5 April 2016

Skipper

Visibility improving; altering our recommendation to a Buy

Rating: **Buy**
Target Price: ₹182
Share Price: ₹140

We upgrade Skipper from a Hold to a Buy, given that its valuations at current levels look attractive. Besides, its long-term fundamentals are unscathed, and healthy inflows subsequent to Q3FY16 have been seen.

Order inflows picking up. Inflows in 9mFY16 were restrained. The company could manage inflows of only ~₹5bn against revenue of ~₹8.6bn. However, subsequent to Q3 FY16, it saw inflows of ~₹6.2bn, which, in conjunction with a healthy pipeline, are likely to keep the growth momentum going.

Aiming at profitable growth. Management continues to look for orders which meet its margin threshold. It is clear that margins would not be compromised merely to secure greater revenue assurance. The company believes that, if it is patient, it would secure the kind of orders it seeks.

Supply contracts with the LATAM TSO (transmission system operator) not restrictive; expanding presence. Addressable international opportunities are abundant. The company's cost competitiveness would see it emerging as a beneficiary, in our view. The recently secured maiden order from Egypt suggests geographic expansion.

Rationalising its distribution channel. For profitable growth in the fiercely competitive PVC-pipe segment, the company is planning to rationalise its distribution channel network (by removing a layer of channel partners) in order to maintain margins.

Valuation. At the current price, the stock trades at 13.8x FY17e EPS of ₹10.1 and 11.5x FY18e EPS of ₹12.1. We value the company at a PE of 15x FY18e, which implies ~30% potential. Owing to the upside on offer and improved visibility on recent inflows, we raise our rating to a Buy, from a Hold. **Risk.** Any significant delay in order execution.

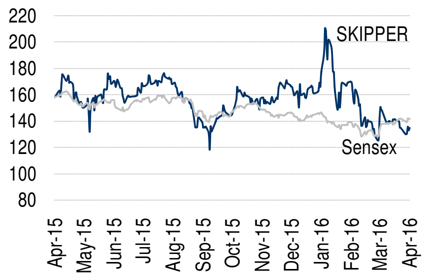
Key financials (YE Mar)	FY14	FY15	FY16e	FY17e	FY18e
Sales (₹m)	10,415	13,128	15,638	18,063	20,591
Net profit (₹m)	269	892	944	1,035	1,240
EPS (₹)	2.6	8.7	9.2	10.1	12.1
Growth (%)	9.5	231.4	5.9	9.6	19.8
PE (x)	53.2	16.1	15.2	13.8	11.5
PBV (x)	6.2	4.7	3.7	3.0	2.5
RoE (%)	12.3	33.3	27.5	24.3	23.7
RoCE (%)	14.5	27.7	26.9	25.5	26.0
Dividend yield (%)	0.1	0.9	0.9	0.9	0.9
Net debt/equity (x)	1.8	1.1	0.8	0.7	0.6

Source: Company, Anand Rathi Research

Key data	SKIPPER IN / SKIP.BO
52-week high/low	₹220 /₹116
Sensex/Nifty	24884/ 7603
3-m average volume	$1.0m
Market cap	₹14bn/$215m
Shares outstanding	102m

Shareholding pattern (%)	Dec '15	Sep '15	Jun '15
Promoters	72.4	72.4	72.4
- of which, Pledged	-	-	-
Free Float	27.6	27.6	27.6
- Foreign Institutions	1.1	-	-
- Domestic Institutions	0.0	-	-
- Public	26.5	27.6	27.6

Relative price performance



Source: Bloomberg

Prem Khurana
Research Analyst
+9122 6626 6470
premkhurana@rathi.com

Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹m)

Year-end:Mar	FY14	FY15	FY16e	FY17e	FY18e
Net revenues	10,415	13,128	15,638	18,063	20,591
Revenue growth (%)	15.7	26.0	19.1	15.5	14.0
- Oper. expenses	9,313	10,976	13,409	15,667	17,838
EBIDTA	**1,102**	**2,152**	**2,229**	**2,396**	**2,753**
EBITDA margins (%)	10.6	16.4	14.3	13.3	13.4
- Interest	605	583	574	584	606
- Depreciation	151	220	248	272	290
+ Other income	21	17	47	45	41
- Tax	98	474	509	550	659
Effective tax rate (%)	26.7	34.7	35.0	34.7	34.7
+ Associates/(minorities)	-	-	-	-	-
Adjusted PAT	269	892	944	1,035	1,240
+ Extraordinary items	-	-	-	-	-
Reported PAT	269	892	944	1,035	1,240
Adj. FDEPS (₹/sh)	2.6	8.7	9.2	10.1	12.1
Adj. FDEPS growth (%)	9.5	231.4	5.9	9.6	19.8

