficiencies to improve competitiveness. Additionally, given that the Perkins’ plant would also serve as an export market in Asia, domestic competition may not be as intense.

Leading market position and improving cost efficiencies to support margin improvement

KKC’s Ebitda margin history suggests that a strong demand environment, and consequently the strong revenue growth, drove improvement in Ebitda margin from FY04-07. This was despite the decline in gross margin. Post FY07-08, gains from operating leverage were not that significant and Ebitda margins moved almost in tandem with gross margins.

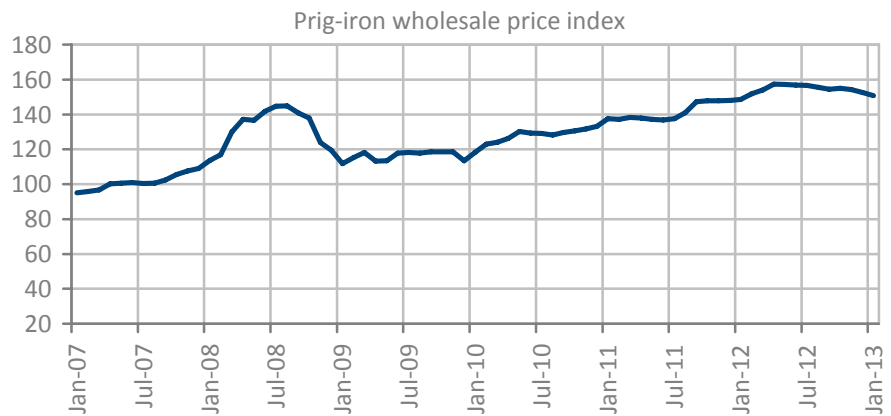
Figure 29: Strong revenue growth drove margin expansion for KKC over FY03-07 as operating leverage played out



Source: Company, IIFL Research

Interestingly, price of the key raw material, pig iron, increased steadily since Jan-2007. Over the same period, Cummins was successful in expanding its gross and Ebitda margins. The key driver for this margin improvement is the strong competitive position of KKC’s offerings amid a robust demand environment.

Figure 30: Pig Iron prices have risen steadily since Jan-07



Source: Bloomberg, IIFL Research

Robust demand environment will help drive margin expansion

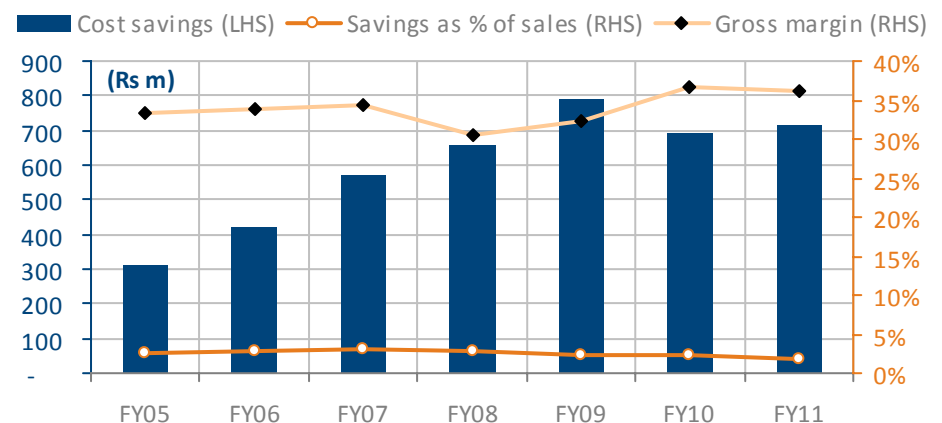
We do not expect any loss in this lever as the domestic demand environment remains robust and Cummins continues to enjoy a leading market position in terms of product offering and distribution network. Even in a scenario of further increases in raw material prices, KKC’s focus on improving cost efficiencies and controlling high-cost imports will help offset any pressure on margins.

KKC focusing on reducing RM costs through higher efficiencies

Continued focus on improving cost efficiencies

Early in FY05, KKC launched the Accelerated Cost Efficiency (ACE) programme that targeted a 20% reduction in direct material spends over three years. The company launched ACE II in 2008 to reduce direct material spending by 20% more over three years. It launched Total Cost of Ownership Reduction in Indirect Materials (TRIMS), another programme focused on reducing indirect material and service costs by 30% over a three-year period. These programmes, along with the continued focus on improving efficiencies through the Six Sigma programme, have resulted in substantial savings and margin improvement since FY05.

Figure 31: Cost saving initiatives also contributed to margin improvement for KKC



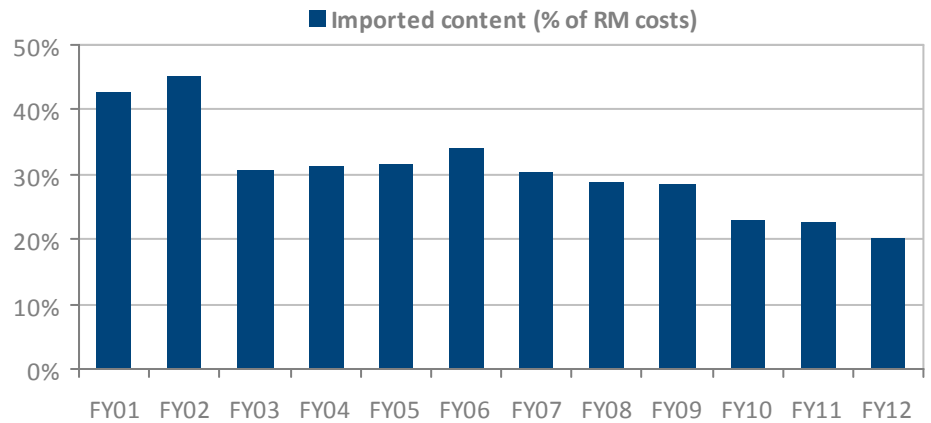
Source: Company, IIFL Research

KKC rapidly indigenises technologies adopted from parent

Increasing localisation to lower pressure on gross margin

Even as KKC continues to adopt technology and products from its parent Cummins Inc, it also invests rapidly to indigenise the technology and manufacturing process to keep expensive imports to the minimum level possible. We expect this trend to continue, limiting any possible hit on profitability from higher RM/component costs. KKC however, will not benefit much from INR depreciation as it shares the benefits with the parent.

