ANANDRATHI

India I Equities

Capital Goods
Result Update

Change in Estimates ☐ Target ☐ Reco ☐

11 November 2016

Skipper

Rating: **Hold**
Target Price: ₹182
Share Price: ₹144

Growth continues, this time led by Polymers; retaining a Hold

Locational advantage and cost competitiveness (owing to backward integration) would ensure Skipper is a key beneficiary of capex on enhanced transformation capacity. We also like the asset-light business approach for its Polymer products, signifying management's averseness to capital intensity. Despite healthy operations, meaningful positive FCF seems unlikely in the foreseeable future as capex continues. Owing to limited positive FCF, we retain our Hold rating.

Polymer products drive growth: Better sweating of new capacities in the Polymer products division led to strong, ~66% yoy, growth in the division's revenue. Consequently, overall revenue was up ~15% yoy. Engineering products growth eased to ~8% on lower export revenues, but strong traction in India provides comfort. Infrastructure projects, the third division, lacks size for a material impact, but clocked an impressive ~218% yoy growth in revenues (new orders seem to have turned revenue contributing).

Healthy margins and lower tax rate aid earnings: Notwithstanding lower margins for the Polymer products (under-absorption of fixed costs, as new capacities yet stabilising) and Infrastructure projects (change in project mix), improved margins for Engineering products helped blended EBITDA margins expand ~122bps yoy. Healthy operations combined with a lower effective tax rate (~33.5%, ~34.7% a year ago) led to ~17% yoy growth in adj. PAT (adj. for forex gain). PAT was down ~25% on lower forex gains.

Cash-conversion cycle shortens yoy: The greater share of the Polymer products division seems to have shortened the cycle by 12 days yoy.

To enhance product portfolio: In order to further optimise its product portfolio and capitalise on its already-established distribution channel, the Board has approved adding HDPE pipes (meant for water transportation) and overhead tanks in its Polymer products portfolio.

Valuation: At the CMP, the stock trades at PE of 14x/~12/~10x FY17e/ FY18e/FY19e EPS. We value it at a PE of 15x FY18e to arrive at a target of ₹182. **Risk.** Any significant delay in order awarding.

Quarterly results (YE Mar)	Q2 FY16	Q2 FY17	% yoy	H1 FY16	H1 FY17	% yoy
Sales (₹m)	3,499	4,013	14.7	5,866	6,857	16.9
EBITDA margin (%)	12.2	13.5	`122bps	13.3	13.8	`49bps
Interest (₹m)	114	150	31.5	262	310	18.7
Depreciation (₹m)	58	72	24.1	117	139	19.4
Other income (₹m)	26	7	-71.9	32	15	-53.1
Exceptional item (₹m)	181	15	-91.9	181	30	-83.7
Tax (₹m)	161	114	-29.1	214	179	-16.3
Reported PAT (₹m)	303	226	-25.3	403	364	-9.8
Adj. PAT (₹m)	184	217	17.5	285	344	20.8

Source: Company

Key data	SKIPPER IN / SKIP.BO
52-week high / low	₹220 / ₹122
Sensex / Nifty	26819 / 8296
3-m average volume	$0.3m
Market cap	₹14.7bn / $221m
Shares outstanding	102m

Shareholding pattern (%)	Sep'16	Jun'16	Mar'16
Promoters	72.4	72.4	72.4
- of which, Pledged	-	-	-
Free Float	27.6	27.6	27.6
- Foreign Institutions	1.5	0.2	0.2
- Domestic Institutions	3.1	3.0	3.2
- Public	23.1	24.5	24.3

Financials (YE Mar)	FY17e	FY18e
Sales (₹ m)	17,758	20,481
Net profit (₹ m)	1,018	1,243
EPS (₹)	10.0	12.1
Growth (%)	32.3	22.1
PE (x)	14.4	11.8
PBV (x)	3.1	2.6
RoE (%)	24.0	23.9
RoCE (%)	23.4	24.0
Dividend yield (%)	1.0	1.0
Net debt / equity (x)	1.0	0.8

