IDBI capital

October 19, 2016

DIWALI PICKS 2016

Diwali Picks

Stock	Market Cap (Rs bn)	CMP (Rs)	Target (Rs)	Upside Potential
ARVIND	90	359	525	46%+
NILKAMAL	26	1,671	2,350	40%+
ZEEL	491	514	642	25%+
NBCC	153	253	320	26%+
AIAENG	120	1,271	1,525	20%+
PERSISTENT	55	691	860	24%+
COROMANDEL	77	262	367	40%+

Note: Holding period is 12 months

Arvind Ltd.

CMP: 359 **Tgt:525**

Key Triggers:

Established in 1931, Arvind Limited (Arvind) is a textile manufacturer and the flagship company of the Arvind Group. It manufactures cotton shirting, denim, knits and bottom-weights fabrics. The company is one of the largest producers of denim in the world, with an annual capacity of 108 mn metres.

As of FY16, Arvind had 953 stores under Arvind Lifestyle Brands. Also, Arvind has 30 brands out of which 4 are power brands.

Denims have evolved from a volume business to a value-added offering. Consequently, the company has consciously cut in capacities (reduction of 36 mn metres over FY05-09) and focused on higher realization (8% CAGR over FY07-16). The longstanding relationship with brands and learning curve from over two and half decades of operations has helped it move up the value chain.

Arvind has launched global brands successfully and also scaled up a few of them to such a level that it has now four power brands, Arrow, Flying Machine, US Polo and Tommy Hilfiger which have been well-received by the markets.

According to FICCI, the textile industry is expected to grow at 10.6% CAGR to $223 bn over 2015-2021. Arvind, with its big size and scale, remains well-poised to benefit from this growth.

Valuation: The stock is currently trading at a FY18 PE multiple of 16x (based on Bloomberg consensus estimate). We have a positive view on the stock.

Financial snapshot **(Rs mn)**

Year	Revenue	EBITDA	EBITDA (%)	Adj. PAT	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoE (%)	RoCE (%)
FY13	52,925	6,874	13.0	2,484	9.6	8.0	6.1	11.6	12.7
FY14	68,621	9,340	13.6	3,703	14.3	12.7	7.9	15.3	13.0
FY15	78,514	10,129	12.9	3,954	15.3	20.5	10.2	14.0	11.0
FY16	84,504	6,510	7.7	4,002	14.0	19.5	9.7	13.0	9.0

Nilkamal Ltd.

CMP: 1671 **Tgt:2350**

Key Triggers:

Dominance in plastic furniture business to continue: Nilkamal (NILK) has a unique business model with pan-India presence and 1,500 distributors, 20,000 retailers, 60 warehouses and 42 branches. It dominates the material handling (market share of 45-50%) and moulded furniture markets (market share of 35-37%) with more than 2,000 products. Its wide distribution network, superior product portfolio, strong brand image and diversified client base are the key features.

Significant turnaround in @home business: After several years of dismal performance, @home is set to see better days due to the company's cautious approach, reduction in cost along with closure of sick units. It turned 17 stores (out of total 19) into profitable business at operating level (v/s 13 in FY12). With better consumer sentiments, entry into e-commerce furniture sale (through Snapdeal/Jabong) and increasing online shopping preference, the retail division would be able to absorb fixed cost proportion to a great extent and see the bottom-line in the positive territory.

Better operating leverage to expand margin and return ratio: With stable RMC, turnaround in retail business along with improvement in plastic volume growth, the consolidated EBITDA would grow at a CAGR of 13% in FY16-18E (with stable margin), while significant debt reduction and positive earnings from retail division (FY17) would boost earnings by around 16% CAGR during FY16-FY18. Its ROCE would also improve from 25% in FY16 to 28% in FY18E.

Valuation: At current market price, NILKL is trading at a P/E multiple of 16.5x on FY18 and EV/EBITDA multiple of 8.4x. We maintain **BUY** rating on the stock.