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Share capital	102	102	102	102	102
Reserves & surplus	2,209	2,936	3,721	4,597	5,677
Net worth	2,312	3,039	3,823	4,699	5,779
Total debt	4,395	3,829	3,830	4,090	4,126
Minority interest	-	-	-	-	-
Def. tax liab. (net)	218	265	281	281	281
Capital employed	**6,924**	**7,132**	**7,934**	**9,070**	**10,186**
Net fixed assets	3,456	3,535	3,857	3,925	3,985
Intangible assets	12	12	22	22	22
Investments	-	-	-	-	-
- of which, Liquid	-	-	-	-	-
Working capital	3,193	3,024	3,425	4,536	5,442
Cash	263	561	630	587	737
Capital deployed	**6,924**	**7,132**	**7,934**	**9,070**	**10,186**
W C turn (days)	112	84	80	92	96
Book value (₹/sh)	22.6	29.7	37.4	45.9	56.5

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Adjusted PAT	269	892	944	1,035	1,240
+ Non-cash items	151	220	248	272	290
Cash profit	420	1,112	1,193	1,307	1,530
- Incr./(decr.) in WC	134	-170	402	1,111	907
Operating cash-flow	286	1,281	791	197	623
- Capex	321	299	580	340	350
Free-cash-flow	-35	982	211	-143	273
- Dividend	18	160	160	160	160
+ Equity raised	-0	-5	0	-0	-
+ Debt raised	188	-519	17	260	36
- Investments	-	-	-	-	-
- Misc. items	-	-	-	-	-
Net cash-flow	135	298	69	-43	150
+ Op. cash & bank bal.	128	263	561	630	587
Cl. Cash & bank bal.	263	561	630	587	737

Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @ ₹140

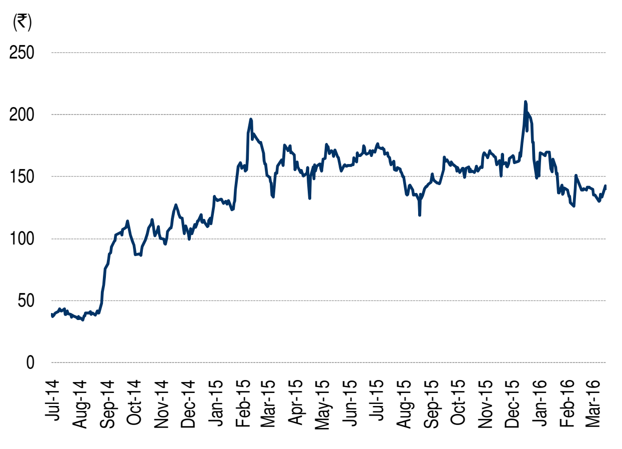
Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
P/E (x)	53.2	16.1	15.2	13.8	11.5
Cash P/E (x)	34.1	12.9	12.0	11.0	9.4
EV/EBITDA (x)	16.7	8.2	7.9	7.4	6.4
EV/sales (x)	1.8	1.3	1.1	1.0	0.9
P/B (x)	6.2	4.7	3.7	3.0	2.5
RoE (%)	12.3	33.3	27.5	24.3	23.7
RoCE (%)	14.5	27.7	26.9	25.5	26.0
Dividend yield (%)	0.1	0.9	0.9	0.9	0.9
Dividend payout (%)	6.7	18.0	16.9	15.4	12.9
Net debt/equity (x)	1.8	1.1	0.8	0.7	0.6
Debtor (days)	81	104	106	106	106
Inventory (days)	80	63	68	70	72
Payables (days)	65	92	100	92	92
Interest cover (x)	1.6	3.3	3.5	3.7	4.1
Fixed asset T/O (x)	3.0	3.7	4.0	4.6	5.1

