Morning Insight

JULY 27, 2018

Equity		% Chg		
	26-Jul	1 Day	1 Mth	3 Mths
Indian Indices				
SENSEX Index	36,985	0.3	4.2	6.5
NIFTY Index	11,167	0.3	3.7	5.2
NSEBANK Index	27,406	1.4	3.0	9.6
NIFTY 500 Index	9,488	0.4	2.8	1.1
CNXMcap Index	18,614	0.6	0.8	(6.9)
BSESMCAP Index	16,306	0.3	0.1	(10.2)
World Indices				
Dow Jones	25,527	0.4	5.8	5.0
Nasdaq	7,852	(1.0)	5.5	10.3
FTSE	7,663	0.1	0.5	2.1
NIKKEI	22,587	(0.1)	1.5	0.6
Hangseng	22,587	(0.1)	1.5	0.6
Shanghai	28,781	(0.5)	0.9	(5.6)

Value traded (Rs cr)	26-Jul	% Chg Day
Cash BSE	3,435	1.9
Cash NSE	43,977	35.8
Derivatives	1,781,228	(1.7)

Net inflows (Rs cr)	25-Jul	MTD	YTD
FII	(624)	(2,666)	(7,505)
Mutual Fund	(199)	5,512	74,115

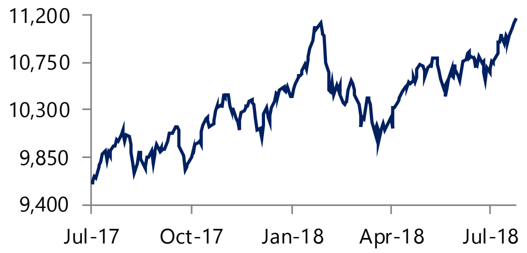
Nifty Gainers & Losers	Price	Chg	Vol
26-Jul	(Rs)	(%)	(mn)
Gainers			
SBI	288	5.8	53.5
ICICI Bank	286	4.0	36.6
Grasim Ind	1,024	3.9	2.3
Losers			
Maruti Suzuki	9,396	(3.7)	1.3
Yest Bank	370	(3.4)	35.3
Indian Oil Corp	159	(2.6)	17.4

Advances / Declines (BSE)					
26-Jul	A	B	T	Total	% total
Advances	214	555	48	817	100
Declines	170	532	45	747	91
Unchanged	4	22	15	41	5

Commodity		% Chg		
	26-Jul	1 Day	1 Mth	3 Mths
Crude (US$/BBL)	74.3	(0.4)	(4.3)	(0.5)
Gold (US$/OZ)	1,223	(0.7)	(2.3)	(7.6)
Silver (US$/OZ)	15.4	(1.5)	(4.0)	(6.6)

Debt / forex market	26-Jul	1 Day	1 Mth	3 Mths
10 yr G-Sec yield %	7.8	7.8	7.8	7.8
Re/US$	68.7	68.8	68.3	66.8

Nifty



News Highlights

- After the peak goods and services tax rate on a number of consumer durables was cut, the government said it would examine the possibility of hiking the import duty on those products. (BS)
- Banks are set to finalise deals for about a dozen stressed power projects with more than 13,000 MW capacity within the next 10 days even if they have to take a steep haircut. The lenders have set August 14 deadline to sign the deals. (ET)
- Novelis Inc, a 100% US-based subsidiary of **Hindalco Industries,** announced acquiring aluminium products maker Aleris Corporation for an enterprise value of US$2.58 bn, giving the Aditya Birla group firm enough room to foray into the high-end and growing aerospace products sector and emerge as a US $21 bn company on a consolidated basis. (BS)
- The department of telecommunications has given the final nod to the merger of Vodafone India with **Idea Cellular** to create Vodafone Idea Limited, the largest carrier in India by subscribers and revenue market share, clearing the last hurdle to the largest M&A deal in the sector. (ET)
- **Adani Ports and Special Economic Zone (APSEZ)** said it has entered into a long-term pact with **GAIL (India)** to provide liquefied natural gas regasification services at its upcoming LNG import terminal at Dhamra port in Odisha. (BS)
- **Tata Steel's** acquisition of **Bhushan Steel** may hit a hurdle as the NCLAT will re-examine Tata Steel's eligibility as a bidder. Besides, the NCLAT has also admitted a petition by operational creditor, **L&T** which has sought Rs 9 bn from Bhushan Steel. (BS)
- **SBI** has asked the telecom department to rethink its decision to cancel the licences of **Reliance Communications** and revoke spectrum, as it would otherwise cause "irreparable harm" to the lenders that are still to recover crores loaned to the telco. (ET)
- **JSW Steel** and AION Investments Private II Ltd will invest Rs8.75 bn in Milloret Steel (MSL), a special purpose vehicle owned by the consortium, as part of the resolution plan approved by NCLT for debt-ridden Monnet Ispat & Energy to fund working capital, capex and payment of financial creditors of the company. (ET)
- **Hindustan Petroleum Corp** cancelled the purchase of an Iranian oil cargo earlier this month after its insurance company refused to provide coverage for the crude because of US sanctions. (ToI)

What's Inside

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

Result Update

EVEREADY INDUSTRIES INDIA LTD (EIIL)

PRICE RS.230 TARGET RS.322 BUY

Stock Details

Market cap (Rs mn)	:	16718
52-wk Hi/Lo (Rs)	:	465 / 217
Face Value (Rs)	:	5
3M Avg. daily vol	:	125,270
Shares o/s (m)	:	72.7

Source: Bloomberg

Financial Summary

Y/E Mar (Rs mn)	FY18	FY19E	FY20E
Revenue	14,563	15,679	17,359
Growth (%)	7.5	7.7	10.7
EBITDA	1,053	1,333	1,823
EBITDA margin (%)	7.2	8.5	10.5
PAT	546	690	1,046
EPS (Rs)	7.5	9.5	14.4
Growth (%)	-41.7	26.23	51.65
BV (Rs/share)	47	55	68
Dividend/share (Rs)	1.5	1.5	1.5
ROE (%)	17.2	18.5	23.5
ROCE (%)	12.5	15.4	18.3
P/E (x)	31.3	24.8	16.3
EV/EBITDA (x)	17.9	14.2	10.4
P/BV (x)	5.0	4.3	3.5

Source: Company

Shareholding Pattern (%)

(%)	Jun-18	Mar-18	Dec-17
Promoters	44.1	41.0	44.0
FII	15.1	16.7	16.2
DII	19.5	12.9	14.6
Others	21.2	29.4	25.2

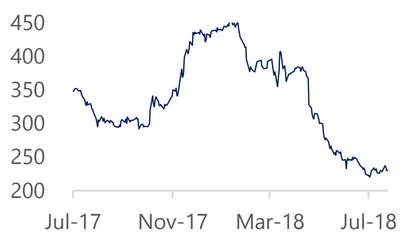
Source: Company

Price Performance (%)

(%)	1M	3M	6M
Eveready Ind	(0.8)	(25.0)	(46.4)
Nifty	3.7	5.2	0.9

Source: Bloomberg

Price chart (Rs)



Source: Bloomberg

EIIL Q1FY19 result was higher than our estimates; company posted operating margin expansion following the immense disappointment in the previous quarter, when the company reported EBITDA loss. Management is able to reassure (during the course of our interaction) that most of the challenges are close to get sorted and situation across verticals have largely stabilized now.

Key Highlights

- EIIL reported 13.2% y/y revenue growth, reported at Rs 3.8 Bn in Q1FY19 driven by LED and home appliances segment. Battery business reported 8.6 y/y growth in the quarter
- Operating margins have recovered after company reporting operating loss in the preceding quarter. This makes us feel more confident about the company's ability to protect margins; and that the company is less vulnerable to fluctuations in the 1/ input prices and 2/ costs related to new business areas viz. consumer appliances, confectionary and FMCG.

Valuation & outlook

Maintain FY19/20 forecasts and DCF assumptions; we recommend 'BUY' with unchanged target price of Rs 322. Despite attractive upside potential, we expect stock to remain under pressure in the short term, susceptible to 1/ further developments in the CCI event and 2/ reversal in sales momentum.

Quarterly performance

(Rs mn)	Q1FY19	Q1FY18	YoY (%)	Q4FY18	QoQ (%)
Income from Operations	**3833**	**3388**	**13.2**	**3498**	**9.6**
Decrease/ (Increase) in stock	(59)	(174)		(96)	
Material consumed	1331	1281	3.8	1007	32.2
Purchase of traded goods	1110	926		1357	(18.2)
Employee expenses	424	403	5.2	443	(4.3)
Other expenses	679	673	1.0	826	(17.8)
Total Expenses	3485	3109	12.1	3537	(1.5)
EBITDA	**348**	**279**	**24.9**	**(39)**	**nm**
Other income	37	15	153.4	13	191.3
Depreciation	53	48	8.7	49	8.2
EBIT	**333**	**245**	**35.8**	**(75)**	**(543.6)**
Finance cost	97	66	45.8	81	
Exceptional Items	0	1		0	
PBT	**236**	**179**	**32.1**	**(156)**	**(251.2)**
Total tax	52	43	20.7	6	852.7
PAT	**184**	**135**	**35.7**	**(162)**	**(213.6)**
Adjusted PAT	**184**	**135**	**35.7**	**(162)**	**(213.6)**
Adj. EPS (Rs)	2.5	1.9	35.7	-2.2	(213.6)
EBITDA (%)	9.1	8.2		-1.1	
Tax Rate (%)	22.2	24.3		-3.5	
RM/Sales	62.1	60.0		64.8	

Source: Company, Kotak-PCG Research

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Result Highlights

Core business shows stability in Q1FY19 after reporting immense disappointment in Q4FY18; consumer appliances business is expected to drive future growth for the company

EIIL reported 13.2% y/y revenue growth, reported at Rs 3.8 Bn in Q1FY19 driven by LED and home appliances segment.

Battery business reported 8.6 y/y growth in the quarter (we note that Q1FY18 had a low base; quarter preceded GST implementation). The segment continues to get adversely affected by cheap Chinese products finding way into Indian market. However, we are encouraged by the operating margin expansion in the battery business despite volatile input price/rupee environment and withdrawal of tax benefits at company's Haridwar unit (this was partly offset by EIIL's newly commissioned manufacturing unit in Assam, which started accruing CGST benefit from Q4FY18).

We note that the Zinc prices have soften in recent past, if the trend continues then there could be a positive impact of 100-120 bps at EBITDA level. Further, on the positive side, BIS compliance could potentially lead to the reduction in the imports of the cheap Chinese batteries. This could benefit the domestic industry as incremental growth was severed by this trait.

Post reduction in GST rate on batteries (reduced form 28% to 18% in mid-November), we have maintained that the battery sales could bottom out and the impact of reduced rates should get reflected from the current year onwards.

Flashlight business was flat y/y despite 5.2% y/y volume growth in the quarter. Segment reported operating margins of 11% in the quarter. We note that the flashlight business is dominated by the unorganized sector. Being the market leader in the organized space, EIIL could potentially benefit immensely going ahead, as more and more such unorganized players come under GST net.

Lighting division reported sales at Rs 747 mn (+8% y/y) driven primarily by 24% y/y growth in LED lighting (volume led growth, per unit LED price continues to fall). EIIL reported operating margin at 10% in the lighting division in Q1FY19. Management sounded confident about further margin improvement in the lighting business on back of its company's recent entrance in luminaire and professional lighting business.

Appliances business reported sales at Rs 360 mn in Q1FY19 vis-à-vis Rs 179 mn in Q1FY18 and Rs 482 mn in Q4FY18. EIIL reported EBITDA loss of Rs 39 mn in the appliances segment (Rs 55 mn in Q4FY18). We note that the consumer appliances segment is still in the built-up phase and expansion/promotion related costs continues to outgrow revenues. Management has guided for reducing losses in consumer appliances business by Rs 70-80 mn in FY19. The distribution base has been constantly growing taking company's reach to over 15000 outlets currently. Management believes that the consumer appliances business has the potential to grow revenues to c. Rs 3 Bn (with 10% EBITDA margin) in the next three to four years.

Operating margins have recovered after company reporting operating loss in the preceding quarter. This makes us feel more confident about the company's ability to protect margin; and that the company is less vulnerable to fluctuations in the 1/ input prices and 2/ costs related to new business areas viz. consumer appliances, confectionary and FMCG. We treat the disappointment in the previous quarter as a one-time event. EIIL reported an EBITDA margin at 9.1% in Q1FY19 vis-à-vis 8.2% in Q1FY18.

