AMBIT RESULTS INSIGHTS

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DAILY

RESULTS UPDATE

Asian Paints (SELL)

Surprise margin gains mask weak volumes

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EBITDA margin expands; positive management outlook

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Different quarter, similar story

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Asian Paints

Surprise margin gains mask weak volumes

Asian Paints reported in-line results as miss on sales (10% YoY growth vs our expectation of 16%) was offset by higher-than-expected EBITDA margin of 20.9% (vs our expectation of 19.6%). This was driven by 260bps surprise on other expenditure which in our view is driven by input tax credits post-GST and A&P spend cuts. Market-share losses continued as volume growth of 4-5% (vs our expectation of more than 10%) compared poorly to Kansai's reported sales growth of 14% YoY. Going forward, we will track: 1) revival in volume growth; 2) market-share trends; and 3) margin trends, as new capacity comes on stream. Reiterate SELL as we expect business model to worsen from 2HFY19 when capacity expands sharply. Post adjustments for this quarter's miss, our new EPS CAGR over FY17-20E is 8% (vs 11% earlier) which does not justify current all-time high multiple of 51x FY19E P/E. Our new TP is Rs960 (Rs996 earlier).

Results overview:

Sales growth came in at 10% YoY (6% below our estimates). GM declined 153bps but EBITDA margin grew 130bps vs our expectation of flat GM and EBITDA margins. With higher other income (up 20% YoY), PAT increased by 19% YoY to Rs5.5bn (in line with our estimates).

- **Sales miss highlights weakness in base business:** Asian Paints' revenues grew by 10% YoY at the consolidated level to Rs42.6bn, 6% below our estimate. It reported low-single digit volume growth for its domestic decorative paints business in 3QFY18. Management indicated that they continued to feel the disruption due to GST. In our view, early festive season that helped boost 2QFY18 volume growth has resulted in volume growth miss in 3QFY18. Also, management believes economic growth is still running weak which is hurting overall growth in the sector. Given Kansai has reported 14% YoY growth in sales, Asian Paints appears to continue losing market share – in line with our thesis.
- **Margin surprise appears unsustainable:** Gross margins contracted by ~153bps YoY (~160bps lower than our estimate) largely on account of the inflation in raw material as TiO_2 and some other monomers continued to see price inflation. Management guided for worsening of input cost inflation, which is in line with our expectations. Decrease in staff costs and other expenditure (20bps and 269bps decrease, respectively, as a percentage of sales) resulted in EBITDA margin gain of ~130bps YoY (at 20.9%), 130bps higher than our expectation. We believe some of this surprise is on account of input tax credit post-GST implementation – company has claimed that this is not a significant amount but did admit that this has not been passed on to the consumers.
- **No price hike announcements explain our thesis well:** We were surprised that management has refrained from announcing price hikes despite guiding for acceleration in input cost pressure. Our channel checks had actually revealed price hikes are being planned from 1st Feb'18. We believe absence of price hikes fits into our thesis that: 1) Asian Paints is facing competitive pressure leading to market-share losses; and 2) focus needs to shift to support volumes to justify upcoming capacity expansion.
- **International business:** Commentary remained same as last quarter when units in Nepal, Oman, Bahrain and Bangladesh continued to do well which was offset by weak performance in Egypt and Ethiopia where forex availability remained a challenge. Performance is also boosted by acquisition in Sri Lanka still not being in the base and start-up of operations in Indonesia.
- **Home improvement:** Ess Ess bathroom fittings and Sleek modular kitchen category performed better sequentially during the quarter.

SELL

Result Update

Stock Information

Bloomberg Code:	APNT IN
CMP (Rs):	1,178
TP (Rs):	960
Mcap (Rs bn/US$ bn):	1,141/17.9
3M ADV (Rs mn/US$ mn):	795.4/12.5

Stock Performance (%)

	1M	3M	12M	YTD
Absolute	5	1	24	3
Rel. to Sensex	(0)	(9)	(6)	(2)

Source: Bloomberg, Ambit Capital research

Ambit Estimates (Rs mn)

	FY17	FY18E	FY19E
Revenues	152.9	167.8	192.4
EBITDA	30.2	32.2	36.6
EPS (Rs)	20.2	20.6	22.9

Source: Ambit Capital research

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Change in earnings estimates

We have cut our sales growth estimate for FY18E from 12% earlier to 10% YoY now. We have also cut our GM from 44% earlier to 42.2% now to adjust for 9M performance. However, EBITDA margin has expanded by 50bps to 19.2% vs 18.7% earlier. This is to factor in input tax credits and cut in A&P spends. This has resulted in our FY18 EPS remaining same as before at 20.6. However, flow through impact of sales cuts to FY19 and beyond combined with higher-than-expected hit to margins going forward given: 1) weakening market positioning is hurting Asian Paints's pricing power; 2) input cost inflation is rising again; and 3) new capacity comes on stream in 2HFY19 leading to negative operating leverage, cut in EPS has been more steep at 4/11% for FY19/20E. This has also resulted in our DCF-based TP coming down from Rs996 to Rs960, implying a downside of 16% hereon.

Exhibit 1: Change in earnings estimates

Rs mn	FY18 Old	FY18 New	Change %	FY19 Old	FY19 New	Change %	FY20 Old	FY20 New	Change %
TP	**996**	**960**							
Sales	171,330	167,840	-2%	196,381	192,392	-2%	223,458	218,925	-2%
EBITDA	32,039	32,225	1%	37,312	36,554	-2%	43,016	39,844	-7%
PAT	20,686	20,654	0%	23,985	23,016	-4%	27,974	25,314	-10%
EPS	20.6	20.6	0%	23.9	22.9	-4%	27.9	25.2	-10%

Source: Ambit Capital research

Where do we go from here?

