MORNING INSIGHT

kotak Securities

PRIVATE CLIENT RESEARCH

MAY 12, 2017

Economy News

- In a watershed moment India's regulator for transgenic products, the Genetic Engineering Appraisal Committee (GEAC), has approved commercial production of genetically modified (GM) mustard. (Mint)
- The Competition Commission has ordered a detailed probe against major telecom players for allegedly trying to block the entry of newcomer Reliance Jio. (Mint)
- The maiden masala bond issue of the National Highways Authority of India (NHAI) received strong response from investors, attracting bids worth over Rs 30 bn. (ET)
- Solar parks have helped renewable energy companies reduce tariffs substantially but some developers are complaining that at times the parks charge high fee and do not provide adequate infrastructure. (BS)

Corporate News

- **Nestlé India Ltd** and **Hindustan Unilever Ltd (HUL)** have evinced interest in buying a controlling stake in Havmor Ice Cream Ltd, a Gujarat-based ice cream brand with a pan India presence. (Mint)
- **Reliance Infrastructure (RInfra)** on Thursday said an arbitral tribunal has awarded its arm Delhi Airport Metro Express Private Limited (DAMEPL) a compensation of Rs 29.5 bn against the Delhi Metro Rail Corporation (DMRC).
- Two- and three-wheeler maker **TVS Motor Company** has announced its entry into Central American market with a reputed local group Masesa (Mayor Servicios Socieda Anonima) as its sales and distribution partner. (BL)
- FMCG major **Emami Ltd** is planning to re-launch the Zandu brand by repositioning its portfolio as a solution provider to lifestyle disorders. (BL)
- **Max India** on Thursday announced that it will raise funds from its sponsor, Max Group's Founder and Chairman Emeritus Analjit Singh, by issuing warrants amounting to Rs 3 bn. (BL)
- The Supreme Court ruling setting aside a decision of the Central Appellate Tribunal for Electricity, effectively denying 'compensatory tariff' to **Tata Power** and **Adani Power**, has driven the producers to cut back power supply to Gujarat, citing financial unviability. (BL)
- **State Bank of India** has clarified that the proposed hike in ATM withdrawal charges will be applicable only to customers of its mobile wallet State Bank Buddy.(BL)
- Isuzu Motors India launched the 'mu-X' premium full size 7-seater sport utility vehicle (SUV) on Thursday. (BL)
- **Infrastructure Leasing & Financial Service (IL&FS)** Transportation today said a consortium led by its Singapore arm has won a USD 165 million (Rs 11 bn) contract for a road project in Laos.(BS)
- Consumer electricals firm **Havells India** would exit from the global market by selling remaining 20 per cent stake in its European lighting business Sylvania to China's Feilo Acoustics for 34.5 million euros (Rs 2.4 bn). (BS)
- In an effort to beat Reliance Jio's free calls and cheaper data plans, Micromax Informatics and **Bharti Airtel** on Thursday tied-up to provide bundled services at an affordable price.(BL)

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

Equity

	11 May 17	% Chg 1 Day	1 Mth	3 Mths
Indian Indices				
SENSEX Index	30,251	0.0	2.0	6.8
NIFTY Index	9,422	0.2	2.4	7.2
BANKEX Index	25,949	0.0	4.9	12.0
SPBSITIP Index	9,907	0.3	(1.0)	(1.6)
BSETCG INDEX	17,995	(0.5)	2.9	16.2
BSEOIL INDEX	14,260	(0.9)	1.3	8.9
CNXMcap Index	18,361	0.0	4.4	13.1
SPBSSIP Index	15,653	(0.1)	5.4	15.1
World Indices				
Dow Jones	20,919	(0.1)	1.6	3.2
Nasdaq	6,116	(0.2)	4.8	6.7
FTSE	7,387	0.0	0.5	1.8
NIKKEI	19,962	0.3	6.8	2.3
HANGSENG	25,126	0.4	3.4	6.7

Value traded (Rs cr)

	11 May 17	% Chg - Day
Cash BSE	3,831	11.4
Cash NSE	25,377	4.4
Derivatives	749,218	64.7

Net inflows (Rs cr)

	10 May 17	% Chg	MTD	YTD
FII	1,365	(335)	(32)	41,980
Mutual Fund	924	192	3,413	24,095

FII open interest (Rs cr)

	10 May 17	% Chg
FII Index Futures	18,006	4.9
FII Index Options	66,586	3.4
FII Stock Futures	71,429	0.8
FII Stock Options	6,000	6.5

Advances / Declines (BSE)

11 May 17	A	B	T	Total	% total
Advances	129	427	75	631	39
Declines	169	674	91	934	58
Unchanged	1	21	11	33	2

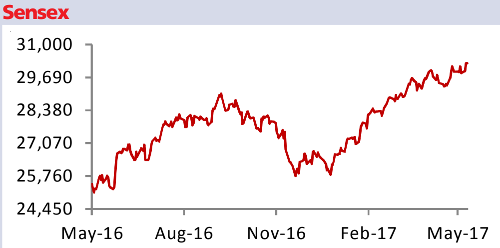
Commodity

	11 May 17	% Chg 1 Day	1 Mth	3 Mths
Crude (US$/BBL)	47.9	0.1	(9.8)	(11.1)
Gold (US$/OZ)	1,225.0	0.4	(3.8)	(0.5)
Silver (US$/OZ)	16.3	0.4	(10.5)	(8.5)

Debt / forex market

	11 May 17	1 Day	1 Mth	3 Mths
10 yr G-Sec yield %	6.9	6.9	6.8	6.8
Re/US$	64.4	64.6	64.5	67.0

Sensex



Result Update

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Summary table

(Rs mn)	FY17	FY18E	FY19E
Sales	467,220	518,642	563,232
Growth (%)	12.5	11.0	8.6
EBITDA	103,087	113,043	121,477
EBITDA margin (%)	22.1	21.8	21.6
PBT	104,049	112,586	121,977
Net profit	84,519	88,244	95,142
EPS (Rs)	59.8	64.0	69.0
Growth (%)	11.3	7.1	7.8
CEPS (Rs)	65.7	70.7	75.9
BV (Rs/share)	236.9	256.8	301.1
Dividend / share (Rs)	24.0	24.0	24.0
ROE (%)	17.8	16.9	16.1
ROCE (%)	21.4	21.3	20.3
Net cash (debt)	121,401	106,260	146,290
NWCapital (Days)	71.9	75.0	74.3
P/E (x)	14.0	13.1	12.2
P/BV (x)	3.5	3.3	2.8
EV/Sales (x)	2.3	2.1	1.8
EV/EBITDA (x)	10.3	9.6	8.6

Source: Company, Kotak Securities - Private Client Research

HCL Technologies Ltd (HCLT)

Price: Rs.839 **Recommendation: REDUCE**
Target Price: Rs.879 **FY19E P/E: 12.2x**

HCLT's results were lower than our expectations with CC revenue growth of 3.8% (v/s estimate of 4.9%) and EBIT margins at 20% (estimate at 20.4%). On an organic basis, QoQ growth was likely 1%, we believe. IMS lagged with just 0.8% growth whereas, Application services grew by 1.8% QoQ. We maintain that, the competition in IMS market is set to intensify with several players now focusing more on this segment. HCLT is making efforts to increase its relatively lower presence in the Digital / Platforms & Products space through the IBM IPR deal. We will watch out for sustainability and growth in the same. We also believe that, HCLT continues to face profitability challenges, in a bid to sustain high growth (SG&A spends at about 11.8% and 85.7% employee utilization rates (incl trainees)). HCLT has guided for a 10.5%-12.5% CC revenue growth in FY18. Organic growth guidance (excluding IBM deals, Geometric, Butler) is about 6.5% - 8.5%, we estimate. EBIT margin guidance stands at 19.5% - 20.5%. We tweak our EPS estimates for FY18 to Rs.64 (Rs.66.3). Our FY19E EPS stands at Rs.69 and our PT stands revised to Rs.879 (Rs.873, earlier), based on target valuations of about 13x FY19 earnings. With limited upsides from current levels, we maintain REDUCE and will wait for better prices to turn buyers in the stock.

FY18 guidance muted - CC revenue growth of 10.5% - 12.5%, EBIT margins at 19.5% - 20.5%

- HCLT, has guided for a CC revenue growth of 10.5% - 12.5% in FY18 with EBIT margins at 19.5% - 20.5%. We view the guidance as muted, especially ex-acquisitions.
- The IP sharing deals, which HCLT entered into in FY17, likely yielded about \$45mn - \$50mn in the first year of operation and their annualized revenue potential is now about \$160mn, according to the management.
- The Butler acquisition likely added about \$24mn in 4QFY17 and the Geometric acquisition about \$35mn in 4QFY17.
- After considering the full fiscal impact of these in FY18, we believe that, on an organic basis, the revenue growth guidance is at 6.5% - 8.5%, which is very much in line with what peers are expected to report.
- We have not considered the revenues which would accrue from the 4th IBP IPR deal signed by the company post 4QFY17 with committed investment of \$80mn.
- The FY18 EBIT margin guidance has been maintained at 19.5% - 20.5%, after assuming the rupee / USD exchange rate at 65.5. We believe that, the impact of acquisitions & salary hikes will keep margins range-bound, in absence of any other major levers.
- HCLT's utilization rates are at 85.6% and SG&A expenses at 11.8% of revenues, providing little scope for improvement.
- The company achieved EBIT margins of 20% in 4QFY17.
- HCLT and TCS are operating at high utilization levels whereas Infosys and Wipro have more space to use this lever to improve margins. HCLT's SG&A expenses are also lower at 11.7% of revenues, providing little scope for further moderation.

