Morning Insight

OCTOBER 15, 2018

	12-Oct	% Chg 1 Day	% Chg 1 Mth	% Chg 3 Mths
Indian Indices				
SENSEX Index	34,734	2.2	(7.9)	(5.0)
NIFTY Index	10,473	2.3	(7.9)	(5.0)
NSEBANK Index	25,396	2.5	(5.3)	(6.0)
NIFTY 500 Index	8,767	2.4	(9.2)	(6.5)
CNXMcap Index	16,746	2.9	(12.1)	(9.4)
BSESMCAP Index	14,159	2.6	(13.9)	(13.8)
World Indices				
Dow Jones	25,340	1.1	(3.1)	1.3
Nasdaq	7,497	2.3	(6.4)	(4.2)
FTSE	6,996	(0.2)	(4.2)	(8.7)
NIKKEI	22,695	0.5	(3.1)	(1.0)
Hangseng	22,695	0.5	(3.1)	(1.0)
Shanghai	25,801	2.1	(6.3)	(10.4)

Value traded (Rs cr)	12-Oct	% Chg Day
Cash BSE	2,893	(10.3)
Cash NSE	34,134	(11.7)
Derivatives	634,995	(68.2)

Net inflows (Rs cr)	11-Oct	MTD	YTD
FII	(2,755)	(16,236)	(31,298)
Mutual Fund	1,354	9,884	98,139

Nifty Gainers & Losers 12-Oct	Price (Rs)	Chg (%)	Vol (mn)
Gainers			
Eicher Motor	23,904	6.9	0.2
Maruti Suzuki	7,287	6.0	1.1
Bajaj Finance	2,287	5.8	3.7
Losers			
TCS	1,918	(3.1)	9.4
HCL Tech	985	(2.4)	2.3
Dr Reddy's	2,451	(0.4)	0.9

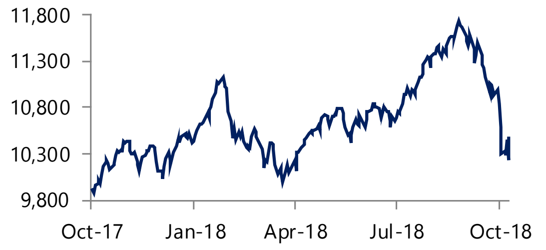
Advances / Declines (BSE)

12-Oct	A	B	T	Total	% total
Advances	376	852	110	1,338	100
Declines	51	147	41	239	18
Unchanged	4	24	11	39	3

Commodity	12-Oct	% Chg 1 Day	% Chg 1 Mth	% Chg 3 Mths
Crude (US$/BBL)	81.4	1.2	4.2	8.1
Gold (US$/OZ)	1,218.0	(0.5)	2.3	(1.6)
Silver (US$/OZ)	14.6	0.2	4.0	(7.5)

Debt / forex market	12-Oct	1 Day	1 Mth	3 Mths
10 yr G-Sec yield %	8.0	8.0	8.1	7.8
Re/US$	73.6	74.1	72.2	68.6

Nifty



Source: Bloomberg

News Highlights

- Industrial output growth faltered in August, dipping to a 3-month low of 4.3 per cent as manufacturing growth slowed down and mining activities contracted. (BS)
- Cement prices could go up by up to 10% in the next six months in order to compensate for the increased fuel and transportation costs, according to a top official of industry body CMA. (Mint)
- The telecom sector is likely to experience three more quarters of losses, hurt by high levies and "unsustainable tariffs", a top official of industry body COAI has said. (ET)
- Stressing on the need to strengthen institutions like IMF to tackle financial crisis, Economic Affairs Secretary S C Garg called for quota reforms so that share of emerging nations increases in line with their growing economic position. (ET)
- Second-quarter residential property sales climbed 15% on-year in top seven markets, led by demand for affordable homes. Sustained conversion of enquiries into purchases suggests that builders are offering solutions within reasonable budgets and sticking to delivery timelines. (ET)
- **CESC** will split into three entities, with the power and retail businesses getting separate identities, while IT, FMCG and Quest Mall would be under the third unit. (ET)
- The Mumbai NCLT Bench rejected the plea of a three-month moratorium against any legal proceedings by any party against **IL&FS** and its 348 subsidiaries. (Moneycontrol)
- The boards of **Indian Oil, ONGC** and **Oil India** may soon consider buying back their shares worth Rs 100 Bn under pressure from the government. The government has demanded these buybacks to meet its divestment target, triggering protests and warnings of a dividend cut from the three oil companies. (ET)
- **Dr Reddy's** US arm is recalling over 35,000 tubes of Nystatin and Triamcinolone Acetonide cream because failed stability specifications. (BS)
- **Allcargo Logistics** is investing over Rs 10 Bn to set up four logistics parks at key locations over the next two years, seeing larger opportunities as the economy moves on at a faster clip. It will utilise its land banks acquired in the past few years in anticipation of GST implementation as well as growth expected in the domestic logistic business. (ET)
- As uncertainties loom over the solar power sector, **JSW Energy** has put its ambitious expansions plans in the segment on the backburner. The company in May had announced plans to set up a 1,000-MW solar photovoltaic panel manufacturing facility at Vijayanagar in Karnataka and to install 200 MW of solar power systems in the current fiscal. (Moneycontrol)

What's Inside

- **Company Update:** Maruti Suzuki India Ltd
- **Result Update:** Tata Sponge Iron, Hindustan Unilever Ltd

Source: ET = Economic Times, BS = Business Standard, FE = Financial Express, IE = Indian Express, BL = Business Line, ToI: Times of India, BSE = Bombay Stock Exchange, MC = Moneycontrol

Company Update

Stock Details

Market cap (Rs mn)	:	2201318
52-wk Hi/Lo (Rs)	:	10000 / 6650
Face Value (Rs)	:	5
3M Avg. daily vol (Nos)	:	760,976
Shares o/s (mn)	:	302

Source: Bloomberg

Financial Summary

Y/E Mar (Rs mn)	FY18	FY19E	FY20E
Revenue	797,627	901,384	1060,457
Growth (%)	17.2	13.0	17.6
EBITDA	120,615	129,303	164,372
EBITDA margin (%)	15.1	14.3	15.5
PAT	77,218	85,561	111,922
EPS	255.6	283.2	370.5
EPS Growth (%)	5.1	10.8	30.8
BV (Rs/share)	1,382	1,569	1,843
Dividend/share (Rs)	80.0	80.0	80.0
ROE (%)	19.8	19.2	21.7
ROCE (%)	28.4	26.9	30.3
P/E (x)	28.5	25.7	19.7
EV/EBITDA (x)	18.2	16.9	13.3
P/BV (x)	5.3	4.6	4.0

Source: Company, Kotak Securities - PCG

Shareholding Pattern (%)

(%)	Jun-18	Mar-18	Dec-17
Promoters	56.2	56.2	56.2
FII	23.7	25.2	25.8
DII	12.7	11.5	11.0
Others	7.4	7.2	7.0

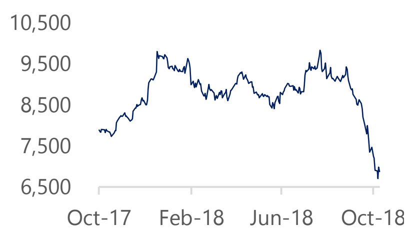
Source: Company

Price Performance (%)

(%)	1M	3M	6M
Maruti Suzuki	(14.2)	(22.0)	(20.8)
Nifty	(7.9)	(5.0)	0.1

Source: Bloomberg

Price chart (Rs)



Source: Bloomberg

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MARUTI SUZUKI INDIA LTD (MSIL)

PRICE RS.7287 **TARGET RS.8522** **BUY**

Passenger vehicle industry witnessed slowdown in 2QFY19 due to floods in Kerala, delayed festive season and some softening in demand. While in the near term, growth is expected to be slow, medium to long term growth outlook for the industry stays intact.

