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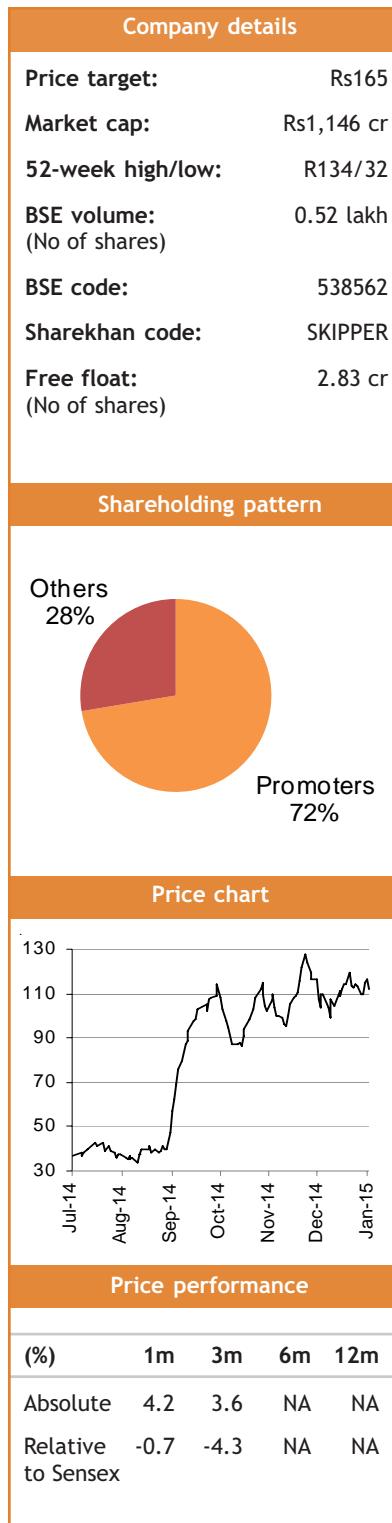
January 19, 2015

Skipper

Reco: Buy

Earnings surge a hop, skip and jump away

CMP: Rs112



Key points

- Firing on two cylinders:** Skipper is in a unique position to exploit the growing opportunities in two lucrative segments: power (transmission tower manufacturing and EPC projects) and water (PVC pipes). It is a leading transmission tower manufacturer in India and ideally placed to gain from the huge investments proposed in the power T&D segment (estimated to grow to Rs3 trillion over the next five years). It has a comfortable order book of Rs2,200 crore in the transmission business and is expected to record a steady growth of 20% CAGR during FY2014-17 with a healthy margin, given its backward integration into manufacturing of steel products.
- Manifold expansion in pipes; going national from regional:** In PVC pipes, the company's footprint is well established but limited to the east and certain parts of central India. However, it has chalked out an aggressive plan to raise its capacity by 4x to 40,000TPA by FY2016 to become a pan-India player. Simultaneously, it is beefing up the hiring process to enter new regions with experienced hands and is looking to widen its distribution channel across India.
- Margin expansion led by operating leverage and restructuring exercise:** It enjoys the benefits of operating leverage on the margin and has restructured its low-margin steel tube business by leasing the capacities to Tata Steel on a cost-plus basis. Consequently, the overall margin will improve from 11% in FY2014 to 14-15% in FY2015 and elevate its RoE from 12% in FY2014 to around 16% in FY2015 (after the release of the working capital deployed in the low-margin tube business).
- Set for strong earnings growth and return ratios; Buy:** Skipper is a play on two key growth areas, power T&D and PVC pipes. While traction in the T&D space and aggressive expansion in the PVC business would drive its growth, the restructuring of the tube business would help expand the margin and improve the return ratios. We expect an earnings growth of 60% CAGR and a substantial expansion in the RoE during FY2014-17. This could be a strong re-rating trigger as the stock's current valuations are also quite comfortable at 14x and 10x FY2016E and FY2017E earnings. Thus, we rate the stock as a Buy with a price target of Rs165 (based on 15x FY2017E earnings).
- Key concern:** The T&D EPC business is usually working capital intensive, hence any abnormal scale-up in this space could expand the working capital cycle and decrease the profitability. The company is also exposed to forex fluctuation risk due to overseas orders.