One more IP sharing deal - increasing presence in Digital / Products & Platforms

- HCLT has further extended its IP partnership with IBM for additional products in the areas of Information Management and Database Management Systems.
- Under this deal, both companies will collaborate on future roadmap and enhancements of those products and extend them to cloud and IoT applications. HCL has committed to invest ~$80mn towards this deal.
- HCLT has been looking at increasing its presence in the products / platforms space through these deals with IBM and this is the fourth such deal.
- The initial deal was for increasing presence in the legacy services and bringing in more automation in the same (Mode 1 : Application services, Business services, IMS and Engineering services).
- However, the other deals have been for products which will enhance presence in the Mode 2 types of services viz. Digital, IoT, Cloud and Security and Mode 3 services which is platforms and products.
- HCLT will be able to further develop the IPs, which will be the property of HCLT. Thus, HCLT has done away with the gestation period for developing these IPs.
- However, these IPs are mature and have been implemented across major global corporations. Thus, HCLT will have to further develop these mature IPs in order to earn significant revenues from the same.

4QFY17 - lower-than-expected

(Rs.mn)	3QFY17	4QFY17 **	QoQ %	4QFY16 *	YoY %
Revenues	**118140.0**	**120530.0**	**2.02**	**106980.1**	**12.67**
Expenditure	91860.0	94040.0		83189.7	
Operating Profit	26280.0	26490.0	0.80	23790.4	11.35
Depreciation	2200.0	2330.0		1570.0	
Gross Profit	**24080.0**	**24160.0**		**22220.4**	**8.73**
Interest	0.0	0.0		0.0	
Other Income	2310.0	2119.4		2000.0	
PBT	**26390.0**	**26279.4**	**-0.42**	**24220.4**	**8.50**
Tax	5690.0	3030.0		4970.0	
PAT	**20700.0**	**23249.4**	**12.32**	**19250.4**	**20.77**
Adj. PAT	**20700.0**	**23249.4**	**12.32**	**19250.4**	**20.77**
Shares (mns)	1413.5	1413.5		1406.0	
EPS (Rs)	**14.6**	**16.4**		**13.7**	
OPM (%)	22.2	22.0		22.2	
GPM (%)	20.4	20.0		20.8	
NPM (%)	17.5	19.3		18.0	

Source : Company
** - FY16 was for 9 month period. Hence, YoY comparable quarter is 3QFY16*
*** - Includes Geometric (1M) & Butler (3M) numbers*

CC growth of 3.8% was lower than estimates

- Revenues grew by 3.8% in CC terms (3% in 3Q, 2.8% in 2QFY17, 3.5% in 1Q).
- This was lower than our expectations of 4.9% growth. During the quarter, Butler's financials were consolidated for 3months and Geometric's financials for 2 months.
- Excluding these, the revenue growth was likely about 1%, we estimate.
- Except in 2QFY15, the organic revenue growth rates have been relatively lower for HCLT, despite winning several large deals over the past few quarters.

Engineering services grew by 15% QoQ (acquisition-led); Application / IMS up by 1.8% / 0.9%

- Engineering services reported a 15% QoQ growth in 4Q. While this is high, we believe that, growth rates were helped by the acquisition of Geometric / Butler and also accrual of revenues from the IPR deal.
- HCLT is favourably placed in the Engineering vertical. Its focus on Manufacturing, Transport, automotive, aviation, etc gives it a head-start over peers, we believe.
- HCLT is seeing several M&A opportunities in this business and has been beefing up its capabilities through this route. The acquisitions of Butler / Geometric are cases in point.
- However, we also note that, this is also a project-based business, which may take time to become annuity based through larger and longer term projects.
- To that extent, we expect volatility in this business to also continue and scale-up may take time.
- Application services revenues grew by 1.8% QoQ. It had reported CC growth rates of 2% in 3Q and 1.9% in 2Q. The business had grown at a rate of sub-2% QoQ for several quarters in the past three years.
- HCLT has lagged behind peers in this service line and will have to strengthen its offerings significantly to compete with larger peers.
- HCLT is witnessing stress in the new ERP implementation business with most ERP OEMs increasingly focusing on Cloud.
- IMS, which has been the growth engine for HCLT for the past several quarters, reported a tepid 0.9% growth in 4Q, following a 2.1% growth in 3Q.
- While the annual growth in IMS over the past two years is encouraging and has been led by the leadership position of HCLT in the re-bid market, the dependence on this business is high. IMS contributed about 40% of HCLT's FY17 revenues. We have been concerned about this over the past few quarters.
- The IMS re-bid market is now facing higher degree of competition, with other large peers also increasing focus on the same.
- Several of HCLT's contracts may come up for re-bid and face increased participation from peers. To that extent, we believe that, it is important for HCLT to start improving the growth of the other businesses.

Services - Constant Currency Growth QoQ (%)

	1QFY17	2QFY17	3QFY17	4QFY17
Application Services	1.90	1.40	2.00	1.80
Infrastructure Services	16.50	4.40	2.10	0.90
Business Services	(15.90)	2.10	2.90	0.20
Engg & R&D Services	0.70	2.30	7.10	14.60

Source : Company

Digital business being beefed up; scale up in Mode 2/3 services

- On the other hand, Digital is witnessing significant traction with organisations across manufacturing, BFSI, Retail, etc looking to digitize parts of their businesses.
- HCLT is making investments in Digital and has seen traction in its integrated offerings like Next-Gen ITO, BEYONDigital and IoT WoRKS. These offerings are in emerging areas like Internet of Things, cloud, automation and artificial intelligence.
- According to the management, Digital revenues currently form 20% of HCLT's Applications business. On an overall basis, the contribution to revenues is much lower, we believe.
- However, we believe that, HCLT needs to invest further in Digital, to support the growth in Applications services.
- HCLT has broken down its services into
  - **Mode 1** - core services in areas of Applications, Infrastructure, BPO and Engineering & R&D (using DRYiCE autonomics),
  - **Mode 2** - outcome-based integrated offerings of Digital & Analytics, IoT WoRKS™, Cloud Services and Cybersecurity and
  - **Mode 3** - IP-based next-gen opportunities.
- According to the management, while Mode 1 services grew by 8.3% in FY17, Mode 2 and Mode 3 services revenues grew by 16.4% and 80.2%, respectively (partly led by acquisitions).
- Mode 2 / 3 services revenues are up to 18.6% of FY17 revenues as compared to 15.9% in FY16.
- HCLT won 8 transformational deals during the quarter.
- The order booking for HCLT has consistently remained above the $1bn mark for the past several quarters.
- However, the revenue growth has not reflected the full impact of these large deals, and we need to see traction in revenues in the future quarters.

EBIT margins fell by 40bps QoQ

- EBIT margins fell by 40bps on a QoQ basis. 4Q saw remaining salary hikes, which likely had an impact of about 10bps in 4Q. Margins were further impacted by about 50bps due to the currency fluctuations.
- These were partly set-off by increased deployment of automation tools across projects and other cost optimization initiatives.
- HCLT is increasingly focusing on automation and the DryICE platform has now been implemented in over 200+ projects.
- Once again, on an organic bases, SG&A expenses have remained stable, we understand. The management has indicated that, while S&M expenses are increasing, G&A expenses are being rationalized, partly due to converting leased property into owned. However, these are expected to stabilize at around 12%, the management said.
- We have been concerned over the past few quarters that, S&M expenses will not be a margin lever and even G&A expenses may increase in line with the additional spends which the company has made and will need to make towards in Digital services and the applications portfolio.
- We maintain that, SG&A expenses, which are 11.8% of revenues, may not be a big driver of margins, going ahead.
- Moreover, the employee utilization levels (including trainees) are at 85.7%.

- This is a relatively high level and the company may find it difficult to increase this significantly from the current levels, especially in the backdrop of the 18% attrition rate in IT services
- Thus, the company will find it difficult to squeeze further margin benefits out of the same, we believe.

Future prospects

- Revenues are expected to rise by 12% in FY18 and 9% in FY19, in USD terms. The IBM IP deal revenues have accrued from 3QFY17. The Butler acquisition and Geometric acquisition have been consolidated WEF 4QFY17. Excluding these, we expect about 8.5% growth in FY18.
- HCLT has signed one more deal with IBM and revenues from the same will also accrue in FY18. If we exclude these, the organic growth would be even lower, we opine.
- For FY19, we expect revenues to grow by about 9% in USD terms.
- We expect the rupee to average about 66.3 / USD in FY18 and 66.1 / USD in FY19.
- Margins are expected to be slightly lower in FY18 / FY19, as compared to FY17. The consolidation of acquisitions and salary increments are expected to be offset by higher automation, higher offshore proportion, cost optimization initiatives and improved profitability in the current low-margin projects.
- We expect the company to report an EPS of Rs.64 in FY18 (Rs.66.3 earlier) and Rs.69 in FY19.