Key Highlights

We believe that slowdown in industry sales to have limited impact on MSIL due to production capacity constraint and market share gains. Domestic passenger vehicle industry grew by ~7% in 1HFY19 (de-grew in 2QFY19). MSIL's growth during the same period stood at 11%, market share gain of 170bps. In the past nine months, INR has depreciated against JPY by ~12%. Accordingly we expect adverse forex movement to impact MSIL's EBITDA margin in FY19. In FY20, we expect EBITDA margin to see some improvement on expectation of price hikes, operating leverage and vendor localization at Gujarat plant.

Valuation

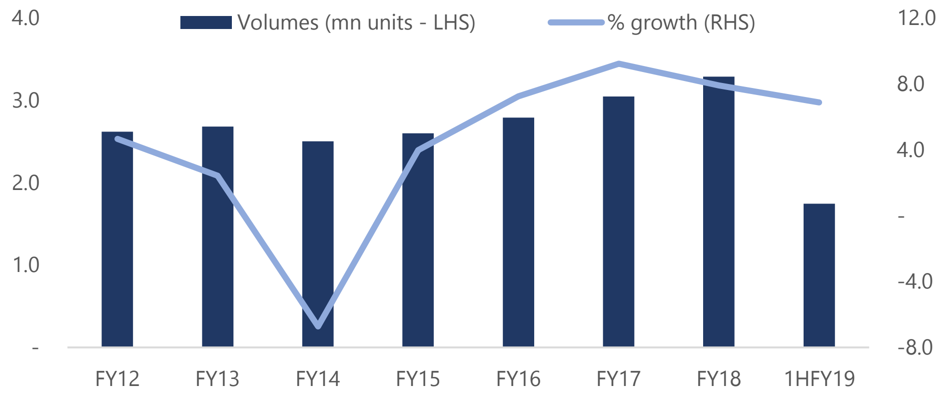
In view of adverse forex movement, we cut our EBITDA estimates by 9% for FY19 and 6.7% for FY20. We also lower PE multiple to 23x (from 25x) due to near term slowdown in demand and margin headwinds. We rate the stock as BUY with revised price target of R8,522 (earlier 10,360). Lower than expected volume growth, commodity cost increase and unfavourable currency movement are key risks to our target price.

Industry outlook – near term headwinds; long term remains positive

Domestic passenger vehicle industry slowed down considerably in 2QFY19, in comparison with growth witnessed in recent quarters. Reasons that led to domestic passenger vehicle industry de-growing YoY in 2QFY19 includes floods in Kerala, delayed festive season and some softening in demand.

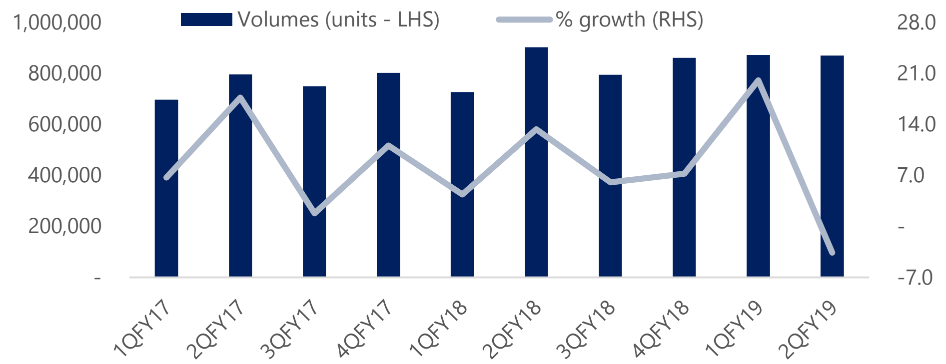
Post floods, passenger vehicle demand in Kerala (accounts for 8% of domestic volumes) came down significantly in August and September impacting industry sales to certain extent. We expect the demand in Kerala to recover gradually in coming quarters. Furthermore, the base of 2QFY18 was also on the higher side (volume growth in 2QFY18 grew by 13% vs 8% growth in FY18), thereby impacting growth. Festive season dealer inventory build-up happened in 2QFY18 and this year the same is spread out in 2QFY19 and 3QFY19. Higher fuel prices and increase in interest cost is likely to have dampened consumer sentiment to some extent and that is likely to continue in the near term. On the back of above mentioned factors, growth for the passenger car industry is expected to be slightly lower in 2HFY19 as compared with 1HFY19.

Domestic passenger vehicle industry volumes



Source - SIAM

Domestic passenger vehicle industry - 2QFY19 volume declined partly due to high base



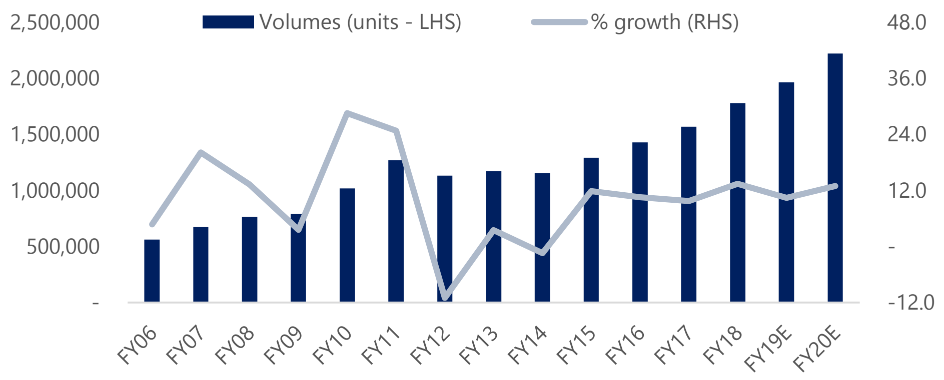
Source - SIAM

In the past seven years (FY12-FY18), volume CAGR in the domestic passenger vehicle industry has been at 4%, much lower than volume CAGR of 16% reported during FY07-FY12. Over the longer term, favourable domestic story (improving income and consumption levels) coupled with low penetration levels provides a huge upside opportunity for the passenger car players in the domestic market.

Slowdown in industry sales to have limited impact on Maruti's volumes

We believe that slowdown in industry sales to have limited impact on MSIL due to production capacity constraint and market share gains. Given capacity constraints, MSIL's production in FY19 is expected to grow by ~10 to 12% and thereby any upside in sales volume growth is restricted. In 1HFY19, MSIL has reported 10% YoY volume growth (11.3% growth in domestic segment) and we expect similar growth for the company going ahead in 2HFY19. Given capacity constraints, MSIL's focus in the past few years has been on the domestic segment. In a scenario of slowdown in domestic demand, MSIL will likely focus on exports (down by 8% in 1HFY19) to utilize spare capacity.

