

October 15, 2018

## Management Meet Update

■ Change in Estimates | ■ Target | ■ Reco

### Change in Estimates

	Current		Previous	
	FY19E	FY20E	FY19E	FY20E
Rating	BUY		-	
Target Price	146		-	
Sales (Rs. m)	13,576	15,016	-	-
% Chng.	-	-	-	-
EBITDA (Rs. m)	2,624	2,977	-	-
% Chng.	-	-	-	-
EPS (Rs.)	7.0	8.1	-	-
% Chng.	-	-	-	-

### Key Financials

	FY17	FY18	FY19E	FY20E
Sales (Rs. m)	11,722	12,040	13,576	15,016
EBITDA (Rs. m)	2,741	2,225	2,624	2,977
Margin (%)	23.4	18.5	19.3	19.8
PAT (Rs. m)	1,706	1,270	1,640	1,889
EPS (Rs.)	7.3	5.4	7.0	8.1
Gr. (%)	62.7	(25.6)	29.1	15.1
DPS (Rs.)	2.5	1.5	2.5	3.1
Yield (%)	2.3	1.4	2.3	2.9
RoE (%)	26.7	17.6	20.5	21.0
RoCE (%)	34.8	23.8	24.8	25.3
EV/Sales (x)	2.3	2.3	2.0	1.8
EV/EBITDA (x)	9.7	12.2	10.2	8.9
PE (x)	14.7	19.7	15.3	13.3
P/BV (x)	3.6	3.3	3.0	2.6

### Key Data

NAVN.BO | NELI IN

52-W High / Low	Rs.179 / Rs.100
Sensex / Nifty	34,865 / 10,513
Market Cap	Rs.25bn / \$ 338m
Shares Outstanding	234m
3M Avg. Daily Value	Rs.61.13m

### Shareholding Pattern (%)

Promoter's	61.78
Foreign	4.78
Domestic Institution	16.69
Public & Others	16.75
Promoter Pledge (Rs bn)	-

### Stock Performance (%)

	1M	6M	12M
Absolute	(14.5)	(31.0)	(37.0)
Relative	(6.5)	(32.3)	(41.4)

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## Growth to accelerate, valuation limits downside

In our recent interaction with Navneet Education Ltd (Navneet) management highlighted that 1) license fee conundrum is over post receipt of approval from Maharashtra State Board on 21<sup>st</sup> June 2018 2) the core publishing business is on track with impending syllabus changes (see exhibit 1) in Gujarat & Maharashtra 3) domestic stationery business is facing stiff competition from ITC but exports are gaining traction and 4) ILL transition is on track as 7 new series for standards 1 to 8 (56 titles in all) have been launched. Further, Navneet is investing in businesses of future like E-sense (digital learning venture) and school management, which will start contributing meaningfully over the next 2-3 years.

Navneet is well placed to clock top-line and bottom-line CAGR of 11.7% and 21.8% over FY18-20E. Despite rising competition in domestic stationary business and investments in long gestation E-learning and school management business, superior return ratios (+20%), ~50% dividend payout, recent buyback and proven track record limits downside. We believe recent correction in stock price (~25% since our last update) and valuations at 15.3x FY19E and 13.3x FY20E EPS make the stock attractive from long term. Upgrade to BUY with a TP of Rs146 per share (Rs161 earlier).

**Clarity over license fee issue provides visibility:** Lack of clarity over implementation of new license policy impacted Navneet's 1QFY19 publishing segment performance (revenues down 1.5% YoY). However, an approval was received in June 2018 and thus there would be some spillover of revenues in 2QFY19 due to delay in publication of books.

**Impending syllabus changes to drive publishing growth:** Syllabus change is a major growth driver as old and second hand books go out from the channel and students buy new books. As seen in exhibit 1, syllabus for standard 2nd, 3rd and 11th in Maharashtra and 1 to 8th, 10th and 12th in Gujarat is expected to undergo a change and thus drive growth in coming years.