Valuations

- HCLT's organic revenues have likely grown by about 8.3% in FY17 and are expected to grow by about 8.5% in FY18. This will be almost in line with the growth rates expected from larger peers.
- HCLT is making efforts to increase its relatively lower presence in the Digital / Products & Platforms spaces through the IBM IPR deal. We will watch out for the success and sustainability of the same.
- On the other hand, HCLT's margins are lower as compared to most of the larger industry peers.

We maintain REDUCE on HCL Technologies Ltd with a price target of Rs.879

- We believe that, SG&A leverage is likely to have a muted impact, going ahead. Utilization levels including trainees at about 85.7% also provide little scope of improvement.
- Thus, we accord a suitable valuations discount as compared to Infosys and TCS.
- We maintain **REDUCE** with a FY19-based PT of Rs.879 (Rs.873, earlier). At our TP, FY19 estimates will be discounted by about 13x.
- We will watch out for the sustainability and improvement of growth rates, going ahead.

Concerns

- A delayed recovery in major user economies may impact our projections.
- A sharp acceleration in the rupee from our assumed levels may impact our earnings estimates for the company.

RESULT UPDATE

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BLUE STAR LTD

PRICE: RS.676 **RECOMMENDATION: ACCUMULATE**
TARGET PRICE: RS.727 **FY19E P/E: 24.9x**

Blue Star (BSL) reported higher than expected revenue led by good performance by MEP as well as Unitary Cooling divisions. However, margins came in lower than expected due to enhanced spending on brand building and corporate expenses. These expenses were mainly in view of the recent product launches (Cooler and Water Purifier). This led to a miss in the reported profits. That apart, the company reported healthy order intake. It also reported improved working capital efficiency resulting robust cash generation. On a net basis, despite the profit miss, we believe that the performance was strong.

We have been bullish on Blue Star as we believe that the room AC sector offers potential for an extended period of high growth due to rising disposable incomes and under-penetration of product within the consumer durable basket. The stock has rallied strongly in the past three months and in view of this, we temper our bullishness on the stock and maintain "ACCUMULATE", thereby advising investors to buy the stock on declines. We revise our TP higher to Rs.727 (earlier Rs.555 based on 26x FY18E earnings).

Summary table - Standalone

(Rs mn)	FY17	FY18E	FY19E
Sales	41121	49595	59464
Growth (%)	16.4	20.6	19.9
EBITDA	1995	2965	3597
EBITDA margin (%)	4.9	6.0	6.0
PBT	1,483	2,600	3,260
PAT	1,120	1,963	2,445
EPS (Rs)	13.1	21.8	27.2
Growth (%)	60.7	66.5	24.5
CEPS	19.2	28.4	34.6
BV (Rs/share)	100.0	112.4	130.3
Dividend/share (Rs)	7.5	8.0	8.0
ROE (%)	13.4	20.2	22.0
ROCE (%)	12.2	19.2	21.4
Net cash (debt)	-712.3	1708.7	3960.2
NW Capital (Days)	-35.7	-25.4	-20.5
EV/Sales (x)	1.4	1.2	0.9
EV/EBITDA (x)	29.7	19.6	15.5
P/E (x)	51.5	31.0	24.9
P/Cash Earnings	35.2	23.8	19.5
P/BV (x)	6.6	5.9	5.1

Source: Company, Kotak Securities - Private Client Research

Quarterly financials

(Rs mn)	Q4FY17	Q4FY16	YoY (%)
Gross Sales	**13044**	**11135**	**17.1**
Excise	118	103	14.4
Net sales	**12925**	**11031**	**17.2**
Raw material costs	5959	4858	22.7
Purchase of Stock in Trade	3277	3253	0.7
Staff costs	827	716	15.5
Other expenditure	2234	1672	33.6
Total Expenditure	12296	10498	17.1
PBDIT	**629**	**533**	**18.0**
Other income	82	104	-21.7
Depreciation	152	152	0.0
EBIT	**559**	**486**	**15.0**
Interest	100	91	9.3
PBT	**460**	**395**	**16.4**
Tax	134	37	264.9
PAT before non recurring items	326	358	-9.1
Exceptional items	0	-188	-100.0
provision for previous years	0	0	
Reported PAT	**326**	**170**	**91.5**
EPS Rs per share	3.6	4.0	
PBDIT (%)	4.9	4.8	
Raw material cost to sales (%)	70.8	72.8	
Other expenditure to sales (%)	17.1	15.0	
Staff costs to sales (%)	6.3	6.4	
Tax rate (%)	29.1	9.3	

Source: Company

Earnings estimate

(Rs mn)	Reported	Estimated	Remarks
Revenue	12,925	13,199	In line revenue growth
EBITDA %	4.9%	6.2%	margin miss due to high other expenditure
Adj PAT	325.70	530.00	leading to significant slippage in profits

Source: Kotak Securities - Private Client Research

Result Highlights

- In a seasonally strong quarter, BSL reported revenues of Rs 12.9 bn, up 17.1% on a yoy basis.
- Segment-wise, the Electro Mechanical Projects and Packaged Airconditioning Systems business accounted for 51% of the total revenues in the quarter. Revenue growth in this segment was healthy at 22% y-o-y for the quarter. The segment had been going through a prolonged phase of challenging business scenario in commercial real estate characterized by tight liquidity and elevated interest rates. However, outlook has started to improve, as reflected by the enhanced growth in revenue and order book. While the revenue and profitability in this were in line with the expectations during the quarter, execution rate continues to remain slow thereby delaying recovery in margins, the management opined.
- Unitary Cooling Products segment (Room ACs mainly) accounted for 49% of the total revenues of the company during the quarter as it being a seasonally strong one for the segment.
- This segment registered a growth of 20% yoy for the quarter driven mainly by early onset of summer in 2017, enhanced penetration, aggressive sales promotion and higher channel productivity. This segment continue to ride on structural demand drivers including increasing disposable income, favourable climate and low penetration among households.
- The market for room ACs grew by 10% y-o-y while BSL's sales volume rose 17% in the fourth quarter.
- The market growth was impacted due to 1) demonetization and 2) Cooler weather in Southern India.

Segment Revenue

(Rs mn)	Q4 FY17	Q4FY16	YoY (%)
Central AC (MEP)	6644	5456	22
Unitary Cooling products	6483	5400	20
Professional electronics	16	178	19

Note: "Others" include the revenue from IT business of BSIL which has been hived off in FY16.

Significantly higher "other expenditure" results in margin miss

The MEP (Mechanical Electrical & Plumbing) segment reported 330 bps expansion in EBIT margin. While the market witnessed modest growth propelled by Government-funded infrastructure projects, profitability of this segment grew mainly due to execution of higher order book in select sub-segments and also an increase in billing from new projects.

Segment margins in "Unitary Cooling products" margins remained stable on a y-o-y basis.

However, overall margins in Q4FY17 was impacted by higher "Other expenditure" which mainly included brand building expenses (additional Rs 100 mn in Q4 and Rs 300 mn in FY17), technology spends and office renovation expenses. The increase is also due to investments made for new products like Air coolers and water purifiers.

Segment margins

(%)	Q4 FY17	Q4FY16
Central AC (MEP)	5.1%	2.8%
Unitary Cooling products	10.7%	10.8%

Source: Company

Order book up 21% y-o-y

Order book at the end of Q4FY17 stands at Rs 19.4 bn, up 21% on a y-o-y basis. We note that the order book is the highest since Q1FY13, indicating that the demand revival has picked up meaningfully.

Although the traditional drivers of the MEP segment (IT/ITES and Retail) have remained muted, the company is seeing traction from Government-funded infrastructure projects.

Conference call highlights

- The company launched the Water Purifiers business in the third quarter and is in the process of ramping up sales across the country. This segment sees robust demand post the summer season and BSL has launched a large portfolio of products to meet demand.
- The company expects to continue making investments in brand-building in the water purifier business at least till H1FY18.
- The company's market share in room ACs stood at 11.5% vs 10.5% on a y-o-y basis.
- The current quarter has started on a strong note due to early onset of summer heat across India. Considering this, the management expects its room AC sales to grow by 30% in Q1FY18.
- For FY18, the management expects the room AC industry to grow by ~ 15% and BSL expects to grow at a faster rate.
- The management expects rising commodity prices to impact from Q1FY18.
- "Other unallocable expenditure" for FY17 (Standalone) grew 18% mainly due to the brand building and technology related expenses. The management expects the thrust on brand building would continue in FY18 as well.
- Capex for FY17 was at Rs 1.0 bn comprising of 1) Rs 300 mn on acquisition of land in Jammu 2) Maintenance and R&D expenses.
- Cash flow has improved in the "MEP" segment and this is reflected in reduction in borrowings.
- As of FY17, the borrowings on a "Standalone" basis has reduced to Rs 1.49 bn vs Rs 2.85 bn y-o-y.