Figure 32: Focus on indigenisation is translating into lower proportion of import content



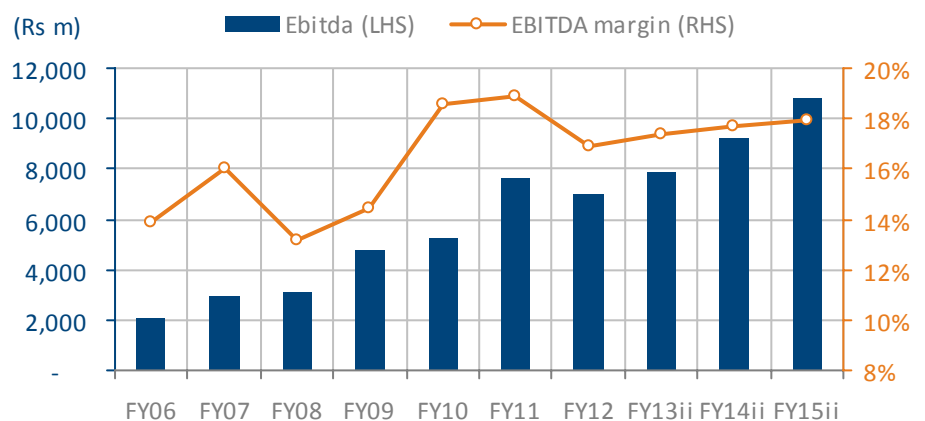
Source: Company, IIFL Research

Cost for parent support will increase starting FY14

The benefits from high localisation will be partially offset by higher cost of services rendered by the parent, Cummins Inc. As per US regulator, charges for services rendered by Cummins Inc to its overseas subsidiaries was very low resulting in higher profits being booked overseas. Reversing this will result in ~Rs600-800m impact on KKC which is ~1.5% of FY14 KKC revenues.

Overall, we expect standalone Ebitda margin to expand 100bps over FY12-15ii. Improving capacity utilisation from the current levels of ~50% for medium-and high-horsepower engine range would also aid expansion in margins.

Figure 33: We estimate 100bps expansion in Ebitda margins over FY13-15



Source: Company, IIFL Research

Robust fundamentals justify premium valuations

We expect KKC to record 16.5% net profit Cagr over FY12-15, driven by 13.6% revenue Cagr and 100bps Ebitda margin expansion. We expect ROE to improve to 32-33% in FY14-15, despite high capex at the Phaltan megasite. This contrasts with other capital goods vendors such as Siemens, ABB, and Thermax that have little visibility on improvement in trajectory and trade at multiples higher than Cummins. Though one-year forward PER of 17.6x is higher than the past five year average, the expansion in multiples is supported by increased confidence in margin sustainability, reasonable revenue visibility and much lower cyclical risks.

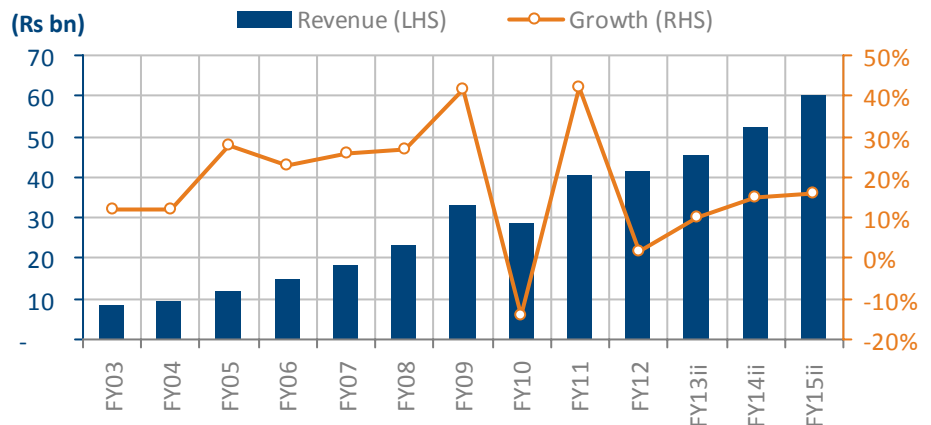
Revenue growth less exposed to domestic capex slowdown

KKC is in an enviable position versus other capital goods companies, given its leadership in the powergen market that is witnessing strong demand despite the overall slowdown in industrial/infrastructure capex.

Revenue visibility for KKC is far better than that for almost all other equipment suppliers. We expect KKC's revenue to increase at 13.6% Cagr over FY13-15. This would be primarily driven by the domestic market where demand for DG sets is likely to remain robust. Although this would be lower than the 19% 10-year Cagr and 17% five-year Cagr, this would still be much higher than that for other capital goods suppliers.

Domestic powergen business will drive the 13.6% revenue Cagr over FY13-15

Figure 34: We estimate revenue Cagr of 13.6% over FY12-15ii



Source: Company, IIFL Research

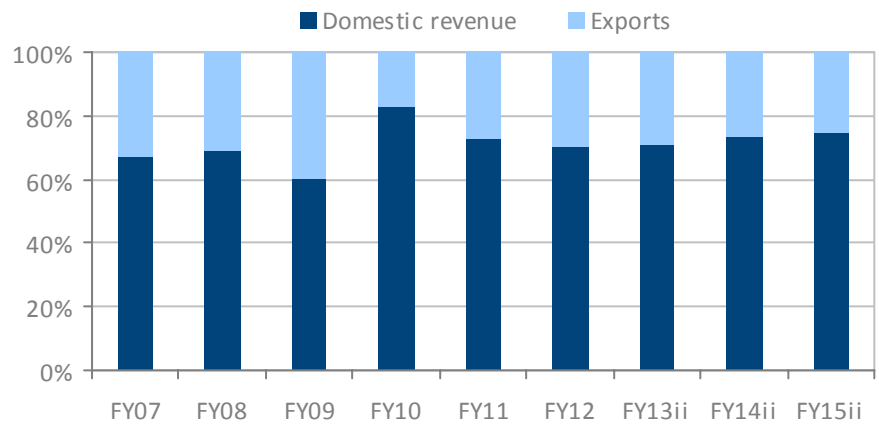
In the domestic market, the powergen segment would drive revenue growth. As highlighted earlier, continued power deficit would drive demand for alternative power sources, including diesel gensets. Apart from robust volume growth, revenue growth in the powergen segment would also be driven by price increases by manufacturers to meet stricter pollution control norms.

Low double digit export growth driven by low HP gensets

Export growth in the next few years would be supported by low HP gensets for which KKC has set up a new dedicated facility in Phaltan. Pick-up in volumes of Low-HP gensets will partially offset the sluggish demand for medium and high HP genset in the developed economies. With exports growing slower than domestic business we

expect the share of exports in total revenues to come down from 29% in FY12 to 25% in FY15.

Figure 35: Share of exports to decline over FY13-15 as domestic revenues grow faster



Source: Company, IIFL Research

Expanding installed base of engines key to distribution division growth

Growth of the distribution segment should track growth in the powergen segment as this is the key driver of increase in the base of installed engines. But even as the share of engines used as a primary source of power goes down and the share of engines used as back-up power increases, we do not expect distribution and service revenue growth to slow down as the need for upkeep of gensets sustains. This is so because even as grid reliability improves, customers will move from a dedicated captive manpower for maintenance of gensets to outsourcing the maintenance works to vendors like KKC.

Growth cyclicity much lower for Cummins compared to other cap goods vendors

We expect contribution of the industrial business to decline, given the continued slowdown in industrial capex. As the capex cycle picks up, improved demand for industrial engines would add growth without necessarily impacting demand for gensets. In fact, in the early stages of an upcycle, demand for gensets increases further as power deficits increase. In the latter half of the cycle, demand is supported by need for back-up power for in all segments – industrial, commercial and residential. Hence, Cummins growth has much lower cyclicity as compared to other cap goods companies.