**Rising stationery exports to provide margin kicker:** While in domestic markets Navneet is facing stiff competition from ITC, it has made strong inroads in the export markets (products exported to the US, Latin America, Africa and Middle East). Rising share of exports is likely to be a key driver of profitability as margins in overseas markets are 15-16% as against 5-6% in domestic market.

**ILL transition is on track:** We believe ILL (erstwhile known as Encyclopedia Britannica Ltd) transition is on track as the company has launched 7 new series for standards 1 to 8 (56 titles in all). Launch of new titles is expected to drive revenues at a CAGR of 24.0% over FY18-FY20E.

**E-sense and KTS business to scale up gradually:** In the E-sense business Navneet is planning to cater to the B2C segment to scale the business. In the school business, the plan is to increase number of schools from 12 in FY18 to 25 in FY20E.

## Key takeaways from the meeting

**Clarity over license fee issue provides visibility:** The Maharashtra State Board came out with a circular in March 2018 stating that all publishers should obtain a license from the board before publishing any title. The rationale given was that since supplementary material is published based on content outlined by the board, it is entitled to some kind of royalty/license fee.

Lack of clarity over implementation of this policy impacted Navneet's 1QFY19 publishing segment performance (revenues down 1.5% YoY) as it did not circulate any supplementary books. However, an approval was received on 21<sup>st</sup> June 2018 and Navneet paid ~Rs2.5mn as license fee towards syllabus changes for standards 1<sup>st</sup>, 8<sup>th</sup> and 10<sup>th</sup> that were lined up in FY19. Henceforth, a yearly fee will have to be paid to the board irrespective of syllabus changes entailing an expense of recurring nature. We believe policy clarity provides stability to the business (delay in publication of supplementary books and subsequent revenue spill-over gets eliminated) and outweighs the additional cost burden in the form of royalty/license fee which can be passed on.

**Impending syllabus changes to drive publishing growth:** Syllabus change is a major growth driver as old and second hand books go out from the channel and students buy new books as per revised syllabus proposed by the respective state education boards. The syllabus across grade 1-10 is evaluated regularly and changes are done once in every five to six years. Maharashtra has seen syllabus change for 3 classes and Gujarat for 2 classes in FY19. FY20 will be a big year with another 3 classes in Maharashtra and much larger number in Gujarat going in for syllabus change.

### Exhibit 1: Syllabus change: FY20 can see significant pick up

Academic Year	Maharashtra		Gujarat	
	Class	Subject	Class	Subject
2018-19	1	All Subjects (All Mediums)	9	Maths, Science, English (All Medium) as per NCERT
	8	All Subjects (All Mediums)	11	Maths, Physics, Chemistry, Biology, English (All Medium) as per NCERT
	10	All Subjects (All Mediums)		
2019-20	2	All Subjects (All Mediums)	1 to 8	Maths (English & Hindi medium)
	3	All Subjects (All Mediums)	6 to 8	Science (English & Hindi medium)
	11	All Subjects (All Mediums)	10	Maths & Science (All mediums)
			12	Maths, Physics, Chemistry and Biology (All mediums)

Source: Company, PL

PS: Syllabus change for class 2nd and 3rd is likely to move to FY21. However, there is no clarity over it in this regard as yet.

### Exhibit 2: Guides and digest see maximum impact of syllabus change

Book Type	Standards catered	Impact
Workbook	1st to 10th	Not much impact as students typically buy new workbooks every year
Guides/Digest	2nd to 12th	Biggest impact as second hand books go out of the system. Typically, volumes rise by 150% when syllabus changes.
21 sets	10th & 12th	Not much impact as new sets are published every year

Source: Company, PL

Considering the impending syllabus changes lined up we expect publishing segment (ex-ILL acquisition) to report revenue growth of 13.0% YoY and 10.0% YoY to Rs7.2bn and Rs7.9bn in FY19E and FY20E respectively.