Subsidiary performance

Blue Star Engineering and Electronics

This subsidiary houses the Professional Electronics and Industrial Systems business. The revenues increased by 13% from Rs 1.9 bn, while segment sesults registered an increase of 7% to Rs 324.8 mn driven by some large surveillance projects billed during the year.

Earnings Revision FY18

(Rs mn)	Earlier	Revised
Revenue	49976	49595
EBITDA (%)	6.4%	6.0%
EPS (Rs)	22.20	21.8
% change		-2%

Source: Kotak Securities - Private Client Research

We remain positive on the room AC industry. However, due to modest upside, we Maintain "Accumulate" (Buy on declines)

We maintain ACCUMULATE on Blue Star Ltd with a price target of Rs.727

We have been bullish on Blue Star as we believe that the room AC sector offers potential for an extended period of high growth due to rising disposable incomes and under-penetration of product within the consumer durable basket. The stock has rallied strongly in the past three months and in view of this, we temper our bullishness on the stock and maintain **"ACCUMULATE",** thereby advising investors to buy the stock on declines.

Segment

	Target PE	Est FY19 EPS	Target Price
UCP	30	14.9	447
Projects	20	12.3	246
subsidiary - BSEEL	15	2.3	34
Total			727

Source:

HAVELLS INDIA LTD (HIL)

RESULT UPDATE

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PRICE: RS.514 **RECOMMENDATION: SELL**
TARGET PRICE: RS.460 **FY19E P/E: 33.3x**

HIL reported Q4FY17 result in line with our estimates driven by strong YY growth in switchgear, consumer appliances and cables division. Operating margins contracted YoY due to partial continuation of dealer incentives to counter demonetization and increased employee expense.

We roll forward our target price on FY19; value HIL stock at 30x FY19 estimated earnings (33x FY18 earnings earlier) and owing to the downside to our target price (stock outperformed significantly in past few trading sessions) move recommendation to 'SELL' from 'Accumulate' with revised price target of Rs 460 (Rs 418 earlier).

Summary table

(Rs mn)	FY17	FY18E	FY19E
Sales	61,352	89,697	102,120
Growth (%)	14.1	46.2	13.8
EBITDA	8,241	11,865	13,724
EBITDA margin (%)	13.4	13.2	13.4
PBT	8265	11375	13214
Net profit	5,968	8,304	9,646
EPS (Rs)	9.6	13.3	15.5
Growth (%)	17.6	39.1	16.2
CEPS (Rs)	11.5	15.5	17.6
BV (Rs/share)	54.0	60.3	67.7
DPS (Rs)	3.5	4.5	5.5
ROE (%)	29.0	32.7	30.3
ROCE (%)	24.8	26.1	25.3
Net cash (debt)	13,051	8,364	10,109
NW Capital (Days)	-55.6	-53.9	-54.4
EV/Sales (x)	5.0	3.4	3.0
EV/EBITDA (x)	37.0	25.7	22.2
P/E (x)	53.9	38.7	33.3
P/Cash Earnings (x)	44.9	33.3	29.2
P/BV (x)	9.5	8.5	7.6

Source: Company, Kotak Securities - Private Client Research

Quarterly performance - Standalone

(Rs mn)	Q4FY17	Q4FY16	% YoY	Q3FY17	QoQ%
Net Income	**17102**	**14597**	**17.2**	**15061**	**13.6**
Decrease/ (Increase) in stock	184	(158)		532	
Raw Material consumed	10231	8745	17.0	8610	18.8
Employee expenses	1312	1004	30.6	1238	5.9
Forex fluctuation	0	0		(22)	
Other expenses	2676	2400	11.5	2243	19.3
advertising expenses	404	388	4.3	531	
Total expenditure	14806	12379	19.6	13131	12.8
EBITDA	**2296**	**2218**	**3.5**	**1930**	**19.0**
Other income	419.3	298.0	40.7	264.0	58.8
Depreciation	307.7	274.1	12.3	301.0	2.2
EBIT	**2408**	**2242**	**7.4**	**1893**	**27.2**
Finance Cost	71	46	53.7	15	364.1
Exceptional items	(767.0)			189.5	
Adj.PBT	**2337**	**2196**	**6.4**	**1878**	**24.5**
Tax	622	567	9.8	537	15.8
Reported PAT	948	3653	(74.1)	1530	(38.1)
Adjusted PAT	1715	1629	5.3	1341	27.9
Adj EPS	**2.7**	**2.6**	**5.3**	**2.1**	**27.9**
EBITDA (%)	13.4	15.2		12.8	
PAT (%)	10.0	11.2		8.9	
RM/Sales (x)	60.9	58.8		60.7	
Tax Rate (%)	26.6	25.8		28.6	

Source: Company

Result highlights

Havells reported 17.2% YoY revenue growth (standalone; net of Excise) at Rs 17 Bn in Q4FY17 driven by switchgears, cables and consumer durable segment. Operating margin contracted YoY to 13.4% in Q4FY17 against 15.2% in Q4FY16. Company has been gradually withdrawing various dealer schemes introduced earlier to counter demonetization. Operating margin also contracted on back of c.30$ YY increase in employee expense to Rs 1.3 Bn from Rs 1 Bn in Q4FY16 driven by inclusion of high cost resources in the strategy team. Management believe that there shall be volume led margin improvement going ahead.

Consumer reported 28.4% YY revenue growth at Rs 3.9 Bn in the quarter primarily led by water heater segment. Consumer durable segment reported contribution margin at 24% against 27.6% in Q4FY16.

Cable and wire division reported 12% YoY revenue growth at Rs 7.6 Bn in Q4FY17 led by 11% YoY volume growth. Further, revenue growth in cable division is partly aided by increase in commodity prices. 150 bps contraction in contribution margins is explained by the timing miss-match between the increases in commodity prices and pricing action taken by the company to offset its impact.

Lighting division reported flat YY revenue growth at Rs 2.3 Bn in the quarter, driven by LED lighting. Traditional lighting and CFL continues to de-grow (industry wide phenomenon; demand is shifting to new LED based technology at a rapid pace). Ex-CFL, lighting division grew 23% YY.

Switchgear division reported muted 15%YY revenue growth at Rs 3.9 Bn on the lower base of Q4FY16. Uptick in low cost housing augers well for company's reo range of products. Contribution margins stood at 36.8% in the segment vis-à-vis 37.3% in Q4FY16.

In Q4FY17, Havells board has approved divesting remaining 20% stake in Feilo Malta (FML) for EUR 34.5 mn (marking a complete exit from Sylvania) and Sylvania Thailand limited for consideration of EUR 1.6 mn. This has led to the an exceptional loss of Rs 767 mn pertaining to the a) impairment loss of Rs 610 mn on its investment in Havells Holdings limited and b) impairment loss of Rs 146 mn on account of termination of JV agreement in Jiangsu Havells Sylvania Lighting Company.

Segment reporting (Standalone)

	Q4FY17	Q4FY16	YoY (%)	Q3FY17	QoQ (%)
Standalone Revenues (Rs mn)					
Switchgear	3913	3401	15.1	3459	13.1
Cable and Wires	7601	6785	12.0	6829	11.3
Lighting and fixtures - India	2399	2406	-0.3	2248	6.7
Electrical consumer durables	3970	3092	28.4	3436	15.5
PBIT (Rs mn)					
Switchgear	1441	1269	13.5	1290	11.7
Cable and Wires	875	884	-1.0	869	0.7
Lighting and fixtures - India	635	559	13.6	641	(0.9)
Electrical consumer durables	951	853	11.5	809	17.5
PBIT (%)					
Switchgear	36.8	37.3		37.3	
Cable and Wires	11.5	13.0		12.7	
Lighting and fixtures - India	26.5	23.2		28.5	
Electrical consumer durables	24.0	27.6		23.6	

Source: Company

Other Highlights

- Havells management has guided for the capex in the range of Rs 2.6-3 Bn for FY18 towards capacity addition in -Cables, Switchgear and ECB segments.
- Management refrained from sharing view/plans with respect to Lloyds operations. Broadly company would focus on enhancing market share/margin profile in Lloyd going ahead.

Background

Havells recently concluded the acquisition of Lloyd consumer durable business for an EV of Rs 16 Bn on debt/cash free basis. The acquisition would provide Havells entry into the consumer durable market (mainly white goods).

Valuation and Recommendation

We recommend SELL on Havells India Ltd with a price target of Rs.460

We roll forward our target price on FY19; value HIL stock at 30x FY19 estimated earnings (33x FY18 earnings earlier) and owing to the downside to our target price (stock outperformed significantly in past few trading sessions) move recommendation to **'SELL'** from 'Accumulate' with revised price target of Rs 460 (Rs 418 earlier).

RESULT UPDATE

Teena Virmani
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THE PHOENIX MILLS LTD (PML)

PRICE: RS.411 **RECOMMENDATION: BUY**
TARGET PRICE: RS.477 **FY19E P/E: 21.1x**

Revenues of the company during the quarter and full year were largely in line with our estimates and margins also stood strong on improvement in rentals across market cities. Interest expense has witnessed a decline which aided net profits. Net profit for Q4FY16 was impacted by exceptional loss related to EWDL hence net profit is not comparable with last year. Going ahead, the focus of the company will be on new investments post funding by CPPIB along with debt reduction. Renegotiation of rentals across malls, debt reduction coupled with lower interest rates is likely to aid net profit growth going forward.