We also highlight that the margin appears to be less encouraging when compared with other consumer facing appliances (and electrical) companies especially taking the effect of low base in the previous year into account. However, we keep in mind the impact of increased manpower/other overheads related to company's expansion/growth in new areas-consumer appliances, confectionary and FMCG space.

Employee expense grew 5.2% y/y to Rs 424 mn (driven by increased manpower including high cost resources in the appliances segment and other new ventured initiatives like confectionary). Advertising expense were reported at c.2.5% of sales in Q1FY19 (similar to Q1FY18) against c.6% in Q4FY18. Management stated that the higher promotional expense are in line with the factors necessitated to upscale new categories-appliances and lighting. Management expect advertising expenses to come down to c.4%-4.5% of sales in subsequent quarters.

Finance cost increased by 45% y/y to Rs 97 mn in the quarter due to increased working capital requirement in the quarter. Management believes it to get normalized in succeeding quarters. Tax expense at Rs 52 mn (22.2% of PBT) vis-à-vis Rs 43 mn (24.3% of PBT) in Q4FY18 resulted in the PAT of Rs 184 mn in the quarter.

EIIL is set to enter the FMCG space in JV with Indonesia based Universal Wellbeing Pte. Ltd; it also eyes opportunity in confectionary market in the fruit chew segment with its 'Jollies' brand

In FY18, EIIL had announced entering into 30% JV with Indonesia based Universal Wellbeing Pte. Ltd to enter into FMCG market. Universal Wellbeing Pte. Ltd (UWL) is one of the leaders in the FMCG market in South East Asia with active presence in several countries. It develops, manufactures and sells a wide variety of products in household and personal care.

As per management, EIIL has strategized to distribute UWL products in India leveraging on its vast distribution network. EIIL distribution network consists of over 4000 dealers providing access to 3.5 mn outlets (including grocery stores).

EIIL had also entered into the confectionary market in the fruit chew segment with its 'Jollies' brand. As per management, fruit chew market has been less cluttered and is pegged at Rs 4-5 Bn and has been growing at 17-18% per year. Competitive landscape includes players like ITC (Candyman and Mint-o brands) Falero and Alpenliebe (brand Juzt Jelly).

As per management, fruit chew is a high gross margin business (similar to other business areas of the company) and could potentially clock Rs 350 mn in FY19 and further grow to Rs 1 Bn by FY20. EIIL aims at attaining pan India reach of Jollies in 2HFY19.

CCI imposed penalty on EIIL along with other key industry players for colluding to fix prices of zinc-carbon dry cells; we view this as a clear and present threat to the company

EIIL stock price suffered a significant drop in last one month following the announcement from the CCI (Competition Commission of India) to impose penalty (in Sou Moto case) on Eveready, Nippo (Indo-National and Association of Indian Dry Cell Manufacturers (AIDCM) for colluding to fix prices of zinc-carbon dry cell batteries in India.

CCI notice alleged that the anti-competitive practices were being carried out from 2008 till August 23, 2016, the date of search and seizure operations by the Director General of CCI.

The quantum of penalty has been fixed at Rs 1.72 Bn (c.2x of FY17 reported PAT) for EIIL which in our view, could have a sizable negative impact on company's balance sheet.

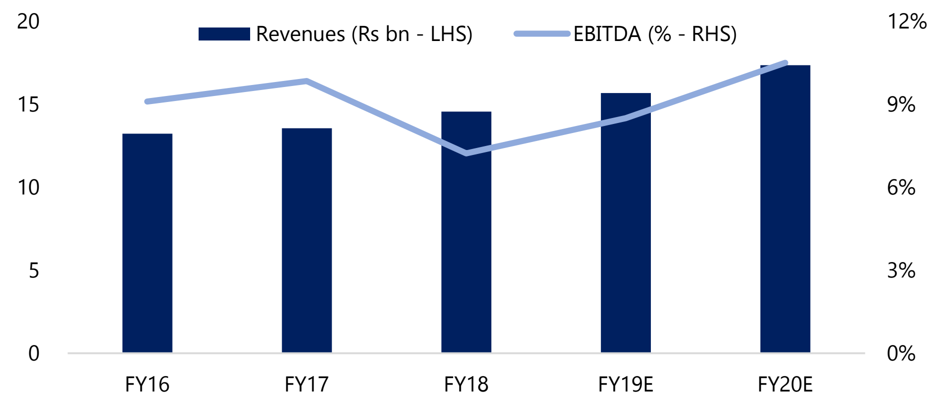
EIIL has appealed and got a stay order on this order from NCLAT (National Company Law Appellate). It has made a deposit of 10% of the penalty amount with NCLAT and awaits further directions in this regards.

We maintain FY19/20 estimates; expect costs overheads to normalize from 2HFY19 onwards

Following our interaction with the management, we maintain our FY19/FY20 earnings estimate. We project revenue growth at 8.6% CAGR between FY17-20 from Rs.13.5 Bn in FY17 to Rs 17.3 Bn in FY20E largely driven by the consumer appliance segmented supported by deeper penetration and lower base.

We expect EBITDA margin to start recovering in 2HFY19 due to increased volumes in the core business and normalization in costs overheads in the appliances/confectionary business. Overall, in our projections, we build EBITDA margin at 8.5% and 10.5% in FY19E and FY20E respectively.

Revenues (Rs bn - LHS) EBITDA (% - RHS)



Source: Company, Kotak Securities – Private Client Research

We note that the company owns certain non-strategic real estate assets, spread all across India which it can look to monetize and cover any such unforeseen liability (related to CCI).

Valuation and Recommendation

Maintain FY19/20 forecasts and DCF assumptions, we recommend 'BUY' with unchanged target price of Rs 322. Despite attractive upside potential, we expect stock to remain under pressure in the short term, susceptible to 1/ further developments in the CCI event and 2/ reversal in sales momentum.

About the company

Eveready Industries India Ltd (EIIL) is market leader in Indian batteries industry, commanding c.55% market share in batteries and holding c.75% market share in India's organized flashlight market. EIIL became part of the Williamson Magor Group in 1993. Founded in 1869, the Williamson Magor Group, gradually progressed to become the world's largest tea producer (McLeod Russel India Limited) and diversified into consumer goods, engineering and construction, emerging as a multi-business enterprise with a turnover of Rs. 50 Bn. The Group is headquartered in Kolkata and has expanded its operations worldwide through its subsidiaries. Mr. Amritanshu K. Khaitan, has been the Managing Director of Eveready Industries India Limited since May 5, 2014. Under his leadership, company has undergone incessant transition in terms of diversifying itself into other segments like small home appliances and lighting businesses. EIIL activities are spreads mainly across five areas-1/Batteries 2/ Flashlights, 3/ Lighting & electrical products, 4/ Small home appliances and 5/ Packet tea.

Financials: Consolidated

Profit and Loss Statement (Rs mn)

(Year-end March)	FY17	FY18	FY19E	FY20E
Revenues	**13,552**	**14,563**	**15,679**	**17,359**
% change yoy	2.4	7.5	7.7	10.7
EBITDA	**1,333**	**1,053**	**1,333**	**1,823**
% change yoy	10.6	(21.0)	26.5	36.8
Depreciation	149	193	175	190
EBIT	**1,184**	**860**	**1,158**	**1,633**
% change yoy	11.3	(27.3)	34.6	41.0
Net Interest	232	287	358	358
Earnings Before Tax	1,047	771	919	1,394
% change yoy	24.7	(26.4)	19.3	51.7
Tax	111	225	230	349
as % of EBT	10.6	29.1	25.0	25.0
XO Items	0	0	0	0
Recurring PAT	**936**	**546**	**690**	**1,046**
% change yoy	68.4	(41.7)	26.2	51.7
Shares outstanding (m)	72.7	72.7	72.7	72.7
EPS (Rs)	**12.9**	**7.5**	**9.5**	**14.4**
DPS (Rs)	1.0	1.5	1.5	1.5
CEPS	14.9	10.2	11.9	17.0

Source: Company, Kotak Securities – Private Client Research

Balance sheet (Rs mn)

(Year-end March)	FY17	FY18	FY19E	FY20E
Cash and cash equivalents	31	41	178	189
Accounts receivable	839	1,206	1,289	1,427
Loans & advances	74	896	896	896
Inventories	2,843	3,001	3,222	3,626
Other current assets	409	1,101	859	951
Current Assets	4,165	6,204	6,265	6,900
Investments	27	27	27	27
Net fixed assets	3,312	3,532	3,732	3,932
Other non-current assets	521	500	500	500
Total Assets	**8,056**	**10,304**	**10,702**	**11,548**
Debt	1,672	1,888	2,388	2,388
Equity & reserves	2,895	3,443	4,001	4,916
Other non-current liabilities	117	166	166	166
Current Liabilities	3,372	4,808	4,147	4,078
Total Liabilities	**8,056**	**10,304**	**10,702**	**11,548**
BVPS (Rs)	40	47	55	68

Source: Company, Kotak Securities – Private Client Research

Cash flow Statement (Rs mn)

(Year-end March)	FY17	FY18	FY19E	FY20E
PBT	1,047	771	919	1,394
Depreciation	149	193	175	190
Current liabilities incl provisions	242	1,436	(661)	(69)
inc in inventory	(469)	(158)	(221)	(405)
inc in sundry Debtors	(133)	(368)	(83)	(138)
inc in advances	289	(822)	-	-
Tax Paid	(111)	(225)	(230)	(349)
Other Adjustments	(178)	(531)	242	(92)
Net cash from operations	**836**	**297**	**142**	**532**
Purchase of fixed Assets	(1,271)	(413)	(375)	(390)
Net investments	-	-	-	-
Other investment activities	238	42	0	0
Net cash from investing	**(1,033)**	**(371)**	**(375)**	**(390)**
Change in Borrowings	289	216	500	-
Dividend Paid	(88)	(131)	(131)	(131)
Net Cash from financing	**201**	**85**	**369**	**(131)**
Cash at the end of year	31	41	178	189

Source: Company, Kotak Securities – Private Client Research

Ratio Analysis

(Year-end March)	FY17	FY18	FY19E	FY20E
EBITDA margin (%)	9.8	7.2	8.5	10.5
EBIT margin (%)	8.7	5.9	7.4	9.4
Net profit margin (%)	6.9	3.8	4.4	6.0
Adjusted EPS growth (%)	68.4	(41.7)	26.2	51.7
Receivables (days)	22.6	30.2	30.0	30.0
Inventory (days)	123.9	121.2	120.0	125.0
Sales / Net Fixed Assets (x)	4.9	4.3	4.3	4.5
Interest coverage (x)	5.1	3.0	3.2	4.6
Debt/ equity ratio	0.6	0.5	0.6	0.5
ROE (%)	37.8	17.2	18.5	23.5
ROCE (%)	26.1	12.5	15.4	18.3
EV/ Sales	1.4	1.3	1.2	1.1
EV/EBITDA	14.2	17.9	14.2	10.4
Price to earnings (P/E)	18.2	31.3	24.8	16.3
Price to book value (P/B)	5.9	5.0	4.3	3.5
Price to cash earnings	15.7	23.1	19.8	13.8

Source: Company, Kotak Securities – Private Client Research

Result Update

Stock Details

Market cap (Rs mn)	:	53963
52-wk Hi/Lo (Rs)	:	496 / 126
Face Value (Rs)	:	2
3M Avg. daily volume	:	1,115,052
Shares o/s (m)	:	133

Source: Bloomberg

Financial Summary

Y/E Mar (Rs mn)	FY18	FY19E	FY20E
Revenue	18,228	20,618	22,576
Growth (%)	8.5	13.1	9.5
EBITDA	2,698	3,313	3,819
EBITDA margin (%)	14.8	16.1	16.9
PAT	1,235	1,798	2,218
EPS	9.3	13.5	16.6
EPS Growth (%)	52.8	45.6	23.4
Book value (Rs/share)	85.7	97.7	112.6
Dividend per share (Rs)	1.0	1.4	1.8
ROE (%)	11.4	14.7	15.8
ROCE (%)	12.3	16.2	18.9
P/E (x)	43.5	29.9	24.2
EV/EBITDA (x)	22.0	17.2	14.6
P/BV (x)	4.7	4.1	3.6

Source: Company

Shareholding Pattern (%)

(%)	Jun-18	Mar-18	Dec-17
Promoters	40.4	40.4	40.4
FII	24.3	22.9	21.9
DII	5.1	5.2	8.2
Others	27.4	28.9	29.5

Source: Company

Price Performance (%)

(%)	1M	3M	6M
Radico Khaitan Ltd	0.9	(2.8)	8.8
Nifty	3.7	5.2	0.9

Source: Bloomberg

Price chart (Rs)

Source: Bloomberg

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RADICO KHAITAN LTD (RKL)

PRICE RS.403 TARGET RS.449 ACCUMULATE

Radico Khaitan Q1FY19 results were ahead of estimates in terms of revenue as well as earnings driven by robust volume growth of 19% on yoy, improvement in EBITDA margins and lower interest expenses.

