

Company Update

Stock Details

Market cap (Rs mn)	:	14268
52-wk Hi/Lo (Rs)	:	2365 / 624
Face Value (Rs)	:	10
3M Avg. daily vol (Nos)	:	109,252
Shares o/s (mn)	:	22.8

Source: Bloomberg

Financial Summary

Y/E Mar (Rs mn)	FY18	FY19E	FY20E
Sales	25,487	28,947	32,779
Growth (%)	10.3	13.6	13.2
EBITDA	1,752	1,394	1,644
EBITDA margin (%)	6.9	4.8	5.0
Net profit	738	424	622
EPS (Rs)	32.3	18.5	27.2
Growth (%)	22.5	(42.6)	46.8
BVPS (Rs)	199.4	214.1	237.4
DPS (Rs)	3.3	3.3	3.3
ROE (%)	17.4	9.0	12.1
ROCE (%)	23.7	16.3	18.3
P/E (x)	19.3	33.7	22.9
EV/EBITDA (x)	9.5	11.9	10.2
P/BV (x)	3.1	2.9	2.6

Source: Company, Kotak Securities - PCG

Shareholding Pattern (%)

(%)	Sep-18	Jun-18	Mar-18
Promoters	56.2	56.2	56.2
FII	21.6	14.7	14.3
DII	6.4	12.5	10.2
Others	15.7	16.6	19.3

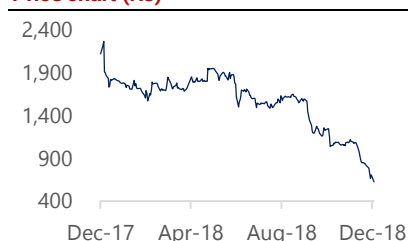
Source: Company

Price Performance (%)

(%)	1M	3M	6M
Shankara Bldg	(43.4)	(60.4)	(61.6)
Nifty	3.1	(6.0)	1.8

Source: Bloomberg

Price chart (Rs)



Source: Bloomberg

SHANKARA BUILDING PRODUCTS LTD

PRICE RS.624

TARGET RS.620

SELL

NEGATIVE SURPRISE: Change in company's business strategy

Shankara building products in its conference call has updated on the business strategy of achieving higher revenue growth in retail segment but at much lower margins which came as a negative surprise. It is transitioning into a low price retailer with focus on plumbing and sanitaryware as key growth drivers in the retail segment. Company expects healthy growth in the retail segment and expects debt to reduce from the current levels with working capital improvement.

In the near term, this change in the business strategy is likely to result in significant earnings reduction and we believe that positive impact of these changes is likely to be reflected after 2-3 quarters. Though we revise our revenue estimates upwards slightly, we revise our EBITDA estimates downwards by 18.7%/26.1% for FY19/20 and PAT estimates downwards by 38%/41% for FY19/20 respectively to reflect the change in the business strategy. We also reduce our valuation multiples for the retail segment owing to decline in margins, earnings growth as well as lower return ratios as against our earlier expectation. We thus downgrade the stock to SELL from BUY earlier.

Key highlights about the company's business update

Shift in the business strategy towards a 'low price retailer'

Shankara Building products has changed its strategy to become a 'low price retailer' and expects to achieve 20-25% growth in the retail segment revenues. Company has reduced the EBITDA margin guidance in the retail segment from 10.7% achieved in FY18 to 6-8% going forward due to increased competition and higher cash discounts. Overall margin guidance has been reduced to 4-4.5% as against 6-7% earlier. From a rapid pace of expanding the number of stores and upgradation of stores in FY17/18, company is now focusing on consolidation and would work upon improving the store level economics and hence reduced the new store addition target to 10-12 stores from 15-20 additions in a year.

The channel and processing segment margin weakness may sustain in the coming quarters but company is trying to put in additional investments on backward integration at its processing facilities. The focus will also be on improving the working capital cycle and collections in this segment.

Though we had expected some reduction in retail segment margins at the cost of high growth, but reduction in margins to 6-8% in retail segment is beyond expectations. This is leading to a sharp downward revision in the earnings of the company going forward.

Focus on working capital improvement and debt reduction

During Q2FY19, borrowings for the company had witnessed an increase which resulted in higher interest expense for the quarter. Increase in borrowings was partly attributed to higher working capital requirements as creditors were paid off during the quarter. Debtor days has also come down to 47 days at the end of Q2FY19 as compared to 61 days in March, 2018.

Teena Virmani

teena.virmani@kotak.com

+91 22 6218 6432

Working capital cycle of the company had moved up to 55 days in FY18 and 66 days in H1FY19 as compared to 44 days in FY17. With the change in the business strategy, company expects to reduce receivables by lowering credit sales and giving higher cash discounts. It intends to reduce the receivable cycle to 25 days and net working capital cycle to 50-55 days by FY19-end. This is also likely to reduce the borrowings to Rs 4 bn by FY19 end as compared to Rs 5.2 bn as on Sep, 18.