We believe Asian Paints' strategy to expand capacity ahead of time and mask hit to margins by cutting down A&P spends are now leading to market-share losses. With festive season led support seen in 2Q not coming through in 3Q, rising weakness in business model is emerging. Rising input costs, lack of price hikes and possible unsustainability of supporting margins by not passing on input tax credits are likely to hit margins as well. This combined with near all-time high valuations (51x FY19E P/E, at 30% premium to last five-year average), we believe Asian Paints could potentially witness a sharp correction in its stock price which would be a combination of weak earnings growth and de-rating as investors realise the weakening of the leader. We build in an EPS CAGR of 8% over FY17-20E driven by Sales CAGR of 13% and OPM hit of 50bps. Our DCF-based TP of Rs960 implies FY19E P/E of 42x. Maintain SELL.

Exhibit 2: Result snapshot

Asian Paints Rs Mn	Consolidated						
	3QFY18	3QFY17	2QFY18	YoY	QoQ	Ambit estimates	Divergence
Total income from operations	42,605	38,571	42,652	10%	0%	45,473	-6%
COGS	24,610	21,691	25,042	13%	-2%	25,553	-4%
COGS as % of Sales	57.8%	56.2%	58.7%	153	(95)	56.2%	
Gross Profit	17,995	16,880	17,610	7%	2%	19,919	-10%
Gross Margin	42.2%	43.8%	41.3%	(153)	95	43.8%	(157)
Staff cost	2,711	2,504	2,822	8%	-4%	3,008	-10%
as%of NS	6.4%	6.5%	6.6%	(13)	(25)	6.6%	
Other expenditure	6,373	6,806	6,777	-6%	-6%	7,991	-20%
as%of NS	15.0%	17.6%	15.9%	(269)	(93)	17.6%	
EBITDA	8,912	7,570	8,011	18%	11%	8,921	0%
EBITDA Margin	20.9%	19.6%	18.8%	129	213	19.6%	130
Depreciation	896	845	889	6%	1%	850	5%
EBIT	8,016	6,725	7,122	19%	13%	8,071	-1%
EBIT Margin	18.8%	17.4%	16.7%	138	212	17.7%	
Other income	497	413	534	20%	-7%	600	-17%
Interest	92	90	88	2%	5%	90	2%
PBT	8,420	7,048	7,569	19%	11%	8,581	-2%
Current tax	2,913	2,430	2,459	20%	18%	2,925	0%
Effective tax rate (%)	35%	34%	32%	11	211	34%	
PAT	5,507	4,617	5,110	19%	8%	5,656	-3%

Source: Ambit Capital research

Balance sheet

Year to March (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Net Worth	65,248	76,023	85,434	94,773	103,955
Total Debt	3,143	5,527	5,527	5,527	5,527
Others	6,805	7,346	8,230	9,246	10,414
Current Liabilities	30,412	35,301	38,750	44,418	50,544
Total Liabilities	**105,609**	**124,198**	**137,941**	**153,964**	**170,440**
Fixed Assets	35,229	35,597	45,356	50,494	50,317
Investments	27,121	26,520	26,520	26,520	26,520
Current Assets	43,258	62,081	66,065	76,951	93,603
Total Assets	**105,609**	**124,198**	**137,941**	**153,964**	**170,440**

Source: Company, Ambit Capital research

Income statement

Year to March (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Net Income	142,715	152,902	167,840	192,392	218,925
% Growth	1%	7%	10%	15%	14%
Gross Profit	62,773	68,596	70,829	81,574	93,262
EBITDA	28,246	30,214	32,225	36,554	39,844
PBIT	25,490	26,826	28,560	31,692	34,668
PBT	27,217	29,146	30,826	34,353	37,782
PAT	18,006	19,394	19,770	22,000	24,145
EPS	19.3	20.2	20.6	22.9	25.2
EPS Growth	29%	8%	2%	11%	10%

Source: Company, Ambit Capital research

Cash flow statement

Year to March (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
EBIT	25,490	26,826	28,560	31,692	34,668
Depreciation	2,756	3,388	3,666	4,862	5,176
Others	(7,794)	(8,913)	(7,547)	(8,317)	(8,995)
Change in working capital	1,978	(6,028)	(2,261)	(3,076)	(3,324)
Cash flow from operations	22,430	15,273	22,417	25,162	27,525
Cash flow from investments	(8,663)	(6,561)	(13,425)	(10,000)	(5,000)
Cash flow from financing	(8,490)	(7,564)	(10,719)	(13,021)	(15,322)
Change in cash	5,277	1,148	(1,726)	2,141	7,203
Free cash flow	14,408	8,601	8,993	15,162	22,525

Source: Company, Ambit Capital research

Ratio analysis/Valuation parameters

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Gross margin (%)	44.0%	44.9%	42.2%	42.4%	42.6%
EBITDA margin (%)	19.8%	19.8%	19.2%	19.0%	18.2%
Net profit margin (%)	12.6%	12.7%	11.8%	11.4%	11.0%
Net debt: equity (x)	(0.0)	(0.0)	(0.0)	(0.0)	(0.1)
RoCE (%)	49.8%	43.1%	36.4%	34.4%	35.0%
RoE (%)	32.3%	26.8%	24.5%	24.4%	24.3%
P/E (x)	59.3	56.6	55.6	49.9	45.5
Price/Sales (x)	7.7	7.2	6.5	5.7	5.0
EV/EBITDA (x)	39.0	36.5	34.3	30.2	27.7

Source: Company, Ambit Capital research

Havells India

BUY

EBITDA margin expands; positive management outlook

Result Update

Havells' EBITDA, excluding Lloyd, grew 31% YoY to Rs2.5bn, 31% above our estimate. This was led by 150bps higher-than-expected EBITDA margin of 15.2% (up 240bps YoY) due to 17% growth in wires and market-leading growth in fans and water heaters (higher than company's overall EBIT margin – wires, fans and water heaters all have higher margin). Revenue growth (excluding Lloyd) grew 11% YoY to Rs16.7bn, 5% above our estimate. Lloyd's revenue increased 16% YoY to Rs2.9bn, 15% below our estimate; EBIT margin of 3% (down 400bps QoQ) was 400bps below our expectation given transition to new energy efficiency norms. Havells' CFO was Rs2bn vs Rs3bn in 3QFY17 due to higher working capital investment in Lloyd as it is entering the season period for air conditioners. Management remains positive on recovery given stabilisation of GST-related hiccups and market share gain from unorganised players. Havells is trading at 43x FY19E EPS; we value Havells at Rs618, implying 48x FY19E P/E.