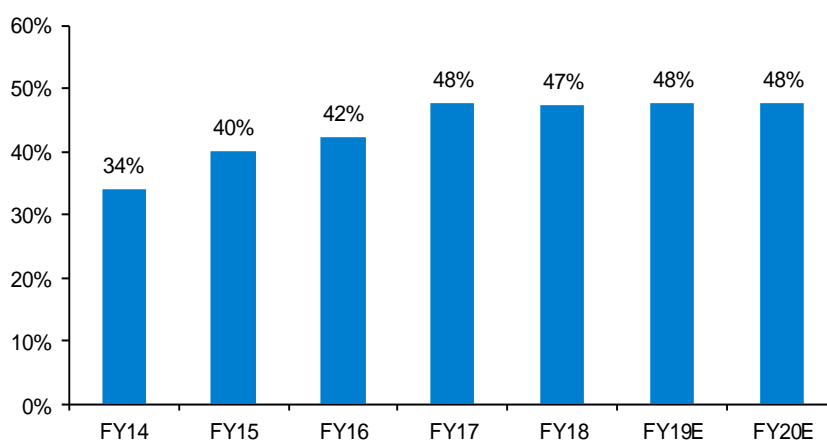
**Exhibit 3: Revenue contribution; 10<sup>th</sup> single biggest contributor**

Class	1 to 4	5 to 7	8 to 9	10th	11th	12th
% contribution	6% each	8% each	10% each	18%	3%	6%
<b>Total</b>	<b>24</b>	<b>24</b>	<b>20</b>	<b>18</b>	<b>3</b>	<b>6</b>

Source: Company, PL

**Rising stationery exports to provide margin kicker:** In the domestic stationery business, Navneet is facing stiff competition from ITC (Classmate and PaperKraft brands). Extended and lenient credit term and benefit of in-house paper manufacturing has enabled ITC to get a lion's share in the domestic market. However, in the export market (products exported to the US, Latin America, Africa and Middle East) Navneet has made considerable inroads over the past five years with revenues growing at a CAGR of 15.6% to Rs2.3bn FY18. Navneet has been able to create a niche in segments which involve manual intervention. Navneet's products are appreciated across retail chains in the US (Walmart is the biggest client). Rising share of exports over years (see exhibit below) is expected to be a key profit driver as margins in the export markets are higher (EBITDA margin of 15-16%) versus domestic (EBITDA margin of 5-6%). Navneet is launching premium products under HQ brand of stationery in the domestic market which should improve margin in the domestic business as well.

**Exhibit 4: Share of high margin exports is on a rise**

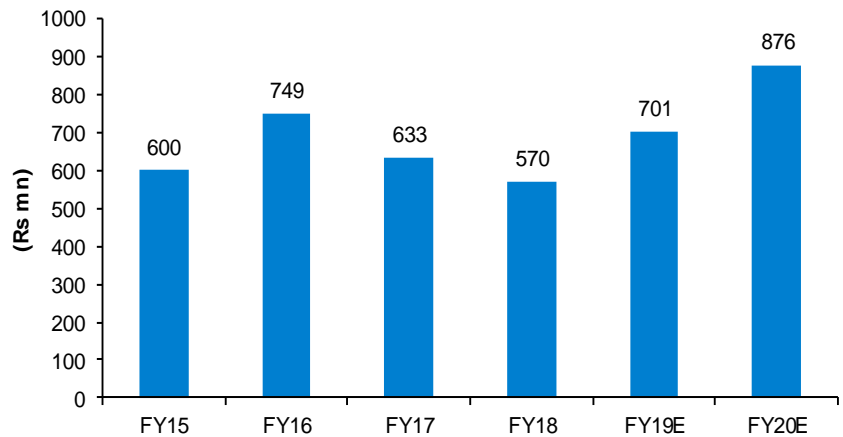


Source: Company, PL

**ILL transition is on track:** Navneet acquired Indiannica Learning Pvt Ltd (erstwhile known as Encyclopaedia Britannica Ltd) in Dec 2016. While the acquisition provided Navneet entry into CBSE curriculum based business, diversified its product portfolio and access to new geographies it reported a loss of Rs153mn in FY17 and Rs194mn in FY18.