Valuations

Particulars	FY2013	FY2014	FY2015E	FY2016E	FY2017E
Net sales	928.2	1073.1	1307.7	1602.5	1912.0
OPM (%)	9.7	11.0	14.7	14.5	14.5
Reported PAT	18.7	26.9	73.4	90.4	112.2
Adjusted PAT*	18.7	26.9	44.5	80.4	112.2
Adjusted EPS	1.8	2.6	4.3	7.9	11.0
Growth (YoY) %	91.7	43.7	65.2	80.9	39.5
PER (x)	61.2	42.6	25.8	14.2	10.2
P/B (x)	5.6	5.0	3.8	3.0	2.3
EV/EBIDTA (x)	16.7	12.7	8.0	6.9	6.0
DE (x)	1.9	1.8	1.4	1.3	1.1
Div. yield (%)	0.1	0.1	0.4	0.5	0.6
RoCE (%)	13.89	16.43	25.07	25.67	25.73
RoE (%)	10.13	12.31	16.76	23.56	25.76

*Adjusted for forex gains/non-recurring income

Investment arguments

Leading tower manufacturer; strong traction in T&D improves visibility: Skipper is one of the top three manufacturers of transmission towers in India and one among the few in the industry having backward integration through rolling mills, which gives it better control over the key raw material, semi-finished steel. The company is one of the focused manufacturers and suppliers of towers, angles, poles and structures, which are largely used in power transmission towers, distribution poles, street lighting poles and high-mast poles. It is also horizontally integrated with manufacturing of fasteners and accessories for towers. The company is already supplying high-mast monopoles and planning to enter into the niche area of manufacturing transmission monopoles. After gaining strength as a leading manufacturer and supplier of transmission towers, of late the company has stepped into engineering, procurement and construction (EPC) projects in the transmission & distribution (T&D) space.

We believe investment in the power T&D space is going to increase significantly in the next four to five years even on a high base, given the enhanced focus of the pro-reform government on strengthening the T&D infrastructure in the country. The power ministry has indicated a requirement of huge investment of around Rs3 lakh crore in the T&D segment over the next five years. Power Grid Corporation of India Ltd (PGCIL) currently has an investment target of around Rs110,000 crore for the 12th Five-Year Plan (FY2012-17) which should improve by 20-30% during the next Five-Year Plan in our view. Moreover, the outlook for investments from the state electricity boards and select private players in the T&D space is substantially better than what it used to be in the recent past.

We believe the incremental investments in the T&D infrastructure could be driven by plans like separate feeder for agriculture, green (renewable) corridor and cross-country transmission line among the South Asian Association for Regional Cooperation countries. Apart from spending by the central utility (PGCIL), we now expect positive traction from the state utilities (distribution companies) after a long hiatus. Hence, we expect a significant increase in the size of the opportunity pie in this space and focused players like Skipper should be the beneficiaries. As an integrated player Skipper enjoys a distinct advantage of having a presence in the eastern part of the country and we expect a significant rise in investments in this space in the north-eastern part of the country.

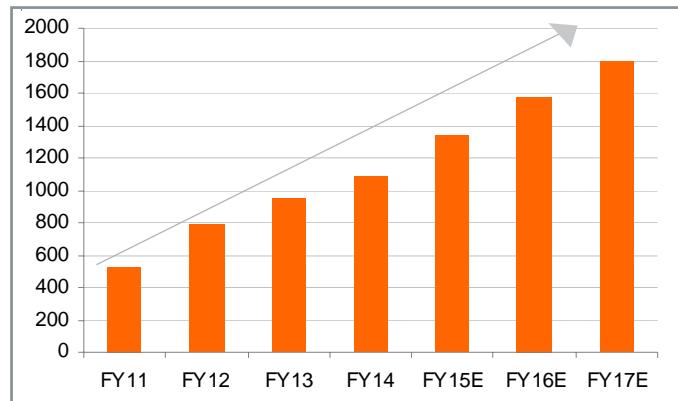
Currently, Skipper has an order book of around Rs2,200 crore out of which around Rs2,000 crore is for tower manufacturing and the remaining Rs200 crore is for EPC

projects. The current order book is around two times the FY2014 sales of its the T&D business. The management expects a healthy inflow of orders in the current year; it expects the order book to reach around Rs3,000 crore in the next 12-15 months.