MSIL volume growth

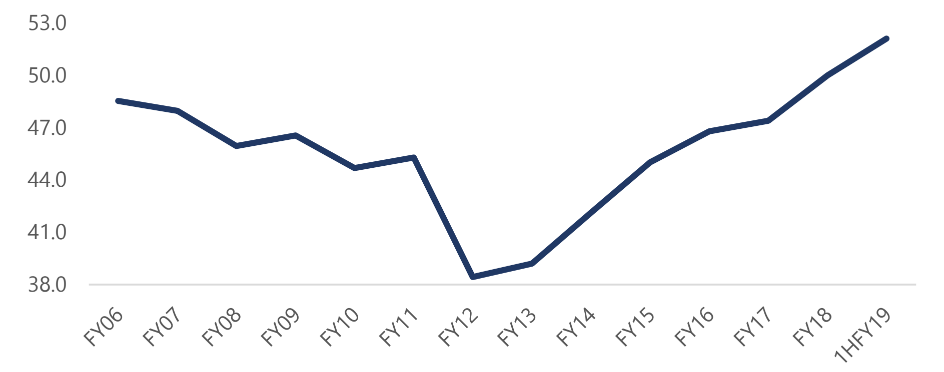


Source: Company, Kotak Securities – Private Client Research

As against competitors, we believe the impact of demand slowdown will be relatively lower on MSIL (and thereby continue to outperform industry growth) on following reasons – strong product portfolio, customer preference for petrol engine and significant volume share from rural segment.

MSIL has widest range in its product portfolio that covers 85% of the industry (in terms of volumes) and makes them less vulnerable to shift in demand within segments. Further, MSIL has least dependence on its top selling model (~16% in FY18). In the past few years, there has been meaningful shift towards petrol vehicles (from 47% in FY14 to 60% in FY18). Given higher fuels prices and emission concerns related to diesel vehicles, we believe demand to stay in favour of petrol vehicles. MSIL is strong player in the petrol vehicle segment (contributes 70% of company volume. Any further shift in demand to petrol vehicle will be positive for MSIL.

MSIL gaining market share for seventh consecutive year



Source: SIAM

Strong presence in rural areas has helped the company tide competitive pressure and demand slowdown in urban areas. Currently, around one third domestic volumes comes through rural sales. In FY18, the top ten cities showed weak demand, whereas non-urban markets witnessed healthy demand. Management had highlighted in 1QFY19 that rural retail demand is growing by 15%. In our view, MSIL will continue concentrating on further improving rural sales on following counts. Firstly, the future growth of the industry will continue to be driven by non-metro cities and rural areas. Secondly, lower penetration levels in rural areas provide with more growth opportunities as compared with metros and large cities. Thirdly, competitive pressure is low as competition's distribution network is largely limited to bigger cities. Fourthly, expanding footprints in rural India is giving MSIL a first mover advantage.

Unfavourable foreign currency movement is near term headwind to margins

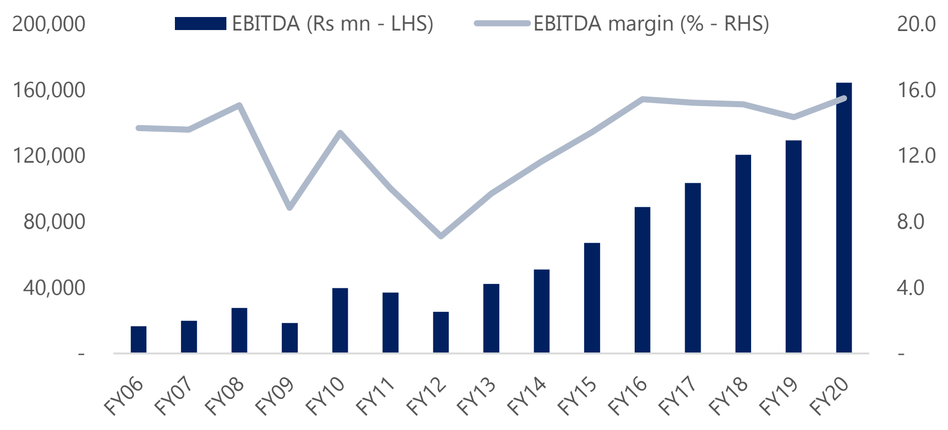
MSIL has foreign currency exposure to currencies like yen, euro and dollar. MSIL's direct forex exposure stands at around 10% of its net sales (relates to raw material imports and royalty payment). Taking into account the exposure of its vendors (raw material imports), the indirect exposure stands at around 10% of the company's net sales. Combined, MSIL's overall gross forex exposure (mainly JPY) is ~20% of its net sales.

For direct imports, MSIL has 50% cover for USD/JPY exposure and for USD/INR exposure, 50% is covered by way of natural hedge and balance 50% exposure there are no hedges. For royalty, two third payments happen in JPY. MSIL compensates its vendors with a lag of one quarter (takes preceding quarters average rate into consideration).

In the past nine months, INR has depreciated against JPY by ~12%. Accordingly we expect adverse forex movement to impact MSIL's EBITDA margin in FY19.

In FY20, we expect EBITDA margin to see some improvement on expectation of price hikes to offset commodity prices and adverse forex movements. Almost all MNC in the passenger vehicle segment operating in India have import content higher as compared to MSIL. Thereby, majority companies in the passenger vehicle segment will be facing pressure on margins from INR depreciation. We thereby see a possibility of price increase in the coming months and that should alleviate pressure on margins. In August 2018, MSIL's announced a price hike owing to increase in commodity cost and adverse foreign exchange rates. Ramp-up at Gujarat plant will provide operating leverage. Further, vendor localization at Gujarat plant is relatively low and is expected to increase over the next few years. Logistics cost will come down with higher vendor localization

MSIL's EBITDA and EBITDA margin



Source: Company, Kotak Securities – Private Client Research

Valuation and Outlook

In view of adverse forex movement, we cut our EBITDA estimates by 9% for FY19 and 6.7% for FY20. We also lower our other income estimates. Accordingly, we cut our net profit estimates by 11.7% for FY19 and 10.6% for FY20. Due to near term slowdown in demand and margin headwinds, we revise our PE multiple to 23x (from 25x) – in line with past four years average one year forward PE multiple. We rate the stock as BUY with revised price target of Rs8,522 (earlier Rs10,360)

Key Risk

Lower than expected volume growth, commodity cost increase and unfavourable currency movement are key risks to our target price.

About the company

Maruti Suzuki India (MSIL), India's largest passenger car company, is a subsidiary of Suzuki Motor Corporation of Japan. Formed as a government owned company, it entered into a JV with Suzuki Motor Corporation. Over the years the company has been one the most successful player in the Indian car market. Currently the company is the market leader with ~50% market share and on a solid footing with a dense sales and service network. MSIL's strong network helps them sell their products to virtually every nook and corner of the country. MSIL's combined annual production capacity is about 1.5mn units in the Gurugram and Manesar facilities. In Gujarat, Suzuki Motor Corporation has set up a facility which it plans to scale-up in the coming years.

