Morning Insight

MAY 15, 2019

	14-May	% Chg 1 Day	% Chg 1 Mth	% Chg 3 Mths
Indian Indices				
SENSEX Index	37,319	0.6	(3.7)	4.0
NIFTY Index	11,222	0.7	(3.6)	4.4
NSEBANK Index	28,829	0.6	(3.7)	6.9
NIFTY 500 Index	9,212	0.6	(4.8)	3.9
CNXMcap Index	16,737	0.5	(7.9)	2.2
BSESMCAP Index	13,844	0.3	(7.8)	3.6
World Indices				
Dow Jones	25,532	0.8	(3.2)	(1.4)
Nasdaq	7,734	1.1	(3.0)	3.5
FTSE	7,242	1.1	(2.6)	0.1
NIKKEI	21,067	(0.6)	(5.0)	0.7
Hangseng	28,122	(1.5)	(5.0)	1.6
Shanghai	2,884	(0.7)	(8.4)	8.6

Value traded (Rs cr)	14-May	% Chg Day
Cash BSE	2,271	1.3
Cash NSE	34,977	19.2
Derivatives	1,068,438	48.2

Net inflows (Rs cr)	13-May	MTD	YTD
FII	(953)	56	68,277
Mutual Fund	1,246	3,353	691

Nifty Gainers & Losers 14-May	Price (Rs)	Chg (%)	Vol (mn)
Gainers			
Indiabulls Housing	697	5.8	10.2
Bharti Airtel	337	5.6	10.8
Sun Pharma	419	5.4	18.8
Losers			
Tech Mahindra	790	(3.3)	2.7
TCS	2,092	(1.7)	2.5
Bajaj Finance	2,882	(1.7)	1.9

Advances / Declines (BSE)

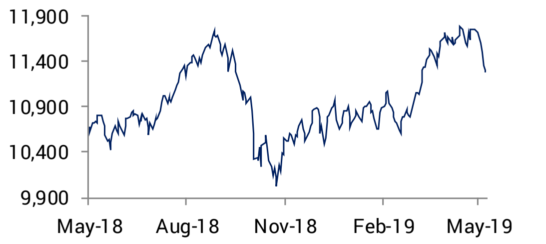
14-May	A	B	T	Total	% total
Advances	284	465	38	787	100
Declines	172	498	67	737	94
Unchanged	5	21	10	36	5

Commodity

	14-May	% Chg 1 Day	% Chg 1 Mth	% Chg 3 Mths
Crude (US$/BBL)	71.1	(0.3)	(0.2)	7.2
Gold (US$/OZ)	1,296.9	(0.2)	0.6	(2.0)
Silver (US$/OZ)	14.8	0.2	(1.4)	(6.4)

Debt / Forex Market	14-May	1 Day	1 Mth	3 Mths
10 yr G-Sec yield %	7.4	7.4	7.4	7.3
Re/US$	70.4	70.5	69.4	71.2

Nifty



Source: Bloomberg

News Highlights

- Monsoon is likely to hit Kerala on June 4, private weather forecaster Skymet said. (BL)
- Wholesale price-based inflation slipped to 3.07% in April on cheaper fuel and manufactured items, even as prices of food articles remained high, according to an official data released on May 14. (hindu)
- A slump in government spending amid ongoing elections has resulted in a cash shortage in the banking system. The deficit is pegged at Rs 408 bn compared with a Rs 158 bn surplus at the same time last year, according to data from the Bloomberg banking liquidity gauge. (ET)
- **Adani** Group on Tuesday received approvals to develop a new container terminal in Myanmar as the diversified conglomerate spreads its port operations beyond Indian shores. This will be Adani's second international port after Australia. (Hindu)
- Lenders to **Jet Airways** and its second-largest shareholder Etihad Airways have approached the Hinduja Group offering a stake in the grounded airline, said people close to the development, adding that exploratory talks are on. (ET)
- Grounded **Jet Airway**s has been left without any top-level executive, days after Abu Dhabi-based Etihad put in its letter of interest to re-invest in the airline as a minority partner. The chances of Jet's revival appeared bleak without any sign of a majority partner, and with the exit of key officials and a large number of its fleet going to rivals. (ET)
- Indian pharma majors **Dr Reddy's, Workhardt, Aurobindo** and **Glenmark,** which are among the generic drug makers named in an anti-trust lawsuit in the US, May 14 denied allegations of engaging in conspiracy to fix prices. (Moneycontrol)
- The consolidation of public sector banks is expected to get fresh impetus as a few mid-sized and small state-run lenders are being considered for mergers with **Punjab National Bank (PNB)** and Canara Bank, two senior finance ministry officials said. (The Print)
- Telecom operator **Bharti Airtel** has tweaked its post-paid plans, a move that involves gradual phasing out of offerings that are less than Rs 499 and retaining limited number of plans above it. (BS)
- Infrastructure major **Larsen and Toubro (L&T)** has acquired 1,168 shares of Mindtree from the open market, taking its overall holding in the mid-sized IT company to 25.94 per cent, according to a regulatory filing. (Moneycontrol)
- **ITC** Managing Director Sanjiv Puri has been appointed as the chairman by the Board of Directors. His new designation will now be chairman and managing director, the company said in a stock exchange filing. (Hindu)

What's Inside

- **Result Update**: MRPL, Akzo Nobel India Ltd

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

Result Update

MANGALORE REFINERY & PETROCHEMICALS LTD.