We believe the improving outlook of the domestic T&D business is going to enhance the visibility of its future growth path. On the export front also, the company is gaining strength on a low base. Currently it has export orders of around Rs500 crore. The management has shared that in the project (T&D EPC) business, the company is very choosy and targets only high-margin projects as manufacturing remains its focused area.

We expect the revenue base of the transmission business (including products and projects) to increase from Rs1,000 crore to Rs1,850 crore during FY2014-17, growing at a 20% compounded annual growth rate (CAGR). We expect a steady margin in this segment, which would continue to contribute the bulk of the profitability of the company in the coming days.

Steady growth of T&D business



Manifold expansion in PVC business; going national from regional: Skipper has aggressive growth plans for its polyvinyl chloride (PVC) pipe business. It aims to expand its capacity ten-fold in the next dour to five years and become a national player as against its current status of a regional player with presence in the eastern part of India only. The management is planning to aggressively add another 30,000 tonne per annum (TPA) of capacity in the other regions of the country and then take the total capacity to 100,000TPA by FY2018, with a pan-India presence.

In the meanwhile, it is beefing up its hiring process to enter the new regions with an experienced team and is working on an extensive plan to expand its distribution network across India. We believe this is challenging but

Snapshot of pan-India PVC pipe players

Pan-India PVC pipe players	Astral Poly Technik	Supreme Industries	Finolex Industries	Jain Irrigation
Capacity TPA	97,000	295,000	230,000	295,000
Revenue (Rs cr) in FY2014	1,070	2,060	1,563	881
OPM (%) in FY2014	14.5	13.5	13.3	7.5

feasible as with the help of the expansion it is targeting a market share of 3-4% in the national PVC market. Besides, a low base would help it exhibit a sharp growth.

With such an aggressive plan, the management expects a steep growth in the PVC business, taking its revenue base from around Rs100 crore in FY2015 to more than Rs500 crore in FY2018. However, we have factored in much lower numbers in our estimate, considering the competition it could face from the established players in the new regions. Hence, we have built in our estimates conservatively. Moreover, by adopting an asset-light expansion model (taking land and site on lease) it could reduce its capital expenditure (capex) by 50-60% which could support the return ratios.

Multiplying PVC capacity in asset-light mode; favourable for return ratios: The company is currently a well-known brand and one of the leading players in eastern India, having a capacity of 10,000TPA. Currently, it is present in three eastern states (West Bengal, Bihar and Odisha) and some part of the north-east. Now, it is looking at new capacities in Gujarat, Maharashtra and Assam, and one location each in north and south India taking its total capacity to around 40,000TPA in the next one year. Further, it intends to scale up the capacity to 100,000TPA by adding capacities in a few more locations with an aim to be a national player.

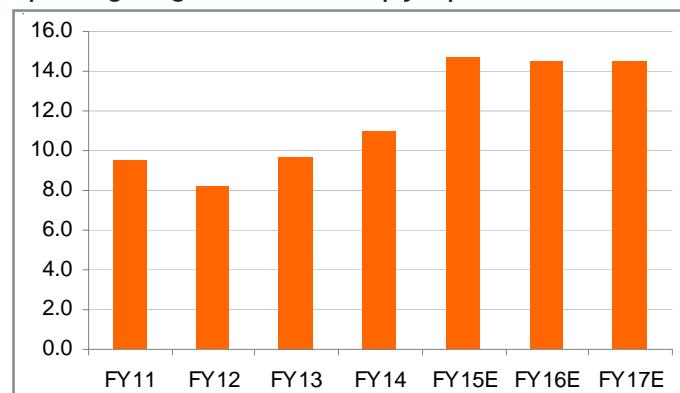
The interesting part of the growth plan is that the company is using the asset-light route where it will take land and plant sites on lease instead of owning the same and invest largely in the machinery and other accessories. By adopting the asset-light route, the company would save on the interest cost which would accrue to its net earnings and return ratios.

On the asset-light route, while it will bear the rental cost (which is typically 4-5% of the cost of the land or commercial establishment), it would be able to save on the interest cost (10-12% on the fund deployed) by lowering its capital deployment. Also this would help the company to reduce its capex by 50-60% and it could achieve the aggressive growth plan with a capex of around Rs100 crore (it would require around Rs250 crore otherwise). Consequently, the company would be able to save around 5-6% on a net basis on Rs150 crore; that translates into Rs8-9 crore annually which could be favourable for its return ratios.