Financial snapshot **(Rs mn)**

Year	Revenue	EBITDA	EBITDA (%)	Adj. PAT	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoE (%)	RoCE (%)
FY13	17,022	1,374	8.1	372	24.9	67.1	20.6	8.7	11.2
FY14	17,522	1,571	9.0	471	31.5	53.0	17.4	10.1	12.9
FY15	18,946	1,562	8.2	505	33.8	49.4	16.9	10.0	13.1
FY16	20,033	2,401	12.0	1,133	75.9	22.0	10.6	19.7	25.4

ZEE Entertainment Enterprises Ltd.

CMP: 514 **Tgt: 642**

Key Triggers: A excellent compounding story

Broadcasters to benefit from digitization of television network: All the 4 phases of digitization are expected to be completed by end-CY17. Based on the implementation in Phase I-II, largely completed, broadcasters remain the key beneficiaries of digitization with benefit on both subscription front and advertisement. We believe that large broadcasters like Zee are best placed to take advantage of the same.

Ad revenue – sector outperformance to continue: The television advertising market is expected to grow at a CAGR of 15% over the next 3 years. We expect Zee to outperform the sector post a strong 29% growth in FY16. FMCG spends, which account for ~55% of ZEE's ad revenue, is expected to continue to do well. Telcos, Autos and Consumer Durables (~4-5% of ZEE's ad revenue) are likely to see pick-up in growth with pick-up in growth in these sectors and entry of new players in Telco segment.

Regional portfolio is expected to do well: ZEE's Marathi youth channel, 'Yuva' added much-needed ad inventory in its dominated Marathi genre . Further, sustenance in viewership growth in Tamil, Telugu and Kannada would enable Zee improve its ad monetization significantly in the medium to long-term.

Sale of sports business to improve balance sheet and profitability: Zee sold its sports business to Sony for US$385mn (~4x FY16 sales). This will strengthen its balance sheet and also remove the negative impact of profitability (sports business had EBITDA loss of Rs350mn in FY16). We expect the sales proceeds to be used to buyback of its redeemable preference shares of Rs20bn.

Valuation: At current market price, Zee is trading at a P/E multiple of 38x/30x on FY17/FY18. We expect Zee to continue to trade at premium valuation as we are confident of 20%+ EPS CAGR over the next three years.

Financial snapshot **(Rs mn)**

Year	Revenue	EBITDA	EBITDA (%)	Adj. PAT	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoE (%)	RoCE (%)
FY13	36,833	9,580	26.0	7,086	7.4	69.5	51.9	19.6	19.5
FY14	43,699	12,068	27.6	8,773	9.1	56.5	41.2	26.6	20.6
FY15	48,730	12,583	25.8	8,112	8.5	60.5	39.5	26.6	18.9
FY16	58,450	15,266	26.1	9,010	9.4	54.7	32.6	22.8	17.4

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NBCC (India) Ltd.

CMP: 253 **Tgt:320**

Key Triggers :

Core competency: National Buildings Construction Corporation (NBCC) is a Navratna organization that comes under category-I, owned by the Govt. of India. This company is engaged in the Real Estate Development & Construction business. Note, 85-90% of the revenue comes from asset-light project management consultancy business. In the entire Indian infrastructure value chain, there is hardly a company that can beat NBCC's core return on capital employed. Note, they are in in excess of 200%. However, holding cash and real estate land parcels in balance sheet, which ekes out paltry returns, brings down the return on equity to 25-30%.

And strong visibility: Today, NBCC has a revenue visibility for eleven years — when even industry stalwarts like L&T has it for not more than 3 years. And that is not all: Here is a company that is targeting the order-backlog to move up to Rs1 tn, from the current Rs.720bn. Thereby, the visibility is on improving trend. In FY17 itself, company is guiding for order backlog to end at Rs800 bn. However, the revenue will not kick start in FY17. Nearly half the order-backlog — mainly from marquee projects like Sarojini, Netaji and Nauroji are scheduled for execution from Q1FY18 onwards.

Attractive valuation: We forecast revenue CAGR of 33% over the next two fiscals. With unmatched revenue visibility, we think NBCC is yet to open the-rabbit-out-of-hat. Further, we anticipate better consultancy margins — primarily led by operating leverage. However, adjusting for pay hikes, we think the net profit could grow 40% CAGR over the next two fiscals. We think urban infrastructure projects are a priority. Thereby, the visibility for smart cities, affordable housing and railways will benefit NBCC in the entire value chain. We continue with a PEG multiple to ~1x. We have a target price to Rs309. And we maintain a **BUY** recommendation.