PRICE RS.63 **TARGET RS.70** **ADD**

Stock Details

Market cap (Rs mn)	:	110940
52-wk Hi/Lo (Rs)	:	108 / 60
Face Value (Rs)	:	10
3M Avg. daily vol (Nos)	:	1,104,814
Shares o/s (mn)	:	1753

Source: Bloomberg

Financial Summary

Y/E Mar (Rs mn)	FY19	FY20E	FY21E
Revenue	632,411	638,346	656,370
Growth (%)	29.0	0.9	2.8
EBITDA	24,131	43,274	47,400
EBITDA margin (%)	3.8	6.8	7.2
PAT	3,400	14,104	16,833
EPS	1.9	8.0	9.6
EPS Growth (%)	-82.9	314.8	19.4
BV (Rs/share)	57	62	68
Dividend/share (Rs)	1.0	2.5	3.0
ROE (%)	3.6	13.2	14.4
ROCE (%)	6.4	11.0	11.8
P/E (x)	32.5	7.8	6.6
EV/EBITDA (x)	9.4	5.4	4.7
P/BV (x)	1.1	1.0	0.9

Source: Company, Kotak Securities - PCG

Shareholding Pattern (%)

(%)	Mar 19	Dec-18	Sep-18
Promoters	88.6	88.6	88.6
FII	1.7	1.7	1.7
DII	3.2	3.2	3.2
Others	6.5	6.5	6.5

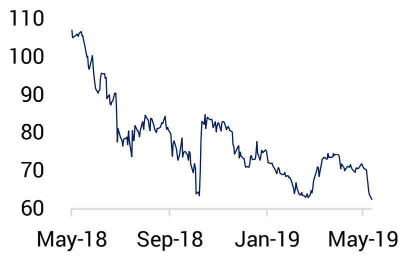
Source: Bloomberg

Price Performance (%)

(%)	1M	3M	6M
MRPL	(11.1)	(1.6)	(22.5)
Nifty	(3.6)	4.4	6.1

Source: Bloomberg

Price chart (Rs)



Source: Bloomberg

Earnings volatility continues: Mangalore Refinery & Petrochemicals Ltd (MRPL) reported better than expected results. Despite higher depreciation charge, higher finance cost and lower other income, the company has reported higher PAT of Rs. 3.2 bn in Q4FY19 due to higher crude throughput and better GRMs as against a net loss of Rs.2.7 bn in Q3FY19 and a PAT of Rs. 5.4 bn in Q4FY18. The company reported crude throughput of 5.01 mmt, 14% qoq resulting in higher capacity utilization (133.6%). In the medium to long term, the key factors to watch out are GRMs, rupee movement, oil prices and petroleum product demand.

Key Highlights

- **Force majeure and planned maintenance shutdown to impact volumes:** The company has announced that due to acute shortage of fresh water in the river Nethravathi, MRPL refinery complex process unit (4 mmtpa) are under partial shutdown as a force majeure. This is along with a 3 mmtpa unit which was shut in April'19 for routine maintenance. We believe this will result in lower capacity utilization in FY20. Currently, the company is operating at 8 mmtpa capacity as against a 15 mmtpa nameplate capacity, we opine.
- MRPL will be commissioning gasoline treating units to maximise production of Euro-VI compliant petrol. India has set a target for a country-wide roll out of Euro VI compliant fuels from April 2020.
- MRPL booked lower forex gain of Rs.1.1 bn as against a forex gain of Rs.3.85 bn in Q3FY19 due to currency fluctuations.
- The company has declared a dividend of Rs.1/share in FY19.

Valuation & outlook

We expect regional GRM to remain stable (at US$5.5/bbl) as global refining capacity addition is likely to be in line with oil demand growth.

We are introducing FY21E earnings and roll-forward our valuation to FY21E earnings. Hence, we now expect MRPL to report an EPS of Rs.8.0 in FY20E (earlier Rs.9.4) and an EPS of Rs.9.6 in FY21E.

At current price, the stock is trading at 6.6x P/E and 0.9x P/B multiples on FY21E earnings. We believe that the stock is reasonably valued at 4.7x EV/EBIDTA on FY21E. We now recommend ADD (earlier BUY) on the stock with a revised price target of Rs.70/share (earlier Rs.75/share) due to ongoing issues with the capacity utilization. We have valued MRPL based on EV/EBITDA multiple of 5x FY21, which is at a significant discount to its peers considering its size, NCI, and limited retail distribution.

Going ahead, we expect MRPL's profitability to improve on account of i). Improved product mix, ii). Better refining margins iii). Economies of scale and iv). Forward integration - Polypropylene plant.

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Quarterly performance table (Standalone)

Particulars (Rs Mn)	Q4FY19	Q3FY19	Q4FY18	YoY (%)	QoQ (%)
Sales	**177,499**	**202,496**	**187,531**	**(5)**	**(12)**
Incr/(Decr) in stock	874	(10,405)	(7,552)		
Total Expenditure	170,212	193,139	169,535	0	(12)
EBIDTA	**8,161**	**(1,047)**	**10,444**	**(22)**	**(879)**
Depreciation	2,249	1,791	1,617	39	26
EBIT	**5,912**	**(2,838)**	**8,827**	**(33)**	**(308)**
Other income	246	368	771	(68)	(33)
Interest-net	1,440	999	1,118	29	44
PBT	**4,718**	**(3,469)**	**8,479**	**(44)**	**(236)**
Extra ordinary Exp/(Inc)	34	103			
Tax	1,495	(895)	3,058	(51)	(267)
PAT	**3,189**	**(2,677)**	**5,421**	**(41)**	**(219)**
EPS (Rs)	1.8	(1.5)	3.1	(41)	(220)