Stock Information

Bloomberg Code:	HAVL IN
CMP (Rs):	553
TP (Rs):	618
Mcap (Rs bn/US$ bn):	345/5.4
3M ADV (Rs mn/US$ mn):	800/12.5

Stock Performance (%)

	1M	3M	12M	YTD
Absolute	(1)	0	41	(3)
Rel. to Sensex	(6)	(10)	11	(7)

Source: Bloomberg, Ambit Capital research

Ambit Estimates (Rs bn)

	FY17	FY18	FY19
Revenues	61.4	90.4	102.5
EBITDA	8.2	10.3	12.5
EPS (Rs)	9.5	11.1	12.8

Source: Bloomberg, Ambit Capital research

Overview of standalone results excluding Lloyd

3QFY18 revenue (net of excise) grew by 11% YoY to Rs16.7bn led by 28% and 21% YoY growth in the lighting and electrical consumer durable business respectively. Adjusting for the impact of the excise on sales from tax-free zone, revenue grew by 14% YoY.

Switchgears revenue increased by 5% YoY due to growth in switches, switchgear sales declined due to sluggish demand from the housing segment. Wires recorded 17% revenue growth, cables declined as orders delayed due to volatility in commodity prices and GST transition; overall cables and wires reported 3% YoY growth.

Fans, water heaters and appliances reported strong growth which led to electrical consumer durables reporting 26% YoY growth. On a sequential basis, there was a strong improvement of 29%. Havells retained market leadership in the premium fan category which contributed to two-third of ceiling fans. In water heaters, Havells continues to be top-3 player with premium product positioning. Lighting revenue grew strongly by 21% YoY led by a strong growth in the B2B segment.

Contribution margin increased by 100bps YoY due to high margin in cables and wires on account of higher growth in wires which is a high-margin category. Margin in electrical consumer durable category improved by 530bps YoY and 180bps QoQ on account of higher capacity utilisation in water heaters. Consequently, EBITDA margin increased by 240bps YoY to 15.2%.

EBITDA also increased by 31% YoY to Rs2.53bn. Other income declined by 58% as Havells used surplus cash for Lloyd's acquisition. APBT increased by 23% YoY to Rs2.7bn.

Lloyd's performance

Revenue increased by 16% YoY and 9% QoQ to Rs2.9bn. However, EBIT margin declined by 410bps YoY to 2.9% due to transition towards the new energy efficiency norms; EBITDA margin came 400bps below our estimate.

Key highlights

CFO declined due to increase in working capital investment to Rs2bn in 3QFY18 vs Rs3bn in 3QFY17 and +Rs1.6bn in 1HFY18. The reason for the decline was the increase in inventory days which increased from 59 days in 3QFY17 to 73 days in 3QFY18. The increase was primarily on account of Lloyd as it is entering the season period for air conditioners.

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Exhibit 1: CFO declined YoY…

Rs mn	3QFY18	3QFY17	2QFY18
PBT (net of exceptional)	2,480	2,070	2,440
Other adjustments	230	50	150
Change in WC	(250)	1,320	(3,250)
Taxes paid	(460)	(390)	(560)
CFO	2,000	2,950	(1,220)
Capex	(270)	(360)	(270)
FCF	3,820	3,030	(1,490)

Source: Company, Ambit Capital research

Positive management commentary: The management this time around was optimistic about sales recovery on the back of GST-related hiccups now being history and scope of accelerated market-share gains for the organised players. However, the management remained uncertain on the timing of a recovery in residential markets despite this persisting since a very long time.

Where do we go from here?

Havells trades at an expensive valuation of 43x FY19 P/E (100% premium to five-year cross-cycle average). Still, we believe there is value in the stock; reverse DCF implies 13.5% EBITDA CAGR over FY18-30 vs our assumption of 18.2%. Havells is best placed amidst peers given management's aggression in pursuing profitable growth (10-year RoIC of 45%), ready architecture, a deep channel network (reaches 1,00,000 retailers), and credible team (significant lateral hires). We value Havells at Rs618, implying 48x FY19E P/E.

Exhibit 2: Quarterly snapshot (excluding Lloyd)

(In Rs mn, unless otherwise specified)	3QFY18	3QFY17	2QFY18	YoY (%)	QoQ (%)	3QFY18E	Deviation
Revenues (net of excise)	16,728	15,060	15,076	*11%*	*11%*	15,900	5%
EBITDA	2,537	1,930	2,380	*31%*	*7%*	2,175	17%
Other income	109	264	254	*-59%*	*-57%*	300	-64%
Depreciation	313	301	310	*4%*	*1%*	310	1%
Interest	55	15	67	*259%*	*-18%*	50	10%
PBT	2,278	1,877	2,257	*21%*	*1%*	2,115	8%
Exceptional	265	190	-5				
Tax	707	537	676	*32%*	*5%*	632	12%
PAT	1,836	1,530	1,576	*20%*	*17%*	1,483	24%
Adjusted PAT	1,571	1,318	1,581	*19%*	*-1%*	1,483	6%
EBITDA (% of sales)	15.2%	12.8%	15.8%	240bps	-60bps	13.7%	150bps
Adjusted tax (% of PBT)	31.0%	28.6%	30.0%	240bps	100bps	29.9%	110bps
APAT (% of sales)	9.4%	8.8%	10.5%	60bps	-110bps	9.3%	10bps

Source: Company, Ambit Capital research

Exhibit 3: Quarterly snapshot (including Lloyd)