Financials: Standalone

Profit and Loss Statement (Rs mn)

(Year-end Mar)	FY17	FY18	FY19E	FY20E
Revenues	**680,348**	**797,627**	**901,384**	**1060,457**
% change YoY	18.2	17.2	13.0	17.6
EBITDA	**103,517**	**120,615**	**129,303**	**164,372**
% change YoY	16.5	16.5	7.2	27.1
Depreciation	26,021	27,579	29,280	32,360
EBIT	**77,496**	**93,036**	**100,023**	**132,011**
% change YoY	27.8	20.1	7.5	32.0
Net interest	894	3,457	750	650
Other Income	23,001	20,455	22,090	27,393
Exceptional income/(loss)	-	-	-	-
Profit before tax	99,603	110,034	121,363	158,754
% change YoY	33.8	10.5	10.3	30.8
Tax	26,101	32,816	35,802	46,833
as % of PBT	26.2	29.8	29.5	29.5
Profit after tax	**73,502**	**77,218**	**85,561**	**111,922**
Adjusted PAT	**73,502**	**77,218**	**85,561**	**111,922**
% change YoY	37.0	5.1	10.8	30.8
Shares outstanding (m)	302	302	302	302
Adjusted EPS (Rs)	**243.3**	**255.6**	**283.2**	**370.5**
DPS (Rs)	75.0	80.0	80.0	80.0

Source: Company, Kotak Securities – Private Client Research

Balance sheet (Rs mn)

(Year-end Mar)	FY17	FY18	FY19E	FY20E
Cash and cash equivalents	21,926	12,884	15,132	13,656
Accounts receivable	11,992	14,618	17,287	20,338
Inventories	32,622	31,608	40,732	47,757
Loans and Adv & Others	37,494	39,013	42,756	46,880
Current assets	104,034	98,123	115,907	128,631
LT investments	263,022	340,729	390,091	480,091
Net fixed assets	145,450	154,849	165,569	173,209
Total assets	**512,506**	**593,701**	**671,567**	**781,930**
Payables	83,673	104,970	116,069	136,552
Other liabilities	50,315	58,596	64,456	70,901
Current Liabilities	133,988	163,566	180,524	207,453
Provisions	4,709	5,865	6,452	7,097
Deferred Tax Liability	4,662	5,589	5,589	5,589
Debt	4,836	1,108	5,000	5,000
Equity	1,510	1,510	1,510	1,510
Reserves	362,801	416,063	472,492	555,281
Total liabilities	**512,506**	**593,701**	**671,567**	**781,930**
BVPS (Rs)	1,206	1,382	1,569	1,843

Source: Company, Kotak Securities – Private Client Research

Cash flow Statement (Rs mn)

(Year-end Mar)	FY17	FY18	FY19E	FY20E
EBIT	77,496	93,036	100,023	132,011
Depreciation	26,021	27,579	29,280	32,360
Change in working capital	9,529	19,685	(694)	10,408
Chg in other net current asset	15,272	7,918	2,703	2,967
Operating cash flow	128,318	148,218	131,311	177,746
Interest	(894)	(3,457)	(750)	(650)
Tax	(23,382)	(31,889)	(35,802)	(46,833)
Other Income	23,001	20,455	22,090	27,393
Deferred Tax Liability	-	-	-	-
Hedge reserves /Others	4,692	3,312	1	-
CF from operations	**131,735**	**136,639**	**116,850**	**157,657**
Capex	(36,302)	(36,978)	(40,000)	(40,000)
(Inc)/dec in investments	(85,488)	(68,092)	(49,362)	(90,000)
CF from investments	**(121,790)**	**(105,070)**	**(89,362)**	**(130,000)**
Proceeds from issue of equities	-	-	-	-
Increase/(decrease) in debt	2,527	(3,728)	3,892	-
Proceeds from share premium	-	-	-	-
Dividends	(12,725)	(27,268)	(29,133)	(29,133)
CF from financing	**(10,198)**	**(30,996)**	**(25,241)**	**(29,133)**
Opening cash	391	138	711	2,959
Closing cash	138	711	2,959	1,483

Source: Company, Kotak Securities – Private Client Research

Ratio Analysis

(Year-end Mar)	FY17	FY18	FY19E	FY20E
Margins				
EBITDA margin (%)	15.2	15.1	14.3	15.5
EBIT margin (%)	11.4	11.7	11.1	12.4
Adj. net profit margin (%)	10.8	9.7	9.5	10.6
Working capital days				
Inventory (days)	18	14	16	16
Receivable (days)	6	7	7	7
Payable (days)	45	48	47	47
Ratios				
Debt/equity ratio (x)	0.0	0.0	0.0	0.0
ROE (%)	22.2	19.8	19.2	21.7
ROCE (%)	29.7	28.4	26.9	30.3
Valuations				
EV/ Sales	3.2	2.7	2.4	2.1
EV/EBITDA	21.1	18.2	16.9	13.3
Price to earnings (P/E)	29.9	28.5	25.7	19.7
Price to book value (P/B)	6.0	5.3	4.6	4.0

Source: Company, Kotak Securities – Private Client Research

Result Update

Stock Details

Market cap (Rs mn)	:	12922
52-wk Hi/Lo (Rs)	:	1249 / 774
Face Value (Rs)	:	10
3M Avg. daily vol (Nos)	:	204,345
Shares o/s (mn)	:	15

Source: Bloomberg

Financial Summary

Y/E Mar (Rs mn)	FY18	FY19E	FY20E
Sales	8,005	9,622	9,502
Growth (%)	43.6	20.2	-1.2
EBITDA	1,827	1,811	1,635
EBITDA margin (%)	22.8	18.8	17.2
Net profit	1,409	1,490	1,377
Adj EPS (Rs)	91.5	96.8	89.4
Growth (%)	140.1	5.8	-7.6
BV (Rs/share)	639.9	712.6	777.8
Dividend / share (Rs)	20.0	20.0	20.0
ROE (%)	14.3	13.6	11.5
ROCE (%)	14.3	13.6	11.5
EV/EBITDA (x)	3.3	2.9	2.6
P/E (x)	9.1	8.6	9.3
P/BV (x)	1.3	1.2	1.1

Source: Company, Kotak Securities - PCG

Shareholding Pattern (%)

(%)	Jun-18	Mar-18	Dec-17
Promoters	54.5	54.5	54.5
FII	8.5	8.7	8.4
DII	0.9	0.9	0.9
Others	36.2	35.9	36.2

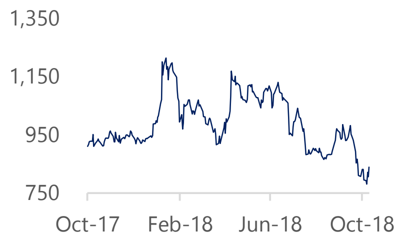
Source: Company

Price Performance (%)

(%)	1M	3M	6M
Tata Sponge Iron	(9.9)	(16.7)	(28.2)
Nifty	(7.9)	(5.0)	0.1

Source: Bloomberg

Price chart (Rs)



Source: Bloomberg

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TATA SPONGE IRON

PRICE RS.839 TARGET RS.977 BUY

Tata Sponge (TTSP) Q2FY19 reported numbers were below our estimates, due to higher iron ore and maintenance costs, which offset the benefit of 3.1% sequential growth in realisation, resulting in 930bps sequential decline in EBITDA margin to 13.8%.

Key Highlights

- Sponge iron sales volume during the quarter declined 19.13% QoQ (marginally up YoY) to 93KT, due to maintenance shutdown. The sponge iron realisation increased 30.5%/3.1% YoY/QoQ to Rs22,047/tonne.
- Clarity on steel capex is still uncertain. Cash at the end of 1HFY19 stands at Rs7 bn.
- Management reiterated confidence in meeting its full year production guidance of 425kt of sponge iron with strong volumes in H2FY19. We are building in 421KT and 425KT of volume for FY19E and FY20E, respectively. Management has applied for the fresh environmental clearance to further enhance its capacity to 465KT.