Key Highlights

- The net revenue for the quarter grew by 25.6% yoy to Rs 5.2 bn and was ahead of our estimates of Rs 4.6bn, driven by 19% yoy growth in IMFL volume which was at 5.6 mn cases. Volume in Prestige and above segment grew at 30% yoy while Regular segment grew at 15% yoy.
- EBITDA margins in the quarter improved by 259 bps yoy to 17.7% led by premiumization, better realization due to price hike in certain states on yoy and lower raw material cost. The company expects improvement in EBITDA margins to continue based on better product mix, benefits of price hikes and lower raw material prices.
- The company is targeting at 14-15% volume growth in FY19E with 100-150 bps margin improvement and intends to be debt free in next 2-2.5 years.

Valuation & outlook

- We have factored in higher volume growth in Q1FY19, improvement in EBITDA margins and lower interest expenses in our estimates and expect RKL's PAT to grow at 34% CAGR in FY18-20E.
- Based on FY19E/FY20E revised EPS of Rs 13.5/16.6, the stock is trading at PE of 29.9/24.2x. We maintain Accumulate rating on the stock with revised target price of Rs 449 (vs Rs 421 earlier).

Quarterly performance table

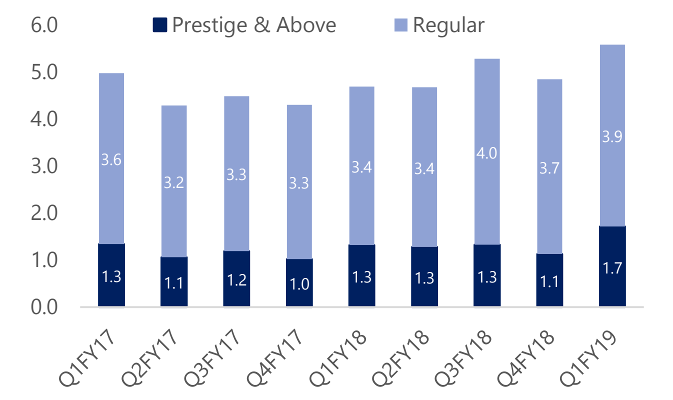
Year to March (INR Mn.)	Q1FY19	Q1FY18	% Chg	Q4FY18	% Chg
Net Revenues	**5,164**	**4,113**	**25.6**	**4,808**	**7.4**
Raw Materials Cost	2,536	2,239	13.3	2,408	5.3
Gross Profit	**2,628**	**1,874**	**40.2**	**2,400**	**9.5**
Employee Expenses	365	340	7.5	414	(11.7)
Selling & Admin exp	686	410	67.4	617	11.2
Other Expenses	664	505	31.5	704	(5.6)
Operating Expenses	4,252	3,493	21.7	4,142	2.6
EBITDA	**912**	**620**	**47.1**	**665**	**37.0**
EBITDA margin (%)	17.7	15.1		13.8	
Depreciation	101	102	(0.1)	102	(0.9)
Other income	27	53	(48.1)	101	(72.9)
Net finance expense	110	189	(41.9)	148	(26.0)
Profit before tax	**728**	**382**	**90.5**	**516**	**41.2**
Provision for taxes	254	126	102.8	174	46.4
Reported net profit	**474**	**257**	**84.5**	**342**	**38.6**
As % of net revenues					
Gross Profit	50.9	45.6		49.9	
Employee cost	7.1	8.3		8.6	
Selling & Admin exp	13.3	10.0		12.8	
Other Expenses	12.9	12.3		14.6	
Operating expenses	82.3	84.9		86.2	
Reported net profit	9.2	6.2		7.1	
Tax rate (% of PBT)	34.9	32.8		33.7	

Source: Company

Robust volume growth drove Q1FY19 revenue

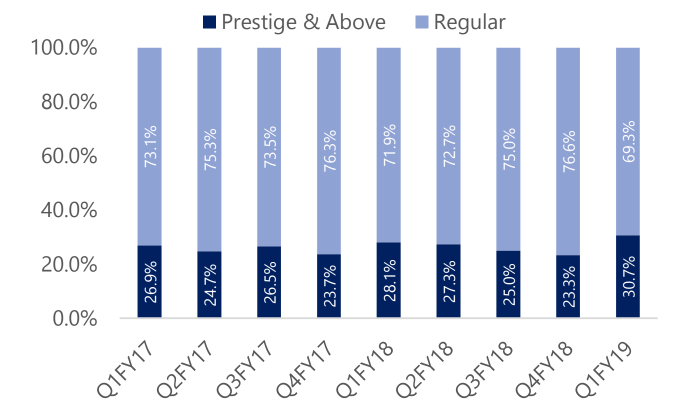
Net revenue grew by 25.6% yoy to Rs 5.16 bn (Vs estimates of Rs 4.6 bn) led by robust 19.1% yoy volume growth in IMFL category and was ahead of our estimates. The growth in IMFL volume was driven by 30.2% yoy volume growth in Prestige and above segment and 14.7% yoy growth in regular segment. In terms of volume mix, prestige segment contributed 30.7% of the quarterly volume and regular segment contributed 69.3%. In value terms Prestige and above contributed 50% of Q1FY19 revenue. The growth in volume is driven higher growth rate with increase in market share in UP. Open market policy implemented in UP for FY19 has led to a strong industry volume growth in the state. In addition, the growth in regular segment also increased due to price increase received by the states like Telangana, Andhra Pradesh, etc, which was not there in Q1FY18. The management is positive on volume growth in coming quarters across both regular as well as Prestige and above category.

Volume trend (mn cases)



Source: Company

Volume Mix (%)



Source: Company

EBITDA margins improved by 259 bps

EBITDA for the quarter grew by 47% yoy with EBITDA margins at 17.7%, improved by 259 bps yoy led by lower raw material prices, price hike received in some of the states on yoy and focus on premiumization resulting in better product mix. Gross margins improved by over 500 bps yoy on lower raw material cost. Sharp decline in molasses prices in UP also resulted in lower raw material prices. In addition, the company had received price increase in the state of AP, Jharkhand, Uttaranchal, Kerala and Telangana towards the end of FY18 which also resulted in better realization in regular category and made it lucrative to sell.

Reduced debt by Rs 1.4 bn, Aims to be debt free in next 2-2.5 years

The company has reduced its debt by Rs 1.4 bn in Q1FY19 to Rs 4.6 bn which was driven by strong operating cashflows. This has also resulted in 44% yoy decline in interest expenses in Q1FY19. Based on strong margins and lower interest expenses, PAT for the quarter grew by 84.5% yoy to Rs 474 mn (Vs estimates of Rs 337 mn). The company targets to reduce its debt in FY19E by Rs 2.5 bn and intends to be debt free in next 2-2.5 years.

Maintained positive growth outlook

The management has guided for 14-15% growth in volume in FY19E with prestige and above segment expected to grow at faster pace. The company expects decent growth in new brands. Its recent launches like 8PM Black which is premium variant of 8PM whisky and 1965 premium rum are doing well. The company intends to launch 2-3 new brands in premium category in next 2 years. Further, the management is confident of maintaining higher margins in coming quarters based of improved realization led by price hikes, continued benefit of lower raw material prices and better product mix. Based on this, the company expects 100-150 bps improvement in EBITDA margins in FY19E and another 100 bps improvement in FY20E.

Other highlights

- Its existing brands such as 8PM whisky, Magic Moments vodka and Morpheus super premium brandy delivered sustained growth.
- RKL has launched Jaisalmer Indian Craft Gin, a product in the luxury segment which is positioned in the fast growing white spirits segment globally.
- Rampur Single Malt whisky is rapidly gaining consumer acceptance and won accolades across the world. The company is selling this in US, EU and other developed market.
- Open distribution system in UP is positive for the company as it stopped the quota system and the company can directly sell its brands to large retailers. This has also positively impacted in terms of cash generation due to reduction in reducing working capital. UP contributes largest revenue share in IMFL business.
- The company has enough capacity to meet its revenue growth in coming years. It would require regular maintenance capex of Rs 150-200 mn per annum.

Outlook and valuation

We have factored in higher volume growth in Q1FY19 in our estimates and upgraded our volume growth assumptions for FY19E at 12.1%. We have estimated 130 bps improvement in EBITDA margin and lower interest expenses and expect RKL's PAT to grow at 34% CAGR in FY18-20. Based on this, we have upgraded our earning's estimates for FY19E/FY20E by 7.3%/6.7% respectively. Based on FY19E/FY20E revised EPS of Rs 13.5/16.6, the stock is trading at PE of 29.9/24.2x respectively. We maintain our Accumulate rating on the stock with revised target price of Rs 449 (Vs Rs 421 earlier), valuing the stock at 27x FY20E EPS.

Change in estimates

Particulars (Rs mn)	Previous		Revised		YoY Chg (%)	
	FY19E	FY20E	FY19E	FY20E	FY19E	FY20E
Revenue	19987	21784	20618	22576	3.2	3.6
EBITDA margin (%)	15.7	16.5	16.1	16.9	37 bps	41 bps
PAT	1676	2078	1798	2218	7.3	6.7
EPS (Rs)	12.6	15.6	13.5	16.6	7.3	6.7

Source: Kotak Private Client Research

Company background

Radico Khaitan Ltd (RKL) is one of the largest players in the Indian spirits industry and owns brands like 8PM whisky, Magic Moments vodka, etc. The company was formerly known as Rampur Distillery which was established in 1943. The promoter Mr. Lalit Khaitan along with his father bought Rampur Distillery in 1972. The company was operating as bottler for other spirit companies till 1999, when it forayed into its own brand. Now, RKL has evolved from a distillery player to a branded IMFL player in India with presence across product categories and has 4 brands in 1mn cases annual sales category. It operates three distilleries and one JV with total capacity of 157 million litres (30 mn cases of IMFL and 7 mn cases of country liquor) and 33 bottling units spread across the country. It has strong sales network through over 55,000 retail outlets across India. It is presently the market leader in premium vodka category with its brand Magic Moments. The company is increasing focus on premium/prestige segment (Price >Rs 300/750ml) which is contributing 26% of its volume and 44% in value terms while regular brands (Price <Rs300/750ml) contributes 74% in volume and 56% in value terms in FY18.