(Rs mn, unless otherwise specified)	3QFY18	3QFY17	2QFY18	YoY (%)	QoQ (%)	3QFY18E	Deviation
Revenues (net of excise)	19,658	15,060	17,774	31%	11%	19,350	2%
Raw materials consumed	11,863	9,141	10,251	30%	16%	12,621	-6%
Gross Profit	7,795	5,919	7,522	32%	4%	6,729	16%
Employee expenses	1,625	1,238	1,617	31%	1%	1,450	12%
Ad-spends	786	531	509	48%	55%	477	65%
Other expenses	2,761	2,243	2,828	23%	-2%	2,385	16%
Total Expenditure	17,035	13,153	15,205	30%	12%	16,933	1%
EBITDA	2,623	1,907	2,569	38%	2%	2,417	9%
Adjusted EBITDA	**2,623**	**1,907**	**2,569**	**38%**	**2%**	**2,417**	**9%**
Other income	278	264	287	5%	-3%	300	-7%
Depreciation	363	301	349	21%	4%	350	4%
Interest	55	15	67	259%	-18%	50	10%
PBT	2,483	1,855	2,440	34%	2%	2,317	7%
Exceptional	209	190	0				
Tax	748	537	730	39%	3%	692	8%
PAT	1,944	1,508	1,710	29%	14%	1,625	20%
Adjusted PAT	1,735	1,318	1,710	32%	1%	1,625	7%
Gross margin (%)	39.7%	39.3%	42.3%	40bps	-260bps	34.8%	490bps
Employee expenses (% of sales)	8.3%	8.2%	9.1%	10bps	-80bps	7.5%	80bps
Other expenses (% of sales)	14.0%	14.9%	15.9%	-90bps	-190bps	12.3%	170bps
Ad-spend as % of revenue	4.0%	3.5%	2.9%	50bps	110bps	2.5%	150bps
EBITDA (% of sales)	13.3%	12.7%	14.5%	60bps	-120bps	12.5%	80bps
Adjusted tax (% of PBT)	30.1%	28.9%	29.9%	120bps	20bps	29.9%	20bps
APAT (% of sales)	8.8%	8.8%	9.6%	0bps	-80bps	8.4%	40bps

Source: Company, Ambit Capital research

Exhibit 4: Segmental information (including Lloyd)

(Rs mn, unless otherwise specified)	3QFY18	3QFY17	2QFY18	YoY (%)	QoQ (%)	3QFY18E	Deviation
Revenues (net of tax)							
Switchgears	3,443	3,309	3,296	4%	4%	3,500	-2%
Cables & Wires	6,256	6,092	5,693	3%	10%	6,150	2%
Lighting & Fixtures	2,871	2,363	2,868	21%	0%	2,550	13%
Electrical Consumer Durables	4,158	3,296	3,216	26%	29%	3,700	12%
Lloyd's consumer division	2,930	NA	2,698	NA		3,450	-15%
Total revenue	**19,658**	**15,060**	**17,771**	**31%**	**11%**	**19,895**	**-1%**
EBIT							
Switchgears	1,380	1,291	1,363	7%	1%		
Cables & Wires	1,070	869	1,133	23%	-6%		
Lighting & Fixtures	818	641	775	28%	6%		
Electrical Consumer Durables	1,230	809	894	52%	38%		
Lloyd's consumer division	480	NA	150				
Total Segmental EBIT	**4,978**	**3,610**	**4,315**	**38%**	**15%**		
EBIT margins(%)							
Switchgears	40.1%	39.0%	41.4%	110bps	-130bps		
Cables & Wires	17.1%	14.3%	19.9%	280bps	-280bps		
Lighting & Fixtures	28.5%	27.1%	27.0%	140bps	150bps		
Electrical Consumer Durables	29.6%	24.6%	27.8%	500bps	180bps		
Lloyd's consumer division	16.4%	NA	5.6%	NA	1080bps		
Capital employed							
Switchgears	4,105	3,949	3,885	4%	6%		
Cables & Wires	4,184	5,579	4,306	-25%	-3%		
Lighting & Fixtures	3,033	2,070	3,522	47%	-14%		
Electrical Consumer Durables	1,703	2,807	1,910	-39%	-11%		
Lloyd's consumer division	16,975	NA	14,572	NA	16%		
Segmental capital employed	**30,000**	**14,405**	**28,194**	**108%**	**6%**		
Unallocable	5,075	16,861	4,950	-70%	3%		
Total	**35,075**	**31,266**	**33,145**	**12%**	**6%**		

Source: Company, Ambit Capital research

Financials

Balance sheet

Year to March (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Networth	26,442	32,736	36,438	40,743	46,512
Loans	443	1,982	1	1	1
Deferred tax liability	749	1,138	1,138	1,138	1,138
Sources of funds	**27,634**	**35,855**	**37,576**	**41,881**	**47,651**
Net block (incl. CWIP)	10,820	12,777	27,008	28,591	30,361
Net current assets	(1,231)	(399)	1,609	194	(2,080)
Investments	4,603	4,101	3,738	3,373	3,008
Cash	13,442	19,375	5,221	9,722	16,360
Application of funds	**27,634**	**35,855**	**37,576**	**41,881**	**47,651**

Source: Company, Ambit Capital research

Income statement

Year to March (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Revenue	54,369	61,353	90,394	102,499	123,145
EBITDA	7,479	8,241	10,301	12,504	16,035
Depreciation	922	1,196	1,256	1,505	1,782
Interest expense	126	122	38	85	103
Other income	687	1,343	860	429	676
PBT	7,118	8,266	9,867	11,344	14,826
Provision for taxation	1,988	2,298	2,875	3,306	4,325
Adj PAT	5,130	5,969	6,993	8,038	10,501
EPS diluted (Rs)	8.2	9.5	11.1	12.8	16.7