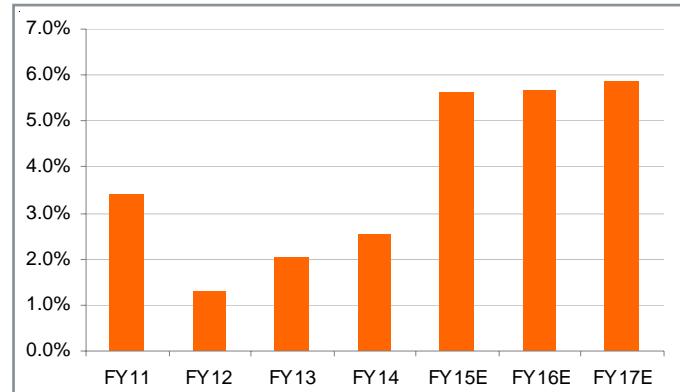
On its way to becoming a national player: The company is currently a well known brand and one of the leading players in the PVC space in eastern India and with an ambition of transforming itself from a regional player into a national player. To achieve this, the company has chalked out a clear growth path for the next three to four years which includes building a distribution network, adding experienced headcounts from the industry, creating brand awareness and adding capacities in the new regions.

We believe that in the initial years, the company would spend a relatively higher proportion of its revenues on advertising and giving incentives to channel partners to improve the visibility of its brand at the national level. But that will pay off well in the long run and could take the company to a new orbit of growth, subject to the execution of its ambitious target that the PVC segment should contribute around 20-25% of its revenues in the next four to five years vs 6% in FY2014.

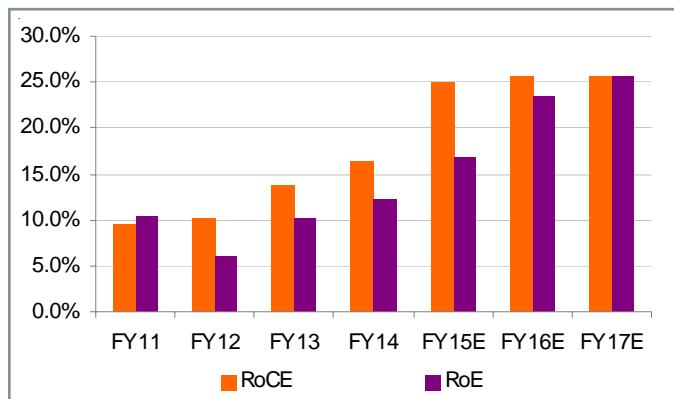
Operating margin to witness sharp jump



Improving profitability to reflect on net margin level too....



Positive impact on return ratios; set to surge



Restructuring of thin-margin tube business to lift margin and return ratios: The company had a steel tube business, which had low margins and was mainly contributing to the top line (about Rs300 crore in FY2014) with a very negligible contribution to the bottom line. During FY2015, Skipper restructured this low-margin tube business by shifting from manufacturing to contract work (on a cost-plus basis). Skipper has now leased out its tube capacity to Tata Steel and will convert tubes on a job work basis for the Tata company.

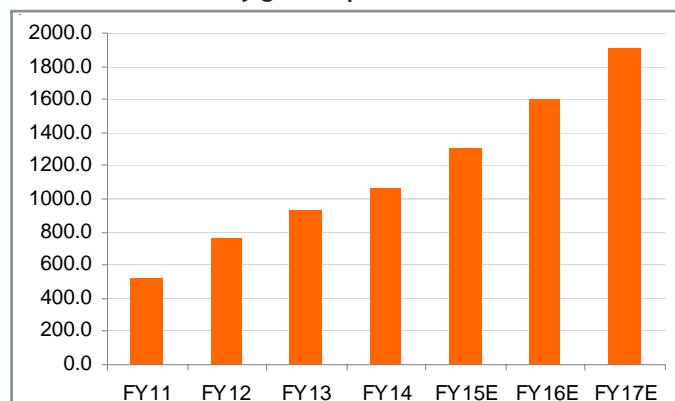
Consequently, going forward, it would not report any revenues from selling tubes, rather it will account for the conversion charges only. Hence, the overall operating profit margin (OPM), which was being dragged earlier by the underperformance of the tube business, will improve. We expect the blended OPM to improve from 11% in FY2014 to 14-15% in FY2015. Moreover, with the release of the capital deployed in the low-margin tube business, we expect a remarkable improvement in the return ratios too. Along with boosting the earnings and margin, the hive-off of the low-margin business would bolster the return on equity (RoE) from 12% in FY2014 to around 16% in FY2015.