Valuation & outlook

We continue to remain positive on TTSP's strong business model. The recent increase in iron ore costs and coal prices (due to INR depreciation), we feel spread would remain subdued in the coming quarters as well. Factoring this, we have revised our earnings estimates downwards to Rs96.8 (earlier Rs98.5) and Rs89.4 (earlier Rs98.7) for FY19E and FY20E, respectively. Sponge iron realisation declined by Rs2,700/tonne from its high of Rs26,700/tonne in the month of September 2018. Post the recent correction in the stock price, we feel at CMP, the stock is trading at 2.6x FY20E EV/EBITDA, is attractive and risk-reward is favorable. Hence, we upgrade to BUY (earlier Accumulate) rating, with a revised target price of Rs977 (earlier Rs1,055), valuing it at 4x FY20 EBITDA. *We have not assigned any value to the investment of Rs1.8bn made by the company on the coal block.*

Quarterly performance table

Particulars (Rs Mn)	2QFY19	2QFY18	% YoY	1QFY19	% QoQ
Net Sales	**2,162**	**1,672**	**29.3**	**2,609**	**(17.1)**
Raw Materials	1,504	1,072		1,709	
% to sales	69.6	64.1		65.5	
Other Expenses	360	256		298	
% to sales	16.7	15.3		11.4	
Total Expenditure	1,864	1,328	40.4	2,007	(7.1)
EBITDA	**298**	**344**	**(13.3)**	**603**	**(50.5)**
EBITDA Margin (%)	13.8	20.6		23.1	
Depreciation	29	31		29	
Interest	3	1		3	
EBT	266	312		571	
Other Income	149	95		119	
PBT	**415**	**407**		**690**	
Tax	139	131		234	
ETR (%)	33.4	32.1		34.0	
PAT (reported)	**276**	**276**	**0.0**	**456**	**(39.4)**
NPM (%)	12.8	16.5		17.5	

Source: Company, Kotak Securities – Private Client Research

Increase in cost and lower volume, offset higher realisation benefit

TTSP took the maintenance shutdown of all the three kilns during the quarter, due to seasonally weak quarter (to manage full year production) and pending resolution on related party transactions (disruption in iron ore sourcing). This has resulted in purchase of iron ore from the third party, resulting in ~19% QoQ increase in iron ore cost to Rs4,285/tonne. Now, with the resolution has been passed with the majority, management stated that the iron ore requirement has resumed from Tata Steel at the normal level. In addition, an increase in the maintenance cost from Rs40mn in 1QFY19 to Rs100mn in 2QFY19 also offset the benefit of the higher realisation.

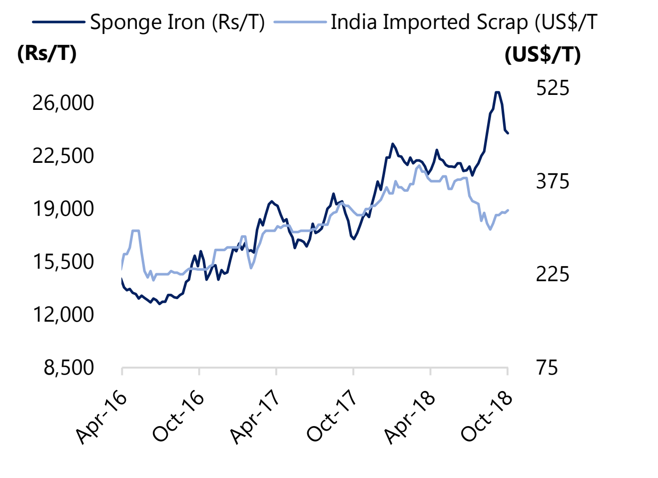
Operational Parameters

	2QFY19	2QFY18	% YoY	1QFY19	% QoQ
Volume					
Sponge Iron (Tonnes)	93	91	1.1	115	(19.1)
Power (Kwh)	33	30	10.0	38	(13.2)
Realisation					
Sponge Iron (Rs/T)	22,047	16,895	30.5	21,384	3.1
Power (Rs/u)	3.4	3.9	(13.5)	4.0	(15.0)

Source: Company, Kotak Securities – Private Client Research

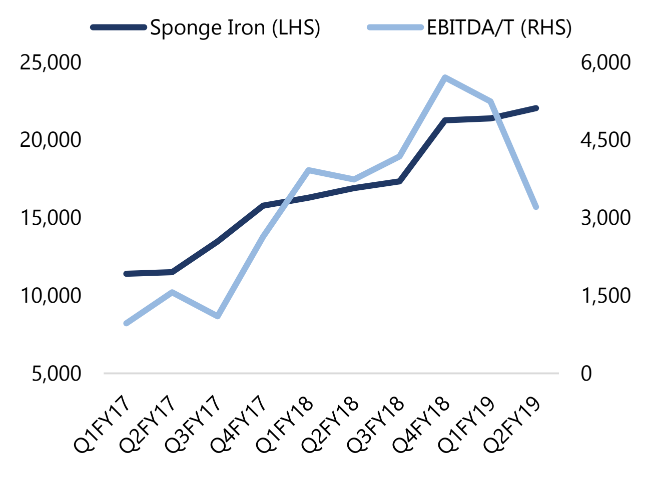
The benefit of higher realization was impacted by increase in input costs and lower volume. The raw material costs during the quarter increased to Rs16,500/tonne. In addition, 15% QoQ declined in power tariff also resulted in 930bps QoQ decline in EBITDA margin to 13.8%. Sponge iron prices have declined in the last fortnight from its peak of Rs26,700/tonne by Rs2,700/tonne. Management expects sponge iron realisation to remain in the range of Rs21,500-Rs24,000/tonne in FY19. EBITDA/T during the quarter stood at Rs3,206/tonne. TTSP, sources 90% of its coal requirement through import, we believe that coal cost in the coming quarters is likely to remain at higher level due to rupee depreciation.

Sponge iron prices and imported scrap (US$/t)



Source: Bloomberg, Industry data, Company

Sponge prices and EBITDA/T (Rs/T)



Source: Bloomberg, Industry data, Company

Conference call highlights

- Management stated that sponge iron prices have upward bias, supported by increase in cost curve and better demand post monsoon. Realisation for FY19 is expected to be in the range of Rs21,000-Rs24,000/tonne.
- Maintenance shutdown in 1HFY19 (Rs40mn and Rs100mn in 1QFY19 and 2QFY19, respectively). No maintenance activities will be held in 3QFY19, 4QFY19 will see minor activities
- All the three kilns was operated on iron ore sourced from third party for the period of 40 days, resulted in increase in costs. Post the approval of the shareholders in AGM in the month of September 2018, the company has resumed the sourcing of iron ore from Tata Steel (result in QoQ decline in iron ore cost).
- Environment clearance for expanding sponge iron capacity by additional 40KT is expected soon. First round of approval in place.
- Despite the INR depreciation, coal cost during the quarter was low, as the company low cost inventory has been fully utilized. Coal cost during the quarter stood at Rs8,500/tone.
- Annual capex for FY19E stands at Rs150mn.