Source: Company, Ambit Capital research

Cash flow statement

Year to March (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
PBT	9,142	7,690	9,981	11,457	14,939
WC changes	(1,446)	(2,070)	(2,875)	(3,306)	(4,325)
CFO	7,268	7,240	6,278	11,043	14,659
Net capex	(1,766)	(2,390)	(2,529)	(3,089)	(3,552)
Net Investments	(291)	80	365	365	365
CFI	(1,662)	(1,380)	(2,051)	(2,611)	(3,074)
Borrowings	(434)	1,530	(1,981)	-	-
Issue of equity	-	-	-	-	-
CFF	(4,965)	(720)	(5,422)	(3,931)	(4,947)
FCF	5,606	5,860	4,227	8,432	11,585

Source: Company, Ambit Capital research

Ratio analysis/Valuation parameters

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Revenue growth (%)	3.8	12.8	47.3	13.4	20.1
EBITDA margin (%)	13.8%	13.4%	11.4%	12.2%	13.0%
Net margin (%)	9.4%	9.7%	7.7%	7.8%	8.5%
RoCE (%)	18.4	16.5	18.0	20.2	23.1
RoE (%)	28.5	18.2	20.5	21.1	24.3
P/E (x)	68.0	58.5	49.9	43.4	33.3
EV/EBITDA(x)	44.6	40.5	32.4	26.7	20.8
EV/Sales (x)	6.1	5.4	3.7	3.3	2.7

Source: Ambit Capital research

Rallis India

Different quarter, similar story

Rallis reported weak results with EBITDA and PAT substantially behind our/consensus estimates. While sales grew 19%, EBITDA/PAT declined 11%/2% YoY. The 17% growth in agrochemicals was healthy but gross margin fell 600bps given inability to pass on the rise in technical ingredient prices. For 9MFY18 (a more correct reflection of numbers factoring in seasonality), overall sales/EBITDA/PBT growth of 8%/3%/6% was muted and likely lags peers. We have been building in 32% EBITDA growth for 3Q in anticipation of a rebound from a soft base and better export realisation, but that doesn't seem to have played out. We don't see any reason to hold the stock given expensive valuation of 21x FY19 EPS (due to weak growth profile). Reiterate SELL as the company will face challenges to grow in double digits given: a) the seeds portfolio remains a low-margin business; b) domestic agrochemicals is at best a feeble branded generics business; and c) using exports to play the high-end CSM and generics manufacturing is a confused positioning.

SELL

Result Update

Stock Information

Bloomberg Code:	RALI IN
CMP (Rs):	271
TP (Rs):	205
Mcap (Rs bn/US$ mn):	53/825
3M ADV (Rs mn/US$ mn):	242/4

Stock Performance (%)

	1M	3M	12M	YTD
Absolute	5	15	30	2
Rel. to Sensex	(1)	5	(2)	(3)

Source: Bloomberg, Ambit Capital research

Ambit Estimates (Rs mn)

	FY17	FY18E	FY19E
Revenues	16,783	18,104	20,296
EBITDA	2,633.4	2,739	3,533
Adj EPS (Rs)	8.74	8.99	11.87

Source: Bloomberg, Ambit Capital research

Results overview

Standalone results: Weak as compared to our expectations

Rallies India's 3QFY18 standalone results were weak as compared to our expectations. Standalone revenue grew 17% YoY to Rs3.6bn, ~1% higher than our estimate. Standalone gross margin at 42.2% (down ~560bps YoY) was ~430bps lower than our estimate. However, this was somewhat offset by lower 'employee cost' and 'other expenses' which were ~100bps and ~150bps lower than our estimates. Thus, the standalone EBITDA margin at 13.1% (~300bps YoY) was below our estimate and standalone absolute EBITDA at Rs0.5bn (down ~5% YoY) was 23% below our estimate. PBT of Rs0.4bn was also 26% below our estimate. However, lower-than-expected tax rate of 13.9% against our expectation of 25%, resulted in PAT (down 3% YoY) coming 15% below our estimate.

Higher proportion of traded goods seemingly has played the spoiler as technical prices increased substantially during the quarter. Lower proportion of self-manufactured products (where Rallis should have benefited from higher technical ingredient prices) too impacted the mix.

Subsidiaries (mainly Metahelix) – Muted performance continues

Metahelix revenues at Rs329mn (up 47% YoY) were ~35% above our estimates. However, absolute EBITDA loss of Rs92mn (down ~33% YoY) was higher than our expected EBITDA loss of Rs49mn. Subsidiaries' PAT at negative Rs81mn (up ~6% YoY) was ~53% below of our estimate.

The Board of Directors of the company has consented to the merger of Zero Waste Agro Organics Ltd, a wholly-owned subsidiary of the company. Consolidated figures include Rs38mn and Rs82mn of sales for the quarter and nine months respectively. Consolidated PAT includes Rs6.5mn and Rs15.7mn of PAT for the quarter and nine months respectively.

Consolidated performance – Substantial miss on profitability

Consolidated revenue grew 19% YoY to Rs3.9bn, 4% above our estimate. Consolidated gross margin at 42.0% (down 730bps YoY) was in line with our estimates. However, consolidated EBITDA margin at 9.6% (down ~320bps YoY) was ~520bps below our expectation on account of higher 'employee cost' and 'other expenses'. Thus, consolidated absolute EBITDA declined by 11% YoY to Rs0.4bn and was 33% below our expectation. The EBITDA performance was worse and it flowed through PBT; PBT declined by 16% YoY to Rs0.3bn and was 41% below our estimate. Consolidated PAT of Rs251mn was 26% lower than our estimate due to lower gross margins and lower margins at the EBITDA level.

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Where do we go from here?

Rallis is headed for another set of weak performance (compared to the industry). We think there was a pressure of higher technical ingredient prices which would have weighed on the gross margins. However, Rallis being a backward integrated manufacturer of certain key products, such as Acephate and Pendamethylene should have benefited from higher margins from B2B sales. No improvement in Metahelix margins continues to perplex us. We think that Rallis' execution remains behind the curve and investors should not hold the stock at current valuations.

