India I Equities

Industrial Consumables
Company Update

Change in Estimates ☑ Target ☑ Reco ☑

25 May 2018

Skipper

Rating: **Buy**
Target Price: ₹287
Share Price: ₹169

Strong execution with steady margins: upgrading to a Buy

Strong order in engineering and polymers and good execution would lead to healthy sales growth. Margins, however, are expected to hold at current levels of ~14%. The recent drop in the stock price renders valuations attractive. Hence, we upgrade our rating to a Buy, and revise our target price to ₹287 (17x FY20e earnings) vs. our earlier TP of ₹299.

Decent order book. Healthy growth in engineering and telecoms orders is expected from Jharkhand, Bihar, Odisha and north-eastern states. The rupee depreciation is expected to improve and strengthen international orders, helped by price competitiveness. Also, PGCIL activity has started picking up as the impact of tariff-based competitive bidding (TBCB) is easing. Of the ₹26bn order book, 44% arises from PGCIL, 44% from domestic operators; exports constitute 12%. Orders of ₹21bn were received in FY18.

Healthy sales growth with steady margins. The strong order book, improving inflows and better execution would ensure healthy sales growth. With higher steel billet prices, EBIT/ton is expected to improve (currently at ~₹11,887). However, we have assumed EBIT/ton levels to continue at ~₹12,000.

Strong growth in the polymers segment. Strong sales and market share by FY20 in the polymers segment is the focus of the management. Engaging Vector Consulting would help Skipper strengthen its supply chain and ties with channel partners. It is confident of increasing volumes in PVC, CPVC and pipe fittings across India in the next two years by ensuring greater availability of products with distributers, resulting in lower inventories.

Strong earnings, better execution. The OB is likely to be ~₹25bn-27bn. FY18-20 sales growth is likely to be healthy. However, excessive delay in order awarding may reduce inflows. We expect margins to be flat and earnings to register a 22% CAGR over FY18-20. **Risk.** Delay in ordering.

Key financials (YE Mar)	FY16	FY17	FY18	FY19e	FY20e
Sales (₹ m)	15,062	17,030	20,737	24,051	27,067
Net profit (₹ m)	951	1,115	1,178	1,470	1,729
EPS (₹)	9.3	10.9	11.5	14.4	16.9
PE (x)	25.3	16.8	18.7	11.8	10.0
EV / EBITDA (x)	12.9	9.3	8.8	6.2	5.4
PBV (x)	6.4	3.8	3.5	2.3	1.9
RoE (%)	28.1	25.7	21.0	21.1	20.7
RoCE (%)	25.1	23.4	24.1	24.7	25.1
Dividend yield (%)	0.6	0.8	0.8	1.0	1.0
Net debt / equity (x)	1.1	0.8	0.7	0.6	0.4

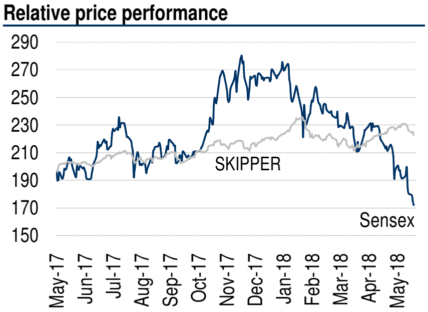
Source: Company, Anand Rathi Research

Key data	SKIPPER IN / SKIP.BO
52-week high / low	₹293 / 140
Sensex / Nifty	34925/ 10605
3-m average volume	$0.4m
Market cap	₹17bn / $252.6m
Shares outstanding	103m

Shareholding pattern (%)	Mar'18	Dec'17	Sep'17
Promoters	70.2	70.4	70.4
- of which, Pledged	-	-	-
Free float	29.8	29.6	29.6
- Foreign institutions	6.2	6.2	2.4
- Domestic institutions	10.9	9.9	11.5
- Public	12.7	13.5	15.7

Estimates revision (%)	FY19e	FY20e
Sales	-2.8	-3.3
EBITDA	3.3	3.7
EPS	-2.9	-4.0

Relative price performance



Source: Bloomberg

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY16	FY17	FY18	FY19e	FY20e
Volumes (tonnes)	**1,57,469**	**1,80,000**	**2,22,750**	**2,56,163**	**2,94,587**
Net revenues	15,062	17,030	20,737	24,051	27,067
Growth (%)	**15.1**	**14.8**	**23.5**	**15.4**	**12.6**
Material cost	9,826	11,474	13,812	15,721	17,792
Employee & other exp.	3,045	3,096	3,901	4,807	5,332
EBITDA	**2,192**	**2,460**	**3,025**	**3,522**	**3,943**
EBITDA margins (%)	14.6	14.4	14.6	14.6	14.6
- Depreciation	241	315	458	461	510
Other income	52	31	22	25	48
Interest expenses	570	611	784	835	833
PBT	1,432	1,565	1,804	2,251	2,648
Effective tax rate (%)	33.6	28.8	34.7	34.7	34.7
+ Associates / (minorities)	-	-	-	-	-
Net Income	951	1,115	1,178	1,470	1,729
Adjusted income	951	1,115	1,178	1,470	1,729
WANS	102	102	102	102	102
FDEPS (₹ / sh)	9.3	10.9	11.5	14.4	16.9
EPS growth (%)	101.6	17.2	5.7	24.7	17.6