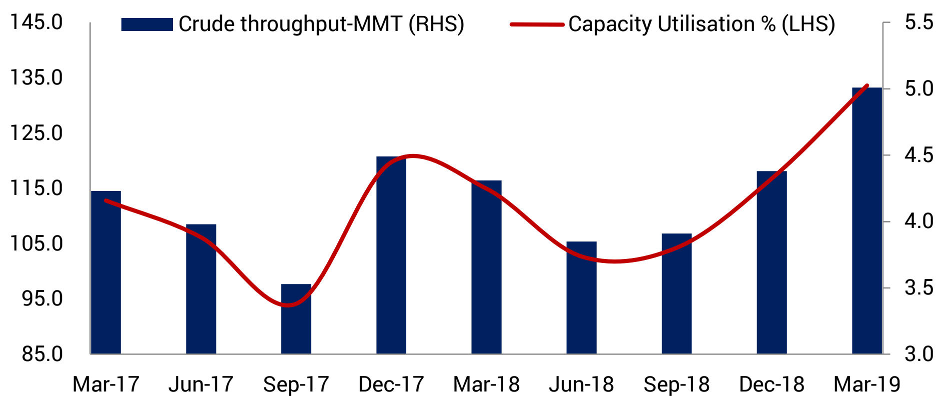
Source: Company

Quarterly result analysis – Q4FY19

- **Revenue growth:** MRPL's gross revenue decreased by 12% qoq to Rs.177.5 bn (-5% yoy) led by rupee appreciation and lower product realization. Average realization stood lower at US$ 69/bbl, -14% qoq and -22% yoy due to lower international product prices.

- **Crude throughput:** MRPL reported significantly higher crude throughput of 5.01 mmt, 14.4% qoq resulting in higher capacity utilization (133.6%). However, in FY19, the crude throughput decreased to 16.23 mmt from 16.31 mmt in FY18. The company reported highest ever high value Polypropylene production of 388 KT in FY19.

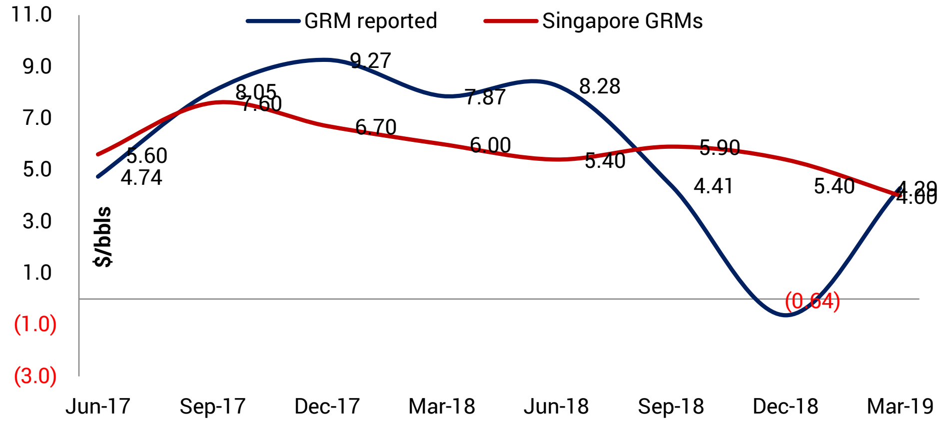
MRPL's crude throughput (mn mt) and capacity utilization (%)



Source: Company

- **Refining margins:** MRPL reported sequentially higher GRMs of US$ 4.29/bbl in Q4FY19 as against (-) US$0.64/bbl in Q3FY19 and US$ 7.87bbl in Q4FY18. However, Benchmark Singapore refining margin stood lower at US$4/bbl in Q4FY19.

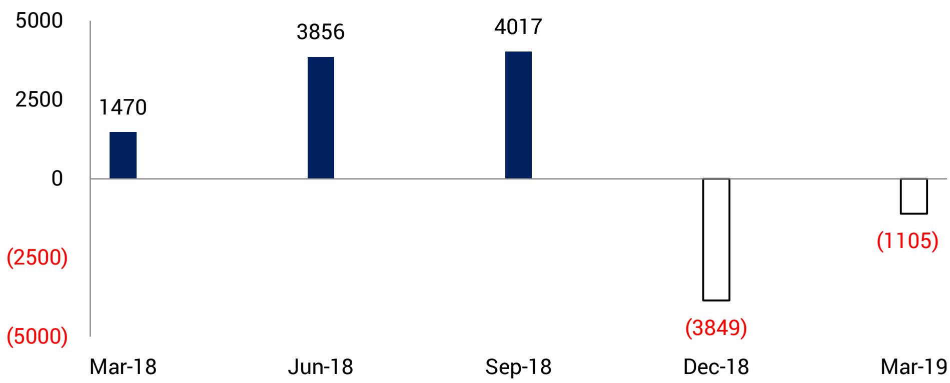
MRPL's GRMs v/s Benchmark Singapore GRMs (US$/bbl)



Source: Company. Note: MRPL's reported GRMs includes inventory gain/loss.