We roll forward our target price on FY19 estimates and also incorporate lower capitalization yield post the commencement of inflow of funds from CPPIB. We thus arrive at a revised price target of Rs 477 on FY19 estimates (Vs Rs 424 earlier on FY18 estimates). We thus upgrade the stock to BUY from ACCUMULATE earlier.

Summary table

(Rs mn)	FY17E	FY18E	FY19E
Sales	18,246	21,428	22,296
Growth (%)	3%	17%	4%
EBITDA	8,469	9,729	9,966
EBITDA margin (%)	46.4%	45.4%	44.7%
PBT	2,758	4,102	4,551
Net profit	1,910	2,690	3,000
EPS(Rs)	12.5	17.6	19.6
Growth(%)	128%	41%	12%
CEPS(Rs)	25.2	30.5	32.7
BVPS(Rs)	132.0	146.9	163.9
DPS (Rs)	2.2	2.2	2.2
ROE (%)	9.8	12.6	12.6
ROCE (%)	11.3	13.3	13.5
Net debt	34,224	32,278	28,475
NW capital (Days)	225.1	225.1	225.1
P/E (x)	33.1	23.5	21.1
P/BV (x)	3.1	2.8	2.5
EV/Sales (x)	5.3	4.4	4.0
EV/EBITDA (x)	11.3	9.6	9.0

Source: Company, Kotak Securities - Private Client Research

Financial highlights

(Rs mn)	Q4FY17	Q4FY16	YoY (%)
Net Sales	**4544.03**	**4659.8**	**-2.5%**
Total Expenditure	2547.3	2610.88	
EBITDA	**1996.73**	**2048.92**	**-2.5%**
EBITDA %	44%	44%	
Depreciation	517.71	476.8	
EBIT	**1479.02**	**1572.12**	**-5.9%**
Interest	992	1201	
EBT(exc other income)	487	371	
Other Income	203.1	77.5	
PBT	**690**	**449**	**53.8%**
Exceptional item	0	-320.8	
PBT after exc item	690	128	
Tax	178	233	
Tax (%)	26%	52%	
PAT	**512**	**-105**	
Minority interest	0	0	
Share of profit of associates	1.724	4.65	
Net profit	514	-101	
Other comprehensive income	62	-30	
Total income	576	-130	
Equity Capital	306.1	305.97	
Face Value (In Rs)	2	2	
EPS (Rs)	**3.36**	**-0.66**	

Source: Company

Revenues in line with our estimates

High Street Phoenix: During Q4FY17, high Street Phoenix has registered 8% YoY improvement in rental income while average trading density has increased by 6% YoY. Current average rentals stand at nearly Rs 313 per sq ft per month (vs Rs 295 per sq ft per month during Q4FY16) and the new lease deals have significantly higher minimum guarantee than the current mall average.

Market cities: For the quarter, Chennai market city revenues grew by 6%YoY and were led by 9% YoY improvement in rental income. Rentals per sq ft were up by 9% YoY. Consumption and trading density for Chennai market city were down YoY during Q4FY17. Bengaluru market city revenues have witnessed an increase of 14% YoY with 15% YoY improvement in rental income, 18% improvement in consumption and 18% improvement in trading density. Rentals per sq ft for Bengaluru market city were up by 10% YoY. Consumption and trading density are witnessing an improvement for Kurla market city but rentals witnessed a decline of 7% YoY. Pune market city has seen 17% improvement in revenues led by 24% improvement in rental income and 10% YoY improvement in trading density. Rentals per sq ft for Pune market city were up by 14% YoY. Total rental income for the company for FY17 stood at Rs 7.7 bn, up 9% YoY.

Renewals expected going forward: High Street Phoenix and Palladium has 13%/18%/23% renewals expected in FY18/19/20 respectively. Bangalore market city lease renewals for nearly 8%/3% of the area are likely to come during FY18/FY19 respectively while for Chennai market city, lease renewals of 46% are likely to come during FY18. Pune market city is likely to see 4%/15% lease renewals during Fy18/19 respectively while Kurla market city is likely to see 9%/10% lease renewals during Fy18/19 respectively. These renewals are likely to aid rental growth for the company.

Residential portfolio - For One-Bangalore West, it commenced hand over for flats for Towers 1-5 while for Kessaku project, construction pace is maintained. We believe that continued slowdown in real estate is likely to impact residential revenues from the pending area yet to be sold.

Hotels portfolio - Q4 FY17 room occupancy at St Regis, Mumbai stood at 79% at an ARR of Rs. 11798 while room occupancy at Courtyard by Marriott, Agra stood at 71%. Company expects the occupancies to move up further going forward based on advance bookings done so far.

We revise our estimates to factor in FY17 financials and also incorporate FY19 estimates. We expect consolidated revenues to grow at a CAGR of 10.5% between FY17-19.

Strong margins and lower interest expenses aided net profits

Operating margins of the company stood at 44%. Gross borrowing on standalone basis stood flat at Rs 7.5 bn while consolidated borrowings moved up to Rs 39.5 bn (Rs 39.2 bn during Q3FY17). Out of the total consolidated borrowings of Rs 39.5 bn, 93% is lease rental discounting and LRD equivalent debt. Bankers have reduced the interest rate for debt at PML (standalone) and Vamona to sub-10%. Reduction of interest rates at Offbeat and debt refinance at Graceworks and UPAL have brought overall interest rate to 10.16%.

During Q1FY18, PML and Canada Pension Plan Investment Board (CPPIB) have signed definitive agreement to develop, own and operate retail-led mixed-use developments across India. CPPIB now owns 30% of the platform with an initial investment of Rs 7.24 bn which has already come to the company. It would then invest Rs 9 bn for buying the additional stake to take it to 49%. The entire amount of Rs 16 bn will come into Island Star Mall Developers which would be utilized for creating leadership assets across the country. They can either buy existing operating assets and ramp them up to the standards of PML or can buy the land, develop and operate the malls. Post money valuation comes at around Rs 32.65 bn which translates into a capitalization yield of 5-6% as against 9-10% used currently to value retail assets.

Phoenix Market city Bangalore has a gross leasable area of 1 mn sq ft and is centrally located in Whitefield. Company has mentioned that this retail asset still has 2 mn sq ft of additional development potential and company would intend to expand the size of the mall by 0.25-3 mn sq ft in the first phase. Later it would take remaining area in further phases.

Along with this, company is evaluating opportunities in Hyderabad, Ahmedabad, and Kolkata, and tier-II cities such as Lucknow and Indore. It bought an under-construction mall in Indore's MR 10 area for Rs 2.35 bn.

Going ahead, the focus of the company will be on new investments post funding by CPPIB along with debt reduction. Renegotiation of rentals across malls, debt reduction coupled with lower interest rates is likely to aid net profit growth going forward.

Valuation and recommendation

We recommend BUY on The Phoenix Mills Ltd with a price target of Rs.477

At current price of Rs 411, stock is trading at 23.5x and 21.1x P/E and 9.6x and 9.0x EV/EBITDA on FY18 and FY19 consolidated estimates. We continue to remain positive on the company as we believe that company is likely to benefit from improved rentals in its market cities, lower interest rates as well as reduction in leverage going forward. We believe that residential segment may continue to see subdued demand which can also impact further launches of the company.

We roll forward our target price on FY19 estimates and also incorporate lower capitalization yield post the commencement of inflow of funds from CPPIB. We thus arrive at a revised price target of Rs 477 on FY19 estimates (Vs Rs 424 earlier on FY18 estimates). We thus upgrade the stock to **BUY** from ACCUMULATE earlier.

Sum of the parts valuation based on FY19

	Phnx Stake	Area (mn sq ft)	Avg rent (Rs/sq ft/m) or rate per sq ft	Value (Rs mn)	Per share
High Street Phoenix	**100%**	**0.9**	**335**	**39805**	**260**
Phase IV @ HSP	100%	0.25		7000	46
Market cities					
Pune	87.00%	1.13	100	5732	37
Kurla	75.00%	1.11	88	2006	13
Bangalore(East)	100.0%	0.98	107	6782	44
Chennai	50.01%	1	127	6280	41
Bangalore(W)-Residential	100%	1.8	9300	1793	12
Big Apple	**74%**		**35-40**	**884**	**6**
Hospitality	**53%**			**2705**	**18**
Total					**477**

Source: Kotak Securities - Private Client Research

RESULT UPDATE

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HERO MOTOCORP (HMC)

PRICE: RS.3462 **RECOMMENDATION: ACCUMULATE**
TARGET PRICE: RS.3691 **FY19E P/E: 16.9x**

HMC's 4QFY17 results were impacted on account of one-off high level of discounting to clear BSIII inventory before Supreme Court deadline and increase in commodity prices. Reported revenues for the quarter came in at Rs69bn (8% lower YoY), EBITDA margin at 13.8% (down YoY and QoQ) and PAT of Rs7.2bn (14% decline YoY). However, adjusted for one-off, EBITDA margin stands at 16.2%. For FY18, management sounded upbeat about volume growth and have guided for double-digit growth and outperforming the domestic two wheeler industry. On the EBIDTA margin front, the company indicated that they will look at controlling cost and maintain healthy margins. We believe that recovery in rural demand, largely supported by expected good monsoons, will be a key volume growth driver for the company. While we expect healthy volume growth for the company (10% volume CAGR over FY17-19E), we believe it will be difficult for the company to outperform industry growth. We maintain our positive view on the stock and rate the stock as ACCUMULATE (earlier BUY) with unchanged price target of Rs3,691.