We decrease our earnings estimates for FY18/19E by 13%/0%

Given the weak 9MFY18 performance, we reduce our FY18/19 estimates. Overall, our revenue estimates for FY18/19 are same. However, in line with 9MFY18 performance, we reduce our FY18 EBITDA margin estimates by 200bps. Overall, our absolute EBITDA estimates for FY18/19 get revised downward by 12%/0%. This also flows through PAT; PAT estimates for FY18/19 get revised downward by 13%/0%.

Exhibit 1: Changes in estimates

Consolidated (Rs mn)	New estimates		Old estimates		Changes in estimates	
	FY18	FY19	FY18	FY19	FY18	FY19
Revenue	18,104	20,296	18,104	20,296	0%	0%
EBITDA	2,739	3,533	3,095	3,533	-12%	0%
EBITDA Margin	15.1%	17.4%	17.1%	17.4%	(197)	-
PAT	1,748	2,308	2,015	2,308	-13%	0%

Source: Company, Ambit Capital research

Exhibit 2: 3QFY18 Standalone results snapshot

(Rs mn)	3QFY18A	3QFY18E	Divergence	3QFY17A	YoY	2QFY18A	QoQ	9MFY18A	9MFY17A	YoY
Total Operating Income	**3,573**	**3,524**	**1%**	**3,066**	**17%**	**5,485**	**-35%**	**11,530**	**10,574**	**9%**
Cost of Materials	2,066	1,885	10%	1,601	29%	3,352	-38%	**5,417**	**4,476**	21%
As % of sales	*57.8%*	*54%*	*432*	*52%*	*560*	*61%*	*(328)*	*47.0%*	*42%*	*465*
Gross profit	**1,507**	**1,639**	**-8%**	**1,465**	**3%**	**2,134**	**-29%**	**6,113**	**6,097**	**0%**
Gross margin	***42.2%***	***47%***	***(432)***	***48%***	***(560)***	***39%***	***328***	***53.0%***	***58%***	***(465)***
Employee Expenses	296	330	-10%	285	4%	326	-9%	**622**	**573**	8%
As % of sales	*8.3%*	*9.4%*	*(109)*	*9.3%*	*(103)*	*5.9%*	*232*	*5.4%*	*5.4%*	*(3)*
Other Expenses	744	700	6%	687	8%	538	38%	**1,283**	**1,107**	16%
As % of sales	*20.8%*	*19.9%*	*97*	*22.4%*	*(157)*	*9.8%*	*1,102*	*11.1%*	*10.5%*	*66*
EBITDA	**467**	**609**	**-23%**	**493**	**-5%**	**1,269**	**-63%**	**4,209**	**4,418**	**-5%**
EBITDA margin	***13.1%***	***17.3%***	***(420)***	***16.1%***	***(300)***	***23.1%***	***(1,006)***	***36.5%***	***41.8%***	***(528)***
Depreciation	104	110	-6%	106	-2%	111	-7%	**215**	**208**	3%
EBIT	**364**	**499**	**-27%**	**387**	**-6%**	**1,158**	**-69%**	**3,994**	**4,210**	**-5%**
EBIT Margin	***10.2%***	***14.2%***	***(398)***	***12.6%***	***(246)***	***21.1%***	***(1,094)***	***34.6%***	***39.8%***	***(517)***
Interest	11	5	128%	5	119%	7	63%	**18**	**17**	8%
Other Income	32	25	26%	23	40%	16	93%	**48**	**46**	4%
PBT	**384**	**519**	**-26%**	**405**	**-5%**	**1,168**	**-67%**	**4,024**	**4,239**	**-5%**
PBT Margin	***10.7%***	***14.7%***	***(398)***	***13.2%***	***(246)***	***21.3%***	***(1,055)***	***34.9%***	***40.1%***	***(519)***
Tax expenses	53	130	-59%	65	-18%	348	-85%	**401**	**333**	21%
Effective Tax Rate	*13.9%*	*25.0%*	*(1,108)*	*16.0%*	*(212)*	*29.8%*	*(1,588)*	*10.0%*	*7.9%*	*212*
Adjusted PAT	**330**	**389**	**-15%**	**340**	**-3%**	**820**	**-60%**	**3,622**	**3,906**	**-7%**
Adjusted PAT Margin	***9.2%***	***11.0%***	***(179)***	***11.1%***	***(184)***	***14.9%***	***(570)***	***31.4%***	***36.9%***	***(553)***

Source: Company, Ambit Capital research

Exhibit 3: Subsidiary (mainly Metahelix) results snapshot

(Rs mn)	3QFY18A	3QFY18E	Divergence	3QFY17A	YoY	2QFY18A	QoQ	9MFY18A	9MFY17A	YoY
Sales	329	245	35%	224	47%	393	-16%	2,668	2,574	4%
EBITDA	(92)	(49)	89%	(69)	33%	(44)	108%	(1,915)	(2,200)	-13%
EBITDA Margin	***-28.0%***	***-20.0%***	***(805)***	***-31.0%***	***296***	***-11.3%***	***(1,678)***	***-71.8%***	***-85.5%***	***1,374***
PAT	(81)	(53)	53%	(86)	-6%	(47)	71%	(2,148)	(2,455)	-13%