Risks: First, redevelopment projects run a litany of classical urban infrastructure risks. In the past, redevelopment project of South extension-II and Kidwai Nagar was quashed off by High Court, once, as "urban slums." Though that is not the case anymore, we seek comfort from Transit-oriented development model where NBCC can rely on Delhi Metro's execution pace to evacuate urban designing issues. Second, Govt. of India acts unilaterally. If the debt of sick units, proposed for acquisition/merger is absorbed by NBCC, we might change our stance. Third, for the time, NBCC has hinted that it will no longer have higher exposure to real estate land-development model. Should there be a flip-flop in company strategy, our multiples risk to be downgraded.

Financial snapshot **(Rs mn)**

Year	Revenue	EBITDA	EBITDA (%)	Adj. PAT	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoE (%)	RoCE (%)
FY13	32,323	1,891	5.9	2,039	3.4	74.4	72.1	23.4	20.9
FY14	40,701	2,398	5.9	2,572	4.3	59.0	58.3	24.6	22.5
FY15	46,741	2,894	6.2	2,784	4.6	54.5	48.8	22.5	23.0
FY16	58,383	3,526	6.0	3,112	5.2	48.8	39.8	21.9	24.6

AIA Engineering Ltd.

CMP: 1271 Tgt:1525

Key Triggers:

Established in 1979, AIA Engineering (AIA), is India's largest manufacturer and supplier of corrosion and abrasion resistant high chrome mill internals (HCMIs), which are used as wear parts in crushing (or grinding) operations in cement, mining and thermal power plants.

Scalable opportunity in the mining segment, resurrection of operating margins back to historical levels and aspirations to become the largest player globally make AIA Engineering (AIA) an interesting play in the oligopolistic high chrome mill internals (HCMI) industry.

The key positive surprise in 1QFY17 was the pick-up in mining segment volumes (+23.4% YoY) to 29,178 tonnes. However, the management commentary suggests a ramp up in volumes will augment from 3QFY17 and segments like gold and copper will add to volume growth.

The management expects additional 20,000-25000 tonnes of incremental volumes for FY17 on the back of new capex and improvement in prices of global commodities.

Valuation: The stock is currently trading at a FY18 PE multiple of 24x (based on Bloomberg consensus estimate). We have a positive view on the stock.

Financial snapshot (Rs mn)

Year	Revenue	EBITDA	EBITDA (%)	Adj. PAT	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoE (%)	RoCE (%)
FY13	17,513	3,102	17.7	2,108	22.4	14.2	7.0	14.8	17.3
FY14	20,168	5,023	24.9	3,250	34.5	16.2	9.3	20.5	15.9
FY15	21,835	5,494	25.2	4,132	43.8	27.4	18.9	20.0	22.5
FY16	21,004	6,093	29.0	4,178	44.3	20.9	13.1	17.5	21.0

Persistent Systems Ltd.

CMP: 691 **Tgt:860**

Key Triggers: An early mover in transition to digital technologies

Focus on Enterprise digital transformation is paying off: Persistent has always had a differentiated business model with focus on outsourced product development, IP and platforms rather there than traditional application development and maintenance (ADM) work. Importantly, Persistent has been proactive in transforming from a outsourced product development company into a partner to enterprise customer in their digital transformation. Its Enterprise Solutions segment is now 27% of revenue and grew by 35% YoY in FY16. It has been focusing on Life Sciences and Financial Services verticals in this segment which saw a strong growth of 14% and 42% respectively in FY16. We expect Persistent's enterprise segment to grow at 20%+ for the next 3 years.

Alliance with IBM Watson is a great move: The deal for IoT with IBM is progressing well. It is expected to add revenue of US$53mn or 15% of FY16 revenue. Persistent will have to make investments upfront which will result in -200bps impact on over-all EBITDA margin in FY17. However we believe that such investments are important especially for getting high growth in digital technologies like IoT. Persistent should be able to offset part of this impact through productivity gains, offshoring and other operational efficiencies.