Summary table

(Rs mn)	FY17E	FY18E	FY19E
Sales	284,750	326,737	348,630
Growth (%)	(0.4)	14.7	6.7
EBITDA	46,348	53,925	56,388
EBITDA margin (%)	16.3	16.5	16.2
PBT	46,585	55,210	58,500
Net profit	33,771	39,475	40,950
EPS (Rs)	169.1	197.7	205.1
Growth (%)	7.8	16.9	3.7
CEPS (Rs)	193.8	224.2	233.6
BV (Rs/share)	506.3	583.6	656.3
Dividend / share (Rs)	85	100	110
ROE (%)	37.4	36.3	33.1
ROCE (%)	49.9	48.9	45.8
Net cash (debt)	46,776	61,984	68,444
NW Capital (Days)	(9.0)	(11.1)	(10.7)
P/E (x)	20.5	17.5	16.9
P/BV (x)	6.8	5.9	5.3
EV/Sales (x)	2.3	1.9	1.8
EV/EBITDA (x)	13.9	11.7	11.0

Source: Company, Kotak Securities - Private Client Research

Quarterly performance

(Rs mn)	4QFY17	4QFY16	YoY (%)	3QFY17	QoQ (%)
Revenues	**69,152**	**75,052**	**(7.9)**	**63,646**	**8.7**
Total expenditure	59,576	63,160	(5.7)	52,853	12.7
RM consumed	47,361	49,636	(4.6)	41,233	14.9
Employee cost	3,281	3,515	(6.7)	3,743	(12.3)
Other expenses	8,935	10,010	(10.7)	7,878	13.4
EBITDA	**9,576**	**11,892**	**(19.5)**	**10,793**	**(11.3)**
EBITDA margin (%)	13.8	15.8	-	17.0	-
Depreciation	1,353	1,147	17.9	1,244	8.8
Interest cost	15	12	22.3	15	(2.6)
Other Income	1,182	1,168	1.3	1,319	(10.4)
Exceptional item			-		-
PBT	**9,390**	**11,900**	**(21.1)**	**10,853**	**(13.5)**
PBT margins (%)	13.6	15.9		17.1	
Tax	2,213	3,567	(38.0)	3,133	(29.4)
Tax rate (%)	23.6	30.0	-	28.9	-
Reported PAT	**7,178**	**8,333**	**(13.9)**	**7,720**	**(7.0)**
PAT margins (%)	10.4	11.1	-	12.1	-
Other Comprehensive Income	(36)	4		-	
Total Comprehensive Income	7,142	8,337	(14.3)	7,720	(7.5)
EPS (Rs)	**35.9**	**41.7**	**(13.9)**	**38.7**	**(7.0)**
Volumes (nos)	16,21,805	17,21,240	(5.8)	14,73,548	10.1
Net Realization (Rs)	42,639	43,603	(2.2)	43,192	(1.3)
RM cost per vehicle (Rs)	29,203	28,837	1.3	27,982	4.4

Source: Company

Result Highlights

- In 4QFY17, HMC's performance was impacted by one-off cost (Rs1.93bn) related to discounts given to clear BSIII inventory ahead of Supreme Court decision and some impact on account of rising commodity prices.
- Revenues for the quarter stood at Rs69bn, 8% lower YoY, due to 6% fall in volumes and 2% lower average selling price. Two wheeler industry was recovering post demonization and hence volumes declined YoY. ASP was lower on account of Rs1.93bn one-off reduced from revenues. Adjusted for the same, ASP would have increased by 2.3% YoY.
- Spare part revenue growth for 4QFY17 and FY17 grew by 7-8% and 4% respectively.
- Gross margins for the quarter suffered on account of sharp rise in key raw material prices. Adjusted for one-off, gross margins for the quarter came down to 33.4%, from 33.9% in 4QFY16 and 35.2% in 3QFY17. Company highlighted that some part of raw material cost increase flowed in 4QFY17 and the balance will get reflected in 1QFY18. To partially offset the cost increase, company took price hike on 1st May 2017 on some models in the range of Rs500-2200.
- Employee cost was during the quarter due to changes related to actuarial variation in gratuity. Management stated that there was no one-off (positive) impact in employee cost and other expenses.
- Reported EBITDA margin for the quarter stood at 13.8%. Hover ever, post adjustment for one-off, EBITDA margin stands at 16.2%, higher YoY, but lower QoQ.
- Depreciation cost increase (YoY) pertains to start of new manufacturing facility in 3QFY17 at Halol, Gujarat. Tax rate was lower during the quarter due to full year adjustments.
- PAT for the quarter came in at Rs7.2bn, 14% lower YoY and 7% lower QoQ. Reported PAT was marginally lower than our estimate of Rs7.4bn.

Conference Call Highlights

- Management expects the domestic two wheeler industry volumes to grow in high single digits in FY18. For HMC, the management guided towards double digit volume growth. HMC witnessed strong double-digit volume growth April 2017 and May 2017 YTD. Company expects that rural recovery wwill strongly contribute to industry growth.
- In the motorcycle segment, the company will consolidate its market share. Company is positive on strong rural demand recovery, backed by expectation of good monsoon, infrastructure spend by the government and impact of full recovery post demonetization.
- In the scooter segment, the company aims to grow at strong pace, ahead of segment growth and thereby gain market share. Company expects that relaunched Maestro Edge and Duet coupled with new product (to be launched later during the year) will support growth in the scooter segment.
- In exports the company is facing headwinds in certain markets (like Columbia). In FY18, the strategy will be to consolidate position in growing markets.
- HMC will be launching six products in FY18 - that will include upgrades of current portfolio and new launches. Company will launch a new scooter and a new motorcycle in FY18.
- On raw material cost, the company faced some pressure in 4QFY17 and there will be some impact during 1QFY18. However, wef 1st May 2017, the company took a price increase of Rs500-2200 on certain models to partially offset the impact.

- Savings under LEAP program in FY17 was similar to FY16. Going ahead, the company will target more cost saving through LEAP and other areas.
- HMC's inventory is ~4-5weeks, lower than normal inventory level of 5-6weeks.
- HMC will spend Rs25bn towards capex over FY18-FY19. Capex would be done on ramp-up at Halol plant, construction of plant in Andhra Pradesh, expansion in Bangladesh, upgradation/modernization of existing plants, new product development and digitization.
- Hero Fincorp financed 10% of HMC's sales in FY17 as against 7% in FY16. Target is to achieve 25% sales financing of HMC's product from Hero Fincorp.

Outlook and Valuation

- Company highlighted that retail volume growth in April and May have been strong. Further with prediction of good monsoon, we expect demand recovery in rural areas. Volume growth for the industry will be strong in 2HFY18 as compared with 1HFY18, partly due to base effect.

We recommend ACCUMULATE on Hero MotoCorp with a price target of Rs.3691

- HMC has stated that they would be going for aggressive market share gains in FY18. While we expect the company's volume growth will be healthy over FY17-FY19E, market share gains looks a challenging task. In our estimates, we build in 10% volume CAGR over FY17-FY19E.
- While there are some near term concerns related to raw material cost increase on margins, we expect EBITDA margins to remain relatively healthy over the medium to longer term. Apart from price hikes, the company is looking at cost saving measures under various expense heads to protect its margins.
- We maintain our positive view on the stock. We rate the stock as **ACCUMULATE** (earlier BUY) with unchanged price target of Rs3,691. We value the stock at a PE of 18x on its FY19E earnings.

RESULT UPDATE

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ASIAN PAINTS LTD (APL)

PRICE: RS.1165 **RECOMMENDATION: REDUCE**
TARGET PRICE: RS.1175 **FY19E P/E: 43.6x**

Low double digit volume growth in the decorative paint segment, improved performance in the industrial and auto OEM segment has led to revenue of Rs 39.5 bn (+7.7% YoY) with recovery post demonetisation. Higher raw material prices during the quarter and weak performance of the home improvement segment eroded margins by 170 bps QoQ to 18%, but is still healthy for the company under the current circumstance. Fiji, Nepal. Jamaica and Middle East contributed to good performance of international operations. We interpret the numbers as moderate for the company, with the company reporting PAT of Rs 4.8 bn below our expecations of 5.1 bn.

We maintain our estimates for FY18, introduce FY19 numbers and value the stock at 44x rolled over EPS of FY19 (premium to medium sized paint companies) and recommend REDUCE (from Accumulate) with a TP of Rs 1175 (from 1050) for the stock, primarily due to rich valuations.