- **Raw material cost including purchases of finished goods:** Despite higher crude throughput, raw material cost decreased 17% qoq to Rs.141 bn (+10% yoy) led by strong currency and fall in international crude oil price. In Q4FY19, MRPL's average crude oil price decreased by 26% qoq to US$ 54/bbl. Raw material cost to sales ratio (%) has decreased 990 bps to 79.2%.
- **Employee cost:** Staff cost has increased 23% qoq to Rs.1.29 bn (+1% yoy).
- **Other expenses:** MRPL's other expenditure increased significantly by 223% qoq (base effect) to Rs.2.8 bn. Operating cost per unit has increased substantially to US$1.16/bbl (+40% qoq) due to higher other expenses.
- **Forex gain:** MRPL booked lower forex gain of Rs.1.1 bn as against a forex gain of Rs.3.85 bn in Q3FY19 due to currency fluctuations.

Forex Loss/ (Gain) volatility impact earnings (Rs. Mn)



Source: company

- **Operating profit:** Higher GRMs and higher crude throughput resulted sequential higher operating profit of Rs.8 bn in Q4FY19 as against an operating loss of Rs.1.05 bn in Q3FY19 and operating gain of Rs.10 bn in Q4FY18.
- **Interest cost:** MRPL's interest cost has increased to Rs.1.4 bn, up 44% qoq and 29% yoy partly due to base effect and higher borrowing. Gross debt (long and short) increased to Rs.122.4 bn as on 31st March 2019 as against Rs. 107.4 bn as on 31st March 2018. With higher crude oil prices and lesser supply from Iran (which provides better credit facilities) we expect increase in working capital which will result in higher borrowings and higher interest cost.

- **Depreciation:** In Q4FY19, depreciation cost increased 26% qoq to Rs.2.25 bn (+39% yoy). Net block (including intangibles and others) stood at Rs. 196 bn as on 31st March 2019 as against Rs. 198 bn as on 31st March 2018.
- **Other income:** MRPL's other income stands at Rs.246 mn in Q4FY19, decreased 33% qoq mainly on account of lower dividend/interest income. Cash and cash equivalent stood lower at Rs. 4.9 bn as on 31st March 2019 as against Rs.8.3 bn as on 31st March 2018 partly due to higher working capital requirement. Working capital increased to Rs. 40 bn as on 31st march 2019 as against Rs. 30 bn as on 31st March 2018. Higher working capital requirement is due to higher crude oil prices (higher inventory levels) and lower creditors as supply from Iran reduced.
- **Profit before tax (PBT):** MRPL reported PBT of Rs.4.7 bn due to higher operating profit as against loss of Rs.3.5 bn in Q3FY19.
- **Extra ordinary Expenses:** MRPL has reported a loss of Rs.34 mn in Q4FY19.

The exceptional item for FY19 includes –

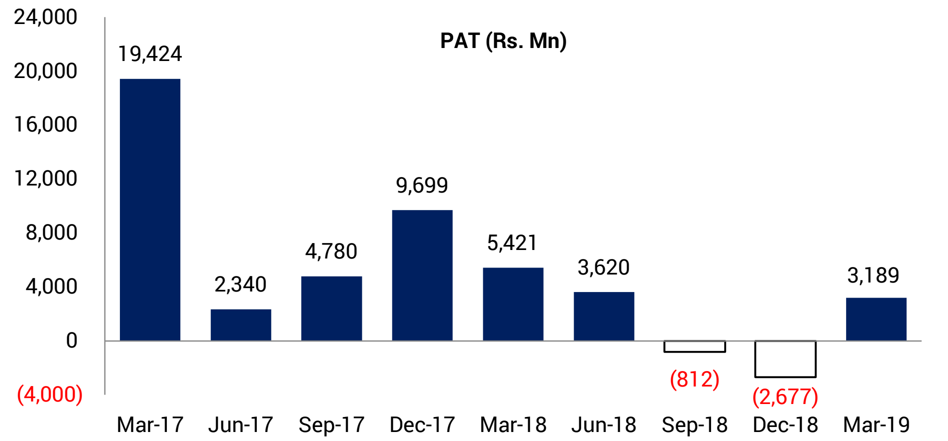
a) Expense of Rs.339.7 mn is on account of estimated cost of purchase of Renewable Energy Certificate (REC) from Indian Energy Exchange (IEX), as per the direction received from Karnataka Electricity Regulatory Commission, for meeting Renewable Energy Purchase Obligation (RPO) from the financial year 2015-16 to 2017-18 based on company's captive consumption.

b) Expense of Rs.228.7 mn is towards contribution to "MRPL Defined Contribution Pension Scheme" for management staff (pertaining to the period January 2007 to March 2018) and non-management staff (pertaining to the period April 2007 to March 2018).

c) Income of Rs. 420.5 mn relating to reclaim of input tax credit under Goods and Service Tax Act (GST Act) for the financial year 2017-18 represents the credit taken based on annual mix of products covered under GST and products not covered under GST.

- **Income Tax:** The company has recognized tax liability of Rs.984 mn under the Income Tax Act, 1961 and deferred tax liability of Rs. 511 mn in Q4FY19.
- **PAT:** Despite higher depreciation charge, higher interest cost and lower other income, the company has reported higher PAT of Rs. 3.2 bn in Q4FY19 due to higher operating profit as against a net loss of Rs.2.7 bn in Q3FY19 and a PAT of Rs. 5.4 bn in Q4FY18.