EPS Cagr of 16.5% over FY13-15 much better than peers

Revenue Cagr of 13.6% over FY13-15 and 100bps expansion in Ebitda margin will drive 16.5% EPS Cagr over the same period. This is much better than the EPS Cagr for all the key large capital goods companies under our coverage.

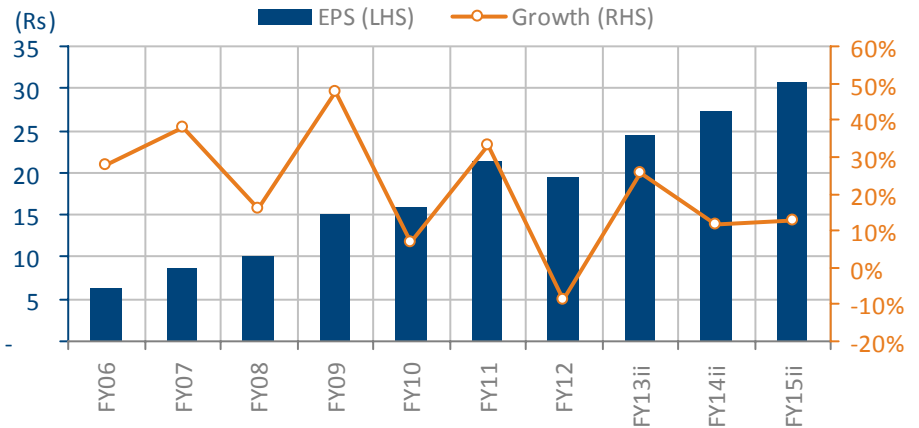
Figure 36: KKC has much better visibility and return ratios than its peers

Company	FY12-15 Cagr (%)		Ebitda margin (%)			RoE (%)		
	Revenue	EPS	10Yr average	Current	FY13-15 expansion	FY13	FY14	FY15
ABB*	8.0	35.0	8.1	3.2	430bps	5.4	11.4	14.9
Siemens**	7.5	12.1	10.2	6.9	110bps	14.0	13.6	14.3
Thermax	0.0	-9.6	11.7	10.4	-	18.2	16.1	15.4
Cummins	13.6	16.5	14.6	17.4	100bps	31.6	32.1	32.8

Source: Company, IIFL Research; YE – ABB* - CY12, Siemens** - Sep-12

KKC's EPS growth at 7% in FY10 was much slower than previous few years. Earnings growth was impacted by 63% decline in export revenues driven by the GFC which dragged down overall revenues by 14%. Sluggish revenue growth (1.8% YoY) again impacted FY12 EPS growth due to negative operating leverage. However, revenue and profit growth visibility is still much better than other capital goods suppliers in our coverage.

Figure 37: 16.5% EPS cagr over FY13-15 will be the highest in our coverage universe



Source: Company, IIFL Research

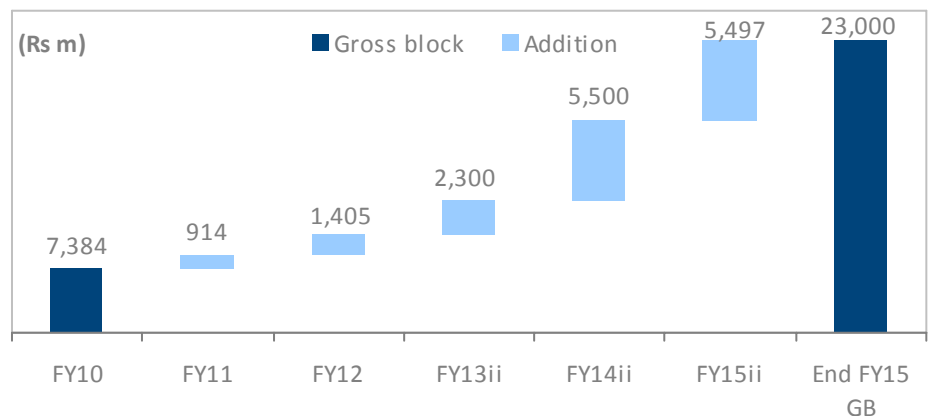
Rs5.5bn capex over FY13-15 towards the Phaltan megasite

Significant capex for Phaltan megasite and office complex

KKC's management has always believed in adding manufacturing capacity before demand picks up, so that it is positioned to capture volume growth and deny competitors an entry. The company continues to invest aggressively, which is evident in the build-up of the Phaltan megasite.

The megasite is spread over 300 acres at Phaltan, Maharashtra, with 150 acres earmarked to build facilities to serve the domestic market and balance being designated as a Special Export Zone (SEZ) to get tax benefits. KKC guided to capex of Rs5.5bn over FY13-15 towards this capacity expansion.

Figure 38: Capex over FY13-15 will be towards Phaltan megasite and integrated office complex



Source: Company, IIFL Research

Key facilities at the megasite are:

- A HHP rebuild facility for rebuilding of mechanical and electronic engines from 19-60 litres for the distribution segment; this unit was commissioned in Mar-2011
- A new parts distribution centre (PDC) to kit, assemble products, parts and components became operational in 3QFY12. This centre will improve logistics to cater to KKC’s other plants and after market needs.
- Increase in manufacturing capacity for Tata Cummins (JV between Cummins Inc and Tata Motors); KKC can buy and customise engines for automotive, power, and industrial applications; this facility is already operational.
- Cummins Technologies India Ltd also established a new reconditioning plant to remake parts and engines up to 19 litres. CTIL sells engines through KKC’s distribution division.
- A power generation plant in the SEZ with initial capacity of 30,000 units and a matured capacity of 50,000 units; this facility will manufacture generator sets and generator drives in the low and medium horsepower range for exports.
- A facility to customise engines for the construction sector, compressors and marine engine segments with per annum capacity of 20,000 engines.

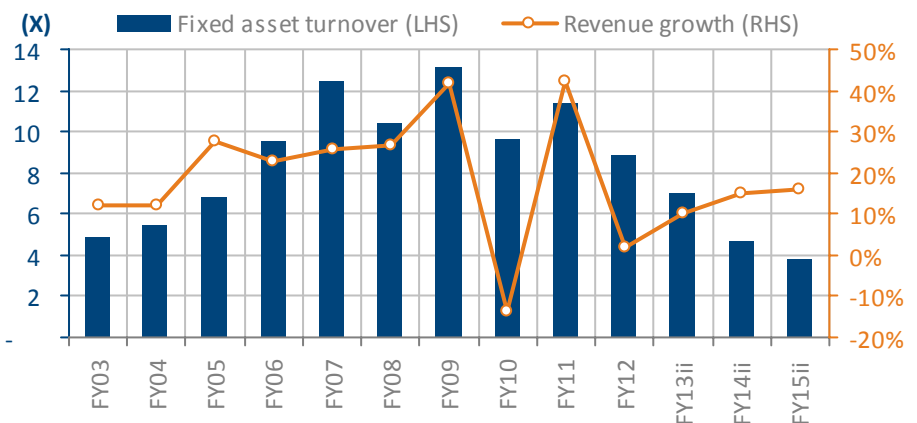
Rs7.3bn capex towards integrated office complex will earn lower returns

KKC is also investing in a new office campus at Balewadi, Pune, which will house all Cummins Inc employees at a single location. Total capex for this office campus is ~Rs7.3bn and the facility will be ready in phases from April 2014 onwards. On the large capex incurred by KKC for entire the Cummins Inc workforce, KKC would earn lease rentals at market rates which would be RoE dilutive.