Long term growth momentum intact

Management is optimistic on the long term growth momentum with near term focus on balance sheet strength and improving store dynamics. Instead of focusing on increasing the number of stores, products and acquiring new business which it had done last year, company would in near term focus on consolidation in terms of stores and products (with focus on plumbing and sanitary ware as key growth drivers). More clarity on the results of these efforts will emerge by March 2019 and hence we believe that till any near term positive triggers, stock would continue to remain under pressure.

Earnings outlook

We incorporate higher growth in the retail segment revenues led by improved revenues per store despite lower than expected store addition. Though we revise our revenue estimates upwards slightly, we revise our EBITDA estimates downwards by 18.7%/26.1% for FY19/20 to reflect lower margins in retail segment and continued pressure on channel and enterprise segment margins. Correspondingly, our PAT estimates are revised downwards by 38%/41% for FY19/20 respectively to reflect the change in the business strategy.

Valuation and recommendation

At current price of Rs 624, stock is trading at 22.9x P/E and 10.2x EV/EBITDA on FY20 estimates. We had earlier ascribed higher valuations to the retail segment owing to higher growth led by incremental store addition, margin improvement and RoE improvement. However, the change in the business strategy is likely to impact margins, earnings and return ratios negatively. We thus reduce our valuation multiples for the company and now value retail segment at 12x EV/EBITDA and channel and enterprise segment at 4x EV/EBITDA and arrive at a revised price target of Rs 620 (Rs 1552 earlier). We downgrade the stock to SELL from BUY earlier.

About the company

Shankara Building Products is one of India's leading organized retailers of home improvement and building products in India, based on the number of stores operating under brand "Shankara Buildpro". Company has three segments – Retail, Enterprise and Channel and also has processing capabilities of 323200 tonnes per annum in products like Steel tubes, galvanized strips, cold rolled strips, bright rods, scaffolding.

Financials: Consolidated

Profit and Loss Statement (Rs mn)

(Year-end Mar)	FY17	FY18	FY19E	FY20E
Revenues	23,101	25,487	28,947	32,779
% change YoY	13.0	10.3	13.6	13.2
EBITDA	1,544	1,752	1,394	1,644
% change YoY	29.0	13.5	(20.4)	17.9
Other Income	3	6	4	4
Depreciation	114	136	175	199
EBIT	1,433	1,622	1,224	1,450
% change YoY	29.0	13.3	(24.6)	18.5
Net interest	508	464	574	496
Profit before tax	925	1,159	649	954
% change YoY	43.0	25.3	(44.0)	46.9
Tax	322	421	226	332
as % of PBT	34.8	36.3	34.8	34.8
Profit after tax	603	738	423	622
Minority interest	0.1	(0.1)	(0.1)	(0.1)
Share of profit of associates	0	0	0	0
Net income	603	738	424	622
% change YoY	48.0	22.5	(42.6)	46.8
Shares outstanding (m)	22.8	22.9	22.9	22.9
EPS (reported) (Rs)	26.4	32.3	18.5	27.2
CEPS (Rs)	31.4	38.3	26.2	35.9
DPS (Rs)	-	3.25	3.25	3.25

Source: Company, Kotak Securities – Private Client Research

Balance Sheet (Rs mn)

(Year-end Mar)	FY17	FY18	FY19E	FY20E
Cash and cash equivalents	662	60	158	33
Accounts receivable	3,123	4,272	3,569	3,862
Inventories	2,795	4,157	3,331	3,772
Loans and Adv & Others	311	642	768	810
Current assets	6,891	9,131	7,826	8,477
Other non current assets	-	25	25	25
LT investments	140	140	140	140
Net fixed assets	2,450	2,831	3,206	3,507
Total assets	9,481	12,127	11,197	12,150
Payables	2,659	4,612	3,172	3,592
Others	293	85	85	85
Current liabilities	2,952	4,697	3,257	3,677
Provisions	194	94	269	269
LT debt	2,236	2,610	2,610	2,610
Min. int and def tax liabilities	162	170	170	170
Equity	228	229	229	229
Reserves	3,708	4,329	4,663	5,196
Total liabilities	9,481	12,128	11,197	12,150
BVPS (Rs)	172.3	199.4	214.1	237.4

Source: Company, Kotak Securities – Private Client Research

Cash flow Statement (Rs mn)