Financials: Standalone

Profit and Loss Statement (Rs mn)

(Year-end March)	FY17	FY18	FY19E	FY20E
Revenues	**16,799**	**18,228**	**20,618**	**22,576**
% change yoy	1.7	8.5	13.1	9.5
EBITDA	**2,125**	**2,698**	**3,313**	**3,819**
% change yoy	13.0	27.0	22.8	15.3
Depreciation	417	409	420	433
EBIT	**1,708**	**2,289**	**2,893**	**3,386**
Other Income	197	267	160	168
Interest	807	682	370	244
Profit Before Tax	**1,097**	**1,873**	**2,683**	**3,310**
% change yoy	11.1	70.7	43.3	23.4
Tax	291	638	885	1,092
as % of EBT	26.5	34.1	33.0	33.0
PAT	**817**	**1,235**	**1,798**	**2,218**
% change yoy	9.8	53.1	45.6	23.4
Shares outstanding (mn)	133	133	133	133
EPS (Rs)	6.1	9.3	13.5	16.6
DPS (Rs)	0.0	1.0	1.4	1.8
CEPS (Rs)	9.2	12.3	16.6	19.9
BVPS (Rs)	77.4	85.7	97.7	112.6

Source: Company, Kotak Securities – Private Client Research

Balance sheet (Rs mn)

(Year-end March)	FY17	FY18	FY19E	FY20E
Paid - Up Equity Capital	266	267	267	267
Reserves	10,033	11,155	12,763	14,747
Net worth	10,299	11,421	13,030	15,014
Borrowings	7,990	5,925	3,525	2,325
Net Deferred tax	693	925	925	925
Total Liabilities	**18,982**	**18,271**	**17,480**	**18,264**
Gross block	7,873	8,098	8,298	8,598
Depreciation	835	1,244	1,664	2,097
Net block	7,038	6,854	6,634	6,502
Capital work in progress	22	202	202	202
Investments	2,054	2,054	2,054	2,054
Inventories	2,936	3,109	3,220	3,587
Sundry debtors	6,240	6,300	6,383	7,051
Cash and equivalents	141	168	107	117
Loans and advances & Others	2,660	3,322	3,322	3,488
Total current assets	11,978	12,898	13,032	14,244
Sundry creditors and others	2,726	3,819	4,406	4,701
Provisions	408	914	1,033	1,033
Total CL & provisions	3,134	4,733	5,439	5,733
Net current assets	8,843	8,165	7,594	8,510
Other net assets	1,025	996	996	996
Total Assets	**18,982**	**18,271**	**17,480**	**18,264**

Source: Company, Kotak Securities – Private Client Research

Cash flow Statement (Rs mn)

(Year-end March)	FY17	FY18	FY19E	FY20E
Pre-Tax Profit	1,086	1,873	2,683	3,310
Depreciation	417	409	420	433
Change in WC	528	705	511	(907)
Other operating activities	(98)	(377)	(885)	(1,092)
Operating Cash Flow	**1,934**	**2,609**	**2,729**	**1,743**
Capex	(164)	(405)	(200)	(300)
Free Cash Flow	1,770	2,205	2,529	1,443
Change in Investments	0	0	0	0
Investment cash flow	**(164)**	**(405)**	**(200)**	**(300)**
Equity Raised	0	1	0	0
Debt Raised	(1,607)	(2,065)	(2,400)	(1,200)
Dividend & others	(149)	(113)	(189)	(234)
CF from Financing	**(1,756)**	**(2,178)**	**(2,589)**	**(1,434)**
Change in Cash	14	27	-60	10
Opening Cash	127	141	168	107
Closing Cash	141	168	107	117

Source: Company, Kotak Securities – Private Client Research

Ratio Analysis

(Year-end March)	FY17	FY18	FY19E	FY20E
Profitability Ratios				
EBITDA margin (%)	12.6	14.8	16.1	16.9
EBIT margin (%)	10.2	12.6	14.0	15.0
Net profit margin (%)	4.8	6.8	8.7	9.8
Adjusted EPS growth (%)	9.8	52.8	45.6	23.4
Balance Sheet Ratios				
Receivables (days)	135.6	126.2	113.0	114.0
Inventory (days)	63.8	62.2	57.0	58.0
Loans & Advances (days)	57.8	66.5	58.8	56.4
Payable (days)	59.2	76.5	78.0	76.0
Cash Conversion Cycle (days)	198.0	178.4	150.8	152.4
Asset Turnover (x)	0.9	1.0	1.2	1.2
Net Debt/ Equity (x)	0.8	0.5	0.3	0.1
Return Ratios				
RoCE (%)	8.8	12.3	16.2	18.9
RoE (%)	8.1	11.4	14.7	15.8
Valuation Ratios				
P/E (x)	66.5	43.5	29.9	24.2
P/BV (x)	5.2	4.7	4.1	3.6
EV/EBITDA (x)	28.9	22.0	17.2	14.6
EV/Sales (x)	3.7	3.3	2.8	2.5

Source: Company, Kotak Securities – Private Client Research

Result Update

Stock Details

Market cap (Rs mn)	:	2838420
52-wk Hi/Lo (Rs)	:	10000 / 7378
Face Value (Rs)	:	5
3M Avg. daily vol	:	494,176
Shares o/s (m)	:	302

Source: Bloomberg

Financial Summary

Y/E Mar (Rs mn)	FY18	FY19E	FY20E
Revenue	797,627	923,995	1071,676
Growth (%)	17.2	15.8	16.0
EBITDA	120,615	142,100	176,182
EBITDA margin (%)	15.1	15.4	16.4
PAT	77,218	96,939	125,182
EPS	255.6	320.9	414.4
EPS Growth (%)	5.1	25.5	29.1
BV (Rs/share)	1,382	1,607	1,925
Dividend/share (Rs)	80.0	80.0	80.0
ROE (%)	19.8	21.5	23.5
ROCE (%)	28.4	30.0	32.8
P/E (x)	36.7	29.3	22.7
EV/EBITDA (x)	23.4	19.9	16.1
P/BV (x)	6.8	5.8	4.9

Source: Company

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

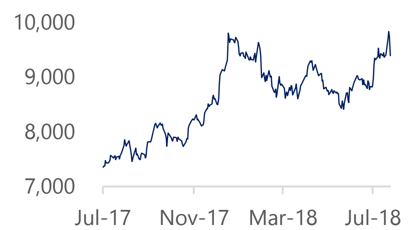
Source: Company

Price Performance (%)

(%)	1M	3M	6M
Maruti Suzuki	5.2	5.0	1.3
Nifty	3.7	5.2	0.9

Source: Bloomberg

Price chart (Rs)



Source: Bloomberg

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MARUTI SUZUKI INDIA LTD (MSIL)

PRICE RS.9397 **TARGET RS.10360** **ACCUMULATE**

MSIL's 1QFY19 revenues came on expected lines. However below expected EBITDA, lower other income and higher tax led to lower than expected net profit. MSIL reported 24% volume growth and saw its market share increase to 52.5% in 1QFY19.

Key Highlights

MSIL reported revenue of Rs224.6bn, 28% increase over 1QFY18 revenue of Rs175.5bn. Sales volume in the quarter grew by 24% YoY on the back of strong growth witnessed in Baleno and Dzire sales. MSIL reported below expected EBITDA on account of cost pressure from commodity prices and adverse foreign currency. EBITDA margin increased YoY and QoQ to 14.9%. MSIL reported PAT of Rs19.8bn, 27% growth over 1QFY18 PAT of Rs15.6bn. However PAT came in well below our and street expectation.

Valuation and Outlook

MSIL is expected to report healthy volume growth in FY19-FY20. Company's existing products continue to do well. Going ahead, we expect new products and facelifts to support volume growth. MSIL's EBITDA margin was on the lower side in 1QFY19. Company highlighted that impact of adverse forex mix will play out in the coming quarters. Over the medium to long term, we expect MSIL to witness gradual improvement in margins. We rate the stock as ACCUMULATE (earlier BUY) with unchanged price target of Rs10,360.

Quarterly performance

(Rs mn)	1QFY19	1QFY18	YoY (%)	4QFY18	QoQ (%)
Total Revenues	**224,594**	**175,457**	**28.0**	**211,656**	**6.1**
Total expenditure	191,083	152,145	25.6	181,506	5.3
RM consumed	155,020	122,884	26.2	143,763	7.8
Employee cost	7,652	6,521	17.3	8,282	(7.6)
Other expenses	28,411	22,740	24.9	29,461	(3.6)
EBITDA	**33,511**	**23,312**	**43.8**	**30,150**	**11.1**
EBITDA margin (%)	14.9	13.3	-	14.2	-
Depreciation	7,198	6,839	5.2	7,025	2.5
Interest cost	207	313	(34)	2,731	(92)
Other Income	2,718	6,827	(60.2)	5,950	(54.3)
Extraordinary income/ (loss)			-		-
PBT	**28,824**	**22,987**	**25.4**	**26,344**	**9.4**
PBT margins (%)	12.8	13.1		12.4	
Tax	9,071	7,423	22.2	7,523	20.6
Tax rate (%)	31.5	32.3	-	28.6	-
Reported PAT	**19,753**	**15,564**	**26.9**	**18,821**	**5.0**
PAT margins (%)	8.8	8.9	-	8.9	-
Other Comprehensive Income	(147)	717		(1,111)	
Total Comprehensive Income	19,606	16,281		17,710	
Reported EPS (Rs)	**65.4**	**51.5**	**26.9**	**62.3**	**5.0**
Sales Volumes	490,479	394,571	24.3	461,773	6.2
Net Realization (Rs)	457,907	444,678	3.0	458,355	(0.1)
RM cost per vehicle (Rs)	316,058	311,437	1.5	311,328	1.5

Source: Company

Strong volume growth in the quarter

MSIL reported revenue of Rs224.6bn, 28% increase over 1QFY18 revenue of Rs175.5bn. Sales volume in the quarter grew by 24% YoY on the back of strong growth witnessed in Baleno and Dzire sales. Domestic volumes grew by 26% YoY, while export volume increase was 2%. Average selling price (ASP) increased by 3% YoY on account of volume share of Baleno, Dzire and S Cross. Other operating income increased by 57% YoY due to freight recovery (now part of other operating income, earlier netted against freight cost) of Rs2.4bn.

Commodity price rise and adverse forex impact operating performance

MSIL reported below expected EBITDA on account of cost pressure from commodity prices and adverse foreign currency. On account of higher discounts (increased QoQ from Rs13,880 per unit to Rs15,161 per unit) and rise in commodity prices, gross margin declined from 32.1% in 4QFY18 to 30% 1QFY19. On a YOY basis, rise in other expenses was on account of higher sales volume, increase in power and fuel cost and impact of freight expenses (on account of accounting change). EBITDA in the quarter stood at Rs33.5bn, 44% growth YoY but 6% below estimates. EBITDA margin increased YoY and QoQ to 14.9%.

PAT impacted from lower other income and higher tax rate

MSIL reported PAT of Rs19.8bn, 27% growth over 1QFY18 PAT of Rs15.6bn. However PAT came in well below our and street expectation. Other income in the quarter declined by 60% YoY and 54% QoQ to Rs2.7bn. Fall in other income was due to MTM loss of Rs4-4.5bn in the quarter (80bps QoQ rise in interest impacted yields. Company has investments to the tune of Rs290mn in 1QFY19. Tax rate for the quarter was higher due to lower other income. Company has guided for 29% tax rate in FY19.

Conference Call Highlights

- Management re-iterated its expectation of 8-9% industry growth in FY19 and MSIL to witness double-digit volume growth. In 1QFY19, MSIL reported 26% domestic volume growth, ahead of 19% volume growth reported by the industry.
- Overall demand for passenger vehicle continues to remain positive. Rural demand is better than demand from urban areas. MSIL generates one third sales volume from rural areas. Company highlighted that rural retail demand is growing by 15%.
- MSIL is witnessing 15% higher enquires and 13% increase in bookings.
- With increased production waiting period for petrol models of Baleno, Dzire and Swift is down to 2-4 weeks and diesel models are readily available. Brezza still has waiting period of 4 months.
- On commodity price, the management stated that majority impact of input cost increase has come in 1QFY19. With stable commodity prices, the company do expect significant impact going ahead.
- During the quarter, forex impact for the company was ~30bps. However, going ahead in the coming quarters, the impact on adverse forex movement is expected to be higher. MSIL has covered 50% of direct JPY exposure. MSIL's overall forex exposure is ~19% of net sales of which ~9% is direct (includes 5% royalty exposure) and ~10% is indirect exposure (related to vendors).

- Royalty in the quarter was 5.5% of net sales and new models (launched post 1st Jan 2017) are attracting lower royalty rate. In 1QFY19, royalty cost did not had any impact of currency MTM. Currently, one third royalty payment is made in INR and balance two third royalty continues to happen in JPY.

Outlook

MSIL is expected to report healthy volume growth in FY19-FY20. Company's existing products continue to do well. Going ahead, we expect new products and facelifts to support volume growth.

MSIL's EBITDA margin is on the lower side in 1QFY19. Company highlighted that impact of adverse forex mix will play out in the coming quarters. Over the medium to long term, we expect MSIL to witness gradual improvement in margins backed by fall in royalty, reduction in logistic cost from vendor localization, operating leverage from higher volumes and cost cutting initiatives by the company.

We rate the stock as ACCUMULATE (earlier BUY) with unchanged price target of Rs10,360. We value the stock at PE of 25x (unchanged) on FY20E earnings.