Source: Anand Rathi Research

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY15	FY16	FY17e	FY18e	FY19e
Net revenues	12,708	14,881	17,758	20,481	23,461
Revenue growth (%)	22.0	17.1	19.3	15.3	14.6
- Oper. expenses	10,976	12,870	15,345	17,692	20,263
EBIDTA	**1,732**	**2,011**	**2,414**	**2,788**	**3,199**
EBITDA margins (%)	13.6	13.5	13.6	13.6	13.6
- Interest	583	570	641	676	702
- Depreciation	220	241	256	286	328
+ Other income	17	52	42	48	73
- Tax	474	482	540	632	755
Effective tax rate (%)	50.1	38.5	34.6	33.7	33.7
+ Associates / (minorities)	-	-	-	-	-
Adjusted PAT	472	770	1,018	1,243	1,486
+ Extraordinary items	420	181	30	-	-
Reported PAT	892	951	1,048	1,243	1,486
Adj. FDEPS (₹ / sh)	4.6	7.5	10.0	12.1	14.5
Adj. FDEPS growth (%)	75.3	63.2	32.3	22.1	19.6

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY15	FY16	FY17e	FY18e	FY19e
Share capital	102	102	102	102	102
Reserves & surplus	2,936	3,713	4,576	5,635	6,937
Net worth	3,039	3,815	4,679	5,737	7,039
Total debt	3,829	4,682	4,999	5,212	5,390
Minority interest	-	-	-	-	-
Def. tax liab. (net)	265	315	315	315	315
Capital employed	**7,132**	**8,812**	**9,992**	**11,264**	**12,744**
Net fixed assets	3,535	4,239	4,623	4,826	5,012
Intangible assets	12	12	10	8	4
Investments	-	-	-	-	-
- of which, Liquid	-	-	-	-	-
Working capital	3,024	4,062	4,943	5,761	6,694
Cash	561	498	416	669	1,034
Capital deployed	**7,132**	**8,812**	**9,992**	**11,264**	**12,744**
Working capital (days)	87	100	102	103	104
Book value (₹ / sh)	29.7	37.3	45.7	56.1	68.8

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹ m)

Year-end: Mar	FY15	FY16	FY17e	FY18e	FY19e
Adjusted PAT	892	951	1,048	1,243	1,486
+ Non-cash items	220	241	256	286	328
Cash profit	1,112	1,192	1,304	1,529	1,814
- Incr. / (decr.) in WC	-170	1,038	881	819	932
Operating cash-flow	1,281	154	423	710	882
- Capex	299	946	638	486	511
Free cash-flow	982	-792	-215	224	371
- Dividend	160	172	184	184	184
+ Equity raised	-5	-2	-0	-	-
+ Debt raised	-519	903	317	213	178
- Investments	-	-	-	-	-
- Misc. items	-	-	-	-	-
Net cash-flow	298	-63	-82	253	365
+ Op. cash & bank bal.	263	561	498	416	669
Cl. Cash & bank bal.	561	498	416	669	1,034

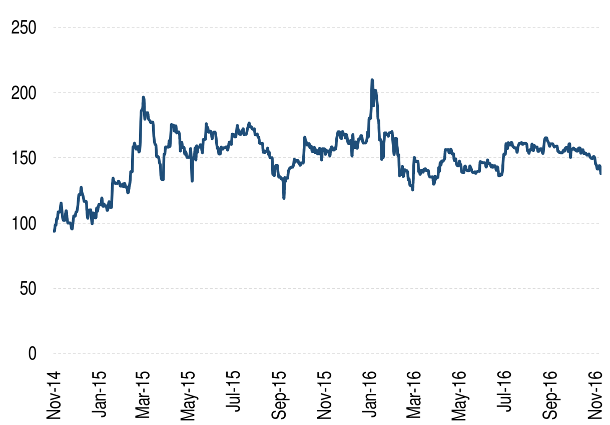
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @ ₹144