ILL has undertaken internal re-structuring which entailed bringing senior management on board to grow the business. ILL transition is on track as the company has launched 7 new series for standards 1 to 8 (56 titles in all). Launch of new titles is expected to drive revenues at a CAGR of 24.0% over FY18-FY20E. Further, with restructuring exercise over we expect ILL to break even by FY20E.

**Exhibit 5: Launch of new titles to boost ILL's sales**

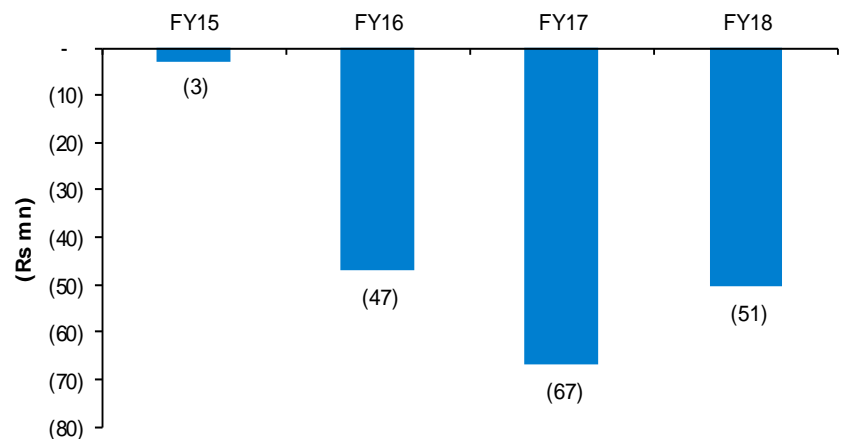


Source: Company, PL

**E-Sense scaling up, break-even will be back ended:** While Navneet's E-learning venture (E-sense) has vast potential both in B2B and B2C segments as students and teachers accept the benefit of digital learning; adaptability and willingness to pay for services has acted as a big challenge.

In order to penetrate deeper in the B2C segment Navneet is planning to increase the marketing strength from 150 to 1,000 people over a period of time. By Sep end, E-sense had 1.5 lakh registrations (target audience is 30m students of Gujarat & Maharashtra). E-sense has a fixed cost of Rs180-200mn per year and considering the stiff competition (lots of digital options available) the e-learning venture is not making money. Navneet has plans to achieve breakeven in another couple of years.

**Exhibit 6: E-sense continues to be in losses**



Source: Company, PL

**KTS school management business:** Navneet is planning to expand the KTS school business (35% stake, rest held by Sequoia). The plan is to increase number of schools from 12 in FY18 to 25 in FY20E. On an average Rs50-70mn is required for infrastructure development and loss absorption (initial 2-3 years) per school. Navneet has invested Rs750mn in KTS school business till date and the plan is to not invest further until the newly launched schools break even. Approximately one school can accommodate 1,000 students and has an average fee of Rs80,000-100,000 per head.

**Valuation:** Navneet continues to remain a dominant player in publishing of supplementary books across Maharashtra and Gujarat with market share of 65% and 70% respectively. Acquisition of ILL has provided entry into CBSE textbook market and diversified the product portfolio. Nonetheless, considering rising competition in domestic stationary market, continued losses in the E-learning venture and new investments in school management business that will require 2-3 years to break-even we reduce our target multiple from 20x to 18x.

Despite a cut in our target multiple we upgrade the stock to a BUY in light of 1) ~25% correction in the stock price since our last update 2) resolution of license fee issue which gives clear business visibility 3) traction in high margin stationery exports 4) probable break even in ILL by FY20E as the restructuring exercise is over 5) impending syllabus changes and 6) strong BS with negligible debt. Our revised TP stands at Rs146 per share. BUY.