View—set for a strong earnings trajectory and jump in return ratios; initiate coverage with a Buy: Skipper is a play on the two key growth areas of power transmission and distribution, and the PVC pipe segment. The high-base tower manufacturing business is gaining traction with an improving investment environment in the T&D space, where the opportunity pie is going to get bigger in the next five years. On the other hand, with an aggressive expansion of the PVC business and restructuring of the low-margin tube business into job work, there are multiple triggers for a strong earnings growth. We see potential for an exponential earnings growth (of above 60% CAGR) over FY2014-17.

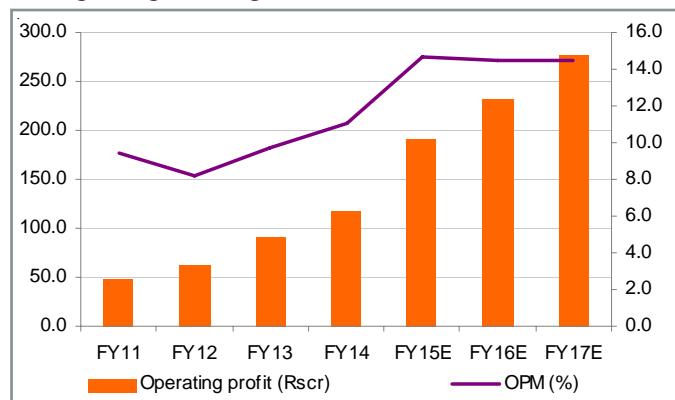
Further, the asset-light route chosen for expansion in the PVC business and the restructuring of its low-margin tube

business (which used to be a drag on its return ratios) would be instrumental in lifting its return ratios substantially in the next three to four years. This could be a strong re-rating trigger as the stock's current valuations are quite comfortable at 10x and 14x the FY2017E and FY2016E earnings. Thus, we initiate coverage on the stock with a Buy rating and a price target of Rs165 (based on 15x FY2017E earnings).

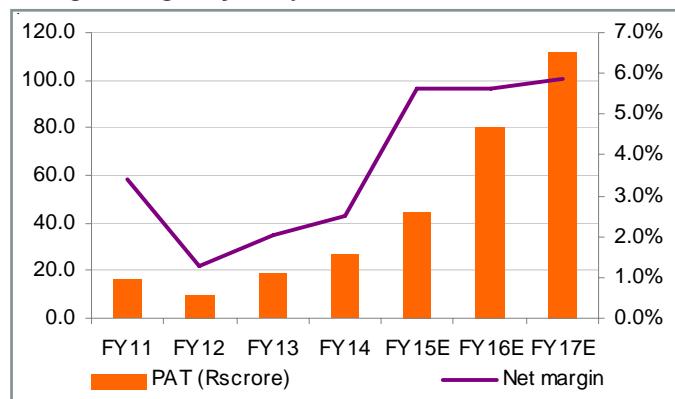
Revenue on a healthy growth path



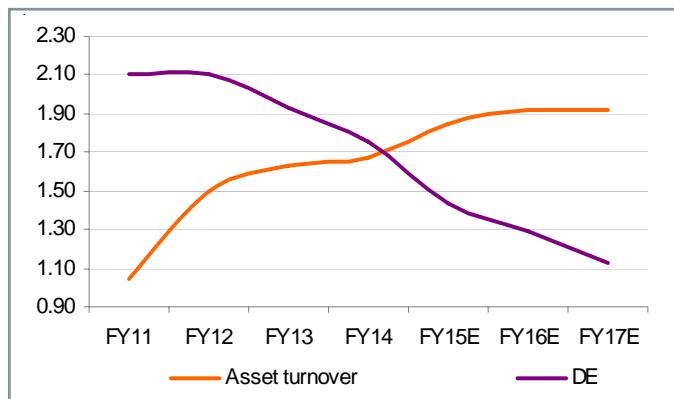
Moving to higher margin zone



Strong earnings trajectory ahead



Improving balance sheet configuration



Concerns

The recent currency movement has resulted in some foreign exchange (forex) gains that might not be sustainable especially if the currency movement turns unfavourable. The company takes forward cover on the international orders to hedge its receivable and restrict its forward exposure in keeping with the outstanding receivable of a project. Hence, any unfavourable forex movement could be a concern.