Source: Company, Anand Rathi Research

Fig 5 –PE band

Source: Bloomberg, Anand Rathi Research

Fig 6 – Price movement



Source: Bloomberg

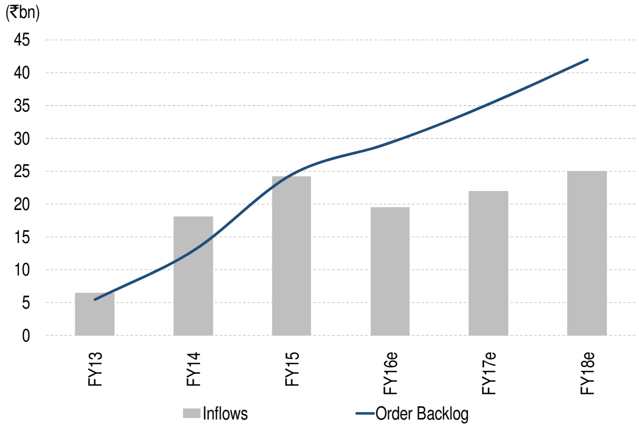
Engineering products: enduring growth

Order inflows

Inflows in 9mFY16 were subdued. The company could manage inflows of only ~₹5bn against revenue of ~₹8.6bn. Order inflows lagging revenue recognition raised concerns among investors whether the company would be able to deliver on its "guidance" of steady ~20-25% volume growth in the next couple of years. Subsequent to Q3 FY16, however, the company has secured orders worth ~₹6.2bn. Further, we learn that it is favourably placed for orders of over ₹20bn. These, when converted into LoAs, would aid to greater assurance regarding revenue. Additionally, the continued focus on improving transmission capacities, we believe, would keep orders coming in.

Subsequent to 3Q, secures orders of a combined value of ~₹6.2bn

Fig 7 –Continuing investment in T&D to keep inflows healthy



Source: Company, Anand Rathi Research

Targeting profitable growth

Management continues to look for orders which meet its margin threshold. It's clear that margins would not be compromised merely to offer better revenue visibility. Besides, it believes the segment that it operates in is not overly competitive and opportunities are abundant. Hence, there is no need to cut margins to obtain orders. A little patience would secure the kind of orders it seeks.

Delay in orders from PGCIL

Generally, with PGCIL, awarding of orders commences in Q3 FY16. This time around, however, this seems to have been pushed forward so as to complete the large CWIP that PGCIL has been faced with. Our interaction suggests that PGCIL has been prioritising critical projects (complete projects where evacuation would be required in the immediate future) over non-critical projects.

Supply contract with the LATAM TSO not restrictive; expanding presence

A tower-supply agreement with the largest TSO in Latin America (a three-year contract to expire in FY17) does not bar / lay any restrictions on the company to supply towers to any others in the same market. Given the vast addressable opportunities internationally, the company is also exploring Europe, Africa and West Asia (the Middle East). It recently secured its first ever order from Egypt. As is the case domestically, the focus here again is on profitable growth, not merely order-book building.

The operating environment, the management says, is not significantly different from that prevailing in the domestic market.

Capacity expansion

Capacity which was 175,000 tonnes per annum at the beginning of the year has already been expanded to 200,000 tpa. Management aims to expand that in line with targeted volume growth. Expansion would be brownfield up to 300,000 tpa. Any figure beyond this would require the company to look for greenfield expansions. For the former, management is eyeing annual expenditure of ~₹0.2bn-0.3bn over the next 3-4 years.

PVC products, scaling up

Started some seven years back, the PVC products division is as important as the engineering products one; therefore, management is equally committed to this segment. It sees this business as strategically important since it offers the chance to diversify from a pure B2B business to a mix of B2B and B2C.

In expansion mode

Having begun with 12,500 tpa, the company has already expanded its capacity to 35,000 tonnes with the recent commissioning of a plant in Sikanderabad (in Q4). With the slated commissioning of Hyderabad in Q1 FY17, the company would have met its short-term target to create capacity of over 40,000 tpa. Expanded capacity would give it access to all the critical markets. For the West, it would have its Gujarat plant, the South would be catered to by Hyderabad, Guwahati would take care of the North East and Sikanderabad (UP) would be able to cater to demand in the North.

Capacity increased from 12,500 tonnes per annum to 35,000 already

Fig 8 – PVC capacity on an upswing

Plant	State	Capacity (tpa)	Status
Uluberia	West Bengal	15,000	Operational
Ahmedabad	Gujarat	10,000	Commissioned, Apr'15
Guwahati	Assam	4,000	Commissioned, Dec'15
Sikanderabad	Uttar Pradesh	6,000	Commissioned, Feb'16
Hyderabad	Telangana	8,000	Being implemented
Total		**43,000**	

Source: Company, Anand Rathi Research

Rationalising the distribution channel

Management is trying to remove a level from the distribution channel so as to offer higher margins to its channel partners and enthuse them to sell its products. Additionally, management also hosts a number of events to educate plumbers (influencers) about the products. The wide range of SKUs (almost 3,000) would also help it gain market share.