Year-end: Mar	FY15	FY16	FY17e	FY18e	FY19e
P/E (x)	31.1	19.1	14.4	11.8	9.9
Cash P/E (x)	21.2	14.5	11.5	9.6	8.1
EV / EBITDA (x)	10.4	9.4	8.0	6.9	6.0
EV / sales (x)	1.4	1.3	1.1	0.9	0.8
P/B (x)	4.8	3.8	3.1	2.6	2.1
RoE (%)	17.6	22.5	24.0	23.9	23.3
RoCE (%)	21.7	22.8	23.4	24.0	24.5
Dividend yield (%)	0.9	1.0	1.0	1.0	1.0
Dividend payout (%)	33.9	22.4	18.1	14.8	12.4
Net debt / equity (x)	1.1	1.1	1.0	0.8	0.6
Debtor (days)	108	91	99	99	99
Inventory (days)	66	61	67	67	67
Payables (days)	69	52	61	61	61
Interest cover (x)	2.6	3.2	3.4	3.8	4.2
Fixed asset T/O (x)	3.6	3.5	3.8	4.2	4.7

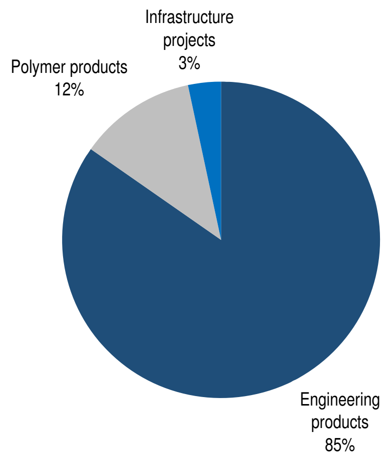
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – FY16 Revenue break-up



Source: Company

Result / Concall Highlights

- For Q2 FY17, Skipper's Engineering products division (adj. for forex gains) registered ~8% yoy revenue growth and ~156bps margin expansion. On the lower international order backlog yoy, we estimate export revenues to have dipped considerably. Lower export revenues seem to have been compensated by strong traction in domestic revenues. Over the course of the call, management said that there were some delays in off-take owing to project execution delayed by the monsoon.
- For Q2 FY17, revenue growth in the Polymer products came at an impressive ~66%, owing to better capacity utilisation at the recently-commissioned capacities. Growth also seems attributable to healthy demand for agri offerings owing to the good rains. However, the EBITDA margin for the segment contracted ~90bps as new capacities are yet stabilising (under-absorption of fixed costs).
- The Infrastructure projects division recorded an even more impressive 218% yoy revenue growth owing to the healthy pace of execution at some of the recently-bagged projects. Margins dipped ~294bps on the change in the project mix.
- Volume growth in Engineering products was ~10%, whereas for Polymer products, it was in line with value growth (~60-65%).

Fig 7 – Segment-wise highlights

(YE: Mar)	Q2 FY16	Q2 FY17	% yoy	Q1 FY17	% qoq	H1 FY16	H1 FY17	% yoy
Segment revenue (₹ m)								
Engineering products	3,196	3,450	8.0	2,358	46.3	5,147	5,808	12.8
Polymer products	264	437	65.7	378	15.5	596	815	36.7
Infrastructure projects	39	125	218.3	108	15.9	122	234	91.2
Total	**3,499**	**4,013**	**14.7**	**2,844**	**41.1**	**5,866**	**6,857**	**16.9**
EBITDA margins (%)								
Engineering products	12.2	13.8	-	14.9	-	13.4	14.2	-
Polymer products	11.7	10.8	-	11.1	-	11.5	10.9	-
Infrastructure projects	16.5	13.6	-	13.4	-	21.2	13.5	-
Blended	**12.2**	**13.5**	**-**	**14.3**	**-**	**13.3**	**13.8**	**-**

Source: Company
Note: Figures include other operating income but exclude forex gain on forward contracts

- Management maintained its growth guidance of ~15-20% in overall revenues and more than 50% in revenue of Polymer products. Management is comfortable with the present level of blended margins but nevertheless expects margins for the Polymer products division to move up (on better capacity utilisation).
- In Q2 FY17, blended capacity utilisation in the Polymer products division was ~50-60% for the current capacity of 41,000 tonnes. Management expects this to increase as product acceptability in the relatively newer areas improves.
- **Capex for the new units in Guwahati and new products**
  - The board-approved plans to set up a 30,000-tonne tower / distribution-poles manufacturing unit and a 7,000-tonne CPVC and UPVC fittings unit in Guwahati are going according to plan. Management hopes to commence operations by Q4 FY17.