...but strong volume growth to drive higher return ratios

Strong capex means that asset utilisation would dip for a couple of years. However, with volume growth likely to remain robust, we expect asset utilisation to improve beyond FY15.

Figure 39: Fixed asset utilisation will come down due to large capex

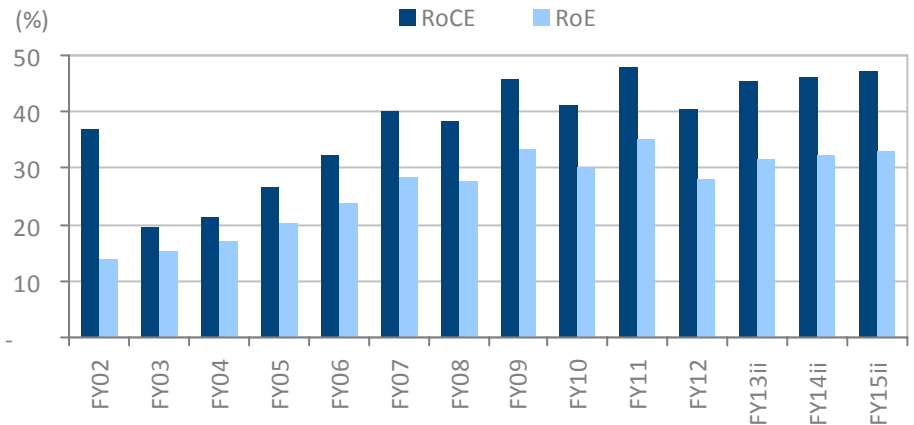


Source: Company, IIFL Research

RoEs to trend up and are much better than peers

Even as fixed asset turns come down, total asset turns will continue to improve primarily due to stable working capital cycle. This will drive the improvement in return ratios for KKC over FY13-15. Unlike other capital goods peers whose return ratios have dipped sharply, KKC's return ratios have remained healthy and would continue to improve over the next three years.

Figure 40: RoE and RoCE to trend up over FY13-15



Source: Company, IIFL Research

Figure 41: Improving total asset turnover to drive RoE improvement

	FY10	FY11	FY12	FY13ii	FY14ii	FY15ii
Net margin (%)	15.6	14.6	13.1	15.0	14.6	14.1
Total asset turnover	1.9	2.4	2.1	2.1	2.2	2.3
Total asset/Networth	1.0	1.0	1.0	1.0	1.0	1.0
RoE (average) (%)	30.0	35.1	28.0	31.6	32.1	32.8

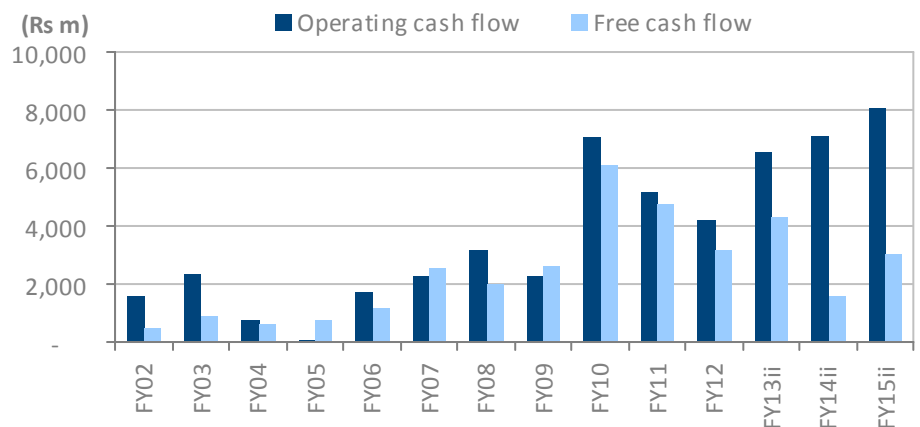
Source: Company, IIFL Research

Volume growth will ensure free cash generation despite large capex

Cash flows to remain positive despite large committed capex

Up tick in volume growth will also help KKC to sustain positive free cash flow generation, despite the large committed capital expenditure towards the megasite and office complex.

Figure 42: Free cash flow will remain positive despite large capex



Source: Company, IIFL Research

Reasonable valuations for sound fundamentals

KKC is currently trading at one-year forward PER of 17.5x. Over the past five years, the stock has traded at an average of 16.4x. We have valued the company at 19x FY15ii earnings, implying a 22% upside to CMP.

Figure 43: One-year forward PER



Figure 44: One-year forward PB



Source: Company, IIFL Research

Increased confidence in margin sustainability to aid multiple expansion

We are assigning a higher-than-historical multiple to KKC due to strong visibility for steady growth in revenue and increased confidence in margin sustainability. Price is not the primary basis of competition for KKC unlike other MNC capital good companies like ABB and Siemens where a significant proportion of revenues are derived through government type contracts where lowest price bidder wins the business.

As highlighted earlier, the company is relatively immune to the current capex slowdown in India. We believe that the multiple expansion would be supported by continued evidence of resilience to the domestic capex cycle and sustainability of margins.

Figure 45: Valuations are reasonable, given KKC’s strong fundamentals

	FY12-15 Cagr (%)		RoE (%)		PER (x)	
	Revenue	EPS	FY13	FY14	FY13	FY14
ABB*	8.0	35.0	5.4	11.4	78	35
Siemens*	7.5	12.1	14.0	13.6	33	29
Thermax	0.0	-9.6	18.2	16.1	22	22
Cummins	13.6	16.5	31.6	32.1	20	18