Recommend BUY

We continue to remain positive on TTSP's strong business model. The recent increase in iron ore costs and coal prices (due to rupee depreciation), we feel spread would remain subdued in the coming quarters as well. Factoring this, we have revised our earnings estimates downwards to Rs96.8 (earlier Rs98.5) and Rs89.4 (earlier Rs98.7) for FY19E and FY20E, respectively. Post the recent correction in the stock price, we feel at CMP, the stock is trading at 2.6x FY20E EV/EBITDA, is attractive and risk-reward is favourable, we opine. Hence, we upgrade the stock to BUY (earlier Accumulate) rating, with a revised target price of Rs977 (earlier Rs1,055), valuing it at 4x FY20 EBITDA. We have not assigned any value to the investment of Rs1.8bn made by the company on the coal block.

Company Background

Tata Sponge is a subsidiary of Tata Steel and has sponge iron production capacity of 4.25 lakh tonne in Orissa with 26 MW of waste heat recovery based captive power. The company has impressive track record and maintains consistent quality. Tata Sponge produce and market sponge iron, which is a single end use (steel making) and a single grade product. The company generates power through Waste Heat Recovery Boilers (WHRB), a non-conventional source of 'green' power, which has helped the company to shift their dependence on thermal power. The company export surplus power to their holding company.

Financials: Consolidated

Profit and Loss Statement (Rs mn)

(Year-end March)	FY17	FY18	FY19E	FY20E
Net sales	**5,573**	**8,005**	**9,622**	**9,502**
Growth (%)	-2.8	43.6	20.2	-1.2
Operating expenses	4,958	6,178	7,811	7,868
EBITDA	**615**	**1,827**	**1,811**	**1,635**
Growth (%)	162.4	196.9	(0.9)	(9.7)
Depreciation	128	123	130	136
EBIT	**488**	**1,704**	**1,680**	**1,499**
Other income	371	431	452	475
Interest paid	24	32	33	34
PBT	**834**	**2,102**	**2,099**	**1,939**
Tax	247	693	609	562
Effective tax rate (%)	32.0	33.8	29.0	29.0
Net profit	**587**	**1,409**	**1,490**	**1,377**
Minority interest	0	0	0	0
Reported Net profit	587	1,409	1,490	1,377
Growth (%)	83.7	140.1	5.8	(7.6)

Source: Company, Kotak Securities – Private Client Research

Balance sheet (Rs mn)

(Year-end March)	FY17	FY18	FY19E	FY20E
Cash & Bank balances	3,068	4,216	5,366	6,006
Other Current assets	3,052	3,756	4,079	4,092
Investments	2,736	2,623	2,248	2,498
Net fixed assets	1,603	1,548	1,547	1,590
Other non-current assets	0	0	0	0
Total assets	**10,459**	**12,144**	**13,240**	**14,185**
Current liabilities	1,619	2,109	2,087	2,026
Borrowings	0	0	0	0
Other non-current liabilities	191	180	180	180
Total liabilities	1,809	2,289	2,266	2,206
Share capital	154	154	154	154
Reserves & surplus	8,494	9,700	10,819	11,825
Shareholders' funds	8,648	9,854	10,973	11,979
Total equity & liabilities	**10,459**	**12,144**	**13,240**	**14,185**

Source: Company, Kotak Securities – Private Client Research

Cashflow Statement

(Year-end March)	FY17	FY18	FY19E	FY20E
Pre-tax profit	834	2,102	2,099	1,939
Depreciation	128	123	130	136
Chg in working capital	(248)	(213)	(346)	(73)
Total tax paid	(272)	(715)	(614)	(567)
Other operating activities	233	193	33	34
Operating CF	**675**	**1,491**	**1,303**	**1,469**
Capital expenditure	(39)	(61)	(127)	(177)
Chg in investments	118	112	376	(250)
Other investing activities	30	0	0	0
Investing CF	**109**	**51**	**248**	**(427)**
Equity raised/(repaid)	0	0	0	0
Debt raised/(repaid)	54	24	32	33
Dividend (incl. tax)	185	371	371	371
Other financing activities	0	0	0	0
Financing CF	**239**	**396**	**404**	**405**
Net chg in cash & bank bal.	545	1,146	1,148	638
Closing cash & bank bal	3,068	4,216	5,366	6,006

Source: Company, Kotak Securities – Private Client Research

Ratio Analysis

(Year-end March)	FY17	FY18	FY19E	FY20E
Profitability and return ratios (%)				
EBITDAM	11.0	22.8	18.8	17.2
EBITM	8.8	21.3	17.5	15.8
NPM	10.5	17.6	15.5	14.5
RoE	6.8	14.3	13.6	11.5
RoCE	6.8	14.3	13.6	11.5
Per share data (Rs)				
EPS	38.1	91.5	96.8	89.4
FDEPS	38.1	91.5	96.8	89.4
CEPS	46.4	99.5	105.2	98.2
BV	561.6	639.9	712.6	777.8
DPS	11.0	20.0	20.0	20.0
Valuation ratios (x)				
PE	21.8	9.1	8.6	9.3
P/BV	1.5	1.3	1.2	1.1
EV/EBITDA	11.3	3.3	2.9	2.6
EV/Sales	1.3	0.7	0.5	0.5
P/CEPS	17.9	8.3	7.9	8.4
Other key ratios				
DSO (days)	23.4	26.8	27.0	27.0

Source: Company, Kotak Securities – Private Client Research

Result Update

Stock Details

Market cap (Rs mn)	:	3397633
52-wk Hi/Lo (Rs)	:	1809 / 1216
Face Value (Rs)	:	1
3M Avg. daily vol (Nos)	:	1,697,505
Shares o/s (mn)	:	2165

Source: Bloomberg

Financial Summary

Y/E Mar (Rs mn)	FY18	FY19E	FY20E
Revenue	345,250	401,874	459,469
Growth (%)	8.3	16.4	14.3
EBITDA	72,760	88,327	107,607
EBITDA margin (%)	21.1	22.0	23.4
PAT	52,990	6,390	7,281
EPS	24.5	29.1	35.7
EPS Growth (%)	24.7	18.8	22.7
BV (Rs/share)	30.7	34.5	44.9
Dividend/share (Rs)	20.0	22.0	22.0
ROE (%)	81.9	89.3	89.8
ROCE (%)	113.8	127.8	128.6
P/E (x)	64.0	53.8	43.9
EV/EBITDA (x)	42.5	35.1	28.8
P/BV (x)	51.1	45.4	34.9

Source: Company, Kotak Securities - PCG

Shareholding Pattern (%)

(%)	Jun-18	Mar-18	Dec-17
Promoters	67.2	67.2	67.2
FII	12.1	12.5	12.4
DII	7.3	6.9	6.9
Others	13.4	13.4	13.5

Source: Company

Price Performance (%)

(%)	1M	3M	6M
Hindustan Unilever	(3.5)	(9.9)	11.1
Nifty	(7.9)	(5.0)	0.1

Source: Bloomberg

Price chart (Rs)

Source: Bloomberg

HINDUSTAN UNILEVER LTD (HUL)

PRICE RS.1568 TARGET RS.1500 SELL

HUL has delivered another strong quarterly performance, with double digit sales YoY growth across all three divisions of home, personal care and food. Overall domestic volume growth was in line with estimates at 10% for Q2FY19 versus 12% sequentially and 4% YoY. Net sales grew 11.1% YoY to Rs 92.3 bn indicating a YoY price increase of meagre 1.1% because of intense competition. However, the company is growing ahead of the industry on the back of WIMI strategy, as also innovations and activations. The company also continues to make margin gains through cost management and favorable product mix. However we believe, sustaining the current level of super normal growth in the longer run would be a huge task for HUL which is trading at super rich valuation of 43.9x FY20 earnings. Post correction of 15% in the last 45days, we continue to recommend SELL on HUL with a decreased TP of Rs 1500 at 42 x FY20 earnings (from Rs 1610 at 45x).