Manufacturing of tower remains the core and focused area of its business. However, in recent past it has tested water in the T&D projects (EPC projects), which are typically working capital intensive. Hence, if the company increases its focus on projects, the working capital cycle would turn longer than currently estimated.

The proposed aggressive expansion of the PVC business will be one of the key growth drivers but on its way to becoming a national player the company could face some challenges, viz competition and execution challenges.

Segments revenue (Rs cr)

Particulars	FY13	FY14	FY15E	FY16E	FY17E
Engg products	835.0	955.4	1127.7	1308.1	1478.2
Growth (%)	25	14	18	16	13
Infra. projects	17.2	27.0	78.3	117.4	152.7
Growth (%)	-58	57	190	50	30
PVC products	48.1	59.1	82.8	157.3	259.6
Growth (%)	58	23	40	90	65
Others & job work	5.7	15.9	18.9	19.6	21.6
Total revenue	906.1	1057.4	1307.7	1602.5	1912.0
Growth (%)	22	17	24	23	19

Company Background

Skipper

Skipper India (Skipper) manufactures integrated infrastructure products such as transmission towers, steel pipes, hot-rolled products, poles and scaffoldings. It also deals with power distribution and lighting poles as part of its transmission tower business. The company has recently started taking projects in the power T&D space too. On the plastic side, the company manufactures PVC pipes and fittings, and has capacity of 10,000TPA currently.

Skipper is based in Kolkata and has three state-of-the-art manufacturing facilities in the city: two at Jangalpur, Howrah and a major one at Uluberia, Howrah. Having a manufacturing base in the eastern region of India is an advantage as it allows it access to

raw material at a competitive price leading to cost-competitiveness.

Skipper is one of the leading players in eastern India having three PGCIL-approved transmission tower plants with a combined capacity of 151,000 million tonne per annum and seven in-house galvanising plants with a plant size of up to 14 metre and an annual galvanising capacity to handle over 2 lakh million tonne. Going forward, it plans to set up satellite manufacturing hubs for plastic pipes to achieve a pan-India presence within three years.

Skipper has a significant presence in the eastern part of India and plans to achieve a pan-India presence with a wide distribution network. Moreover, on the export front, the company is currently exporting to more than 20 countries.

Installed capacities (MT per annum)

Particulars	Uluberia	Unit I of Jangalpur	Unit II of Jangalpur	Total
Transmission towers	46,000	69,000	36,000	151,000
Hot-rolled angles	180,000			180,000
ERW tubes - black	72,000			72,000
ERW tubes - galvanised	48,000			48,000
Tubular products (poles, scaffoldings, solar structures)	42,000			42,000
Plastic tubes & fittings	10,000			10,000
Total	398000	69000	36000	503000

Financials

Profit & Loss account

Particulars	FY13	FY14	FY15E	FY16E	FY17E	Rs cr
Net sales (Rs cr)	928.2	1073.1	1307.7	1602.5	1912.0	
Growth YoY (%)	21.7	15.6	21.9	22.5	19.3	
Total cost	838	955	1116	1370	1635	
Operating profit	90	118	192	232	277	
OPM	9.7	11.0	14.7	14.5	14.5	
Other income	1.4	2.1	2.6	3.2	3.8	
EBITDA	92	120	194	236	281	
Depreciation	12.6	15.1	16.6	21.0	24.2	
Interest	51.4	68.5	71.2	83.5	94.3	
PBT	28	37	106	131	163	
Tax	9.1	9.8	33.0	40.6	50.4	
Reported PAT	19	27	73	90	112	
E/O item	-0.02	0	28.98	10	0	
Adjusted PAT	19	27	44	80	112	
Growth YoY (%)	92	44	65	81	39	
PAT margin	2.0	2.5	5.6	5.6	5.9	
Effective tax rate (%)	32.6	26.68	31.0	31.0	31.0	
EPS (Rs)	1.8	2.6	7.2	8.8	11.0	
Adjusted EPS	1.8	2.6	4.3	7.9	11.0	