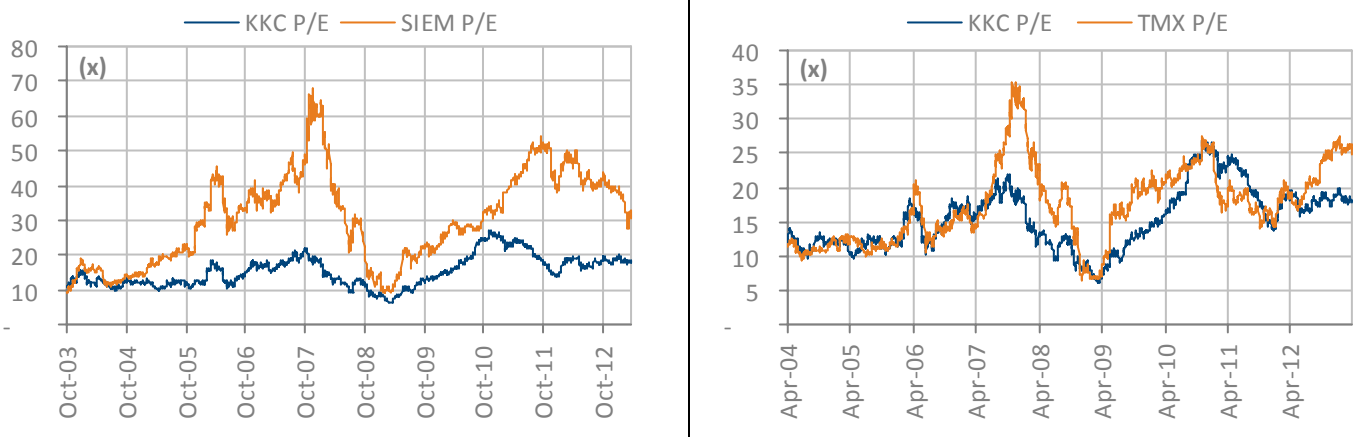
Source: Company, IIFL Research *FY13 corresponds to CY12 for ABB and Sep-13 for Siemens

KKC’s more resilient earnings trajectory warrants a premium

Cummins should trade at a premium and not at a discount to other capital goods vendors

Historically, ABB, Siemens and Thermax have traded at the premium to Cummins probably driven by stronger earnings growth visibility as domestic investment cycle was on an uptick. The premium has persisted in the downturn as well even as earnings trajectory of these companies deteriorated driven by a collapse in revenue growth and contracting margins. In our view, the premium reflects expectations of sharp recovery in both revenue and margin trajectory as the capex cycle revives. However, there is still little evidence of this outcome materializing at least in the near-term. On the other hand, KKC has demonstrated much better resilience to domestic cyclical conditions. A more predictable earnings trajectory with better return profile should warrant a premium in our view.

Figure 46: KKC has traded at a discount to Siemens and Thermax historically



Source: Bloomberg, IIFL Research

Key risks

- Significant domestic presence of parent:** Cummins Inc is present in India through nine legal entities. Each entity has a defined product offering. Nevertheless, there have been instances when the parent made new product launches for the domestic market through the owned entities and KKC earns only the marketing margin on the same e.g. the 60L engine was manufactured and launched by Cummins Technologies India Ltd (CTIL).

100% parent owned entities have launched a few products in India

According to KKC, the rationale for using CTIL as the vehicle for introducing the 60L vehicle was that, it is primarily meant for exports with only minimal domestic sales. However, KKC has dedicated export facilities like the low HP genset facility at Phaltan. Future preference of CTIL or other vehicles over KKC for product launches would impinge on growth opportunities for KKC.

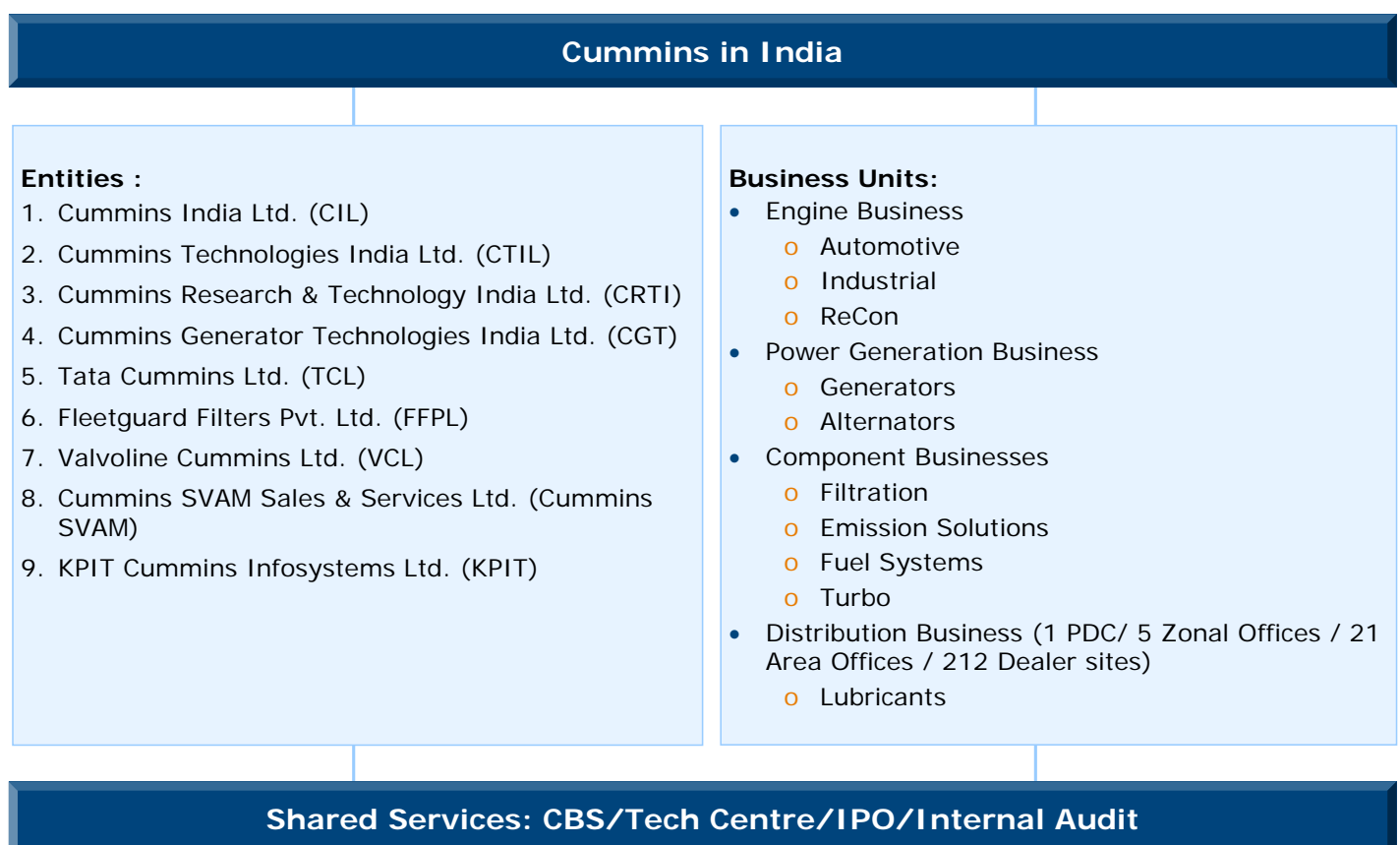
- KKC earning sub-par return on investments strategically important for the group:** KKC is setting up a new integrated office complex at Balewadi, Pune to house all employees of Cummins Inc at a single location. KKC will incur capex of ~Rs7.3bn and will let out the premises to group entities at market-linked lease rates. While it is comforting that there are no transfer pricing issues involved, the fact remains that the investments would earn returns much lower than ROCE in the core business. Over the past five years, KKC’s RoCE has averaged at 42% whereas commercial rental yields seldom cross double digits in India.
- Increase in diesel prices:** Increase in diesel prices would further increase cost of power generated by DG sets, over an already high base. Thus, comparison with other alternatives will become even more adverse. This should logically have a negative impact on demand for DG sets. However, DG sets have remained uncompetitive vis-à-vis other sources of power by a wide margin for a long time now. There could be some demand destruction, but the hard fact of the absence of reliable alternative remains unchanged. Hence, demand elasticity to diesel price increases will likely remain low.