Working capital shorter than for engineering products

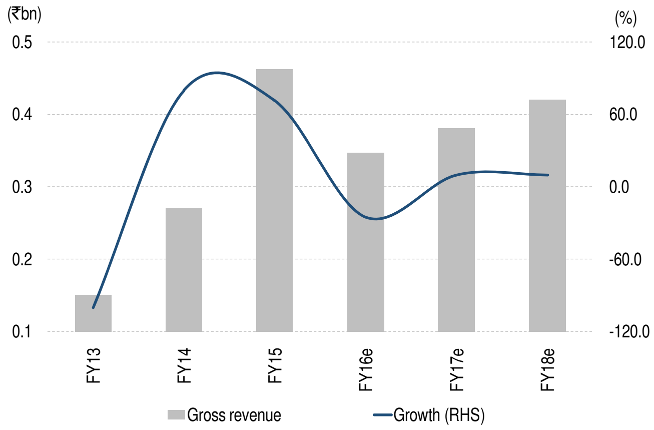
The working-capital cycle for the PVC business is shorter than for engineering products as the company offers a credit period of only 15-20 days. Additionally, shorter production time (than for tower manufacturing) helps keep inventory days lower.

Infrastructure projects (EPC) – Measured growth aimed

As it has already seen some of its peers struggle for reckless growth targets, the company intends to grow this business in a measured manner. Management highlights that it is under no pressure to bid aggressively for EPC orders as, unlike with some of its peers, the share from this segment is very low and even a small order would suffice to deliver growth.

Under no pressure to bid aggressively

Fig 9– Targeting measured growth

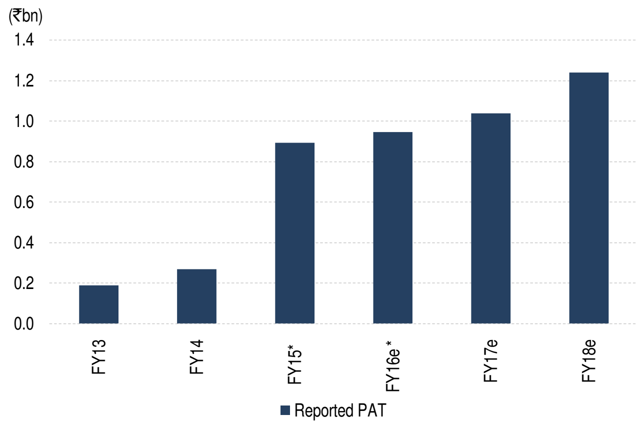


Source: Company, Anand Rathi Research

Valuation and Risk

At the current price, the stock trades at 13.8x FY17e EPS of ₹10.1 and 11.5x FY18e EPS of ₹12.1. We value the company at a PE of 15x FY18e, which implies ~30% potential. Owing to the upside on offer and improved visibility on recent inflows, we raise our rating to a Buy, from a Hold.

Fig 10–Profitable growth to lead to re-rating



Note: FY15 and FY16 include pre-tax forex gain of ~₹0.4bn and ~₹0.2bn respectively
Source: Company, Anand Rathi Research

Risks

- Any significant delay in order execution.

Appendix

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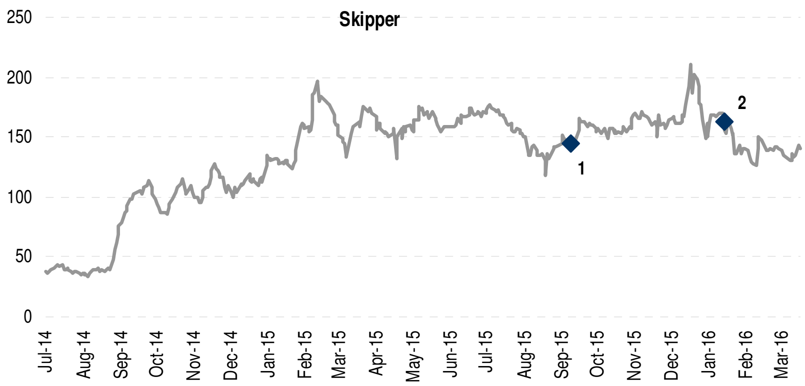

	Date	Rating	TP (₹)	Share Price (₹)
1	29-Sep-15	Buy	204	145
2	02-Feb-16	Hold	182	170

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