Quarterly earnings volatility continues



Source: Company

Key Developments

- **Force majeure and planned maintenance shutdown to impact volumes:** The company has announced that due to acute shortage of fresh water in the river Nethravathi, MRPL refinery complex process unit (4 mmtpa) are under partial shutdown as a force majeure. This is along with a 3 mmtpa unit which was shut in April'19 for routine maintenance. We believe this will result in lower capacity utilization in FY20. Currently, the company is operating at 8 mmtpa capacity as against 15 mmtpa (300 kbpd) nameplate capacity. In general, the refinery needs 13 mn gallons per day (mgd) to maintain operations, for which it depends largely on the Nethravathi.
- In response, MRPL is using higher sewage water. Additionally, it is setting up a desalination plant and the same is scheduled to commence by Sept'20 to use sea water.
- MRPL will be commissioning gasoline treating units to maximise production of Euro-VI compliant petrol. India has set a target for a country-wide roll out of Euro VI compliant fuels from April 2020.
- **Marketing initiatives:** The Company has increased its market presence by way of direct marketing of its products Petcoke, Sulphur and Polypropylene. The company is increasing the product grades of Polypropylene to enhance Polypropylene (PP) market share and thereby fetch higher margins.
- **New expansion plans in place – Growth is a process:** MRPL has set-up the next milestone and is planning to enhance its refining capacity to 25 mmtpa (19% higher than targeted) as against an earlier target of 21 mmtpa and current capacity of 15.5 mmtpa. Additionally, the company is planning to scale up its petrochemical capacity to boost its margins. The Company will invest Rs.110 bn in this expansion. We like the sharpened focus of the company on the growth strategy. The expansion is seen as a major margin driver as it will help the company to process cheaper, heavier crudes into high-value products like diesel, liquefied petroleum gas and propylene..
- **Re-commencing retail outlets** - The Company has commissioned COCO (company owned and company operated) retail outlet in Mangalore in Feb'18 and also commissioned its first ever dealer owned dealer operated retail outlet at Mandya in March'18. In Karnataka, this is the sixth RO for MRPL. MRPL has drawn up plans for opening over 100 retail outlets which will improve its overall margins due to addition of marketing margins. The company is in the process of obtaining statutory approvals. MRPL has also taken over retail outlet of ONGC set up near the refinery unit and has now become a part of MRPL retail outlet map.
- **Auto fuel up-gradation:** MRPL is in the process of upgrading its facilities to produce BS-VI grade MS& HSD by April 2020 in-line with the Supreme Court directive and Auto fuel upgradation policy of Govt of India.

Recommend ADD

We expect regional GRM to remain stable (at US$5.5/bbl) as global refining capacity addition is likely to be in line with oil demand growth.

We are introducing FY21E earnings and roll-forward our valuation to FY21E earnings. Hence, we now expect MRPL to report an EPS of Rs.8.0 in FY20E (earlier Rs.9.4) and an EPS of Rs.9.6 in FY21E.

At current price, the stock is trading at 6.6x P/E and 0.9x P/B multiples on FY21E earnings. We believe that the stock is reasonably valued at 4.7x EV/EBIDTA on FY21E. We now recommend ADD (earlier BUY) on the stock with a revised price target of Rs.70/share (earlier Rs.75/share) due to ongoing issues with the capacity utilization. We have valued MRPL based on EV/EBITDA multiple of 5x FY21, which is at a significant discount to its peers considering its size, NCI, and limited retail distribution.

Going ahead, we expect MRPL's profitability to improve on account of i). Improved product mix, ii). Better refining margins iii). Economies of scale and iv). Forward integration - Polypropylene plant.

Valuation

Particulars Unit FY21E	Unit	
EBIDTA	Rs. mn	47,400
Multiple EV/EBIDTA	x	5.0
EV		236,998
Less: Net debt		114395
M.cap		122603
Fair Value / Share (Rs.)		**70**
CMP		63
Upside/ (Downside) (%)		11

Source: Kotak Securities - Private Client Research

Key Risk and Concerns:

- Wide fluctuations in crude, forex and product prices can impact the margins.
- If global supply exceeds demand then margins can be under pressure.
- Any delay in executing the project can significantly impact the valuations.

Company Background

Mangalore Refinery and Petrochemicals Ltd. (Mini-Ratna status) is a pure play crude oil refiner with strong promoter backing of ONGC (India's biggest government owned exploration Company). MRPL has transformed itself into a large and complex refinery with phase-III capacity expansion and has emerged into a much stronger player in the industry.

Financials: Consolidated

Profit and Loss Statement (Rs mn)

(Year-end Mar)	FY18	FY19	FY20E	FY21E
Revenues	**490,429**	**632,411**	**638,346**	**656,370**
% change YoY	12.1	29.0	0.9	2.8
EBITDA	**46,343**	**24,131**	**43,274**	**47,400**
% change YoY	(7.2)	(47.9)	79.3	9.5
Other Income	1,158	3,445	850	850
Depreciation	9,661	10,475	11,214	11,496
EBIT	**37,840**	**17,101**	**32,909**	**36,753**
% change YoY	(37.1)	(54.8)	92.4	11.7
Net interest	9,127	10,587	11,369	11,078
Profit before tax	**28,713**	**6,514**	**21,540**	**25,675**
% change YoY	(43.2)	(77.3)	230.7	19.2
Tax	10,977	3,001	7,324	8,730
as % of PBT	38.2	46.1	34.0	34.0
Profit after tax	**17,736**	**3,513**	**14,216**	**16,946**
Minority interest	(2,191)	112	112	112
Share of profit of associates	0	0	0	0
Net income	**19,927**	**3,400**	**14,104**	**16,833**
% change YoY	(42.6)	(82.9)	314.8	19.4
Shares outstanding (m)	1,753	1,753	1,753	1,753
EPS (reported) (Rs)	**11.4**	**1.9**	**8.0**	**9.6**
CEPS (Rs)	15.6	8.0	14.5	16.2
DPS (Rs)	3.0	1.0	2.5	3.0