Summary table

(Rs mn)	FY17	FY18E	FY19E
Sales	1,52,903	1,69,109	1,87,598
Growth (%)	11.0	10.6	10.9
EBITDA	30,217	33,340	36,967
EBITDA margin (%)	19.8	19.7	19.7
PBT	29,148	32,060	35,917
Net profit	20,169	22,942	25,642
EPS (Rs)	21.0	23.9	26.7
Growth (%)	10.1	13.7	11.8
CEPS (Rs)	24.6	27.4	30.1
BV (Rs/share)	69.2	87.1	107.8
Dividend / share (Rs)	10.3	6.0	6.0
ROE (%)	30.4	27.5	24.8
ROCE (%)	41.4	35.3	31.9
Net cash (debt)	40,072	48,024	58,608
NW Capital (Days)	15.2	16.0	17.0
EV/EBITDA (x)	37.2	33.7	30.4
P/E (x)	55.5	48.8	43.6
P/Cash Earnings	47.5	42.5	38.7
P/BV (x)	16.9	13.4	10.8

Source: Company, Kotak Securities - Private Client Research

Quarterly consolidated

(Rs mn)	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17
Net Sales	**36,698**	**36,374**	**37,635**	**39,370**	**39,524**
QoQ (%)	-4.3	-0.9	3.5	4.6	0.4
YoY (%)	3.8	0.4	-0.4	2.6	7.7
Raw Material	20,050	19,190	20,875	22,045	22,194
Employee	2,683	2,775	2,794	2,643	2,652
Other expenses	6,987	6,206	6,834	6,918	7,560
Total operating expenses	29,720	28,171	30,503	31,606	32,406
EBIDTA	**6,978**	**8,203**	**7,132**	**7,764**	**7,118**
EBIDTA margin	19.0	22.6	19.0	19.7	18.0
Depreciation	721	855	843	855	835
EBIT	**6,257**	**7,348**	**6,289**	**6,909**	**6,283**
Interest	148	64	60	92	90
Other income	466	719	791	414	701
Exceptional	0	0	0	0	0
PBT	**6,575**	**8,003**	**7,020**	**7,231**	**6,894**
Taxes	2,279	2,603	2,207	2,465	2,204
PAT	**4,296**	**5,400**	**4,813**	**4,766**	**4,690**
Minority /Associate	49	125	138	127	106
Reported PAT	4,345	5,525	4,951	4,893	4,796
Equity	959	959	959	959	959
EPS (Rs)	**4.5**	**5.8**	**5.2**	**5.1**	**5.0**

Source: Company

Highlights of the quarter:

- Low double digit volume growth in the decorative paint segment, improved performance in the industrial and auto OEM segment has enabled APL to report healthy revenue of Rs 39.5 bn (+7.7% YoY).
- Management indicated that there was no change in product mix in the quarter
- West and Southern Indian markets have recovered faster than North and East India post demonetisation
- Management also indicated that the raw material prices have firmed up in the last 6 months which necessitated a 3% price increase from 1st March 2017
- Increase in raw material prices during the quarter and weak performance of the home improvement segment eroded margins by 170 bps QoQ to 18%

- Fiji, Nepal, Jamaica and Middle East contributed to good performance of international operations
- Home improvement segment continue to be weak for Asian Paints
- We interpret the numbers as moderate for the company, with the company reporting PAT of Rs 4.8 bn.
- Company has announced a final dividend of Rs.5.6 and a special dividend of Rs.2 (to celebrate 75 years of the company). Total dividend for FY17 = Rs.10.6 per share.

Sales was driven by all the segments

Management indicated the sales performance of Q4FY17 could be attributed to:

- Low double digit volume growth in the decorative segment
- Improved demand in the industrial and auto OEM segment
- Healthy performance of the international business aided by contribution from the units in Fiji, Nepal and Middle East.
- Growth has been slower than expected in the home improvement segment

Company took average price hike of 3% from March 2017

OPECs decision to limit production, backed by Russia, Kazakhstan and a few other countries had led to increase in Brent crude prices by more than 14% in Q4FY17 from USD 49 per barrel and similar increase in crude derivatives used by the paint industry. Even prices of pigments like Titanium Dioxide, Iron oxide and Zinc oxide had increased during the quarter. To offset the impact of increase in raw material prices, APL has taken an average increase of 3% in prices effective 1st March, 2017.

The price hike by APL reflects; 1) Confidence of Management in healthy volume growth going forward; 2) Sustained high raw material prices and 3) Intention of the management to protect the margin and profitability.

Prices of raw material have softened in the last 2 months which should aid the margins of the company going forward.

Current capacities and capex

APL is further planning to set up paint manufacturing facilities in Mysore and Vizag. APL is currently doing civil works in Mysore and ground leveling at Vizag. The capacities at both these manufacturing facilities will be built in a phased manner by APL (over the next 5 to 6 years) starting FY18, to cater to the future demand. Plus, APL is also upgrading and expanding its capacity at Ankleshwar Gujarat involving an investment of Rs 6.5 bn per annum over the next 4 years .Apart from these fixed capital investments we estimate the company to spend Rs 3 bn per annum towards maintenance capex, translating to an approximate total capex of Rs 10 bn per annum.

Investment in new facilities by APL

Area	Vizag	Mysore	Ankleshwar
Capacity (lakh Kilo Litre)	400000	600000	200,000
Investment (Rs bn)	17.5	23.0	6.5
Estimated over FY17 to FY22			

Source: Company

Valuation

We recommend REDUCE on Asian Paints Ltd with a price target of Rs.1175

For APL, we remain confident of 10% overall volume CAGR over FY17 to FY19E with stable margins, earnings CAGR of ~13% with ROE of 25% and ROCE of 32% for FY19E. We assigne a small premium valuation to APL over other players in the industry for its leadership position, healthy pay-out ratio, better margins and superior return ratios. We value the stock at 44x rolled over EPS of FY19 (premium to medium sized paint companies) and Recommend Reduce (from Accumulate) with a TP of Rs 1175 (from 1050) for the stock, primarily due to rich valuations.

RESULT UPDATE

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GUJARAT PIPAVAV PORT LTD (GPPL)

PRICE: RS.164 **RECOMMENDATION: ACCUMULATE**
TARGET PRICE: RS.180 **FY19E P/E: 27.4X**

Q4FY17 performance was marked by 1) subdued volumes across segments, 2) improving product mix (liquid and Ro-Ro account for 10% of the volumes), 3) contribution from high margin project cargo business of Rs 247 mn, 4) commissioning of Khatuwas terminal (aids pickup in double-stacked rail volumes and addresses imbalance) and 5) operating leverage benefits and ongoing cost-reduction program at the port. Sales was reported at of Rs 1.75 bn (+8% YoY and 3.1% QoQ), EBIDTA of Rs 1.15 bn translating into highest ever OPM of 65.7% (+400 bps QoQ and +410 bps YoY) and PAT of Rs 661 mn ahead vs. expectation of Rs 639 mn. Weak global container market and intense competition is impacting the performance of the company in the key container segment. From here, we expect the growth to come from other segments. We are not optimistic about immediate term performance (expect quarterly PAT of Rs 6 to 6.5 bn), but are optimistic about the long term prospects of the company, with the company expected to benefit from the upcoming Dedicated Freight corridor (DFC) with Pipavav Rail Corporation preparing to connect the port with the DFC. We recommend ACCUMULATE (from Buy) with an increased TP of Rs 180 (from Rs 175).

Summary table

(Rs mn)	FY17	FY18E	FY19E
Sales	6,838	7,391	7,894
Growth (%)	3.6	8.1	6.8
EBITDA	4,184	4421	4,698
EBITDA margin (%)	61.2	59.8	59.5
PBT	3,455	3,761	4,019
Net profit	2,484	2,746	2,934
EPS (Rs)	5.1	5.7	6.1
Growth (%)	40.8	10.5	6.8
CEPS (Rs)	7.4	7.8	8.2
BV (Rs/share)	44.4	47.8	51.5
Dividend / share (Rs)	1.8	2.0	2.0
ROE (%)	11.6	11.9	11.8
ROCE (%)	16.0	16.2	16.1
Net cash (debt)	3,142	3,696	4,407
NW Capital (Days)	(19.5)	(18.5)	(19.0)
EV/EBITDA (x)	18.4	17.3	16.1
P/E (x)	32.3	29.2	27.4
P/Cash Earnings	22.5	21.2	20.1
P/BV (x)	3.7	3.5	3.2

Source: Company, Kotak Securities - Private Client Research

Quarterly consolidated numbers

(Rs mn)	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17
Sales	**1,610**	**1,679**	**1,722**	**1,692**	**1,745**
YoY (%)	-14.4	-9.0	15.4	2.3	8.4
QoQ (%)	-2.7	4.3	2.6	-1.7	3.1
Operating expense	295	287	367	312	247
Employee cost	75	129	125	112	118
Administration	248	255	244	224	234
Operating Expenditure	618	671	736	648	599
EBIDTA	**992**	**1,008**	**986**	**1,044**	**1,146**
EBIDTA (%)	61.6	60.0	57.3	61.7	65.7
Depreciation	247	251	280	275	259
Interest payment	1	1	1	1	1
Other income	65	66	119	108	67
Tax	310	220	228	231	292
PAT	**499**	**602**	**594**	**645**	**661**
Equity	4,835	4,835	4,835	4,835	4,835
EPS	**1.0**	**1.2**	**1.2**	**1.2**	**1.2**

Source: Company

Financial highlights for the quarter

- Volumes were subdued across segments except for Liquid
- Company has reported a total revenue of Rs 247 mn in the project logistics business which has an EBiDTA margin of over 80%. This has contributed significantly to the revenues and earnings during the quarter.
- Management indicated that the project logistics business would continue to contribute in future as well
- Sales was reported at Rs 1.75 bn (+8% YOY and +3% QoQ).