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY16	FY17	FY18	FY19e	FY20e
Share capital	102	102	102	102	102
Net worth	3,815	4,942	6,373	7,640	9,167
Total debt	4,682	4,378	4,804	4,967	4,775
Minority interest	-	-	-	-	-
DTL / (assets)	315	391	539	539	539
Capital employed	**8,811**	**9,712**	**11,716**	**13,146**	**14,481**
Net tangible assets	3,840	4,634	5,189	5,342	5,447
Net Intangible assets	12	8	6	3	-0
Goodwill	-	-	-	-	-
CWIP (tang. & intang.)	399	144	29	150	150
Investments (strategic)	-	-	-	-	-
Investments (financial)	-	-	-	-	-
Current assets (ex cash)	7,153	8,274	12,035	13,589	15,198
Cash	498	249	176	327	745
Current liabilities	3,091	3,597	5,720	6,266	7,058
Working capital	4,062	4,677	6,315	7,323	8,140
Capital deployed	**8,811**	**9,712**	**11,716**	**13,146**	**14,481**
Contingent liabilities	167	178		-	-

Fig 3 – Cash-flow statement (₹ m)

Year-end: Mar	FY16	FY17	FY18	FY19e	FY20e
PBT	1,432	1,565	1,804	2,251	2,648
+ Non-cash items	830	920	1,220	1,276	1,300
Oper. prof. before WC	2,263	2,485	3,025	3,527	3,948
- Incr. / (decr.) in WC	1,036	298	1,931	1,008	817
Others incl. taxes	576	435	304	781	919
Operating cash-flow	651	1,752	790	1,738	2,212
- Capex (tang. + intang.)	-947	-850	-896	-732	-611
Free cash-flow	-297	902	-107	1,006	1,601
Acquisitions	-	-	-	-	-
- Div. (incl. buyback & taxes)	160	331	203	203	203
+ Equity raised	-	-	-	-	-
+ Debt raised	853	-304	426	162	-191
- Fin investments	-	-	-	-	-
- Misc. (CFI + CFF)	459	516	190	815	789
Net cash-flow	-63	-249	-73	151	418

Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis

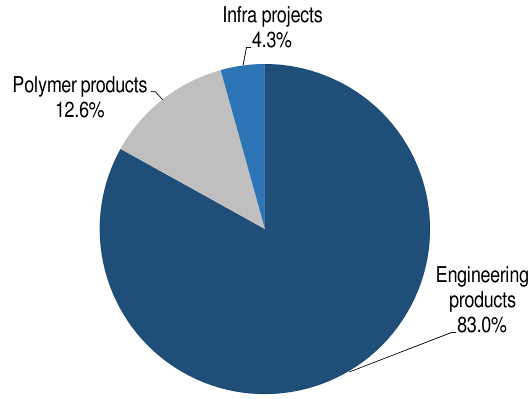
Year-end: Mar	FY16	FY17	FY18	FY19e	FY20e
P/E (x)	25.3	16.8	18.7	11.8	10.0
EV / EBITDA (x)	12.9	9.3	8.8	6.2	5.4
EV / sales (x)	1.9	1.4	1.3	0.9	0.8
P/B (x)	6.4	3.8	3.5	2.3	1.9
RoE (%)	28.1	25.7	21.0	21.1	20.7
RoCE (%) - after tax	25.1	23.4	24.1	24.7	25.1
RoIC (%) - after tax	17.9	17.5	16.1	16.5	17.1
DPS (₹ / sh)	1.4	1.6	1.7	1.7	1.7
Dividend yield (%)	0.6	0.8	0.8	1.0	1.0
Dividend payout (%) - incl. DDT	18.1	14.2	17.2	13.8	11.7
Net debt / equity (x)	1.1	0.8	0.7	0.6	0.4
Receivables (days)	93	81	91	89	89
Inventory (days)	62	80	99	100	101
Payables (days)	60	72	101	92	93
CFO:PAT %	68.4	157.2	67.0	118.3	128.0