Annexure: Cummins Inc’s presence in India

Cummins Inc has an extensive presence in India through nine legal entities that represent all its global business units. Apart from KKC, other legal entities include:

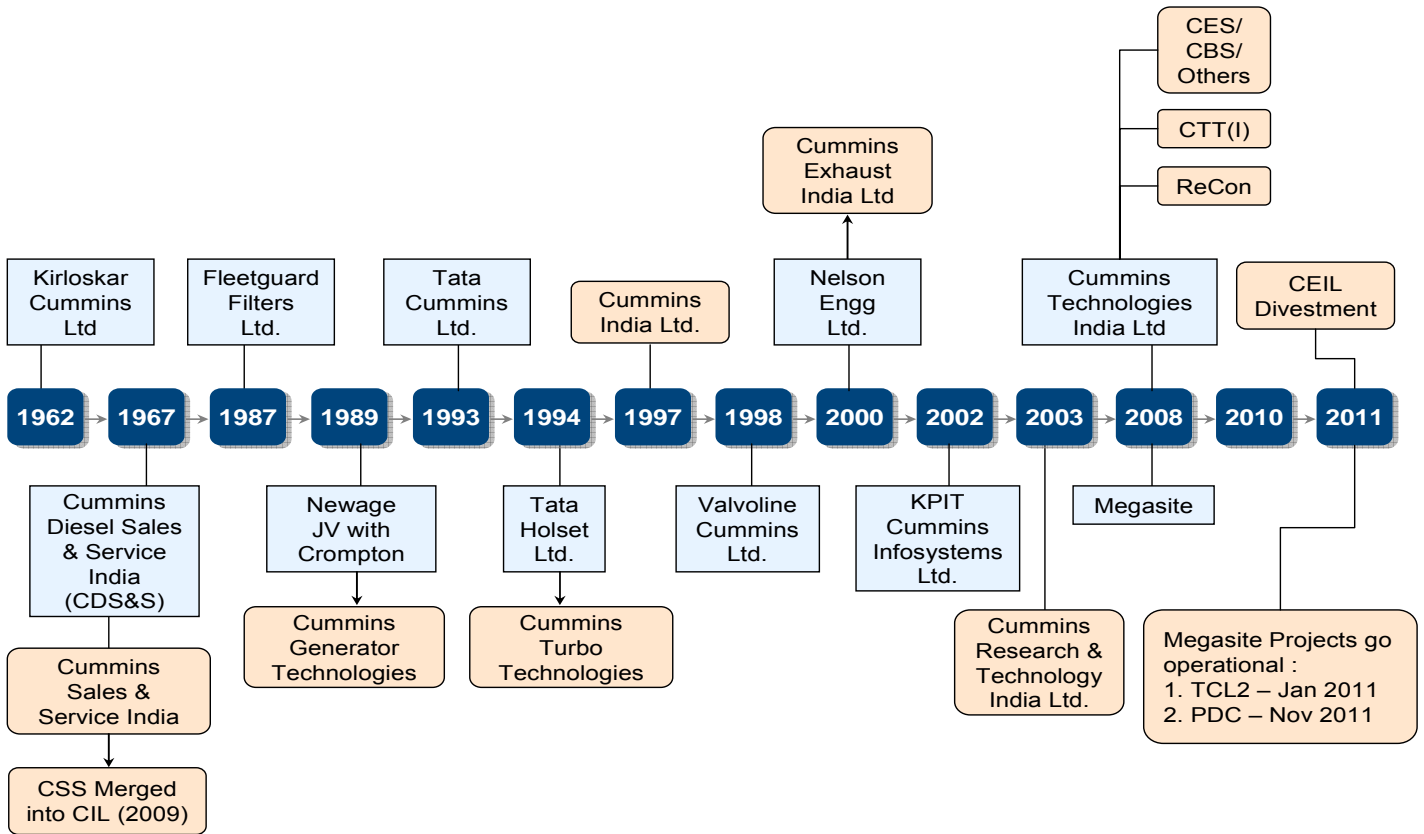
- Cummins Generator Technologies India, a market leader in brushless AC Generator product range
- Cummins Technologies India Ltd, that offers turbochargers, emission solutions, and ReCon parts
- **Cummins Research & Technology India** Ltd, a JV of KKC and Cummins Inc to provide mechanical engineering designs to Cummins Technical Centres worldwide
- Tata Cummins Ltd, a 50:50 JV of Cummins Inc and Tata Motors to manufacture diesel engines for commercial vehicles of Tata Motors Ltd with a total capacity of 180,000 engines annually
- Fleetguard Filters Pvt Ltd, a leading manufacturer of heavy duty air, fuel, lube and hydraulic filters and coolants
- **Valvoline Cummins Ltd**, a JV between Ashland Inc, USA and Cummins Sales & Services India (100% subsidiary of KKC) for manufacture of automotive lubricants, transmission fluids, gear oils, hydraulic lubricants, and automotive filters, among others
- KPIT Cummins Infosystems Ltd, a company focused on domain-intensive technology solutions for manufacturing corporations.
- **Cummins SVAM Sales & Services** is a 50:50 JV of KKC and SVAM power plants for sales & service of gensets in North India

