

CHHOTA (TO) MOTA IDEAS UPDATE

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VENKY'S INDIA LTD

PRICE: RS.4575
TARGET PRICE: RS.3700

RECOMMENDATION: SELL
FY20E PE: 24.6X

Venky's stock has now run up 216% since we initiated coverage (July, 2017) on the stock. In the last three months, the stock has appreciated 85%, as strong earnings performance in recent quarters has led to better perception among investors, aiding a re-rating. In our last update (March, 2018), we had noted signs of weakening poultry prices. Over the last month, decline in poultry prices has been sharper (more than 20% decline y/y), which is likely to affect near-term performance of the stock negatively. Moreover, industry sources indicate that there may be an excess supply in the poultry market (supply has risen faster than anticipated demand growth), which could affect medium-term earnings. We lower our (poultry) pricing assumptions, leading to a cut in gross margins/ earnings. With FY19E/20E earnings estimates 15%/16% lower, we cut our price target to Rs 3700 (Rs 4600 earlier). Downgrade to SELL as we think there is a high likelihood of significantly lower entry points in the stock (for longer-term play).

Summary table

(Rs mn)	FY18E	FY19E	FY20E
Sales	26,049	30,822	35,285
Growth (%)	5.2	18.3	14.5
EBITDA	3,867	4,001	4,334
EBITDA margin (%)	14.8	13.0	12.3
PBT	3,306	3,621	4,070
PAT	2,040	2,335	2,625
EPS	144.8	165.8	186.3
Growth (%)	63.5	14.5	12.4
CEPS (Rs)	165.9	189.8	213.2
Book value (Rs/share)	510.4	659.0	822.6
Dividend per share (Rs)	10.0	15.0	20.0
ROE (%)	32.6	28.4	25.2
ROCE (%)	28.3	25.0	22.3
Net cash (debt)	-735	569	1,998
Net Working Capital (Days)	27.4	24.7	24.2
P/E (x)	31.6	27.6	24.6
P/BV (x)	9.0	6.9	5.6
EV/Sales (x)	2.5	2.1	1.8
EV/EBITDA (x)	16.9	16.0	14.4

Source: Company, Kotak Securities – Private Client Research

Broiler/ chick prices under pressure, signs of oversupply

We had noted in our earlier report (March, 2018), that poultry prices growth had turned negative. While the navratri in the period has had an impact on prices, we also gather from industry sources that the supply of chicken may be rising faster than demand, indicating that it may be general oversupply that has begun to impact prices negatively. Venky's revenues/ earnings have benefited in the past few quarters, due to a re-adjustment in poultry supply that was affected in the weaker years of the industry (FY14-FY15). Recent price trends, as well as industry sources indicate that the industry has not been able to contain supply at low levels. This could have implications for medium/long-term; in the immediate term, 4QFY18/1QFY19 results are likely to be less exciting than what investors have seen over the past few quarters. We expect 7.5% EBITDA growth in 4QFY18 (PAT growth is likely to be strong, helped by lower interest expenses/ lower effective tax rate).

Forecast of normal monsoon a positive, reduce uncertainty related with raw material prices

While data on broiler prices over the past one month has been incrementally negative, news on monsoon is a positive. Venky's has been enjoying the benefits of relatively low raw material prices over the past year, and a weak monsoon could have an impact on soya/ corn prices, which are primary raw materials for the company. Forecast by Skymet indicates that India is likely to witness a normal monsoon in 2018. Therefore, raw material prices should be expected to register only moderate growth over the coming quarters.

Cut estimates on lower pricing growth expectations, cut price target to Rs 3700, downgrade to SELL

Given that data/ industry sources indicate that there may be a case of at least a temporary over supply (implying that y/y prices growth is negative) in the industry, our prior pricing assumptions may be high; we reduce our pricing growth expectation by 3%. We note that if there is indeed a case of significant oversupply, our 5% pricing growth assumption may prove too high – while we wait for confirmation and persistence of this trend, we find it prudent to cut pricing growth expectation from 8% to 5%. Our FY19/FY20 earnings estimates are cut by 15%/16% as a result. We also cut our target multiple to 20X (21X FY20 earlier), on lower growth expectations and higher uncertainty on

earnings. Given the weakness in poultry prices over the past six weeks, the run-up in the stock over the past month has likely been excessive, and takes for granted a significant rise in poultry prices. We believe there is a high likelihood of a significant decline in Venky's stock over the next year. We downgrade the stock to **SELL**, with a price target of Rs 3700.

Risks to our investment view/ earnings estimates

(1) Venky's earnings estimates are significantly dependent on broiler/ day-old chick prices, and our assumption of lower pricing growth may be incorrect. There may be upside/ downside risks to our earnings estimates/ investment view on Venky's. We would be watching poultry prices carefully. (2) the company is likely to benefit, over the longer term, from a shift to frozen chicken – how early the market shall begin to discount the same determines the re-rating that Venky's stock may see. There may be downside risks to our investment view from such developments.

We recommend **SELL** on Venky's India Ltd with a price target of Rs.3700

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- 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
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- NOTE** – Our target prices are with a 9-month perspective. Returns stated in the rating scale are our internal benchmark.

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