- EBIDTA was reported at Rs 1.15 bn (+15% QOQ and +10% YoY) with highest ever margin of 65.7% (+400 bps QoQ and +410 bps YoY)
- Consequently PAT was reported at Rs 661 mn ahead of our expectation of Rs 639 mn

Quarterly volumes for GPPL

Segment	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17
Container (No of TEUs)	177,000	172,000	166,000	167,000	158,000
Bulk (mn tonnes)	0.38	0.60	0.71	0.52	0.30
Liquid (mn tonnes)	0.25	0.13	0.78	2.30	2.50
Rail volumes (mn tonnes)	1.77	1.69	1.82	1.76	1.58
ICD volumes (TEUs)	119,000	119,000	127,000	113,000	106,000
No of rakes	702	640	665	583	516
Cars handled	8,700	11,000	21,570	27,000	24,000
No of calls for cars	10	9	21	18	18

Source; Company

Facilities expanded and made more efficient

GPPL has invested Rs 4.5bn to increase its container handling capacity to 1.4mn TEU p.a (from 0.85 mn TEUs), expand its container storage yard, add modern equipment's and strengthen handling capacity of the berths. The company has replaced its old cranes with more efficient cranes, lowering the turnaround time of ships which can lead to the shifting of some shipping vessels from other ports in Gujarat and Maharashtra to GPPL.

No investment would be made in expanding capacities of handling other commodities. GPPL would take a call on further capacity addition once capacity utilization reaches the 80% mark. Till then, we do not expect any major capex for GPPL, except for maintenance capex of Rs 500 mn per annum over FY17 to FY19E.

Current capacities at GPPL

Segment	Capacity
Container	1.4 mn TEUs
Bulk	5 mn MT
Liquid	50 lakh MT
RoRo	2.5 lakh cars

Source: Company

Current environment in container shipping market and ports

The market environment in which container ports like GPPL and shipping lines are operating has changed substantially today. Shipping lines have started demanding better rates, better services, quicker turnaround time, berthing for larger vessels, zero congestion and superior hinterland connectivity as shipping lines consolidate business and look to save cost. Here, GPPL is doing two things: (1) ensuring that existing services are satisfied of its offering and (2) convincing old and new shipping lines to add new services at its port, now that they have slots to offer on berths 3 and 4. Despite the above, it is increasingly becoming difficult for GPPL to attract volumes in the container segment due to weak global container shipping market and competition from the Western Ports of Mundra, JNPT and Hazira for the same cargo.

Superior network of GPPL

Parameter	Remark
Superior Rail connectivity	269km broad gauge rail built by PRCL to connect to Surendranagar which connects to the national grid
Road connectivity	11km four-lane expressway connects to the National Highway 8E.
Double stacking	Saves cost for shipping lines/train operators
Four container berths	With modern cranes
Draft of 14.5 mts	Can handle ships upto 12,000 TEUS
Other facilities	Liquid/ Bulk/RoRo
Parentage of Maersk	Strong relations with all shipping lines

Source: Company

Volume assumption over FY17 to FY19E

- Parentage of Maersk, improved services, relations with shipping lines, strategic location on the west coast and ability to provide seamless railway connectivity to hinterland would continue to help GPPL attract container volumes. We expect container volumes to grow at a CAGR of 6% in FY18.
- With Gujarat developing as an Auto hub, we expect the share of high margin RoRo to increase in future, which should aid margins for GPPL.
- With increasing demand for chemicals, petroleum products, Lubricants and petro-chemicals serving industries like oil and gas, Chemicals, Pharma, Textiles, and Paints and so on, we expect the clients of GPPL to increase throughput at the port on a continuous basis. We estimate the company to handle 7 mn tonnes in FY18E and 8 mn tonnes of liquid cargo in FY19E.
- Overall, bulk volumes continue to be a very small portion of the overall cargo and we are not very optimistic (even management of GPPL) on bulk cargo in near term for GPPL.

Volume Estimates for GPPL

Segment	CY12	CY13	15MFY15	FY16	FY17	FY18E	FY19E
Containers (mn TEUs)	0.57	0.64	0.98	0.69	0.66	0.70	0.74
Bulk (mn tonnes)	3.9	4.0	4.7	2.5	2.1	2.0	2.2
Liquid (mn tonnes)	0.0	0.0	0.3	0.7	5.7	7.0	8.0

Source; Company, Kotak Securities - Private Client Research

Concerns:

- Focused only on container business
- Weak global container trade
- Competition from other ports in Maharashtra and Gujarat
- Inadequate strategy relative to competition from Mundra and JNPT

Valuation and Recommendation

For GPPL, we have not made changes to our earnings estimate but believe the container segment to report slow growth in volumes in the long run due to weak global container market, increasing competition and inadequate strategy of the company. Liquid and RoRo would remain strong for GPPL with improvement in share in the overall cargo portfolio.

We have made marginal increase to volume assumptions in medium to long term. We also assume GPPL to be a going concern, which would reinvest all its cash flows to increase container handling capacity through subsequent expansions (it has around 600 acres of unutilized land at the port and can expand 5x from here).

Valuation Table

Particulars	Value of equity Rs mn	Share of GPPL (%)	FCFE base case
Port	79,956	100.0	79,956
Gujarat Pipavav Rail Corporation			
(at 1.5 x Book value)	17,000	38.8	6,596
Total Value			**86,552**
No of shares (mn)			483.4
Value per share			**179.0**

Source: Kotak Securities - Private Client Research

We recommend ACCUMULATE on Gujarat Pipavav Port Ltd with a price target of Rs.180

Our FCFE for the port comes at ~ Rs166 and Pipavav Rail Corporation contributes ~ Rs 14 per share to the value of GPPL, valuing the company at Rs 180 per share. Recommend **ACCUMULATE** (from Buy) with an increased TP of Rs 180 (from Rs 175).

Bulk deals

Trade details of bulk deals

Date	Scrip name	Name of client	Buy/ Sell	Quantity of shares	Avg. price (Rs)
11-May	ADLABS	Nylim Jacob Ballas India (Fpi) Iv Llc	B	4,58,000	87.4
11-May	AKASHDEEP	Rajesh Mangalchand Jhaveri Huf	S	25,000	29.2
11-May	AKASHDEEP	Renuka R Jhaveri	S	45,000	29.2
11-May	AKASHDEEP	Joynet Devlopers Llp	B	81,100	29.2
11-May	AKASHDEEP	Tejas Bipin Shah	S	24,000	29.2
11-May	AMRAFIN	Lts Investment Fund Ltd	B	69,600	58.0
11-May	BPCAP	Rajendra Naniwadekar	B	16,000	17.6
11-May	CHEMBOND	Shree Damodar Krishna Trust	B	81,000	228.5
11-May	CHEMBOND	Multi Act Equity Consultancy - Pms	B	1,73,760	228.5
11-May	CHEMBOND	Guloo Perviz Dastur	S	3,50,000	228.5
11-May	OMANSH	Ankit Thakker	S	1,40,005	19.5
11-May	OMANSH	Ashish Vrundavan Karia	S	1,49,669	19.4
11-May	OMANSH	Bhavishya Ecommerce Private Ltd	B	2,00,002	19.5
11-May	OMANSH	Epoch Mercantiles Pvt Ltd	B	1,11,350	19.3
11-May	PURPLE	Dhiraj Shivkumar Gogia	S	50,000	28.9
11-May	VOL	Pinalben R. Shah	B	27,000	45.1
11-May	VOL	Jhaveri Trading & Investment Pvt Ltd	S	24,000	45.1

Source: bseindia.com

Gainers & Losers

Nifty Gainers & Losers

	Price (Rs)	chg (%)	Index points	Volume (mn)
Gainers				
Eicher Motor	29,469	5.7	NA	0.2
ZEEL	545	5.5	NA	7.6
Hero MotoCorp	3,462	4.2	NA	1.0
Losers				
ONGC	184	(2.3)	NA	10.8
Gail India	408	(2.2)	NA	3.2
Indian Oil Corp	432	(2.1)	NA	4.5

Source: Bloomberg

Forthcoming events

Company/Market

Date	Event
12 May	Nestle India earnings expected
15 May	Colgate Palmolive earnings expected
16 May	Grasim Industries, Shree Cement 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 9 months

ACCUMULATE – We expect the stock to deliver 5% - 12% returns over the next 9 months

REDUCE – We expect the stock to deliver 0% - 5% returns over the next 9 months

SELL – We expect the stock to deliver negative returns over the next 9 months

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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 9-month perspective. Returns stated in the rating scale are our internal benchmark.

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