(Year-end Mar)	FY17	FY18	FY19E	FY20E
EBIT	1,432	1,623	1,224	1,450
Depreciation	114	136	175	199
Change in working capital	(311)	(889)	(37)	(356)
Chgs in other net current assets	131	(444)	175	-
Operating cash flow	1,367	425	1,537	1,293
Interest	(508)	(464)	(574)	(496)
Tax	(322)	(421)	(226)	(332)
Cash flow from operations	537	(459)	737	465
Capex	(358)	(517)	(550)	(500)
(Inc)/dec in investments	-	-	-	-
Cash flow from investments	(358)	(517)	(550)	(500)
Proceeds from issue of equity	10	-	-	-
Inc/(dec) in debt	9	374	-	-
Proceeds from share premium	440	-	-	-
Dividends	-	-	(89.1)	(89.1)
Cash flow from financing	459	374	(89)	(89)
Opening cash	24	662	60	158
Closing cash	662	60	158	34

Source: Company, Kotak Securities – Private Client Research

Ratio Analysis

(Year-end Mar)	FY17	FY18	FY19E	FY20E
EBITDA margin (%)	6.7	6.9	4.8	5.0
EBIT margin (%)	6.2	6.4	4.2	4.4
Net profit margin (%)	2.6	2.9	1.5	1.9
Receivables (days)	46.9	53.0	45.0	43.0
Inventory (days)	42.3	49.8	42.0	42.0
Sales/assets(x)	9.4	9.0	9.0	9.3
Interest coverage (x)	2.8	3.5	2.1	2.9
Debt/equity ratio(x)	0.7	0.6	0.6	0.5
ROE (%)	17.6	17.4	9.0	12.1
ROCE (%)	24.7	23.7	16.3	18.3
EV/ Sales (x)	0.7	0.7	0.6	0.5
EV/EBITDA (x)	10.2	9.5	11.9	10.2
Price to earnings (x)	23.7	19.3	33.7	22.9
Price to book value (x)	3.6	3.1	2.9	2.6
Price to Cash Earnings (x)	19.9	16.3	23.8	17.4

Source: Company, Kotak Securities – Private Client Research

RATING SCALE

Definitions of ratings

BUY	–	We expect the stock to deliver more than 12% returns over the next 12 months
ACCUMULATE	–	We expect the stock to deliver 5% - 12% returns over the next 12 months
REDUCE	–	We expect the stock to deliver 0% - 5% returns over the next 12 months
SELL	–	We expect the stock to deliver negative returns over the next 12 months
NR	–	Not Rated. Kotak Securities is not assigning any rating or price target to the stock. The report has been prepared for information purposes only.
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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 12-month perspective. Returns stated in the rating scale are our internal benchmark.

FUNDAMENTAL RESEARCH TEAM

Rusmik Oza Head of Research rusmik.oza@kotak.com +91 22 6218 6441	Arun Agarwal Auto & Auto Ancillary arun.agarwal@kotak.com +91 22 6218 6443	Amit Agarwal Transportation, Paints, FMCG agarwal.amit@kotak.com +91 22 6218 6439	Nipun Gupta Information Tech, Midcap nipun.gupta@kotak.com +91 22 6218 6433	Deval Shah Research Associate deval.shah@kotak.com +91 22 6218 6423
Sanjeev Zarbade Cap. Goods & Cons. Durables sanjeev.zarbade@kotak.com +91 22 6218 6424	Ruchir Khare Cap. Goods & Cons. Durables ruchir.khare@kotak.com +91 22 6218 6431	Jatin Damania Metals & Mining, Midcap jatin.damania@kotak.com +91 22 6218 6440	Cyndrella Carvalho Pharmaceuticals cyndrella.carvalho@kotak.com +91 22 6218 6426	Ledo Padinjarathala Research Associate ledo.padinjarathala@kotak.com +91 22 6218 7021
Teena Virmani Construction, Cement, Buildg Mat teena.virmani@kotak.com +91 22 6218 6432	Sumit Pokharna Oil and Gas, Information Tech sumit.pokharna@kotak.com +91 22 6218 6438	Pankaj Kumar Midcap pankajr.kumar@kotak.com +91 22 6218 6434	Krishna Nain M&A, Corporate actions krishna.nain@kotak.com +91 22 6218 7907	K. Kathirvelu Support Executive k.kathirvelu@kotak.com +91 22 6218 6427

TECHNICAL RESEARCH TEAM

Shrikant Chouhan shrikant.chouhan@kotak.com +91 22 6218 5408	Amol Athawale amol.athawale@kotak.com +91 20 6620 3350
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DERIVATIVES RESEARCH TEAM

Sahaj Agrawal sahaj.agrawal@kotak.com +91 79 6607 2231	Malay Gandhi malay.gandhi@kotak.com +91 22 6218 6420	Prashanth Lalu prashanth.lalu@kotak.com +91 22 6218 5497	Prasenjit Biswas, CMT, CFTe prasenjit.biswas@kotak.com +91 33 6625 9810
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