Key Highlights

- Underlying Volume Growth was reported at 10% with sales of Rs 92.3 bn (+11.1% YoY and -2.7% QoQ). Management indicated that the company experienced double digit volume growth across all three divisions of home care, personal care and food driven by rural demand, increasing consumer spending, and a return of normalcy to trade channels. Rural market was growing faster than the urban one for HUL, with small towns and villages contributing about 40% to overall sales.

Quarterly Performance

(Rs mn)	Q2FY18	Q1FY19	Q2FY19	QoQ (%)	YoY (%)
Net Sales	**83,090**	**94,870**	**92,340**	**(2.7)**	**11.1**
Raw Material consumed	39290	43640	44350	1.6	12.9
Gross Profit	43,800	51,230	47,990	(6.3)	9.6
Gross Profit Margin	52.7	54.0	52.0	(3.8)	(1.4)
Employee cost	4,350	4,420	4,380	(0.9)	0.7
Advertising	10,230	11,530	11,060	(4.1)	8.1
Other expenses	12,400	12,770	12,360	(3.2)	(0.3)
Total operating cost	66,270	72,360	72,150	(0.3)	8.9
Ebidta	**16,820**	**22,510**	**20,190**	**(10.3)**	**20.0**
Ebidta %	20.2	23.7	21.9		
Depreciation	1,150	1,270	1,300	2.4	13.0
Interest	60	70	70	0.0	16.7
Other income	2,040	1,350	3,050	125.9	49.5
PBT	**17,650**	**22,520**	**21,870**	**(2.9)**	**23.9**
Exceptional	360	-590	-350	(40.7)	(197.2)
Taxes	5,250	6,640	6,270	(5.6)	19.4
ETR	29.7	29.5	28.7	(2.8)	(3.6)
PAT	**12,760**	**15,290**	**15,250**	**(0.3)**	**19.5**
Equity	2,165	2,165	2,165		
EPS	**5.9**	**7.1**	**7.0**	**(0.3)**	**19.5**

Source: Company

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- Gross margins contracted 200 bps YoY to 52% due to negative impact of crude price inflation and currency depreciation and was partly offset by benign vegetable oil and food prices. Management has guided for 'continuous modest margin expansion driven by cost-savings'.
- Higher cost of goods sold, improvement in product mix, judicious pricing and a strong saving program, but higher advertising and promotional expenditure (to support innovation and face competition) led to EBIDTA of Rs 20.2 bn (+20% YoY and -10.3% QoQ) with margin of 21.9% (+170 bps YoY and -180 bps QoQ)
- Consequently company reported PAT of Rs 15.25 bn (EPS of Rs 7 and +19.5 % YoY) .The Company has declared an interim dividend of Rs 9 per share.

Valuation & outlook

Strong volume growth, ability to take price hikes and sustained margins have been the highlight of quarterly performances of HUL. Management also indicated that the rural growth is picking up and overall competitive intensity is easing. So we highlight no change in fundamentals of the company and hence we maintain our FY19/FY20 estimates. However we believe, sustaining the current level of super normal growth in the longer run would be a huge task for HUL which is trading at super rich valuation of 43.9x FY20 earnings.

Also with increasing global yields, higher country and liquidity risk, we estimate the cost of equity (COE) to have increased for FMCG companies including HUL. Multiyear high target multiple HUL and increasing equity risk premium compel us to lower the target multiple accorded to HUL. Post correction of 15% in the stock price of HUL in the last 45days, we continue to recommend SELL on HUL with a decreased TP of Rs 1500 at 42 x FY20 earnings (from Rs 1610 at 45x). We note that our SELL rating is only on account of stretched valuations.

Segmental Performance

Home care segment slightly disappointed in the quarter due to input cost inflation and weak performance of the water- purifier sub segment. The management indicated that fabric wash and household care which includes brands such as Domex, Vim and Surf Excel reported double digit growth, while performance of the water purifier segment was weak due to weakness in Gravity purifiers; there is a fundamental shift towards RO and electronic devices. The management indicated that it is reviewing its purifier portfolio strategy and remains committed to the category. Overall, home care segment delivered revenue of Rs 30.8 bn (+12.4% and -2.1% QoQ) with EBIT margin of 37.6% (+200 bps YoY and -310 bps QoQ). We note that Home care portfolio EBIT margin dropped 310 bps QoQ to 16%. Management termed the 16% margin level as a fairly healthy level. The company has taken price hikes of 2/3% in this segment in Q2FY19, impact of which would reflect in future quarters.

In the **beauty and personal care segment** (includes personal wash, skin, hair, oral, deos, and color cosmetics) management indicated that Skin care registered strong double digit growth on the back of Fair & Lovely and Pond's performance while Hair Care witnessed another double digit growth quarter, led by the premium portfolio and continued robust performance of Indulekha. However, oral care business has not been doing well for HUL due to heightened competitive intensity from Colgate, Dabur and Patanjali. Consequently this segment reported revenue of Rs 43.16 bn (+10.4% YoY) with EBIT margin of 25.8% (-60 bps QoQ and +160 bps YoY). We believe this segment has the room and potential for improvement in performance and contribute more to the value of the company.

Foods and refreshments ((tea, coffee, ice cream, and frozen dessert) - F&R segment revenue was reported at Rs 17.04 bn (+13% YoY) with EBIT margin of 20.8%. Beverages segment reported broad-based double-digit growth. Food registered double-digit growth led by Kissan ketchup and jam. The management highlighted that WIMI strategy is helping the company in F&R business.

Segmental Performance

(Rs mn)	Q2FY18	Q1FY19	Q2FY19	QoQ (%)	YoY (%)
Revenues					
Home	27,390	31,460	30,800	(2.1)	12.4
Beauty and Personal Care	39,100	44,070	43,160	(2.1)	10.4
Food and Refreshment	15,100	17,850	17,040	(4.5)	12.8
EBIT					
Home	3,830	6020	4920	(18.3)	28.5
Beauty and Personal Care	9,480	11620	11150	(4.0)	17.6
Food and Refreshment	2,400	3340	2880	(13.8)	20.0

Source: Company

Other comments

- Management indicated that rural sales grew ahead of urban in Q2FY19. Monsoon started well but ended with below-normal season in parts of the country.
- HUL management indicated its margin performance was driven by cost saving initiatives and the impact of crude price inflation and currency depreciation and was partly offset by benign vegetable oil and food prices.
- HUL has lost its market share in the oral care segment due to the popularity of Patanjali's Dant Kanti brand.
- HUL will continue to implement cost-saving measures to improve operating margin. The company is now using data analytics to identify patterns and spot opportunities where cost-saving measures can be used.
- From a portfolio perspective, the company witnessed strong growth in (a) fair and lovely and Pond's in skin care, (b) Indulekha in hair, (c) Lakme in color cosmetics, (d) Dove and Pears in personal wash, (e) Kissan and Knorr in foods, and (f) the Ice-cream portfolio
- Management expects the demand to be stable in the near term. Also the management would keep a strict vigil on currency depreciation and the rise in crude oil prices.

Valuation & outlook

In terms of numbers, we factor in 17%/14% growth in revenues for FY19/FY20. While gross margins are likely to contract in the coming year, we expect that the company shall be able to save costs in other lines to expand EBITDA margin by ~140 bps over FY18-FY20E. We expect EPS growth of 19%/x23% in FY19/FY20.