Source: Company, Kotak Securities – Private Client Research

Balance sheet (Rs mn)

(Year-end Mar)	FY18	FY19	FY20E	FY21E
Cash and cash equivalents	8,330	4,896	1,630	1,668
Accounts receivable	25,768	23,739	26,233	26,974
Inventories	52,404	63,087	64,709	66,536
Loans and Adv & Others	23,710	25,676	25,679	25,706
Current assets	110,211	117,399	118,252	120,884
Misc exp.	0	0	0	0
LT investments	384	366	366	366
Net fixed assets	208,911	209,899	210,886	211,874
Total assets	**319,506**	**327,663**	**329,504**	**333,124**
Payables	47,926	46,932	45,577	46,629
Others	55,027	49,098	44,187	44,450
Current liabilities	102,953	96,030	89,764	91,079
Provisions	601	806	808	831
LT debt	107,403	122,384	124,379	116,063
Min. int and def tax liabilities	6,215	8,985	6,096	6,091
Equity	17,527	17,527	17,527	17,527
Reserves	84,808	81,931	90,930	101,533
Total liabilities	**319,506**	**327,663**	**329,504**	**333,124**
BVPS (Rs)	58	57	62	68

Source: Company, Kotak Securities – Private Client Research

Cash flow Statement (Rs mn)

(Year-end Mar)	FY18	FY19	FY20E	FY21E
EBIT	37,840	17,101	32,909	36,753
Depreciation	9,661	10,475	11,214	11,496
Change in working capital	7,530	(16,030)	(10,271)	(1,261)
Chgs in other net current assets	-	-	-	-
Operating cash flow	55,030	11,546	33,852	46,989
Interest	(9,127)	(10,587)	(11,369)	(11,078)
Tax	(10,977)	(3,001)	(7,324)	(8,730)
Cash flow from operations	**34,926**	**(2,042)**	**15,160**	**27,181**
Capex	(10,188)	(11,463)	(12,202)	(12,484)
(Inc)/dec in investments	34	19	-	-
Cash flow from investments	**(10,154)**	**(11,444)**	**(12,202)**	**(12,484)**
Others	43	1,391	(6,109)	(1,126)
Increase/(decrease) in debt	(25,193)	14,981	1,995	(8,316)
Proceeds from share premium	-	-	-	-
Dividends	(12,731)	(6,319)	(2,109)	(5,217)
Cash flow from financing	**(37,881)**	**10,053**	**(6,223)**	**(14,659)**
Opening cash	21,438	8,330	4,896	1,630
Closing cash	**8,330**	**4,896**	**1,630**	**1,668**

Source: Company, Kotak Securities – Private Client Research

Ratio Analysis

(Year-end Mar)	FY18	FY19	FY20E	FY21E
EBITDA margin (%)	9.4	3.8	6.8	7.2
EBIT margin (%)	7.7	2.7	5.2	5.6
Net profit margin (%)	4.1	0.5	2.2	2.6
Receivables (days)	19	14	15	15
Inventory (days)	39	36	37	37
Sales/gross assets(x)	2.2	2.9	2.8	2.8
Interest coverage (x)	4.0	1.3	2.8	4.3
Debt/equity ratio(x)	1.2	1.2	1.1	1.0
ROE (%)	17.1	3.6	13.2	14.4
ROCE (%)	12.9	6.4	11.0	11.8
EV/ Sales	0.4	0.4	0.4	-
EV/EBITDA	4.5	9.4	5.4	4.7
Price to earnings (P/E)	5.5	32.5	7.8	6.6
Price to book value (P/B)	1.1	1.1	1.0	0.9

Source: Company, Kotak Securities – Private Client Research kotak Securities

Result Update

AKZO NOBEL INDIA (AKZO)

PRICE RS.1625 **TARGET RS.1800** **ADD**

Stable volume growth in the decorative segment and weakness in the industrial segment (primarily automotive), continued raw material price inflation and small price hikes in Q4FY19 were the highlights of the results for Akzo during the quarter. Maintain ADD with an unchanged TP of Rs 1800 at 33x at FY21E earnings.

Stock Details

Market cap (Rs mn)	:	73730
52-wk Hi/Lo (Rs)	:	1995 / 1471
Face Value (Rs)	:	10
3M Avg. daily vol (Nos)	:	7,903
Shares o/s (mn)	:	46

Source: Bloomberg

Financial Summary

Y/E Mar (Rs mn)	FY19	FY20E	FY21E
Revenue	29,183	32,111	33,969
Growth (%)	3.1	10.0	5.8
EBITDA	3,425	3,870	4,135
EBITDA margin (%)	11.7	12.1	12.2
PAT	2,121	24,732	28,099
EPS	46.5	52.6	56.1
EPS Growth (%)	4.1	13.1	6.7
BV (Rs/share)	279.5	115.0	133.5
Dividend/share (Rs)	24.0	26.0	27.0
ROE (%)	17.7	18.1	17.7
ROCE (%)	25.1	24.6	25.5
P/E (x)	34.9	30.8	28.9
EV/EBITDA (x)	18.5	16.4	15.4
P/BV (x)	5.8	5.3	4.9

Source: Company, Kotak Securities - PCG

Shareholding Pattern (%)