Investment for these two is pegged at ~₹0.7bn.

- In order to optimise product offering and capitalise on its distribution channel for Polymer products, the Board, during the quarter, approved adding two product lines (HDPE pipes and Overhead tanks) to the polymer products range. HDPE pipe manufacturing is to be set up at its Telangana plant, with a starting capacity of 3,000 tonnes. This would entail capex of ~₹30m. The overhead tank manufacturing plant is to be set up at its existing plant at Uluberia, Kolkata, with initial capacity of 1,200 tonnes at capex of ~₹40m.
- Management highlights that the new product lines are an extension of offerings and remains hopeful of robust demand.

■ During the quarter, management completed the capacity expansion of the rolling mill at Uluberia, Kolata. Consequently, capacity is now ~250,000 tonnes. This was done to meet the envisaged increase in T&D volumes.

■ At present, tower capacity is pegged at 200,000 tonnes, and is set to increase to 230,000 tonnes on completion of the Guwahati capex.

■ For supply orders in the North East, the under-execution Guwahati unit is likely to offer the freight-cost advantage of ₹3,000-3,500 a tonne (vis-à-vis peers in other parts of the country). From Uluberia, Kolkata, the potential freight-cost advantage could be ~₹2,000-2,500 a tonne.

■ The company could secure new orders to the tune of revenues booked. Consequently, the order backlog was largely flat at ~₹23bn. This implies ~1.8x book-to-bill ratio.

■ Besides the orders secured in H1, management commented about bids under evaluation of ~₹6bn-7bn. These bids under evaluation are lower than management normally has (~₹10bn), the reason attributed to the cancellation of the tendering process for two large PGCIL projects (of ~₹300bn; Skipper had participated for orders worth ~₹10bn-12bn). Management hopes to see these two projects return for bidding sooner than later.

■ Management identifies healthy growth potential in India. It sees PGCIL capex as flat over the next 4-5 years but sees an increasing share of TBCB orders and increasing state expenditure on T&D infrastructure to drive growth. In management's view, the greater size of SEB orders and the conducive payment structure render SEB orders attractive.

■ Regards international orders, the tower-supply contract with LATAM TSO expired in Sep'16. TSO has not renewed the contract as it has yet to take up the quantity earlier contracted for. Skipper has pending orders of ~₹4.5bn from the TSO, likely to be executed by Q3 FY18.

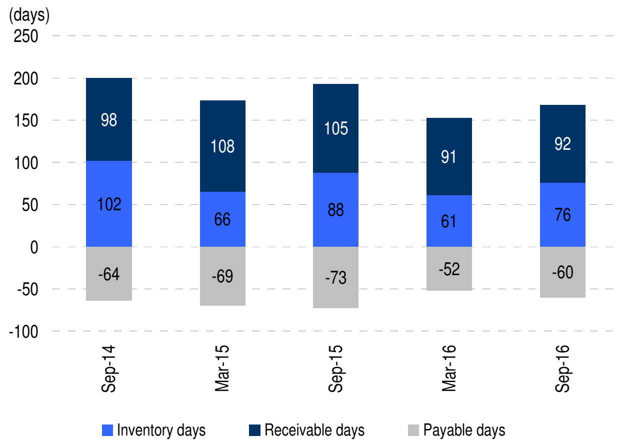
■ In LATAM, management is in touch with a large number of operators to maintain business continuity. However, it is unlikely to take up orders at the cost of margins. Besides, its efforts continue to enhance its international operations and it identifies south-east Asian countries and West Africa as areas offering huge potential.

■ Based on TTM net sales, **the cash-conversion cycle** shortened by 12 days, to 108, yoy. The improvement is ostensibly due to the greater share of Polymer products, which entail fewer receivable days.

However, in the last six months, the cycle has lengthened by 7 days. This could largely be attributed to the seasonality of the tower business (inventory built for H2) and the slower-than-expected off-take by clients due to the prolonged monsoon (and consequent delayed project execution). The rise in inventory was partly balanced off by more creditor days.