US$0.5bn should come in FY18 and moving towards becoming a US$1bn company: We believe that Persistent has all the ingredients to become a US$1bn company. Importantly this will be excluding traditional ADM or infrastructure management services work.

Valuation: At current market price, Persistent is trading at a P/E multiple of 17.5x/14.5x on FY17/FY18. We expect PSYS to outperform the sector growth over the next three years. As a result, we expect we expect Persistent Systems to be one of the top performing IT stock in the next three years

Financial snapshot **(Rs mn)**

Year	Revenue	EBITDA	EBITDA (%)	Adj. PAT	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoE (%)	RoCE (%)
FY13	12,965	3,368	26.0	1,876	24.31	28.4	14.6	20.2	20.2
FY14	16,692	4,326	25.9	2,493	32.03	21.6	11.3	22.3	22.2
FY15	18,913	3,904	20.6	2,906	36.84	18.7	12.6	22.1	22.1
FY16	23,123	4,138	17.9	2,974	37.17	18.6	11.9	19.5	19.5

Coromandel International Ltd.

CMP: 262 **Tgt:367**

Key Triggers:

After two years of below normal rainfall, the 2016 monsoon season has ended with rainfall at 97 per cent of LPA; this qualifies as a normal monsoon. This should augur well for fertilizer companies like Coromandel International (CRIN).

Higher exposure to Non-Subsidy products: First, the Indian Agro Chemicals market is tilted towards Fertilizers (Urea), Phosphate Fertilizers (DAP, Complex fertilizers, SSP, MOP). Urea continues to suffer from regulations. However, phosphate fertilizers are decontrolled. Yet they are regulated under the NBS Scheme. With considerable pricing freedom, the days could be brighter ahead. CRIN, with a production capacity of 3.6mnt of DAP and complex fertilizers, is a leading player. Note, in NPK market, CRIN has a market share of 22%. With the acquisition of the Liberty group, the company increased its footprint into the Northern/Western SSP sector. With this, SSP manufacturing capacity exceeds 1mnt. The current market share in this segment is 16%. A fraction of revenue though, CRIN has a complete range of products to offer including Urea as it has bagged government contracts for handling Urea at Kakinada and Karaikal ports.

Vertical integration to help in low cost: CRIN has strategic alliances. First, it has a long term tie-up with Foskor, South Africa and Group Chemique, Tunisia for inputs. Second, it has a supply agreement with Mitsui for ammonia and sulphur; and potash with Canpotex. Third, with strategic locations of Phosphoric acid plants, Visak and Ennore refinery helps in bringing down the cost. Fourth, freight cost is lower. Fifth, with stake in APGENCO, the power cost, too, remains lower.

Strong marketing network: CRIN has 7000+ dealers. This could put, arguably, CRIN in top-three. The width of distribution and farmer engagement is key for industry players to be able to differentiate their offerings given the generic nature of the Indian crop protection market and the lack of exclusivity from retailers and dealers.

Valuation and view: Coromandel is targeting an improvement in the non-subsidy business. The target envisaged, over the next four years, could contribute as high as 50% to EBITDA (from the current 36%). Further, Specialty nutrients will lead the show. Even with 70% capacity utilization, CRIN could achieve 15% RoE. If gross margins could maintained at FY16 levels, EBITDA could jump three folds in 100% capacity utilization. In fact, company guides for 85% capacity utilization in the fiscal to come.

Financial snapshot **(Rs mn)**

Year	Revenue	EBITDA	EBITDA (%)	Adj. PAT	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoE (%)	RoCE (%)
FY13	90,337	7,679	8.5	4,333	15.3	17.3	12.9	18.9	13.1
FY14	100,532	7,926	7.9	3,669	13.0	20.4	11.2	16.4	14.8
FY15	113,064	8,495	7.5	4,063	14.3	18.5	11.1	18.1	17.2
FY16	114,598	7,123	6.2	3,609	12.4	21.1	14.1	15.6	12.3

Team

IDBI Capital Markets & Securities Ltd.

Wishing you

Happy Diwali

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