(%)	Mar 19	Dec-18	Sep-18
Promoters	74.8	74.8	74.8
FII	1.4	1.4	1.5
DII	7.9	7.9	7.7
Others	15.9	15.9	16.1

Source: Bloomberg

Price Performance (%)

(%)	1M	3M	6M
Akzo Nobel	(8.1)	(4.8)	2.3
Nifty	(3.6)	4.4	6.1

Source: Bloomberg

Price chart (Rs)

Source: Bloomberg

Key Highlights

- As per management commentary, Akzo experienced low-single digit YoY growth in the decorative segment. While the company reported de-growth in the industrial segment.
- Management commented that inflation (including Raw material cost), volatility in crude prices and INR movement continue to impact the operating margins in Q4 as well. Management is making efforts to increase product prices and reduce various cost to counter the situation.
- Sales (excluding GST) was reported at Rs 7.06 bn (+0.7% YoY). Raw material price inflation and weakness in the industrial segment (including two—wheelers) impacted the Gross margin and EBIDTA margin for the quarter.
- Company took one small price hikes in the decorative segment, to counter the steep increase in raw material (RM) prices including crude derivatives. However, these hikes were not enough to mitigate the increase in RM costs.
- Management mentioned that the industrial segment including automotive segment is weak and it is difficult to pass on the RM hikes in this segment. While decorative is strong for the entire industry.
- Consequently, PAT was reported at Rs 928 mn vs. our expectation of Rs 1070 mn.

Quarterly Performance

Rs mn	Q4FY18	Q3FY19	Q4FY19	YoY (%)	QoQ (%)
Net sales	**7004**	**7832**	**7056**	**0.7**	**(9.9)**
Raw material	4020	4655	4045	0.6	(13.1)
Employee cost	812	628	599	(26.2)	(4.6)
Other expenses	1473	1538	1377	(6.5)	(10.5)
Total operating cost	6305	6821	6021	(4.5)	(11.7)
EBIDTA	**699**	**1011**	**1035**	**48.1**	**2.4**
EBIDTA margin	10.0	12.9	14.7		
Finance cost	17	23	8		
Depreciation	150	165	185	23.3	12.1
Other income	128	98	152	18.8	55.1
PBT	**660**	**921**	**994**	**50.6**	**7.9**
Taxes	199	319	291	46.2	(8.8)
Adjusted PAT	**461**	**602**	**703**	**52.5**	**16.8**
Exceptional item	0	0	0		
Reported PAT	**461**	**602**	**703**	**52.5**	**16.8**
Equity	467	467	467	0.0	0.0
EPS	**9.9**	**12.9**	**15.1**	**52.5**	**16.8**

Source; Company

Amit Agarwal
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Management indicated the performance of Q4FY19 could be attributed to:

- Stable performance of the decorative segment.
- Weakness in the industrial segment due to weak private capex cycle and weak automotive segment.
- Unfavourable product mix
- Higher raw material prices in large part of the quarter

Volume uncertainty

Slow growth in the current quarter reflects uncertainty in the near-term demand outlook. Variables like monsoon and easing of credit cycle needs to be watched closely.

Industrial business - In the industrial business, the automotive segment witnessed slowdown in the second half of the year as the auto OEM segment witnessed subdued growth. Further, high RM prices and inadequate price increase impacted profitability.

Decorative segment

In the decorative segment, Akzo has a presence in premium as well as mass market and economy segments, with strong positioning in the premium segment through its well established brand “DULUX”. Akzo manufactures the Dulux brand of paints for interior and exterior decoration and protection as well as products for surface preparation and wood care.

In the last one year, Akzo launched a series of innovative and environment friendly new products, which as per management has received good response from the market. Some of them are:

- Dulux Aquatech – water proofing range,
- WeatherShield Flash – two coat system, revolutionary technology for exterior walls,
- Supercover Sheen – entry level sheen product in premium emulsion.

Launch of innovative products would be key for Akzo to maintain volume growth over FY19 – FY21E.

Industrial Paints

Industrial paints segment contributes approximately 10% of the overall revenues of the company. Akzo has a market share of 3% in the segment and management has internally set a target ROI of 25% from this business which would augment the overall profits of the company.

Presence of Akzo in Industrial paints

Segment	Usage	Outlook
Marine coating	Ship Construction	Neutral
Powder coating	Automobiles, white goods, General Industrial	Positive
Metal coating	Building and construction	Positive
Vehicle refinishes	Vehicle repairs	Positive

Source: Company

Performance may remain under pressure in H1FY20

Akzo experienced almost 300 bps expansion in margins from FY12 to date on the back of benign raw material prices, strong growth in the automotive segment, healthy demand in the decorative segment, premiumisation and up trading. Though the company was able to pass on price hikes in the decorative segment, a delay or lack of ability to completely pass on the price hikes in the industrial segment impacted EBITDA margin in FY19. Akzo primarily caters to the 2-wheeler segment. We estimate things to normalize for Akzo in H2FY20 as automotive downturns historically has ranged 1 to 1.5 years

Outlook and Valuation

We estimate that branded paint demand will remain robust in a country like India where per capita consumption is very low and 30% paint market is still unorganised. Favourable macro environment, reduction in GST rates and recent correction in raw material prices is positive for the industry. Management of Akzo also indicated that the volume trends remain strong for the company and expect the trend to continue in medium term. Change in top management for Akzo may translate into much needed aggression and expansion urge for the company.