Figure 47: Cummins Inc in India – business structure



Source: Company, IIFL Research

Figure 48: Evolution of Cummins in India

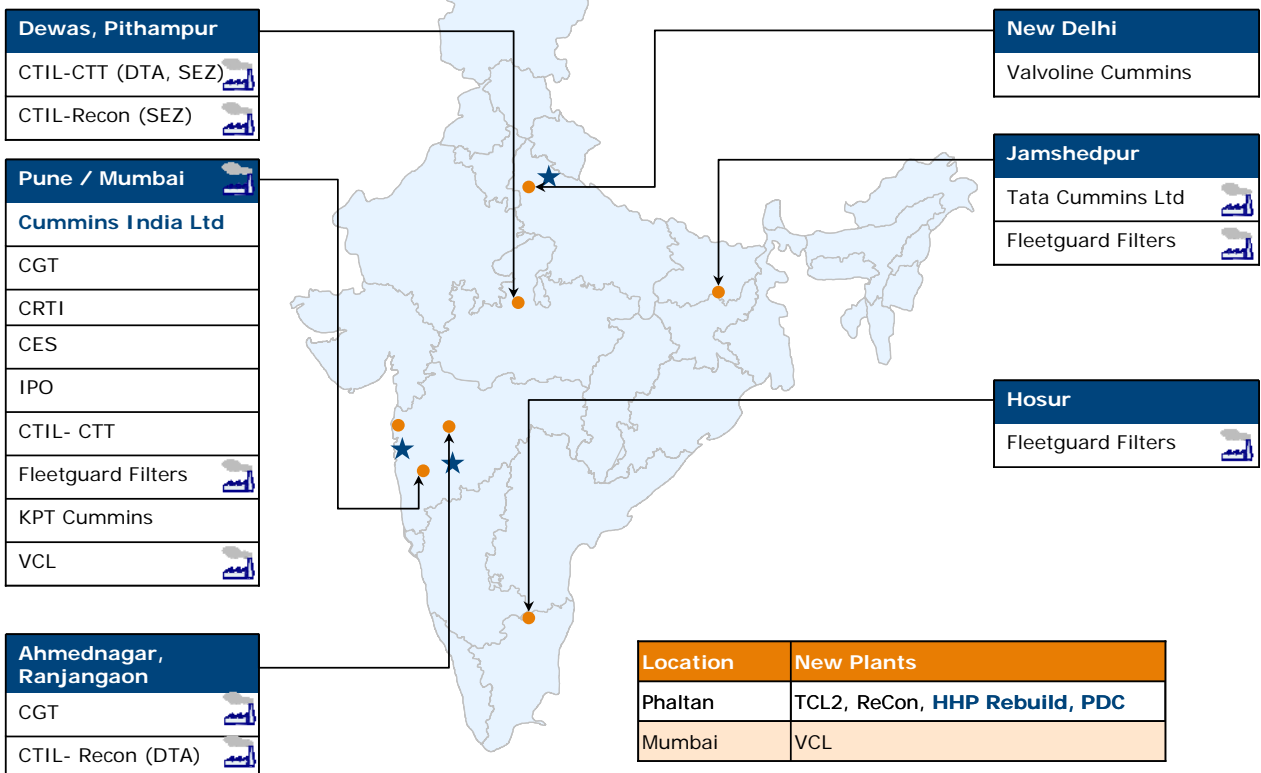


Source: Company, IIFL Research

Figure 49: Cummins Inc – manufacturing locations in India under various entities

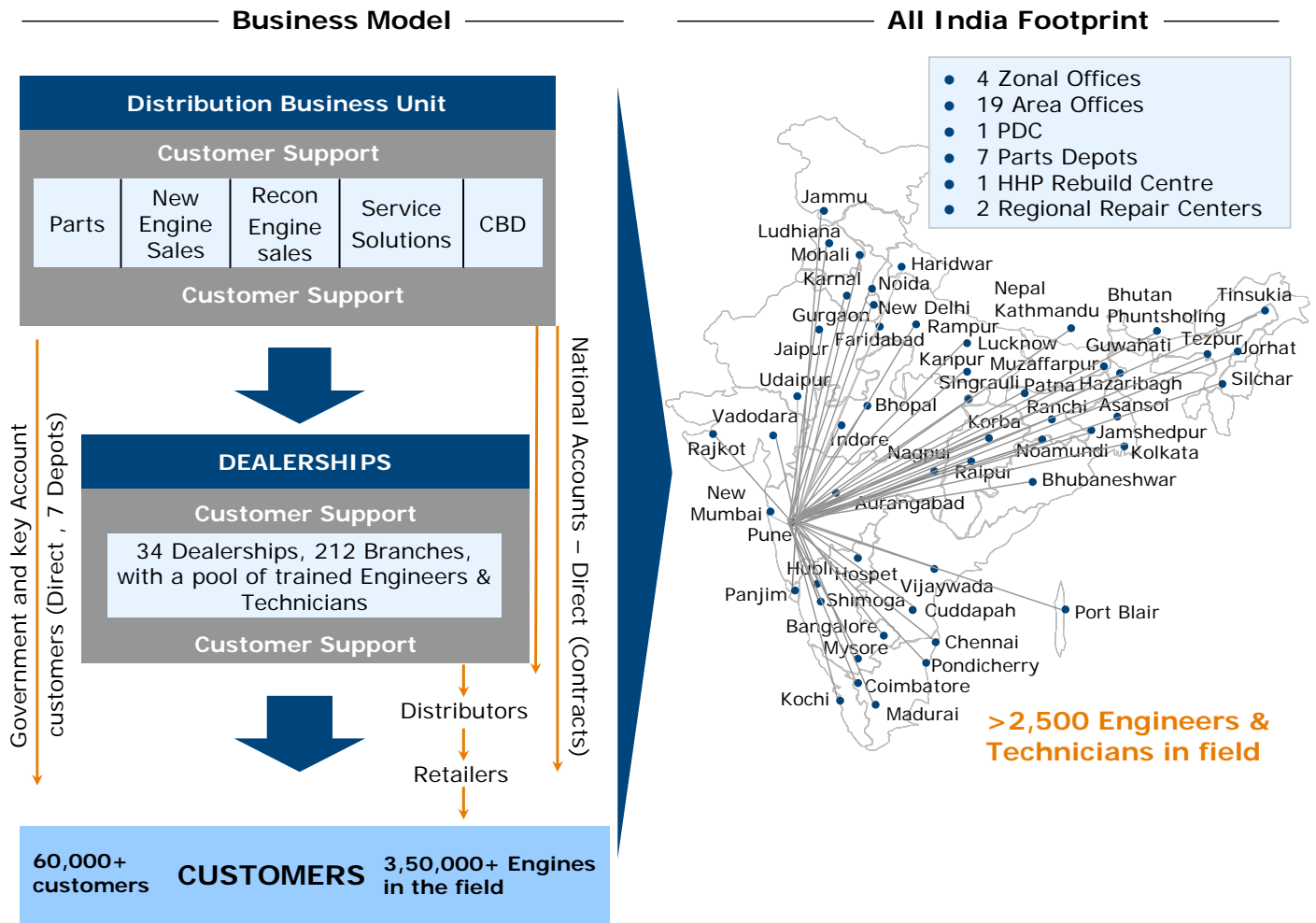
9 Legal Entities (5 JVs)
Over 15,000 employees
\$2.2B 2012 sales

★ - New Plants
🏭 - Factory



Source: Company, IIFL Research

Figure 50: KKC has an extensive distribution network across India, Nepal and Bhutan



Source: Company, IIFL Research

Figure 51: Powergen product range for KKC

LHP Domestic	LHP Export	MHP/HHP Domestic
<ul style="list-style-type: none"> X series - gensets S series - G Drive B series - G Drive Spares 	<ul style="list-style-type: none"> X series - Gensets & G drive S series - Gensets & G drive B series - D drive NT 855 - G drive Spares 	<p>G drive products</p> <ul style="list-style-type: none"> C NT855 Nt-14 K19 V28 K38 K50 QSK60 Gas Models (50L/60L/91L)* QSK60 & QSK78*

Source: Company, IIFL Research *Imported

Financial summary

Income statement summary (Rs m)