Key Risk

Lower than expected volume growth, commodity cost increase and unfavorable 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 March)	FY17	FY18	FY19E	FY20E
Revenues	**680,348**	**797,627**	**923,995**	**1071,676**
% change YoY	18.2	17.2	15.8	16.0
EBITDA	**103,517**	**120,615**	**142,100**	**176,182**
% change YoY	16.5	16.5	17.8	24.0
Depreciation	26,021	27,579	29,280	32,360
EBIT	**77,496**	**93,036**	**112,820**	**143,821**
% change YoY	27.8	20.1	21.3	27.5
Net interest	894	3,457	750	650
Other Income	23,001	20,455	25,432	34,391
Exceptional income/(loss)	-	-	-	-
Profit before tax	**99,603**	**110,034**	**137,502**	**177,563**
% change YoY	33.8	10.5	25.0	29.1
Tax	26,101	32,816	40,563	52,381
as % of PBT	26.2	29.8	29.5	29.5
Profit after tax	**73,502**	**77,218**	**96,939**	**125,182**
Adjusted PAT	73,502	77,218	96,939	125,182
% change YoY	37.0	5.1	25.5	29.1
Shares outstanding (m)	302	302	302	302
Adjusted EPS (Rs)	**243.3**	**255.6**	**320.9**	**414.4**
DPS (Rs)	75.0	80.0	80.0	80.0

Source: Company, Kotak Securities – Private Client Research

Balance sheet (Rs mn)

(Year-end March)	FY17	FY18	FY19E	FY20E
Cash and cash equivalents	21,926	12,884	13,058	13,222
Accounts receivable	11,992	14,618	17,720	20,553
Inventories	32,622	31,608	41,599	48,187
Loans and Adv & Others	37,494	39,013	42,756	46,880
Current assets	104,034	98,123	115,134	128,841
LT investments	263,022	340,729	400,091	500,091
Net fixed assets	145,450	154,849	165,569	173,209
Total assets	**512,506**	**593,701**	**680,794**	**802,141**
Payables	83,673	104,970	113,917	132,124
Other liabilities	50,315	58,596	64,456	70,901
Current Liabilities	133,988	163,566	178,373	203,026
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	483,871	579,920
Total liabilities	**512,506**	**593,701**	**680,794**	**802,141**

Source: Company, Kotak Securities – Private Client Research

Cash flow Statement (Rs mn)

(Year-end March)	FY17	FY18	FY19E	FY20E
EBIT	77,496	93,036	112,820	143,821
Depreciation	26,021	27,579	29,280	32,360
Change in working capital	9,529	19,685	(4,146)	8,787
Chg in other net current asset	15,272	7,918	2,703	2,967
Operating cash flow	128,318	148,218	140,656	187,936
Interest	(894)	(3,457)	(750)	(650)
Tax	(23,382)	(31,889)	(40,563)	(52,381)
Other Income	23,001	20,455	25,432	34,391
Deferred Tax Liability	-	-	-	-
Hedge reserves /Others	4,692	3,312	1	-
CF from operations	**131,735**	**136,639**	**124,776**	**169,296**
Capex	(36,302)	(36,978)	(40,000)	(40,000)
(Inc)/dec in investments	(85,488)	(68,092)	(59,362)	(100,000)
CF from investments	**(121,790)**	**(105,070)**	**(99,362)**	**(140,000)**
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	885
Closing cash	138	711	885	1,049

Source: Company, Kotak Securities – Private Client Research

Ratio Analysis

(Year-end March)	FY17	FY18	FY19E	FY20E
Margins				
EBITDA margin (%)	15.2	15.1	15.4	16.4
EBIT margin (%)	11.4	11.7	12.2	13.4
Adj. net profit margin (%)	10.8	9.7	10.5	11.7
Working capital days				
Inventory (days)	18	14	16	16
Receivable (days)	6	7	7	7
Payable (days)	45	48	45	45
Ratios				
Debt/equity ratio (x)	0.0	0.0	0.0	0.0
ROE (%)	22.2	19.8	21.5	23.5
ROCE (%)	29.7	28.4	30.0	32.8
Valuations				
EV/ Sales	4.1	3.5	3.1	2.6
EV/EBITDA	27.2	23.4	19.9	16.1
Price to earnings (P/E)	38.6	36.7	29.3	22.7
Price to book value (P/B)	7.8	6.8	5.8	4.9

Source: Company, Kotak Securities – Private Client Research

Result Update

KPIT TECHNOLOGIES LTD

PRICE RS.287 NOT RATED

KPIT delivered a strong revenue and operating performance. Revenue came at USD 150.5mn,0.2%/12% QoQ/YoY. Growth was led by PES (38.2% of revenue) and digital transformation which grew by 5.5% and 2.2% respectively.

Key Highlights

- KPIT's revenue grew by 0.2% sequentially to USD 150.5mn in line with our estimates. Margins at 12.1% was too in line with our estimates. Notably adjusting for cost relating to merger and demerger with BirlaSoft, EBITDA margin would have been higher by ~110bps.
- Revenue growth was backed by Product Engineering and Digital Transformation. Product growth has inherently remained a lumpy business and reported a de growth of 41% sequentially. IT services too was sluggish largely due to SAP which reported a de growth of 3.5% QoQ.
- The KPIT – Birlasoft merger demerger is on track and has received the approval from the CCI and has filed the scheme with NCLT. Almost all regulatory requirements for the mandatory open offer have been fulfilled. The transactions are likely to be completed this year.

Valuation & outlook

We are positive on merger and demerger plan with Birlasoft. Current valuations capture recovery in margins and revenue growth expected from Birlasoft, based on numbers shared at time of the demerger announcement. We believe further upside will depend on traction in Birlasoft which we do not know at this point. Birlasoft will be about one third size of the combined entity post the merger demerger scheme, so due to inadequate information about Birlasoft we restrict rating on the stock.

Quarterly performance table

(Rs.mn)	4QFY18	1QFY19	QoQ (%)	1QFY18	YoY (%)
Sales (USD Mn)	**150**	**151**	**0.2**	**134**	**12.0**
Sales	**9,664**	**10,138**	**4.9**	**8,704**	**16.5**
Expenditure	8,566	8,910		7,909	
EBDITA	**1,098**	**1,228**	**11.8**	**795**	**54.5**
Depreciation	256	271		190	
EBIT	**842**	**958**	**13.8**	**605**	**58.4**
Interest	29	28		26	
Other Income	191	162		121	
PBT	**1,004**	**1,092**	**8.8**	**700**	**56.1**
Tax	165	241		170	
PAT	**839**	**851**	**1.5**	**530**	**60.7**
Minority Int	6	12		1	
XO Item	-	-		26	
Adjusted PAT	**833**	**840**	**0.8**	**555**	**51.4**
EPS (Rs)	4.3	4.4		2.9	
OPM (%)	11.4	12.1		9.1	
EBIT (%)	8.7	9.4		6.9	
NPM (%)	8.7	8.4		6.1	

Source: Company

Stock Details

Market cap (Rs mn)	:	56741
52-wk Hi/Lo (Rs)	:	305 / 104
Face Value (Rs)	:	2
3M Avg. daily volume	:	2,096,625
Shares o/s (m)	:	197.5

Source: Bloomberg

Financial Summary

Y/E Mar (Rs mn)	FY18	FY19E	FY20E
Revenue	36,656	41,471	45,685
Growth (%)	10.3	13.1	10.2
EBITDA	3,785	4,814	5,658
EBITDA margin (%)	10.3	11.6	12.4
PAT	2,559	3,135	3,816
EPS	13.2	16.2	19.9
EPS Growth (%)	6.0	23.1	22.6
BV (Rs/share)	94.9	108.6	125.9
Dividend/share (Rs)	2.0	2.0	2.0
RONW (%)	14.9	15.9	17.0
ROCE (%)	18.2	20.2	21.6
P/E (x)	22.0	17.9	14.6
EV/EBITDA (x)	14.7	11.6	9.8
P/BV (x)	3.1	2.7	2.3

Source: Company

Shareholding Pattern (%)

(%)	Jun-18	Mar-18	Dec-17
Promoters	18.9	18.9	18.9
FII	49.6	51.8	50.0
DII	5.0	6.3	6.5
Others	20.2	23.0	24.5

Source: Company

Price Performance (%)

(%)	1M	3M	6M
KPIT Technologies	5.8	16.0	35.9
Nifty	3.7	5.2	0.9

Source: Bloomberg

Price chart (Rs)

Source: Bloomberg

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Strong growth across Automotive and Energy & Utilities; Manufacturing de grows

Automotive reported growth of 5% sequentially contributing 47% of total revenue. Company has a leadership and domain expertise in embedded electronics with focus on five main areas. These are the areas where large investments are being made or planned to be made by the global auto majors. Company is investing to develop its own IPs, tools, software products and platforms to enhance its growth. Energy & Utilities vertical grew by 3% sequentially as the company continues to focus on newer technologies and streamlining business processes across applications. Manufacturing (~29% of revenue) after reporting a strong Q4FY18 de grew by 1% sequentially. Within manufacturing life science industry is seeing growing momentum for IOT programs for service enablement and higher adoption of cloud solutions in regulatory compliance sensitive areas. Hi Tech is seeing good traction due to emergence of new business models and supporting technologies. There is also growing opportunity with complex supply chain networks. SAP de grew by 3.5% sequentially and has bottomed out during the quarter. Company has made several organizational and strategy changes to focus on large deals going forward. The key areas within SAP are HANA, cloud and Hybris.

Revenue break - up - verticals

Particulars (Rs mns)	1QFY19	4QFY18	QoQ (%)	1QFY18	YoY (%)
Auto & Trans	70	67	5	55	28
Contribution in %	47	45		41	
Energy / Utilities	28	27	3	24	17
Contribution in %	18	18		18	
Manufacturing	44	45	-1	43	3
Contribution in %	29	30		32	
Others	8	12	-28	13	-35
Contribution in %	6	8		10	

Source : Company

Conference call Highlights

- Management maintained its revenue and margin guidance for the full year in spite of margin beat during the quarter. It would revise the margin guidance in 3Q if required.
- Company continues to focus on digital and Top 40 accounts. The top 40 accounts contribute about 65% of the total revenue for the company.
- Growth was lead by USA geographically. Asia degrowth was largely due to the product business as services business reported strong growth.
- Lower utilization during the quarter was due to increase in headcount which was not in line with growth in revenue.
- Wage hikes would be given in next Q2 which would impact margins by about 230bps. Wage hikes would be higher than the normal industry hike. Company expects to absorb about 100bps of wage hike impact through better operational efficiencies and revenue growth.
- Growth within product business is expected to remain low for the rest of the year due to changes in government regulations. Company has made required investments to tap any oppurtunities.

Company background

KPIT is a leader in technology solutions and services. Its business IT solution offerings help clients run their businesses more efficiently and smartly while the product engineering solutions enable customers to build products that are energy efficient, cleaner and safer. Leveraging its technology and domain prowess, it partners with client to create transformational value that provides sustainable competitive advantage to their businesses.