The management has indicated that while the quarter's growth should not be read as a trend, the worst is behind in terms of demand, and that rural growth is picking up. Management mentioned that the competitive intensity has eased. The company is growing ahead of the industry and is consistently delivering higher margins. However we believe, sustaining the current level of super normal growth in the longer run would be a huge task for HUL which is trading at super rich valuation of 43.9x FY20 earnings.

Near term fundamentals of the company remain intact and hence we maintain our estimates for HUL for FY19 and FY20. But with increasing global bond yields, higher country and liquidity risk, we estimate the cost of equity (COE) to have increased for Indian FMCG companies including HUL. Multiyear high target multiple and increasing equity risk premium compel us to lower the target multiple accorded to HUL. Post correction of 15% in the stock price of HUL in the last 45days, we continue to recommend SELL on HUL with a decreased TP of Rs 1500 at 42 x FY20 earnings (from Rs 1610 at 45x). We note that our SELL rating is only on account of stretched valuations.

Company background

Hindustan Unilever Limited (HUL) is India's largest Fast Moving Consumer Goods Company with a heritage of over 80 years in India. HUL is a subsidiary of Unilever, one of the world's leading suppliers of Food, Home Care, Personal Care and Refreshment products with sales in over 190 countries and an annual sales turnover of €53.7 billion in 2017. Unilever has over 67% shareholding in HUL.

Financials: Consolidated

Profit and Loss Statement (Rs mn)

(Year-end Mar)	FY17	FY18	FY19E	FY20E
Revenues	**318,900**	**345,250**	**401,874**	**459,469**
% change YoY	2.7	8.3	16.4	14.3
Raw material cost	156,850	162,320	192,836	220,759
Employee cost	16,200	17,450	18,323	19,239
Other expenses	85,380	92,720	102,388	111,865
Total Operating expd	258,430	272,490	313,547	351,862
EBITDA	**60,470**	**72,760**	**88,327**	**107,607**
Depreciation	3,960	4,780	5,019	5,270
EBIT	**56,510**	**67,980**	**83,308**	**102,337**
Other income	5,260	5,690	6,828	8,194
Financial expenses	220	200	200	200
Profit before tax	61,550	73,470	89,936	110,330
Tax	19,060	20,480	26,981	33,099
ETR (%)	31.0	27.9	30.0	30.0
Profit after tax	**42,490**	**52,990**	**62,955**	**77,231**
Minorities& Associates	0	0	0	0
Net income	**42,490**	**52,990**	**62,955**	**77,231**
% change YoY	2.0	24.7	18.8	22.7
Shares outstanding (m)	2,164	2,165	2,165	2,165
EPS	**19.6**	**24.5**	**29.1**	**35.7**

Source: Company, Kotak Securities – Private Client Research

Balance sheet (Rs mn)

(Year-end Mar)	FY17	FY18	FY19E	FY20E
Cash	16,466	31,918	40,922	66,937
Debtors	9,280	11,470	10,838	12,407
Inventory	23,620	23,590	27,095	31,018
Other current assets	12,660	19,220	16,008	17,577
Total current assets	*45,560*	*54,280*	*53,941*	*61,003*
LT investments	41,370	35,210	35,210	35,210
Net fixed assets	42,270	45,699	45,658	45,365
Total assets	**145,666**	**167,107**	**175,732**	**208,516**
Creditors	60,060	70,130	70,447	80,647
Provisions	1,810	2,030	2,030	2,030
Other current liabilities	20,740	28,580	28,580	28,580
Total current liabilities	*82,610*	*100,740*	*101,057*	*111,257*
LT debt	0	0	0	0
Minority Interest	0	0	0	0
Equity Capital	2,164	2,165	2,165	2,165
Reserves	60,892	64,202	72,510	95,093
Networth	*63,056*	*66,367*	*74,674*	*97,257*
Total liabilities	**145,666**	**167,107**	**175,732**	**208,516**
BVPS (Rs)	29.1	30.7	34.5	44.9

Source: Company, Kotak Securities – Private Client Research

Cash flow Statement (Rs mn)

(Year-end Mar)	FY17	FY18	FY19E	FY20E
PAT	42,490	52,990	62,955	77,231
Depreciation +DTL	3,960	4,780	5,019	5,270
Change in working capital	6,050	9,410	656	3,139
CF from operations	**52,500**	**67,180**	**68,630**	**85,640**
Capex	(13,230)	(8,209)	(4,978)	(4,977)
Investments	(10,580)	6,160	-	-
CF from investments	**(23,810)**	**(2,049)**	**(4,978)**	**(4,977)**
Equity issuance	-	1	-	-
Debt raised	-	-	-	-
Dividend Paid	(42,228)	(49,680)	(54,648)	(54,648)
Miscellanous items	-	-	-	-
CF from financing	**(42,228)**	**(49,679)**	**(54,648)**	**(54,648)**
Net cash flow	(13,538)	15,452	9,004	26,015
Opening cash	30,004	16,466	31,918	40,922
Closing cash	**16,466**	**31,918**	**40,922**	**66,937**

Source: Company, Kotak Securities – Private Client Research

Ratio Analysis

(Year-end Mar)	FY17	FY18	FY19E	FY20E
EBITDA margin (%)	19.0	21.1	22.0	23.4
EBIT margin (%)	17.7	19.7	20.7	22.3
Net profit margin (%)	13.3	15.3	15.7	16.8
ROE (%)	67.5	81.9	89.3	89.8
ROCE (%)	98.2	113.8	127.8	128.6
DPS	17.0	20.0	22.0	22.0
Dividend payout (%)	99.4	93.8	86.8	70.8
Working capital turnover (days)	(38.9)	65.2	63.7	65.9
Debt Equity (x)	0.0	0.0	0.0	0.0
PER (x)	79.8	64.0	53.8	43.9
P/C (x)	73.0	58.7	49.9	41.1
Dividend yield (%)	1.1	1.3	1.4	1.4
P/B (x)	53.7	51.1	45.4	34.9
EV/Sales (x)	10.5	9.7	8.3	7.3
EV/ EBITDA (x)	50.8	42.5	35.1	28.8

Source: Company, Kotak Securities – Private Client Research

RATING SCALE

Definitions of ratings

BUY	–	We expect the stock to deliver more than 12% returns over the next 12 months
ACCUMULATE	–	We expect the stock to deliver 5% - 12% returns over the next 12 months
REDUCE	–	We expect the stock to deliver 0% - 5% returns over the next 12 months
SELL	–	We expect the stock to deliver negative returns over the next 12 months
NR	–	**Not Rated.** Kotak Securities is not assigning any rating or price target to the stock. The report has been prepared for information purposes only.
SUBSCRIBE	-	We advise investor to subscribe to the IPO.
RS	–	**Rating Suspended.** Kotak Securities has suspended the investment rating and price target for this stock, either because there is not a Sufficient fundamental basis for determining, or there are legal, regulatory or policy constraints around publishing, an investment rating or target. The previous investment rating and price target, if any, are no longer in effect for this stock and should not be relied upon.
NA	–	**Not Available or Not Applicable.** The information is not available for display or is not applicable
NM	–	**Not Meaningful.** The information is not meaningful and is therefore excluded.
NOTE	–	Our target prices are with a 12-month perspective. Returns stated in the rating scale are our internal benchmark.

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