Source: Company, Ambit Capital research

Exhibit 4: 3QFY18 Consolidated results snapshot

(Rs mn)	3QFY18A	3QFY18E	Divergence	3QFY17A	YoY	2QFY18A	QoQ	9MFY18A	9MFY17A	YoY
Total Operating Income	**3,902**	**3,769**	**4%**	**3,289**	**19%**	**5,879**	**-34%**	**14,199**	**13,147**	**8%**
Cost of Materials	2,261	2,179	4%	1,664	36%	3,537	-36%	8,163	7,364	11%
As % of sales	*58%*	*58%*	*14*	*51%*	*736*	*60%*	*(222)*	*57%*	*56%*	*148*
Gross profit	**1,641**	**1,590**	**3%**	**1,625**	**1%**	**2,342**	**-30%**	**6,036**	**5,783**	**4%**
Gross margin	***42.0%***	***42.2%***	***(14)***	***49.4%***	***(736)***	***39.8%***	***222***	***42.5%***	***44.0%***	***(148)***
Employee Expenses	390	330	18%	367	6%	426	-9%	1,221	1,105	11%
As % of sales	*10.0%*	*8.8%*	*123*	*11.2%*	*(117)*	*7.2%*	*274*	*8.6%*	*8.4%*	*20*
Other Expenses	876	700	25%	835	5%	690	27%	2,521	2,461	2%
As % of sales	*22.5%*	*18.6%*	*388*	*25.4%*	*(292)*	*11.7%*	*1,071*	*17.8%*	*18.7%*	*(97)*
EBITDA	**375**	**560**	**-33%**	**423**	**-11%**	**1,225**	**-69%**	**2,294**	**2,217**	**3%**
EBITDA margin	***9.6%***	***14.9%***	***(525)***	***12.9%***	***(326)***	***20.8%***	***(1,123)***	***16.2%***	***16.9%***	***(71)***
Depreciation	120	125	-4%	119	1%	126	-5%	360	353	2%
EBIT	**255**	**435**	**-41%**	**305**	**-16%**	**1,099**	**-77%**	**1,934**	**1,864**	**4%**
EBIT Margin	***6.5%***	***11.5%***	***(499)***	***9.3%***	***(272)***	***18.7%***	***(1,215)***	***13.6%***	***14.2%***	***(56)***
Interest	12	6	102%	12	-2%	8	55%	31	47	-33%
Other Income	37	37	0%	26	43%	34	10%	116	83	40%
PBT	**280**	**466**	**-40%**	**318**	**-12%**	**1,125**	**-75%**	**2,018**	**1,900**	**6%**
PBT Margin	***7.2%***	***12.4%***	***(518)***	***9.7%***	***(249)***	***19.1%***	***(1,195)***	***14.2%***	***14.5%***	***(24)***
Tax expenses	31	130	-76%	65	-53%	352	-91%	**544**	**449**	21%
Effective Tax Rate	*11.0%*	*27.8%*	*(1,685)*	*20.4%*	*(940)*	*31.3%*	*(2,033)*	*27.0%*	*23.6%*	*331*
Adjusted PAT before MI	**249**	**336**	**-26%**	**253**	**-2%**	**773**	**-68%**	**1,474**	**1,451**	**2%**
Adjusted PAT Margin	***6.4%***	***8.9%***	***(253)***	***7.7%***	***(131)***	***13.1%***	***(675)***	***10.4%***	***11.0%***	***(65)***
MI	**1**	**1**	40%	**1**	**1**	2	-7%	**4**	**3**	**4**
Adjusted PAT after MI	**251**	**337**	-26%	**254**	**-1%**	**774**	-68%	**1,478**	**1,454**	**2%**
Reported PAT	**251**	**337**	**-26%**	**254**	**-1%**	**774**	**-68%**	**1,478**	**2,663**	**-44%**

Source: Company, Ambit Capital research

Financials

Balance Sheet

Year to March (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Total Networth	8,922	11,116	12,338	13,952	15,779
Loans	898	390	390	390	390
Deferred tax liability (net)	358	498	498	498	498
Total liabilities	**10,178**	**12,004**	**13,226**	**14,840**	**16,667**
Gross block	6,072	6,477	7,177	7,962	8,849
Net block	5,644	5,585	5,783	6,010	6,278
CWIP	405	421	302	302	302
Investments (non-current)	281	2,392	2,392	2,392	2,392
Total Current Assets	8,596	8,886	10,214	12,232	14,480
Current liabilities	4,483	4,997	5,010	5,675	6,268
Provisions	266	284	455	421	517
Total Current Liabilities	4,749	5,281	5,464	6,097	6,785
Total assets	**10,177**	**12,003**	**13,226**	**14,839**	**16,667**

Source: Company, Ambit Capital research

Income Statement

Year to March (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Revenue	**15,291**	**16,783**	**18,104**	**20,296**	**22,525**
Operating expenditure	13,001	14,150	15,365	16,763	18,535
EBITDA	**2,290**	**2,633**	**2,739**	**3,533**	**3,989**
Depreciation	436	473	502	557	619
EBIT	**1,854**	**2,160**	**2,237**	**2,975**	**3,370**
Interest expenditure	136	73	35	35	35
Non-operating income	143	128	130	137	151
Adjusted PBT	**1,860**	**3,799**	**2,331**	**3,078**	**3,486**
Tax	390	829	583	769	871
Adjusted PAT	**1,471**	**2,970**	**1,748**	**2,308**	**2,614**
EPS (Rs)	**7.4**	**15.3**	**9.0**	**11.9**	**13.4**

Source: Company, Ambit Capital research

Cash flow Statement

Year to March (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
PBT	1,857	3,799	2,331	3,078	3,486
Depreciation	436	473	502	557	619
Tax	(406)	(855)	(583)	(769)	(871)
(Incr)/decr in net w. capital	307	538	(50)	(664)	(335)
Cash flow from operations	**2,321**	**3,889**	**2,106**	**2,099**	**2,782**
Capex (net)	(724)	(467)	(700)	(785)	(887)
(Incr)/decr in investments	(39)	(2,111)	-	-	-
Other income (expenditure)	(706)	72	130	137	151
Cash flow from investments	**(1,469)**	**(2,701)**	**(570)**	**(648)**	**(736)**
Net borrowings	(103)	(151)	-	-	-
Dividend paid	(350)	(584)	(526)	(695)	(787)
Cash flow from financing	**(588)**	**(802)**	**(561)**	**(730)**	**(822)**
Net change in cash	**264**	**386**	**975**	**722**	**1,225**
Free cash flow	**1,597**	**3,422**	**1,406**	**1,314**	**1,895**
Opening cash balance	15	279	170	1,145	1,866
Closing cash balance	**279**	**170**	**1,145**	**1,866**	**3,091**