However, weak macros and weak automotive segment can impact the performance of the company in H1FY20. Accordingly, we have cut our EPS estimate by 10% for FY20 and introduce FY21E numbers. Maintain ADD with an unchanged TP of Rs 1800 at 33x FY21E earnings (at 20% discount to PE multiple of peers).

Company Background

Akzo Nobel NV, the world's largest paints company, operates in India through its subsidiary Akzo Nobel India (AKZO) which it acquired as a part of the global acquisition of Imperial Chemicals Industries (ICI) Plc. in FY08 for USD16bn. Its brand portfolio includes well-known brands such as Dulux, Sikkens, Glidden and International. The company has it's headquarter in Amsterdam and operates in more than 80 countries. Akzo in India enjoys ~8% market share in decorative paints in India serviced through its network of 9000 plus dealers, 90 depots and six manufacturing facilities.

Financials: Consolidated

Profit and Loss Statement (Rs mn)

(Year-end Mar)	FY18	FY19	FY20E	FY21E
Revenues	**28,318**	**29,183**	**32,111**	**33,969**
% change YoY	0.2	3.1	10.0	5.8
RawMaterial	16,182	16,908	18,080	19,125
Employee cost	2,490	2,651	2,900	3,038
Other expenses	6,654	6,199	7,261	7,670
Total Operating expd	25,326	25,758	28,241	29,834
EBITDA	**2,992**	**3,425**	**3,870**	**4,135**
Depreciation	595	657	735	778
EBIT	**2,397**	**2,768**	**3,135**	**3,357**
Other income	460	422	475	500
Interest expense	37	24	31	38
Profit before tax	**2,820**	**3,166**	**3,579**	**3,819**
Tax	783	1,045	1,181	1,260
ETR (%)	27.8	33.0	33.0	33.0
Profit after tax	**2,037**	**2,121**	**2,398**	**2,559**
JV & Associates	0	0	0	0
Net income	**2,037**	**2,121**	**2,398**	**2,559**
% change YoY	7.0	4.1	13.1	6.7
Shares outstanding (m)	46	46	46	46
EPS	**44.7**	**46.5**	**52.6**	**56.1**

Source: Company, Kotak Securities – Private Client Research

Balance sheet (Rs mn)

(Year-end Mar)	FY18	FY19	FY20E	FY21E
Cash	1,854	3,449	4,012	4,788
Debtors	3,954	4,166	4,534	4,823
Inventory	4,018	4,106	4,561	4,808
Loans & advances	20	20	20	20
Other current assets	637	680	736	785
Total current assets	8,630	8,972	9,850	10,436
LT investments	3,700	3,900	4,200	4,500
Net fixed assets	5,423	5,354	5,554	5,709
Total assets	**19,608**	**21,676**	**23,618**	**25,435**
Creditors	5,891	6,340	6,914	7,253
Provisions	939	903	1,004	1,080
Other current liabilities	1,575	1,633	1,741	1,877
Total current liabilities	8,405	8,876	9,658	10,210
LT debt	191	237	313	382
Minority Interest	0	0	0	0
Equity Capital	456	456	456	456
Reserves	10,556	12,003	12,967	14,037
Networth	11,012	12,459	13,423	14,493
Total liabilities	**19,608**	**21,676**	**23,618**	**25,435**

Source: Company, Kotak Securities – Private Client Research

Cash flow Statement (Rs mn)

(Year-end Mar)	FY18	FY19	FY20E	FY21E
PAT	2,037	2,121	2,398	2,559
Depreciation +DTL	673	762	853	904
Change in working capital	132	128	(96)	(33)
Cash flow from operations	**2,842**	**3,011**	**3,155**	**3,430**
Capex	(595)	(589)	(934)	(933)
Investments	(261)	(200)	(300)	(300)
Cash flow from investments	**(856)**	**(789)**	**(1,234)**	**(1,233)**
Equity issuance	-	(2,350)	-	-
Debt raised	51	46	76	69
Dividend Paid	(1,241)	(1,324)	(1,434)	(1,489)
Miscellanous items	-	3,000	-	-
Cash flow from financing	**(1,190)**	**(628)**	**(1,358)**	**(1,420)**
Net cash flow	796	1,594	563	777
Opening cash	1,058	1,854	3,449	4,012
Closing cash	**1,854**	**3,449**	**4,012**	**4,788**

Source: Company, Kotak Securities – Private Client Research

Ratio Analysis

(Year-end Mar)	FY18	FY19	FY20E	FY21E
EBITDA margin (%)	10.6	11.7	12.1	12.2
EBIT margin (%)	8.5	9.5	9.8	9.9
Net profit margin (%)	7.2	7.3	7.5	7.5
ROE (%)	19.0	17.7	18.1	17.7
ROCE (%)	32.7	25.1	24.6	25.5
DPS	22.5	24.0	26.0	27.0
CEPS	57.7	61.0	68.7	73.2
Book Value (Rs/share)	245.4	279.5	303.2	329.4
Working capital turnover (days)	(1.6)	3.7	2.0	1.6
Debt Equity (x)	0.0	0.4	0.2	0.0
PER (x)	36.3	34.9	30.8	28.9
P/C (x)	28.1	26.6	23.6	22.2
Dividend yield (%)	1.4	1.5	1.6	1.7
P/B (x)	6.6	5.8	5.3	4.9
EV/Sales (x)	2.5	2.4	2.2	2.1
EV/ EBITDA (x)	20.6	18.5	16.4	15.4

Source: Company, Kotak Securities – Private Client Research

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ADD	–	We expect the stock to deliver 5% - 15% returns over the next 12 months
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