Financials: Consolidated

Profit and Loss Statement (Rs mn)

(Year-end March)	FY17	FY18	FY19E	FY20E
Net Sales	**33,234**	**36,656**	**41,471**	**45,685**
% Growth	7.8	10.3	13.1	10.2
Cost of sales	29,747	32,871	36,657	40,027
% of Net Sales	89.5	89.7	88.4	87.6
EBITDA	**3,486**	**3,785**	**4,814**	**5,658**
EBITDA Margin (%)	10	10	12	12
Depreciation	827	843	1,020	1,000
EBIT	**2,660**	**2,942**	**3,794**	**4,658**
Interest Exps.	136	104	107	100
EBT	**2,524**	**2,838**	**3,687**	**4,558**
Extraordinary Items	261.3	40.7	11.6	0.0
Other Income	206.6	450	427	430
Share of Profit	(0.1)	(72.5)	(39.6)	-
PBT	**2,992**	**3,256**	**4,086**	**4,988**
Tax-Total	606	698	951	1,172
Profit after tax	2,386	2,559	3,135	3,816
PAT Margin (%)	7.2	7.0	7.6	8.4

Source: Company, Kotak Securities – Private Client Research

Balance sheet (Rs mn)

(Year-end March)	FY17	FY18	FY19E	FY20E
Equity Capital	377	380	380	380
Reserves and Surplus	15,465	17,825	20,441	23,762
Shareholders' Funds	15,841	18,205	20,821	24,141
Total Loan Funds	3,336	2,927	2,627	2,327
Total Liabilities	**19,177**	**21,132**	**23,448**	**26,468**
Gross Block	9,503	10,713	11,463	12,213
Accumulated Depn.	5,535	6,378	7,398	8,398
Net Fixed Assets	3,968	4,335	4,064	3,814
Goodwill	4,117	4,275	4,275	4,275
Investment	2,496	2,147	2,500	2,500
Inventories	433	239	0	0
Sundry Debtors	7,843	8,057	9,295	9,985
Cash and Bank Bal	3,902	5,049	6,457	8,558
Other Current Asset	2,525	3,227	3,487	4,166
Total Current Assets	14,703	16,572	19,240	22,709
Current Liabilities	6,107	6,197	6,630	6,830
Net Current Assets	8,597	10,375	12,610	15,879
Total assets	**19,177**	**21,132**	**23,449**	**26,469**

Source: Company, Kotak Securities – Private Client Research

Cash flow Statement (Rs mn)

(Year-end March)	FY17	FY18	FY19E	FY20E
Net profit before tax	2,730	3,288	4,114	4,988
Depreciation	827	843	1,020	1,000
Interest	136	104	107	100
Other Income	(207)	(450)	(427)	(430)
Opt Profit before WC Changes	3,486	3,785	4,814	5,658
WC Changes	(1,597)	(739)	(739)	(1,169)
Cash Gene from Op.	1,889	3,046	4,076	4,489
Direct Taxes Paid	(542)	(589)	(1,038)	(1,172)
Cash from Ope act	**1,347**	**2,456**	**3,037**	**3,317**
Purchases of F.A /CWIP	(2,036)	(1,368)	(750)	(750)
Investment	(196)	349	(353)	-
Others	-	-	-	-
Cash from Inv Act	**(2,232)**	**(1,019)**	**(1,103)**	**(750)**
Proc from Issue of Eq Shares	(13)	331	0	0
Net loans	1,165	(409)	(300)	(300)
Interest paid	(136)	(104)	(107)	(100)
Dividend paid & Others	(649)	(496)	(496)	(496)
Other Income	467	388	376	430
Cash from Fin Act	**834**	**(290)**	**(526)**	**(466)**
Net Increase in Cash	(51)	1,147	1,408	2,101
Cash at Beginning	3,953	3,902	5,049	6,457
Cash at End	3,902	5,049	6,457	8,558

Source: Company, Kotak Securities – Private Client Research

Ratio Analysis

(Year-end March)	FY17	FY18	FY19E	FY20E
Per Share (Rs)				
EPS	12.4	13.2	16.2	19.9
Cash EPS	16.8	17.6	21.6	25.1
Book value	82.6	94.9	108.6	125.9
Margin (%)				
EBITDA	10.5	10.3	11.6	12.4
PAT	7.2	7.0	7.6	8.4
Balance sheet Ratios				
Receivable (days)	86.1	80.2	81.8	79.8
Payables (days)	14.4	15.8	14.5	14.8
Return ratios (%)				
RONW	16.1	14.9	15.9	17.0
RoCE	17.1	18.2	20.2	21.6
Valuation (x)				
P/E	23.3	22.0	17.9	14.6
Price/Book value	3.5	3.1	2.7	2.3
EV/EBITDA	15.9	14.7	11.6	9.8
EV/Sales	1.7	1.5	1.3	1.2

Source: Company, Kotak Securities – Private Client Research

Result Update

ITC LTD

PRICE RS.287 | TARGET RS.330 | BUY

ITC's EBITDA/ PAT growth was reasonably healthy at +19.2%/+18.2% YoY, well ahead of our and consensus estimates with significant improvement in performance in cigarettes/ other segments in the aggregate. Strong performance was exhibited by Cigarettes, Agri-business and Paper board. Despite strong performance, ITC is trading at a steep discount to other large FMCG players, which trades at 35x-45X FY20E PER (vs. 25X FY20E PER for ITC). We retain BUY on ITC with an unchanged price target of Rs 330 at 29x FY20E PER.

Key Highlights

- Revenue was reported at 107.07 bn (+6.5% YoY), a marginal 1% above expectations led by strong performance of Cigarettes, Agri-business and Paper board divisions
- Other operating income was also higher than expected at Rs 1.52 bn (+95% YoY)
- Aggregate EBITDA was reported at Rs 42.0 bn (+19.2% YoY) translating into a healthy EBIDTA margin of 39.2%. It's commendable that the company is able to sustain its operating margin at ~40% level post GST. The strong operational performance was on the back of good performance of cigarettes and paper board.
- Recurring PAT was reported at Rs 28.2 bn (+18.2%) by and ahead of our estimate. It was aided by strong operational performance.

Quarterly Performance

(Rs mn)	Q1FY18	Q4FY18	Q1FY19	QoQ (%)	YoY (%)
Net Sales	**100,540**	**105,867**	**107,071**	**1.1**	**6.5**
Raw Material consumed	42455	40012	41094	2.7	(3.2)
Gross Profit	58,085	65,855	65,977	0.2	13.6
Gross Profit Margin	57.8	62.2	61.6	(0.9)	6.7
Employee cost	7,003	6,113	7,429	21.5	6.1
Other expenses	15,819	18,302	16,526	(9.7)	4.5
Total operating cost	65,277	64,427	65,049	1.0	(0.3)
Ebidta	**35,263**	**41,440**	**42,022**	**1.4**	**19.2**
EBIDTA (%)	35.1	39.1	39.2		
Depreciation	2,612	3,039	2,987	(1.7)	14.4
Interest	101	232	73	(68.5)	(27.7)
Other income	4,205	5,165	4,039	(21.8)	(3.9)
PBT	**36,755**	**43,334**	**43,001**	**(0.8)**	**17.0**
Exceptional	0	0	0		
Taxes	12,907	14,006	14,812	5.8	14.8
ETR	35.1	32.3	34.4	6.6	(1.9)
PAT	**23,848**	**29,328**	**28,189**	**(3.9)**	**18.2**
Equity	12,147	12,204	12,204	-	-
EPS (Rs)	**2.0**	**2.4**	**2.3**	**-**	**-**

Source: Company

Stock Details

Market cap (Rs mn)	:	3505968
52-wk Hi/Lo (Rs)	:	295 / 250
Face Value (Rs)	:	1
3M Avg. daily volume	:	10,664,090
Shares o/s (m)	:	12207

Source: Bloomberg

Financial Summary

Y/E Mar (Rs mn)	FY18	FY19E	FY20E
Revenue	406,275	451,737	492,058
Growth (%)	1.3	11.2	8.9
EBITDA	155,410	177,416	196,910
EBITDA margin (%)	38.3	39.3	40.0
PAT	108,104	125,257	138,753
EPS	8.9	10.3	11.4
EPS Growth (%)	6.0	15.9	10.8
BV (Rs/share)	42.4	44.8	47.3
Dividend/share (Rs)	5.2	7.0	8.0
ROE (%)	21.8	23.5	24.7
ROCE (%)	33.3	36.0	37.7
P/E (x)	32.4	28.0	25.2
EV/EBITDA (x)	19.1	16.5	14.9
P/BV (x)	6.8	6.4	6.1

Source: Company

Shareholding Pattern (%)

(%)	Jun-18	Mar-18	Dec-17
Promoters	0.0	0.0	0.0
FII	17.5	18.0	19.9
DII	37.6	36.7	36.7
Others	44.9	44.9	43.4

Source: Company

Price Performance (%)

(%)	1M	3M	6M
ITC Ltd	8.5	3.2	2.1
Nifty	3.7	5.2	0.9

Source: Bloomberg

Price chart (Rs)

Source: Bloomberg

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Valuation & outlook

Despite operating under an unfavorable regulatory environment, ITC has been consistently posting strong numbers and is one of the most attractive stocks available in the FMCG space with strong prospects. The adverse abrupt increase in indirect taxes on cigarettes in the past looks history, with we estimating a more stable and predictable GST policy on cigarettes. Non-cigarette (FMCG) segment have started to deliver and should do well in line with estimated improvement in consumer demand in rest of FY19.

Despite strong performance, ITC is trading at a steep discount to other large FMCG players, which trade at 35x-45X FY20E PER (vs. 25X FY20E PER for ITC). We note that several much-more-expensive peers have performed equally well or poorly to ITC. We remain positive on ITC as the current valuations factor less than super-normal growth over FY18 to FY20E. We retain BUY on ITC with an unchanged price target of Rs 330 at 29x FY20E PER.

Segmental Performance

	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19
Segment Revenues (Sales, Rs mn)					
FMCG - Cigarette	50,316	45,542	46,292	49,365	51,276
FMCG - Other	23,851	28,041	28,718	30,518	28,700
Hotels	2,874	3,002	4,044	4,080	3,412
Agri- Business	27,941	19,680	15,309	18,083	31,512
Paper and Paperboards	13,229	13,094	12,796	13,008	13,558
Segment Results (PBIT, Rs mn)					
FMCG - Cigarette	30,045	32,917	32,693	35,058	35,584
FMCG - Other	-45	205	470	912	501
Hotels	12	42	548	755	132
Agri- Business	2,373	2,562	2,333	1,239	1,945
Paper and Paperboards	2,477	2,742	2,683	2,424	2,956

Source: Company

Segmental highlights

At the outset, we note that reported financials are not comparable on a y/y basis above the EBITDA line, due to accounting changes related with GST.

In the **cigarette segment,** we estimate that, (judging by the growth in revenues and EBIT) the company experienced volume increase of 1-2%. The improvement in volumes is important for the company and has arrested the decline experienced by the company in the previous 3 quarters. The company has also taken price hike on cigarettes in the previous quarter. Price hike with positive volume growth has resulted in strong performance of the cigarettes business in Q1FY19.

ITC's emerging **non-cigarette consumer goods business** has disappointed in the quarter with QoQ fall in revenues and EBIT. However, enhanced scale, product mix enrichment and cost management initiatives helped the segment report strong YoY performance. We expect this segment to do well in rest of FY19 in line with performance of other FMCG majors.

Strategic investments in imported pulp substitution and process innovation leading to improved pulp yield, has helped ITCs **paperboards segment** to deliver strong growth.

Higher room rates and strong food and beverage sales helped ITC report YoY improvement in its **hotel business**. However, overall, the hotel business of the company looks weak. The company is currently building four properties post commissioning of its property in Hyderabad in the quarter.

Agri business was marginally impacted by pressure on legal cigarette volumes and lower export incentives. Despite that performance of the agri-business remained strong.

GST rate on cigarette untouched in the latest GST council meet

The GST council meeting on 21st July was an important one for ITC from a cigarette taxation standpoint to the extent that it was the first meeting post the anniversary of the last revision in cigarette taxation (July 17, 2017). The GST council, this time had not touched the GST rate on cigarettes. We accept the "No revision" as a positive signal by the government with respect to stability of indirect taxes on cigarettes. With this with investors are taking comfort from the frequency of cigarette increased taxation under the old regime. The overhang (risk of punitive revision in the 'next' council meeting in November 2018) remains as the Government makes attempts to increase its GST revenues. Overall, we expect that the indirect taxation regime shall now be stable for ITC with 6-8% growth on an annual basis.

Outlook and Investment View

ITC's core cigarette segment has exhibited volume growth after 3 quarters of volume decline. This was despite regular price hikes taken by the company (to offset GST-related hikes). The company continues to be largely dependent on cigarettes for its profits; with sectors like FMCG and Paperboard doing well in the quarter. We expect the current trend in growth to continue for the rest of FY19.

ITC remains relatively attractively valued, at 25x PER FY20E, versus 35x-45x FY20E for larger FMCG companies. We expect that the company to experience a gradual re-rating as growth in cigarette profits rises to double digits over the next few quarters. We expect that taxation regime shall now be stable with 6-8% growth on an annual basis. Helped by these, we expect that ITC valuation to only improve from here. We retain BUY on ITC with an unchanged price target to Rs 330 at 29x FY20E PER.

Key risks: regulation remains the largest risk for the company. Other risks are economic/ competitive in nature.

Company background

ITC Ltd. is India's largest cigarette company. The company is also involved in several other businesses, including (non-cigarette) FMCG, hotels, Agri-commodities, and paper and paperboards. Though, cigarette business contributes more than 80% of the profits of the company, 80% of the capital is invested in the non-tobacco businesses.