Source: Company, Ambit Capital research

Key ratios and valuation

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Revenue growth	(16)	10	8	12	11
EBITDA growth	(17)	15	4	29	13
PAT growth	(9)	107	(41)	32	13
EPS norm (dil) growth	(9)	107	(41)	32	13
EBITDA margin	15.0%	15.7%	15.1%	17.4%	17.7%
EBIT margin	12.1%	12.9%	12.4%	14.7%	15.0%
Net margin	9.6%	17.7%	9.7%	11.4%	11.6%
RoCE	16.5%	16.8%	14.7%	17.3%	17.3%
RoIC	16.1%	18.6%	18.6%	23.3%	24.8%
RoE	16.8%	17.0%	14.9%	17.6%	17.6%
P/E (x)	34.2	28.9	28.1	21.2	18.8
P/B(x)	5.5	4.4	4.0	3.5	3.1
EV/EBITDA(x)	25.2	21.9	21.1	16.3	14.5
EV/EBIT (x)	31.1	26.7	25.8	19.4	17.1
EV/Sales (x)	3.8	3.4	3.2	2.8	2.6

Source: Company, Ambit Capital research

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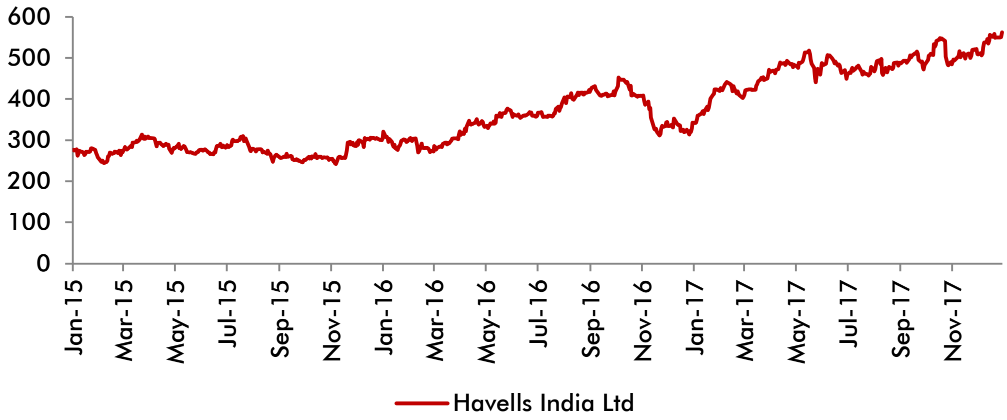
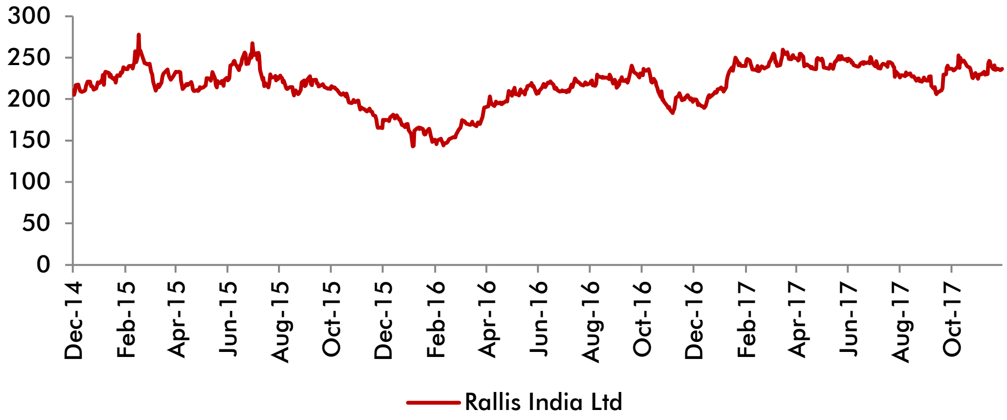
Havells India Ltd (HAVL IN, BUY)



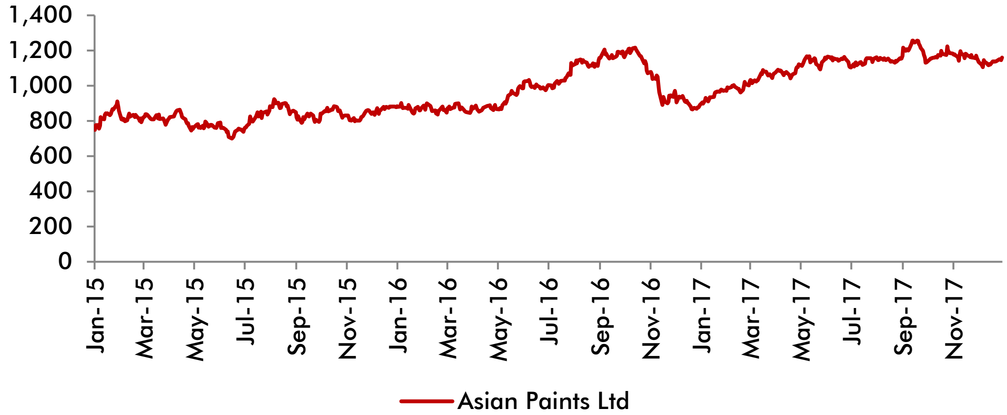
Source: Bloomberg, Ambit Capital research

Rallis India Ltd (RALI IN, SELL)



Source: Bloomberg, Ambit Capital research

Asian Paints Ltd (APNT IN, SELL)



Source: Bloomberg, Ambit Capital research

Explanation of Investment Rating

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BUY	>10%
SELL	≤10%
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