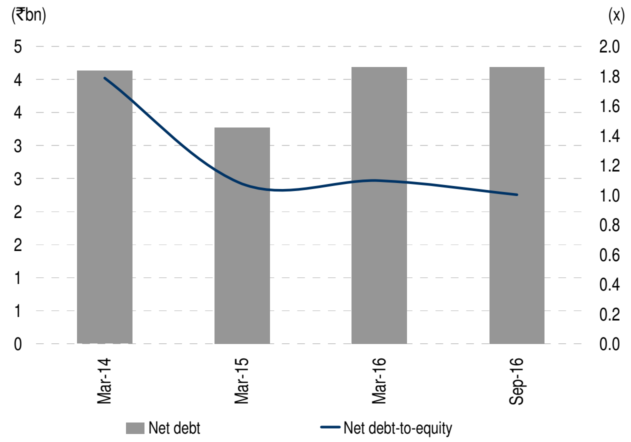
- Cash PAT for H1 FY17 (~₹0.5bn) seems to have been entirely utilised to meet capex (~₹0.3bn) and increased working-capital needs. Consequently, net debt at ~₹4.2bn is flat over H1 FY17. Net-debt-to-equity declined to ~1x, against ~1.1x as at 31st Mar'16.

Fig 8 – Cash conversion cycle turns shorter yoy



Source: Company, Anand Rathi Research

Fig 9 – Debt up yoy / flat over H1

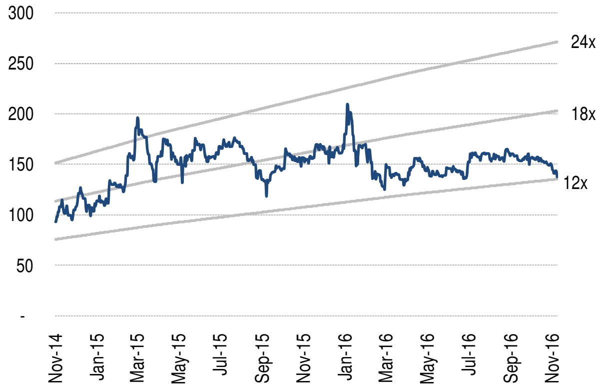


Source: Company

Valuation

At the CMP, the stock trades at PE of 14x/~12/~10x FY17e/FY18e/ FY19e EPS. We value it at a PE of 15x FY18e to arrive at a target of ₹182. The PER multiple is at a discount to its two-year median of 17x.

Fig 10 – PE band



Source: Bloomberg, Company, Anand Rathi Research

Risk

- Any significant delay in order awarding.

Appendix

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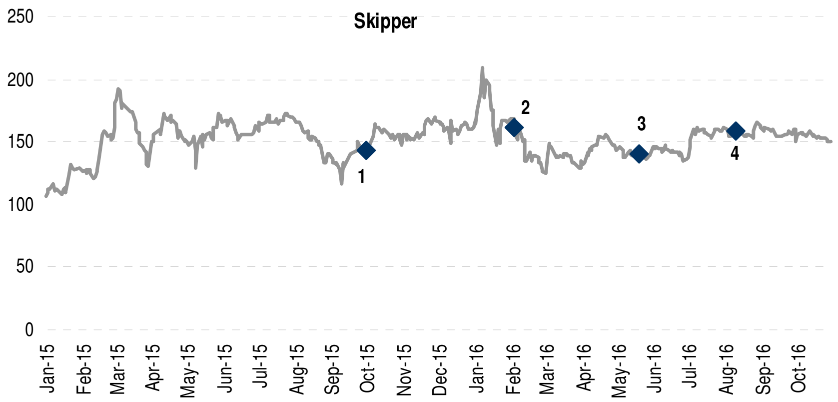

	Date	Rating	TP (₹)	Share Price (₹)
1	29-Sep-15	Buy	204	145
2	02-Feb-16	Hold	182	170
3	18-May-16	Hold	183	142
4	09-Aug-16	Hold	182	158

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