Financials: Consolidated

Profit and Loss Statement (Rs mn)

(Year-end March)	FY17	FY18	FY19E	FY20E
Revenues	**400,887**	**406,275**	**451,737**	**492,058**
% change YoY	9.6	1.3	11.2	8.9
Raw material cost	159,763	157,900	173,919	186,982
Employee cost	24,443	24,875	26,865	28,745
Other expenses	70,900	68,091	73,538	79,421
Total Operating expd	255,106	250,866	274,321	295,148
EBITDA	**145,780**	**155,410**	**177,416**	**196,910**
Depreciation	10,380	11,454	12,735	13,872
EBIT	**135,400**	**143,956**	**164,681**	**183,038**
Other income	19,859	21,298	26,802	29,049
Interest expense	230	867	250	250
Profit before tax	**155,030**	**164,388**	**191,233**	**211,837**
Tax	53,021	56,285	65,975	73,084
ETR (%)	34.2	34.2	34.5	34.5
Profit after tax	**102,009**	**108,104**	**125,257**	**138,753**
Minorities& Associates	0	0	0	0
Net income	**102,009**	**108,104**	**125,257**	**138,753**
% change YoY	9.4	6.0	15.9	10.8
Shares outstanding (m)	12,147	12,204	12,204	12,204
EPS	**8.4**	**8.9**	**10.3**	**11.4**

Source: Company, Kotak Securities – Private Client Research

Balance sheet (Rs mn)

(Year-end March)	FY17	FY18	FY19E	FY20E
Cash	29,497	9,743	35,247	62,556
Debtors	22,075	23,570	26,208	28,547
Inventory	78,640	72,372	80,470	87,652
Other current assets	43,946	62,035	68,972	75,124
Total current assets	144,661	157,976	175,649	191,323
Investments	185,853	233,972	233,972	233,972
Net fixed assets	184,173	205,916	203,180	199,308
Total assets	**544,184**	**607,608**	**648,049**	**687,160**
Creditors	25,512	33,829	37,614	40,972
Other current liabilities	42,788	54,737	60,862	66,295
Provisioning	1,552	1,956	2,175	2,369
Total current liabilities	69,853	90,522	100,651	109,635
LT debt	180	111	111	111
Minority Interest	0	0	0	0
Equity Capital	12,147	12,204	12,204	12,204
Reserves	462,003	504,770	535,082	565,210
Networth	474,151	516,975	547,286	577,414
Total liabilities	**544,184**	**607,608**	**648,049**	**687,160**
BVPS (Rs)	39.0	42.4	44.8	47.3

Source: Company, Kotak Securities – Private Client Research

Cash flow Statement (Rs mn)

(Year-end March)	FY17	FY18	FY19E	FY20E
PAT	102,009	108,104	125,257	138,753
Depreciation+DTL	13,031	14,268	16,034	17,526
Change in working capital	6,786	7,354	(7,544)	(6,690)
Cash flow from operations	**121,826**	**129,725**	**133,748**	**149,589**
Capex	(30,252)	(33,197)	(10,000)	(10,000)
Investments	(52,608)	(48,119)	-	-
Cash flow from investments	**(82,859)**	**(81,316)**	**(10,000)**	**(10,000)**
Equity issuance	4,100	57	-	-
Debt raised	(114)	(69)	-	-
Dividend Paid	(69,848)	(72,280)	(98,245)	(112,280)
Miscellanous items	-	4,129	-	-
Cash flow from financing	**(65,862)**	**(68,163)**	**(98,245)**	**(112,280)**
Net cash flow	(26,895)	(19,754)	25,503	27,310
Opening cash	56,392	29,497	9,743	35,247
Closing cash	29,497	9,743	35,247	62,556

Source: Company, Kotak Securities – Private Client Research

Ratio Analysis

(Year-end March)	FY17	FY18	FY19E	FY20E
EBITDA margin (%)	36.4	38.3	39.3	40.0
EBIT margin (%)	33.8	35.4	36.5	37.2
Net profit margin (%)	25.4	26.6	27.7	28.2
ROE (%)	22.4	21.8	23.5	24.7
ROCE (%)	34.1	33.3	36.0	37.7
DPS	5.0	5.2	7.0	8.0
Dividend payout (%)	68.5	66.9	78.4	80.9
Working capital turnover (days)	71.2	63.9	57.6	58.1
Debt Equity (x)	0.0	0.0	0.0	0.0
PER (x)	34.2	32.4	28.0	25.2
P/C (x)	30.3	28.6	24.8	22.4
Dividend yield (%)	1.7	1.8	2.4	2.8
P/B (x)	7.4	6.8	6.4	6.1
EV/Sales (x)	8.4	8.3	7.5	6.9
EV/ EBITDA (x)	20.4	19.1	16.5	14.9

Source: Company, Kotak Securities – Private Client Research

Result Update

QUESS CORP LTD (QUESS)

PRICE RS.1128 **TARGET RS.1302** **BUY**

Stock Details

Market cap (Rs mn)	:	164121
52-wk Hi/Lo (Rs)	:	1303 / 784
Face Value (Rs)	:	10
3M Avg. daily volume	:	109,893
Shares o/s (m)	:	145

Source: Bloomberg

Financial Summary

Y/E Mar (Rs mn)	FY18	FY19E	FY20E
Revenue	61,673	81,641	94,950
Growth (%)	42.9%	32.4%	16.3%
EBITDA	3,485	4,635	5,409
EBITDA margin (%)	5.65	5.68	5.70
PAT	3,097	4,173	4,737
EPS	21.3	28.7	32.6
EPS Growth (%)	154.1	34.9	13.5
BV (Rs/share)	169	198	230
Dividend/share (Rs)	-	-	-
ROE (%)	16.1	15.6	15.2
ROCE (%)	17.9	15.2	15.4
P/E (x)	53.0	39.3	34.6
EV/EBITDA (x)	45.5	33.8	28.6
P/BV (x)	6.7	5.7	4.9

Source: Company

Shareholding Pattern (%)

(%)	Jun-18	Mar-18	Dec-17
Promoters	71.7	71.7	71.7
FII	13.7	9.0	7.3
DII	5.8	6.0	4.1
Others	8.8	13.3	16.9

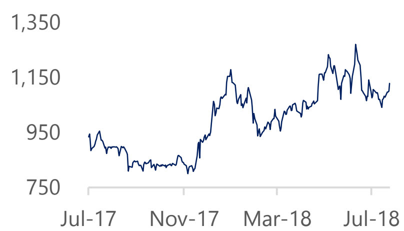
Source: Company

Price Performance (%)

(%)	1M	3M	6M
Quess Corp Ltd	5.8	(2.9)	1.4
Nifty	3.7	5.2	0.9

Source: Bloomberg

Price chart (Rs)



Source: Bloomberg

One-off impact: The company has booked a non-operating accounting charge of ~Rs.160 mn (prior-period) in Q1FY19 resulting in lower PAT and lower margins. However, management is optimistic that in 9MFY19 the margins will improve. It has already started a business transformation program encapsulating zero based budgeting, service excellence and digitization of key business processes to further enhance margins.

Key Highlights

- Quess has reported lower than expected bottom line. Quess's Q1FY19 reported PAT decreased 28% qoq to Rs.544 mn (+19% yoy) mainly due to lower operating profit, one-time non-operating accounting charge, lower other income, higher tax paid and higher depreciation charge.
- In Q1FY19, operating margin declined by 58 bps qoq and 59 bps yoy to 5.2% mainly due to 1) Impact of seasonality in the business operations of recently acquired entities such as Conneqt Business Solutions and Manipal Integrated Services and 2) Impact of ongoing strategic investments in Technology, sales and operations at Monster and DigiCare.
- Employee headcount increased by 39%/4% yoy / qoq to ~272,000 in Q1FY19.

Valuation & outlook

We now expect Quess to report an EPS of Rs.28.7 in FY19E and an EPS of Rs. 32.6 in FY20E supported by both recent acquisitions done by the company and organic growth. We maintain BUY rating on Quess with a revised target price of Rs.1302/share (earlier Rs. 1320/share), valuing the company at a P/E multiple of 40x on FY20E. In India, every month ~1 million people are entering the workforce, generating sustainable employment becomes an imperative which opens huge growth opportunities for Quess.

Quarterly performance table

Particulars (Rs Mn)	Q1FY19	Q4FY18	Q1FY18	YoY (%)	QoQ (%)
Income from ops	**19,684**	**18,908**	**12,973**	**51.7**	**4**
Total Expenditure	18,659	17,814	12,221	53	5
EBIDTA	**1,025**	**1,093**	**752**	**36**	**(6)**
Depreciation	299	285	136	120	5
EBIT	**726**	**809**	**616**	**17.8**	**(10)**
Other income	156	240	35	342	(35)
Interest-net	261	252	170	54	4
PBT	**621**	**797**	**482**	**29**	**(22)**
Extra ordinary Exp/(Inc)	(16)	8	(6)		
Tax	93	31	31	199	198
PAT	**544**	**758**	**457**	**19**	**(28)**
Basic EPS	3.7	5.2	3.1	19	(28)

Source: Company.

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Quarterly result analysis – Q1FY19

- **Net revenue growth** – In Q1FY19, Quess reported net revenue at Rs.19.7 bn, higher 4% qoq and 52% yoy (includes an Organic growth of 28% yoy) supported by growth in People and Services business (4% qoq), Global technology solutions (9% qoq), and Internet business segment (58% qoq, low base).
- **Cost of material and stores and spare parts consumed:** In Q1FY19, raw material cost increased 57% qoq (base effect) to Rs.650 bn (128% yoy) mainly due to higher consumption of material and stores and spare parts.
- **Staff Cost:** Employee cost increased by 2% qoq to Rs.15.5 bn (+42% yoy) in Q1FY19. However, employee cost to total revenue ratio declined 140 bps qoq and 516 bps yoy reflecting efficient utilization of resources. Employee headcount increased by 39% yoy to ~272,000 in Q1FY19.
- **Other expenditure:** In Q1FY19, Quess other expenditure increased meaningfully 12% qoq to Rs.2.5 bn (138% yoy).

Operating matrix

	Q1FY19	Q4FY18	Q1FY18	YoY (bps)	QoQ (bps)
Margin Ratio (%)					
EBITDA Margin	5.2	5.8	5.8	(59)	(58)
EBIT Margin	3.7	4.3	4.8	(106)	(59)
Adj PAT Margin	2.7	4.1	3.5	(79)	(137)
Other Income/PBT	25.1	30.1	7.3	1,781	(495)
Tax/PBT	14.9	3.9	6.4	851	1,104
Expenses (Rs. Mn)					
Raw Material consumption	650	414	285	128	57
Staff costs	15,486	15,141	10,877	42	2
Other Expenditure	2,523	2,260	1,060	138	12
Total	18,659	17,814	12,221	53	5
Expenses Ratio (%)					
RM to Sales	3	2	2	1	1
Staff to Sales	79	80	84	(5)	(1)
Other expenses to Sales	13	12	8	5	1

Source: company

- **Operating margin (%):** In Q1FY19, operating margin declined by 58 bps qoq and 59 bps yoy to 5.2% mainly due to 1) Impact of seasonality in the business operations of recently acquired entities such as Conneqt Business Solutions and Manipal Integrated Services and 2) Impact of ongoing strategic investments in Technology, Sales and Operations at Monster and DigiCare.
- The company has indicated that the benefits from these investments are expected to be seen from Q3FY19 and onwards.
- **Operating profit decline (Rs. Mn):** Quess reported lower EBIDTA profit of Rs.1.03 bn (-6% qoq but 36% yoy) in Q1FY19 on account of significantly higher other expenditure, one time charge and higher cost of material and stores and spare parts consumed.
- **Finance cost:** Quess has reported higher interest cost at Rs.261 mn, 4% qoq (base effect) and 54% yoy due to increase in total debt (short term and long term). Gross long term debt stands at Rs.2.7 bn as on 31st March 2018.
- **Depreciation charge:** In Q1FY19, Quess's depreciation charge increased by 5% qoq to Rs.299 mn (+120% yoy) which includes amortization charges.