**Exhibit 7: Publishing segment has higher revenue share in first quarter due to seasonality**

Particulars	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19
Publishing	60%	63%	60%	26%	66%	64%	48%	25%	55%
Stationary	39%	34%	39%	74%	34%	35%	51%	74%	45%

Source: Company, PL

Note: The contribution is calculated ex-of inter-segment revenues & miscellaneous contribution from other segment

**Exhibit 8: Margin profile of stationary segment is improving**

Particulars	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19
Publishing	42%	31%	28%	25%	40%	32%	20%	15%	42%
Stationary	20%	-2%	-4%	10%	15%	-9%	7%	13%	18%

Source: Company, PL

## Financials

### Income Statement (Rs m)

Y/e Mar	FY17	FY18	FY19E	FY20E
<b>Net Revenues</b>	<b>11,722</b>	<b>12,040</b>	<b>13,576</b>	<b>15,016</b>
YoY gr. (%)	23.0	2.7	12.8	10.6
Cost of Goods Sold	5,447	5,849	6,571	7,222
Gross Profit	6,276	6,191	7,005	7,793
Margin (%)	53.5	51.4	51.6	51.9
Employee Cost	1,187	1,468	1,625	1,821
Other Expenses	2,348	2,499	2,756	2,996
<b>EBITDA</b>	<b>2,741</b>	<b>2,225</b>	<b>2,624</b>	<b>2,977</b>
YoY gr. (%)	33.1	(18.8)	18.0	13.5
Margin (%)	23.4	18.5	19.3	19.8
Depreciation and Amortization	284	307	331	349
<b>EBIT</b>	<b>2,457</b>	<b>1,918</b>	<b>2,293</b>	<b>2,628</b>
Margin (%)	21.0	15.9	16.9	17.5
Net Interest	43	77	85	87
Other Income	223	260	270	280
<b>Profit Before Tax</b>	<b>2,638</b>	<b>2,100</b>	<b>2,478</b>	<b>2,821</b>
Margin (%)	22.5	17.4	18.3	18.8
Total Tax	827	829	828	942
Effective tax rate (%)	31.3	39.5	33.4	33.4
<b>Profit after tax</b>	<b>1,811</b>	<b>1,272</b>	<b>1,650</b>	<b>1,879</b>
Minority interest	-	0	0	0
Share Profit from Associate	(105)	(1)	(10)	10
<b>Adjusted PAT</b>	<b>1,706</b>	<b>1,270</b>	<b>1,640</b>	<b>1,889</b>
YoY gr. (%)	59.5	(25.6)	29.1	15.1
Margin (%)	14.6	10.5	12.1	12.6
Extra Ord. Income / (Exp)	-	-	-	-
<b>Reported PAT</b>	<b>1,706</b>	<b>1,270</b>	<b>1,640</b>	<b>1,889</b>
YoY gr. (%)	60.5	(25.6)	29.1	15.1
Margin (%)	14.6	10.5	12.1	12.6
Other Comprehensive Income	-	-	-	-
Total Comprehensive Income	1,706	1,270	1,640	1,889
<b>Equity Shares O/s (m)</b>	<b>234</b>	<b>234</b>	<b>234</b>	<b>234</b>
<b>EPS (Rs)</b>	<b>7.3</b>	<b>5.4</b>	<b>7.0</b>	<b>8.1</b>