Balance Sheet

Particulars	FY13	FY14	FY15E	FY16E	FY17E	Rs cr
Share capital	9.7	10.2	10.2	10.2	10.2	
Reserves & surplus	196.3	220.9	289.2	373.3	477.6	
Total Shareholder's funds	206.1	231.2	299.5	383.5	487.8	
Total debt	397.6	406.2	431.2	496.2	551.2	
Deferred tax liabilities	18.1	21.8	27.0	34.5	43.9	
Total liabilities	621.8	659.2	757.6	914.3	1,083.0	
Gross block	367.5	394.3	434.3	499.3	574.3	
Less: Depreciation	41.3	55.8	72.4	93.4	117.5	
Net Block	326.2	338.5	361.9	405.9	456.8	
CWIP	3.6	8.3	15.8	21.7	25.0	
- Inventories	237.8	229.0	286.6	360.0	445.3	
- Sundry debtors	154.9	231.8	286.6	360.0	445.3	
- Cash and Bank	12.8	26.3	19.7	27.6	22.2	
- Loans and advances	50.7	45.5	55.4	67.9	81.0	
Other current assets						
Current assets	456.2	532.6	648.3	815.5	993.7	
Current liabilities	163.9	220.5	268.7	329.3	392.9	
Provisions	1.2	1.8	2.0	2.2	2.4	
Net current assets	291.2	310.3	377.6	484.1	598.4	
Other assets	0.9	2.1	2.3	2.6	2.8	
Total assets	621.9	659.2	757.6	914.3	1,083.0	

Cash flow statement

Particulars	FY13	FY14	FY15E	FY16E	FY17E	Rs cr
PAT		18.7	26.9	73.4	90.4	112.2
Depreciation		12.6	15.1	16.6	21.0	24.2
Change in WC		-28.1	-6.8	-74.2	-98.7	-120.0
Operating CF		3.2	35.2	15.8	12.7	16.3
Capex		-57.4	-31.5	-47.5	-70.9	-78.2
Investments		0.0	0.0	0.0	0.0	0.0
Others		-19.2	3.1	3.4	6.6	9.0
Investing CF		-76.6	-28.4	-44.1	-64.3	-69.2
Dividends		-1.1	-1.8	-5.2	-6.3	-7.9
Debt		53.8	8.6	25.0	65.0	55.0
Equity		25.0	0.0	0.0	0.0	0.0
Financing CF		77.6	6.8	19.8	58.7	47.1
Net change		4.3	13.5	-8.4	7.0	-5.8
Opening cash		8.6	12.8	26.3	19.7	27.6
Closing cash		12.8	26.3	19.7	27.6	22.2
Closing cash & bank balance	12.8	26.3	17.9	26.7	21.8	

Key ratios

Particulars	FY13	FY14	FY15E	FY16E	FY17E
Sales growth (%)	21.7	15.6	21.9	22.5	19.3
Operating margin (%)	9.7	11.0	14.7	14.5	14.5
PBITM (%)	8.5	9.8	13.6	13.4	13.4
PAT Margin (%)	2.0	2.5	5.6	5.6	5.9
Earnings growth (%)	91.7	43.7	65.2	80.9	39.5
Price/Earnings (x)	61.2	42.6	25.8	14.2	10.2
EV/EBITDA (x)	16.7	12.7	8.0	6.9	6.0
EV / Sales (x)	1.6	1.4	1.2	1.0	0.9
Price / Book Value (x)	5.6	5.0	3.8	3.0	2.3
Net Debt per share	37.6	37.1	40.2	45.8	51.7
Debt / Equity (x)	1.9	1.8	1.4	1.3	1.1
P/CEPS (x)	36.6	27.3	12.7	10.3	8.4
Current Ratio (x)	2.8	2.4	2.4	2.5	2.5
Inventory days	80.0	79.4	80.0	82.0	85.0
Debtor days	60.9	78.9	80.0	82.0	85.0
Creditors days	64.4	75.0	75.0	75.0	75.0
Net WC days	76.4	83.2	85.0	89.0	95.0
Asset turnover (x)	1.6	1.7	1.8	1.9	1.9

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