13.6% revenue Cagr over FY13-15 driven by domestic business

Y/e 31 Mar, Parent	FY11A	FY12A	FY13ii	FY14ii	FY15ii
Revenues	40,425	41,172	45,256	52,017	60,298
Ebitda	7,634	6,973	7,881	9,215	10,830
Depreciation and amortisation	(366)	(420)	(506)	(688)	(945)
Ebit	7,268	6,553	7,375	8,527	9,886
Non-operating income	804	1,233	2,350	2,350	2,350
Financial expense	(48)	(54)	(54)	(54)	(54)
PBT	8,024	7,732	9,671	10,823	12,182
Exceptionals	0	514	0	0	0
Reported PBT	8,024	8,246	9,671	10,823	12,182
Tax expense	(2,114)	(2,334)	(2,901)	(3,247)	(3,655)
PAT	5,910	5,913	6,770	7,576	8,527
Minorities, Associates etc.	0	0	0	0	0
Attributable PAT	5,910	5,913	6,770	7,576	8,527

Ratio analysis

16.5% EPS Cagr supported by 100bps Ebitda margin expansion

Y/e 31 Mar, Parent	FY11A	FY12A	FY13ii	FY14ii	FY15ii
Per share data (Rs)					
Pre-exceptional EPS	21.3	19.5	24.4	27.3	30.8
DPS	10.7	11.0	14.7	16.4	18.5
BVPS	65.2	73.7	81.0	89.1	98.3
Growth ratios (%)					
Revenues	42.1	1.8	9.9	14.9	15.9
Ebitda	44.8	(8.7)	13.0	16.9	17.5
EPS	33.1	(8.7)	25.4	11.9	12.6
Profitability ratios (%)					
Ebitda margin	18.9	16.9	17.4	17.7	18.0
Ebit margin	18.0	15.9	16.3	16.4	16.4
Tax rate	26.3	28.3	30.0	30.0	30.0
Net profit margin	14.6	14.4	15.0	14.6	14.1
Return ratios (%)					
ROE	35.1	28.0	31.6	32.1	32.8
ROCE	47.8	40.5	45.4	46.1	47.1
Solvency ratios (x)					
Net debt-equity	(0.4)	(0.4)	(0.3)	(0.1)	0.0
Net debt to Ebitda	(1.0)	(1.1)	(0.9)	(0.4)	0.0
Interest coverage	NM	NM	NM	NM	NM

100bps expansion in Ebitda margin over FY13-15

Source: Company data, IIFL Research

Balance sheet summary (Rs m)

Capex on Phaltan megasite and office complex drains cash

Y/e 31 Mar, Parent	FY11A	FY12A	FY13ii	FY14ii	FY15ii
Cash & cash equivalents	7,705	7,455	6,984	3,279	356
Inventories	5,190	5,676	6,239	7,171	8,313
Receivables	7,182	6,783	7,456	8,570	9,935
Other current assets	3,596	5,132	5,641	6,483	7,515
Creditors	7,001	6,849	7,528	8,653	10,031
Other current liabilities	3,593	3,736	4,107	4,720	5,472
Net current assets	13,079	14,461	14,685	12,130	10,616
Fixed assets	4,210	5,146	6,940	11,751	15,807
Intangibles	0	0	0	0	0
Investments	587	755	755	755	755
Other long-term assets	187	70	70	70	70
Total net assets	18,063	20,432	22,449	24,707	27,248
Borrowings	0	0	0	0	0
Other long-term liabilities	0	0	0	0	0
Shareholders equity	18,063	20,432	22,449	24,707	27,248
Total liabilities	18,063	20,432	22,449	24,707	27,248

Cash flow summary (Rs m)

Positive free cash flow despite large capex as volume growth remains strong

Y/e 31 Mar, Parent	FY11A	FY12A	FY13ii	FY14ii	FY15ii
Ebit	7,268	6,553	7,375	8,527	9,886
Tax paid	(2,114)	(2,334)	(2,901)	(3,247)	(3,655)
Depreciation and amortization	366	420	506	688	945
Net working capital change	(1,072)	(1,633)	(695)	(1,150)	(1,409)
Other operating items	0	0	0	0	0
Operating cash flow before interest	4,448	3,006	4,285	4,818	5,767
Financial expense	(48)	(54)	(54)	(54)	(54)
Non-operating income	804	1,233	2,350	2,350	2,350
Operating cash flow after interest	5,205	4,185	6,581	7,114	8,063
Capital expenditure	(1,168)	(1,255)	(2,300)	(5,500)	(5,000)
Long-term investments	822	(169)	0	0	0
Others	(90)	398	0	0	0
Free cash flow	4,769	3,159	4,281	1,614	3,063
Equity raising	0	158	0	0	0
Borrowings	(86)	0	0	0	0
Dividend	(3,457)	(3,568)	(4,752)	(5,319)	(5,986)
Net chg in cash and equivalents	1,225	(250)	(471)	(3,705)	(2,923)

Source: Company data, IIFL Research

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Key to our recommendation structure

BUY - Absolute - Stock expected to give a positive return of over 20% over a 1-year horizon.

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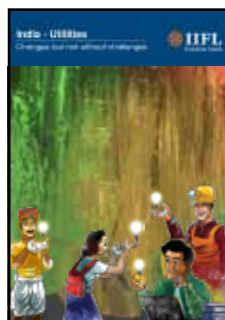
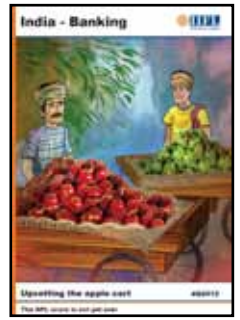
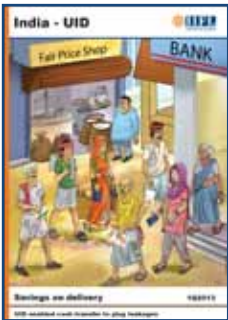
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IIFL - India
 India Infoline Ltd
 9th Floor, IIFL Centre,
 Kamala City, Senapati Bapat
 Marg, Lower Parel (W),
 Mumbai - 400013
 Tel +91-22-4646-4600
 Fax +91-22-4646-4700

IIFL - Singapore
 IIFL Securities Pte Ltd,
 6 Shenton Way,
 #18-08B,
 OUE Downtown 2,
 Singapore - 068809
 Tel +65-6511 6160
 Fax +65-6224 0650

IIFL - UK
 IIFL Wealth (UK) Limited
 45, King William Street,
 London - EC4R 9AN,
 United Kingdom
 Tel +44 (0) 207-993-6929

IIFL - USA
 IIFL Inc.
 1114 Avenue of the Americas
 34th Floor,
 New York,
 NY 10036
 Tel +1-212-221-6800
 Fax +1-212-221-6818

IIFL - Sri Lanka
 IIFL Securities Ceylon (Pvt) Ltd
 27th Floor, East Tower,
 World Trade Centre,
 Echelon Square,
 Colombo - 1
 Tel +94-112-333-000
 Fax +94-112-333-383