Source: Company Data, PL Research

### Balance Sheet Abstract (Rs m)

Y/e Mar	FY17	FY18	FY19E	FY20E
<b>Non-Current Assets</b>				
<b>Gross Block</b>	<b>4,463</b>	<b>4,664</b>	<b>5,033</b>	<b>5,352</b>
Tangibles	3,829	3,991	4,330	4,619
Intangibles	634	673	703	733
<b>Acc: Dep / Amortization</b>	<b>2,397</b>	<b>2,574</b>	<b>2,947</b>	<b>3,340</b>
Tangibles	2,162	2,272	2,603	2,951
Intangibles	235	303	345	389
<b>Net fixed assets</b>	<b>2,067</b>	<b>2,089</b>	<b>2,085</b>	<b>2,011</b>
Tangibles	1,667	1,719	1,727	1,668
Intangibles	399	370	358	344
Capital Work In Progress	28	42	42	42
Goodwill	457	457	457	457
Non-Current Investments	298	667	667	667
Net Deferred tax assets	1	32	-	-
Other Non-Current Assets	115	108	125	130
<b>Current Assets</b>				
Investments	-	-	-	500
Inventories	3,843	4,282	4,463	4,937
Trade receivables	2,781	3,181	3,348	3,620
Cash & Bank Balance	97	68	667	831
Other Current Assets	300	536	589	648
<b>Total Assets</b>	<b>10,208</b>	<b>11,536</b>	<b>12,683</b>	<b>14,092</b>
<b>Equity</b>				
Equity Share Capital	467	467	467	467
Other Equity	6,471	7,053	8,004	9,031
<b>Total Network</b>	<b>6,938</b>	<b>7,520</b>	<b>8,471</b>	<b>9,498</b>
<b>Non-Current Liabilities</b>				
Long Term borrowings	6	-	-	-
Provisions	148	166	180	194
Other non current liabilities	-	-	-	-
<b>Current Liabilities</b>				
ST Debt / Current of LT Debt	1,588	2,253	2,403	2,630
Trade payables	760	753	744	823
Other current liabilities	769	842	884	947
<b>Total Equity &amp; Liabilities</b>	<b>10,207</b>	<b>11,536</b>	<b>12,682</b>	<b>14,093</b>

Source: Company Data, PL Research

**Cash Flow (Rs m)**

Y/e Mar	FY17	FY18	FY19E	FY20E
PBT	2,533	2,099	2,478	2,821
Add. Depreciation	284	307	331	349
Add. Interest	43	77	85	87
Less Financial Other Income	223	260	270	280
Add. Other	(181)	(131)	(162)	(168)
Op. profit before WC changes	2,679	2,352	2,732	3,089
Net Changes-WC	(1,140)	(1,155)	(551)	(678)
Direct tax	(766)	(882)	(788)	(892)
<b>Net cash from Op. activities</b>	<b>773</b>	<b>315</b>	<b>1,393</b>	<b>1,519</b>
Capital expenditures	(476)	(550)	(327)	(275)
Interest / Dividend Income	124	187	162	168
Others	(420)	(8)	-	-
<b>Net Cash from Inv. activities</b>	<b>(771)</b>	<b>(371)</b>	<b>(165)</b>	<b>(107)</b>
Issue of share cap. / premium	-	-	-	-
Debt changes	562	(9)	150	227
Dividend paid	-	(703)	(420)	(689)
Interest paid	(43)	(77)	(85)	(87)
Others	(582)	-	-	-
<b>Net cash from Fin. activities</b>	<b>(63)</b>	<b>(790)</b>	<b>(356)</b>	<b>(549)</b>
<b>Net change in cash</b>	<b>(61)</b>	<b>(846)</b>	<b>873</b>	<b>863</b>
Free Cash Flow	195	(46)	1,067	1,244

Source: Company Data, PL Research

**Quarterly Financials (Rs m)**

Y/e Mar	Q2FY18	Q3FY18	Q4FY18	Q1FY19
<b>Net Revenue</b>	<b>1,834</b>	<b>1,744</b>	<b>2,126</b>	<b>6,700</b>
YoY gr. (%)	6.6	11.4	1.8	19.0
Raw Material Expenses	843	801	1,034	3,525
Gross Profit	991	944	1,092	3,175
Margin (%)	54.0	54.1	51.4	47.4
<b>EBITDA</b>	<b>281</b>	<b>205</b>	<b>238</b>	<b>1,974</b>
YoY gr. (%)	(82.7)	(27.2)	16.2	730.5
Margin (%)	15.3	11.7	11.2	29.5
Depreciation / Depletion	56	62	64	57
<b>EBIT</b>	<b>225</b>	<b>143</b>	<b>173</b>	<b>1,917</b>
Margin (%)	12.3	8.2	8.2	28.6
Net Interest	16	1	17	42
Other Income	47	44	79	71
<b>Profit before Tax</b>	<b>256</b>	<b>186</b>	<b>235</b>	<b>1,946</b>
Margin (%)	13.9	10.7	11.1	29.0
Total Tax	89	67	84	683
Effective tax rate (%)	34.9	36.1	35.9	35.1
<b>Profit after Tax</b>	<b>166</b>	<b>119</b>	<b>151</b>	<b>1,263</b>
Minority interest	-	-	-	-
Share Profit from Associates	-	-	-	-
<b>Adjusted PAT</b>	<b>166</b>	<b>119</b>	<b>151</b>	<b>1,263</b>
YoY gr. (%)	(10.5)	(6.1)	(10.7)	15.2
Margin (%)	9.1	6.8	7.1	18.9
Extra Ord. Income / (Exp)	-	-	-	-
<b>Reported PAT</b>	<b>166</b>	<b>119</b>	<b>151</b>	<b>1,263</b>
YoY gr. (%)	(10.5)	(6.1)	(10.7)	15.2
Margin (%)	9.1	6.8	7.1	18.9
Other Comprehensive Income	(4)	(3)	(38)	(39)
<b>Total Comprehensive Income</b>	<b>162</b>	<b>116</b>	<b>113</b>	<b>1,224</b>
Avg. Shares O/s (m)	234	234	234	234
<b>EPS (Rs)</b>	<b>0.7</b>	<b>0.5</b>	<b>0.6</b>	<b>5.4</b>