Source: Company, Anand Rathi Research

Fig 5 – Price movement

Source: Bloomberg

Fig 6 – Q4 FY18 revenue break-up



Source: Company

Result Highlights

Fig 7 – Segment-wise highlights

(YE: Mar)	Q4 FY17	Q4 FY18	% Y/Y	FY17	FY18	% Y/Y
Revenue (₹ m)						
Engineering products	4,756	4,924	3.5	13,993	17,782	27.1
Polymer products	711	748	5.2	1,980	2,100	6.1
Infrastructure projects	317	257	(18.9)	813	855	5.2
Total	**5,784**	**5,929**	2.5	**16,786**	**20,738**	23.5
EBITDA margins (%)						
Engineering products	12.9	19.6	-	14.0	15.2	-
Polymer products	9.5	7.5	-	10.2	8.7	-
Infrastructure projects	13.9	13.8	-	13.8	13.2	-

Source: Company

Fig 8 – Quarterly trend

	FY17				FY18							
(₹ m)	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Y/Y (%)**	**FY17**	**FY18**	**Y/Y (%)**
Sales	2,842	4,013	4,251	5,837	3,988	5,156	5,664	5,929	33.2	11,106	14,809	33.3
Raw material cost	1,771	2,528	2,843	3,767	2,470	3,458	3,902	3,416	37.3	7,141	9,830	37.6
Employee cost	154	192	194	192	210	251	236	237	21.6	540	697	29.2
Other expense	524	752	632	966	792	765	786	1190	24.4	1,908	2,342	22.7
% of sales												
Raw material cost	62.3	63.0	66.9	64.5	61.9	67.1	68.9	57.6		64.3	66.4	
Employee cost	5.4	4.8	4.6	3.3	5.3	4.9	4.2	4.0		4.9	4.7	
Other expenses	18.4	18.8	14.9	16.5	19.9	14.8	13.8	20.1		17.2	15.8	
EBITDA margins	13.8	13.5	13.7	15.6	12.9	13.2	13.1	18.3		13.7	13.1	
Interest cost (₹ m)	179	150	190	124	169	200	176	239	(7.3)	519	545	5.0
Depreciation (₹ m)	68	72	76	100	107	121	118	113	54.5	215	346	60.5
Tax rate (%)	*32.0*	*35.0*	*31.7*	*24.2*	*35.5*	*36.4*	*35.1*	*33.4*		*29.7*	*34.7*	
PAT (₹ m)	105	226	222	528	160	232	292	493	31.5	1,242	684	(44.9)

Source: Company

Concall Highlights

Engineering segment

- The engineering segment's performance continued to be robust even in the challenging conditions. The increase in EBIT margins in Q4 was due to execution of a few high-value orders.
- The engineering products capacity has been increased by 35,000 tonnes to 265,000 tonnes.
- The company received various railway orders from the north-eastern states.
- It expects continued growth from Jharkhand, Bihar and Odisha, besides the north-eastern states.
- SEB action is expected to be healthy especially in Karnataka, West Bengal, Andhra Pradesh and Telangana.
- There has been a lull in ordering due to TBCB. With PGCIL involved in various intra-state transmission projects, however, activity is expected to pick up in FY19.
- Rural electrification because of government measures (Saubhagya, DDUGJY) would prove to be a huge opportunity for the company.
- The present rupee devaluation makes exports even more appealing.
- A few days back, the Railways announced upgrading of railway lines in the north-east, where Skipper has a monopoly.
- FY18 utilisation was ~90%.

The polymer division

- The performance of the polymer division was subdued because of the challenges faced by the company due to the GST and demonetisation.
- The present PVC capacity is 51,000 tons, with 50% utilisation.
- The company has made a prudent move to maintain margins and growth.
- However, with situations stabilising on all fronts, ~35-40% growth is expected in FY19.
- The company has engaged the Vector Consulting Group to boost the sales and contribution of the polymers division. With the application of the theory of constraints in its processes, Vector Consulting will help Skipper strengthen its supply chain and ties with channel partners. This would ensure greater availability of products with distributers, and lower inventory. This would be accomplished by setting meaningful associations with plumbers through a long-term royalty-based programme.

Other points

- The company shifted from AS to Ind AS. FY17 figures were re-stated according to Ind AS.
- With Skipper expanding its product range and with increasing exports, there is an equalising effect; revenue is now skewed across all quarters almost equally unlike in previous years where Q3 and Q4 were heavy revenue generators.
- The Railways and solar contribution to revenue is small since these are relatively new segments for the company.
- Other expenses were higher in Q4 because of the greater proportion of exports. Freight cost and foreign-currency translation costs in Q4 were higher than in previous quarters.
- Most contracts that the company enters into have price escalation clauses. However, a few short-term contracts can be fixed-price contracts.
- The existing capacity is fungible for other business segments as well, such as the Railways, solar, etc.
- The JV with Metzer is expected to start operations in Oct'18. The company has a 50% stake in the JV. ~$4mn is expected to be used as capex, which would be equally funded by debt and equity. The expected margin is ~15% (as with other industry operators).