- **Other income:** In Q1FY19, Quess's other income decreased by 35% qoq (higher base) to Rs.156 mn (+342% yoy). In Q4FY18, the company got higher dividend income.
- **Profit before tax declined (PBT):** Quess reported lower PBT of Rs.621 mn in Q1FY19 as against a PBT of Rs.797 mn in Q4FY18 mainly on account of higher operating cost (5% qoq), higher depreciation charge, decline in other income and marginally higher interest cost.
- **Income Tax:** In Q1FY19, the company paid tax at the rate of 14.9% of PBT (v/s 3.9% in Q4FY18 and 6.4% in Q1FY18) i.e. Rs. 93 mn (+198% qoq and -20% yoy)
- As per the amendment in the finance Act 2016, deduction under Section 80JJAA of Income tax Act, 1961 was extended across all sectors subject to fulfillment of conditions as stipulated in the said section. The amendment was first applicable for the FY17. In FY18, Quess has claimed Rs.565.2 mn as excess provision related to prior years.
- **PAT:** Quess's Q1FY19 reported PAT decreased 28% qoq to Rs.544 mn (+19% yoy) mainly due to lower PBT and higher tax paid.
- The company has booked a non-operating accounting charge of ~Rs.160 mn in Q1FY19 following the acquisitions done in FY18. Which includes amortization of intangible assets of ~Rs.90 mn and non-controlling interest put option of ~Rs.70 mn.
- The company has indicated that adjusted PAT for Q1FY19 should increase to Rs. 700 mn resulting in a PAT margin at 3.55% and normalized diluted EPS at Rs. 4.8. Despite that PAT has declined by 7% qoq.

Other Key developments

- **General Staffing business:** This division has added a total headcount of 7,400 across General Staffing and the Apprenticeship program during Q1FY19. The Staffing headcount has reached ~164,400 as on June 30, 2018.
- **Conneqt Business Solutions (CBS)**: CBS has expanded its business operations to two new international geographies — Vietnam and the Middle East.
- In Q1FY19, Terrier Security Services registered an all-time record win of over 4,000 new headcounts.
- DigiCare Services has expanded its store count by 33% by adding 60 new stores in Q1FY19 bringing the total count to 240 plus stores across India.

Acquisitions

- In Q1FY19, Quess completed the acquisition of 100% stake in HCL Computing Products Limited (Branded as DigiCare Services).
- Accordingly, the financials of the acquired entity has been fully consolidated into Quess w.e.f. Q1FY 19. The acquisition gave Quess a strategic entry into the mobile and consumer durable break fix and repairs market across India and has complemented the company's offering in the Customer Lifecycle Management (CLM) space.
- Quess also completed the acquisition of 90% stake in Greenpiece Landscapes India Private Limited with effect from May 08, 2018. Accordingly, the financials of the acquired entity has been fully consolidated into Quess w.e.f. Q1FY19.

Landscaping is an adjacency to Quess' Facility Management business and the acquisition further differentiated its offerings and brought in much needed institutional approach to this segment.

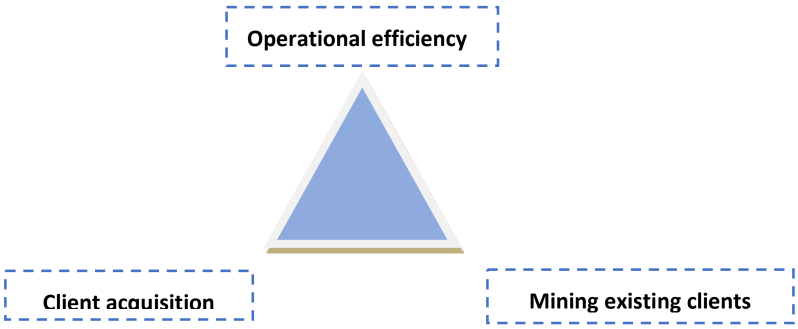
Investment Arguments

- **Structural shift - Clients switching to asset light model, opens great business opportunity:** In today's digital world, competitive intensity has increased, traditional supply chain has been disrupted, and clients switching to asset-light business models, reflecting companies (startups and others) intent to remain flexible to fast changing market conditions. As a result, corporates are outsourcing non-core activities to professional service providers like Quess corp. In this regard, Quess acquired technology and digital capabilities across businesses to "variabilize" fixed costs for its clients, transition internal businesses and manufacturing processes into managed services and providing flexibility of pay-per-use for common business service requirements.

- Increased acceptance of outsourcing non-core activities and sustained commercial/office space absorption have been significant growth drivers for facility management services in India. In FY16, the IFM market size has grown at a five year CAGR of ~15% to Rs.104 bn and management believes the is expected to grow at a 25% CAGR over the next three years reflecting huge growth potential for integrated service providers like Quess corp.

- **Leverage scale to bring in operating efficiency** - The company's management is strategically focusing on client acquisition, mining existing clients to achieve scale and improve operating level efficiency (such as higher associate to core employee ratio, reduction in DSO days). This is helping the company to grow its business, expand operating margin and improve return ratios.

Tripod – Spectacular growth, Margin expansion and Better returns



Source: Company and Kotak Securities - Private Client Research

- **Structural growth story of Quess** - We have seen a paradigm shift in Quess business operations. It has evolved from a normal HR outsourcing company to a business services juggernaut, reflecting sound structural growth opportunity. On a micro level, large corporate are outsourcing ancillary services as they believe that professionals are more efficient, effective, and competitive to do the same. Also, in a volatile economic landscape, with shifting consumer preferences and far reaching technological changes companies are focusing on its core competency and outsourcing ancillary activities.

Maintain BUY

We now expect Quess to report an EPS of Rs.28.7 in FY19E and an EPS of Rs. 32.6 in FY20E supported by both recent acquisitions done by the company and organic growth. We maintain BUY rating on Quess with a revised target price of Rs.1302/share (earlier Rs. 1320/share), valuing the company at a P/E multiple of 40x on FY20E. In India, every month ~1 million people are entering the workforce, generating sustainable employment becomes an imperative which opens huge growth opportunities for Quess.

Valuation

Particulars Unit FY20E	Unit	
EPS (FY20E)	Rs./share	32.6
Target – P/E	x	40
Target price (Rs/share)	Rs. Mn	1302
CMP	Rs. Mn	1128
Potential upside/(downside)	**%**	**15.5**

Source: Kotak Securities - Private Client Research

Key Risk and Concerns:

- Weak cash conversion cycle
- Acquisition risk
- losing clients
- Slowdown in IT sector
- Employee is the key to success – Inability to recruit, train and retain qualified associates

Company background

Quess Corp Ltd. (erstwhile IKYA Human Capital Solutions) is one of India's leading integrated business services providers. The company offers comprehensive solutions including recruitment, temporary staffing, technology staffing, IT products and solutions, skill development, payroll, compliance management, integrated facility management and industrial asset management services.

Incorporated in 2007 and headquartered in Bengaluru, the Company has strong presence in India, North America, the Middle East and South-East Asia. Quess Corp is promoted by Fairfax Financial Holdings through its Indian subsidiary, Thomas Cook India Ltd (TCIL) and Mr. Ajit Isaac (Chairman and CEO). The Company got listed on exchanges in 2016.

Diversified business segments and revenue streams

Quess has key four business segments - People & Services, Global Technology Solutions, Integrated Facility Management and Industrial asset management. The company has a strong team of 189,200 people (54% yoy, including manipal integrated services (MIS) and terrier security services (Terrier)) serving more than 1700 clients in nine countries.

Financials: Consolidated

Profit and Loss Statement (Rs mn)

(Year-end March)	FY17	FY18	FY19E	FY20E
Revenues	**43,149**	**61,673**	**81,641**	**94,950**
% change YoY	25.6	42.9	32.4	16.3
EBITDA	**2,379**	**3,485**	**4,635**	**5,409**
% change YoY	48.1	46.5	33.0	16.7
Other Income	154	628	568	504
Depreciation	333	747	929	1,111
EBIT	**2,201**	**3,365**	**4,274**	**4,802**
% change YoY		52.9	27.0	12.3
Net interest	479	755	101	65
Profit before tax	**1,722**	**2,611**	**4,173**	**4,737**
% change YoY	50.1	51.6	59.8	13.5
Tax	504	(482.6)	0	0
as % of PBT	29.3	-18.5	0.0	0.0
Profit after tax	**1,218**	**3,093**	**4,173**	**4,737**
Minority interest	(1)	(4)	-	-
Share of profit of associates	0	0	0	0
Net income	**1,219**	**3,097**	**4,173**	**4,737**
% change YoY	50.1	154.1	34.7	13.5
Shares outstanding (m)	127	145	145	145
EPS (reported) (Rs)	**8.4**	**21.3**	**28.7**	**32.6**
CEPS (Rs)	10.7	26.4	35.1	40.2
DPS (Rs)	0.0	0.0	0.0	0.0

Source: Company, Kotak Securities – Private Client Research

Balance sheet (Rs mn)

(Year-end March)	FY17	FY18	FY19E	FY20E
Cash and cash equivalents	4,626	8,365	7,463	9,637
Accounts receivable	8,966	13,936	16,552	19,250
Inventories	71	85	112	131
Loans and Adv & Others	2,001	5,844	7,736	8,997
Current assets	15,664	28,229	31,863	38,015
Misc exp.	0	0	0	0
LT investments	776	2,862	2,862	2,862
Net fixed assets	11,793	16,340	16,490	16,990
Total assets	**28,234**	**47,431**	**51,214**	**57,867**
Payables	778	1,481	1,917	2,150
Others	11,468	19,043	20,578	22,034
Current liabilities	12,246	20,524	22,495	24,184
Provisions	588	1,150	1,492	1,719
LT debt	2,744	2,686	0	0
Min. int and def tax liabilities	(393)	(1,538)	(1,553)	(1,553)
Equity	1,268	1,455	1,455	1,455
Reserves	11,780	23,153	27,326	32,063
Total liabilities	**28,234**	**47,431**	**51,214**	**57,867**
BVPS (Rs)	90	169	198	230

Source: Company, Kotak Securities – Private Client Research

Cash flow Statement (Rs mn)

(Year-end March)	FY17	FY18	FY19E	FY20E
EBIT	2,201	3,365	4,274	4,802
Depreciation	333	747	929	1,111
Change in working capital	5,158	(1,137)	(2,224)	(2,062)
Chgs in other net current assets				
Operating cash flow	7,691	2,976	2,979	3,851
Interest	(479)	(755)	(101)	(65)
Tax	(504)	483	-	-
Cash flow from operations	**6,708**	**2,704**	**2,878**	**3,786**
Capex	(9,580)	(5,294)	(1,079)	(1,611)
(Inc)/dec in investments	(740)	(2,085)	-	-
Cash flow from investments	**(10,320)**	**(7,380)**	**(1,079)**	**(1,611)**
Proceeds from issue of equity	8,273	8,473	(16)	-
Increase/(decrease) in debt	(1,150)	(58)	(2,686)	-
Proceeds from share premium	-	-	-	-
Dividends	-	-	-	-
Cash flow from financing	**7,123**	**8,415**	**(2,702)**	**-**
Opening cash	1,115	4,626	8,365	7,463
Closing cash	4,626	8,365	7,463	9,637

Source: Company, Kotak Securities – Private Client Research

Ratio Analysis

(Year-end March)	FY17	FY18	FY19E	FY20E
EBITDA margin (%)	5.5	5.7	5.7	5.7
EBIT margin (%)	5.1	5.5	5.2	5.1
Net profit margin (%)	2.8	5.0	5.1	5.0
Receivables (days)	75.8	82.5	74.0	74.0
Inventory (days)	0.6	0.5	0.5	0.5
Sales/gross assets(x)	3.7	2.9	2.9	3.0
Interest coverage (x)	4.3	3.6	36.8	66.1
Debt/equity ratio(x)	0.2	0.1	-	-
ROE (%)	14.7	16.1	15.6	15.2
ROCE (%)	14.6	17.9	15.2	15.4
EV/ Sales	3.8	2.6	1.9	1.6
EV/EBITDA	68.2	45.5	33.8	28.6
Price to earnings (P/E)	134.8	53.0	39.3	34.6
Price to book value (P/B)	12.6	6.7	5.7	4.9

Source: Company, Kotak Securities – Private Client Research

Forthcoming Events

Forthcoming events

Date	Event
27-Jul	Genus Power, HCL Tech, Reliance Industries earnings expected
28-Jul	Balmer Lawrie, JK Cement, Persistent earnings expected
30-Jul	Chennai Pet, Escorts, GSPL, HDFC, Idea Cellular, IDFC, IDFC Bank, Shree Cement, Tech Mahindra earnings expected
31-Jul	BEL, Bludart, Castrol India, Dabur, MGL, Redington, Supreme Ind, Tata Motors, Tech Mahindra, Vedanta earnings expected
1-Aug	Apollo Tyres, Gateway Distriparks earnings expected
2-Aug	Marico, MOIL, Mold-Tek Packaging, Time Technoplast earnings expected
3-Aug	Berger Paint, Carborundum Universal, Gujarat Alkalies, VIP Industries earnings expected

Source: www.bseindia.com

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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