Source: Company Data, PL Research

**Key Financial Metrics**

Y/e Mar	FY17	FY18	FY19E	FY20E
<b>Per Share(Rs)</b>				
EPS	7.3	5.4	7.0	8.1
CEPS	8.5	6.8	8.4	9.6
BVPS	29.7	32.2	36.3	40.7
FCF	0.8	(0.2)	4.6	5.3
DPS	2.5	1.5	2.5	3.1
<b>Return Ratio(%)</b>				
RoCE	34.8	23.8	24.8	25.3
ROIC	26.9	19.3	20.7	21.1
RoE	26.7	17.6	20.5	21.0
<b>Balance Sheet</b>				
Net Debt : Equity (x)	0.2	0.3	0.2	0.1
Net Working Capital (Days)	183	203	190	188
<b>Valuation(x)</b>				
PER	14.7	19.7	15.3	13.3
P/B	3.6	3.3	3.0	2.6
P/CEPS	8.5	6.8	8.4	9.6
EV/EBITDA	9.7	12.2	10.2	8.9
EV/Sales	2.3	2.3	2.0	1.8
Dividend Yield (%)	2.3	1.4	2.3	2.9

Source: Company Data, PL Research

**Key Operating Metrics**

Y/e Mar	FY17	FY18	FY19E	FY20E
<b>Segment Revenues</b>				
Publishing	6,139	6,402	7,235	7,958
Stationery	4,860	5,010	5,561	6,061
<b>EBIDTA</b>				
Publishing	2,270	2,113	2,387	2,626
Stationery	553	501	567	618

Source: Company Data, PL Research

**Recommendation History**

No.	Date	Rating	TP (Rs.)	Share Price (Rs.)
1	08-Nov-17	Accumulate	189	171
2	10-Jan-18	Accumulate	204	159
3	08-Feb-18	BUY	200	138
4	15-Mar-18	BUY	200	138
5	13-Apr-18	BUY	200	155
6	14-May-18	Accumulate	161	140
7	23-May-18	BUY	161	136
8	21-Jun-18	Accumulate	161	125

**Analyst Coverage Universe**

Sr. No.	Company Name	Rating	TP (Rs)	Share Price (Rs)
1	Dish TV India	NR	-	74
2	Entertainment Network (India)	BUY	843	640
3	Music Broadcast	BUY	409	309
4	Zee Media Corporation	BUY	39	24

**PL's Recommendation Nomenclature (Absolute Performance)**

<b>Buy</b>	: > 15%
<b>Accumulate</b>	: 5% to 15%
<b>Hold</b>	: +5% to -5%
<b>Reduce</b>	: -5% to -15%
<b>Sell</b>	: < -15%
<b>Not Rated (NR)</b>	: No specific call on the stock
<b>Under Review (UR)</b>	: Rating likely to change shortly

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