Guidance for FY19

- The company has guided to ~15% growth in revenue in FY19, and to maintain ~13-14% margins.
- ~85%-90% of the revenue arises from the engineering and EPC division, which has a ~13-14% EBITDA margin. The polymer division has a ~9% margin and the company wishes to maintain it, considering the sluggish market.
- The working capital cycle is expected to hold at 180 days (inventory 100 days, debtors 80, creditors 90). In-house raw material manufacturing extends their cycle by ~45 days. The increasing shares of other divisions might improve the working-capital cycle.
- Till last year, exports brought ~25% to revenue. Now, with the rupee devaluation, robust growth in exports can be expected. Also, the devaluation makes Indian products more competitive internationally. However, it doesn't increase profits as international projects are hedged.
- The company has requisite approvals from ~35 countries, including from Mexico and Canada recently.
- The bid book is ~₹25bn, with an expected win ratio of 35-40%.
- FY18 capex was ₹610m. For FY19 it is expected at ~₹750m (engineering ~₹550m, polymers ~₹200m) and includes maintenance.
- The agriculture and plumbing mix was 90:10 a few years back. In FY17 it became 70:30 and FY18 was 65:35. The focus is on increasing the share of plumbing, which enjoys higher margins, to 50%.
- On the engagement with Vector Consultancy, the polymer division is expected to grow ~40%.

Valuation

The stock now trades at 11.8x FY19e and 10x FY20e earnings. Order inflows have been gradually increasing. However, the order book is likely to be ~₹26bn-27bn based on strong execution. Sales growth in FY18-20 is likely to be modest. We expect margins to be flat and earnings to register a 22% CAGR over FY18-20. The recent fall in the stock price makes valuations attractive. Hence, we upgrade our rating to a Buy, with a revised target price of ₹287 (17x FY20e earnings) vs. our earlier TP of ₹299.

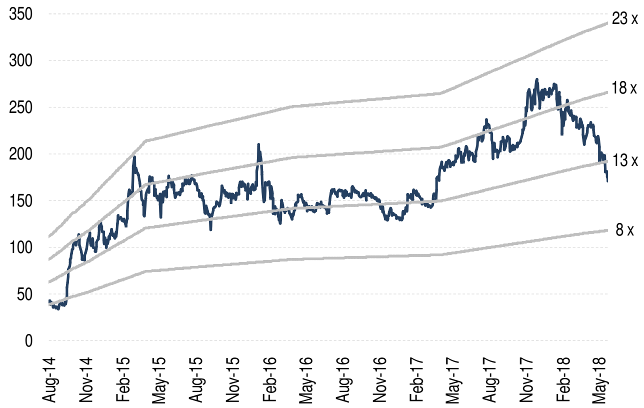
Change in estimates

Fig 9 – Change in estimates

(₹ m)	Original Estimates		Revised Estimates		Change (%)	
	FY19e	FY20e	FY19e	FY20e	FY19e	FY20e
Revenue	24,748	27,986	24,051	27,067	-2.8	-3.3
EBITDA	3,408	3,804	3,522	3,943	3.3	3.7
EPS (₹)	14.8	17.6	14.4	16.9	-2.9	-4.0

Source:

Fig 10 – One-year-forward PER



Source: Company, Anand Rathi Research

Key risk

- Delay in the awarding of orders

Appendix

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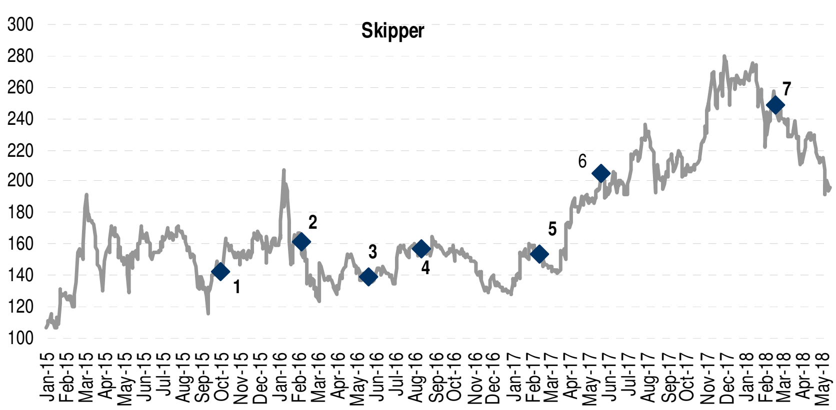

	Date	Rating	TP (₹)	Share Price (₹)
1	29-Sep-15	Buy	204	145
2	02-Feb-16	Hold	182	170
3	18-May-16	Hold	183	142
4	09-Aug-16	Hold	182	158
5	09-Feb-17	Hold	189	155
6	17-May-17	Buy	271	205
7	14-Feb-18	Hold	299	247

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