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Analyst Notes: Titan: Rich valuations ignoring GST risk

Abhishek Ranganathan, CFA, Tel: +91 22 3043 3085

Titan should deliver ~37% YoY growth in 4QFY17E driven by >40% growth in jewellery revenues. The demand revival is aided by a favourable base and near doubling of revenue growth of wedding jewellery. Wider/improved collections and pricing interventions will help Titan gain market share in the Rs1500bn wedding jewellery market. This inelastic category provides visibility of jewellery revenue growth (17% CAGR over FY17-20) but would cap RoE to 25% given lower margins and turns. GST poses risk to these assumptions as a rate of >8% (Government's tax neutral rate when coupled with customs duty of 5%) would not only diminish gold's store of value but also favour unorganised players. This could impact 30% of Titan's revenues that come from exchanged gold. Given a lower-than-historical RoE profile and the GST risks, valuation of 35x FY19E EPS seems expensive (click here for detailed report).

Source: Ambit Capital research

Please refer to our website for complete coverage universe

http://research.ambitcapital.com

The sceptical CEO

Quick Insight

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As we read less and surf more, our investment habits are changing

Indian investors are submerging themselves in high-frequency data and news flow even as they spend less than time reading newspapers and in-depth reports. This change in reading habits is likely to breed overconfidence, which leads to excessive trading and lowers returns for investors. Other adverse impacts of focusing on news and data are a reduced ability to perform second-level thinking even as more stocks trade at extreme valuations (the number of stocks trading in excess of 50x trailing EPS is near record levels in India). Whilst these developments are likely to result in lower fees for run-of-the-mill funds, the alpha associated with that small minority of investors who can take lonely, very long-term positions will grow.

"It's not what a man don't know that makes him a fool, but what he does know that ain't so."

- ***Josh Billings, nineteenth century American humorist***

We are reading less and surfing more

When I first moved to India in 2008, newspaper journalists would routinely call up sell-side analysts for their views on the market. Over the last 12 months, I can see that newspaper journalists no longer call us as much as they used to (and "no" it is not just because we are bearish!). Instead, a new breed of journalists employed by websites and newswires assiduously pursues my colleagues for their views. The reason for this shift is simple – the press (especially the English newspapers) is rapidly losing ground in India as websites dispensing up-to-minute news and views become the default mode of accessing news. This is true generally for news and especially true for financial news where up-to-minute news is, arguably, even more useful for the end-consumer. As shown in the tables below, sites like Moneycontrol are seeing rapid growth in readership whereas the English newspapers are either seeing slow growth or no growth in readership.

Whilst it is easy to say that such changes are only taking place in the reading habits of retail investors, it would be fair to say that even professional investors increasingly read fewer in-depth reports and are more inclined to read concise, bulleted emails. Furthermore, the concentration in trading activity around the quarterly results suggests investors make disproportionately more trades around quarterly results than the informational content of these results would justify. We can also see that trend in the readership summary reports that vendors like Thomson Reuters and Factset share with us – investors are avid readers of reports pertaining to corporate results.

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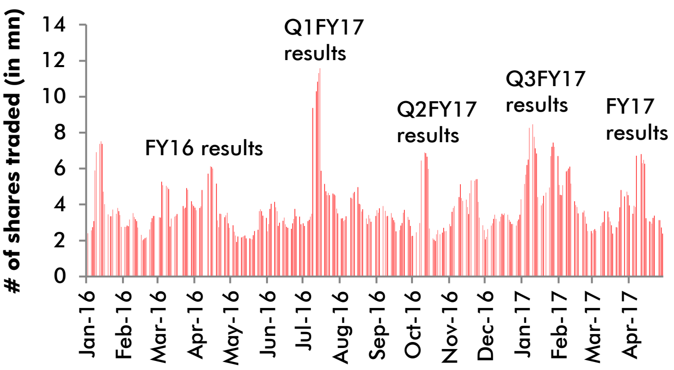
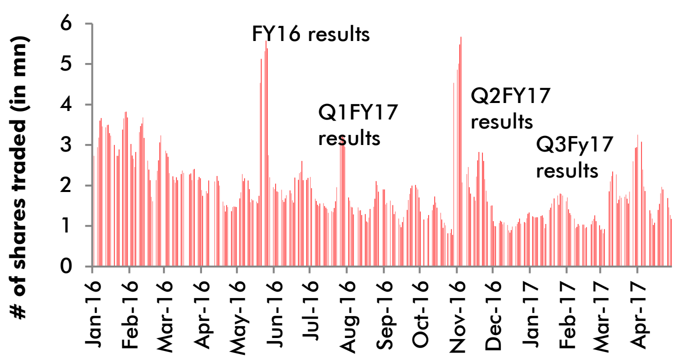
Exhibit 1: Infosys shares trading volume since Jan'16



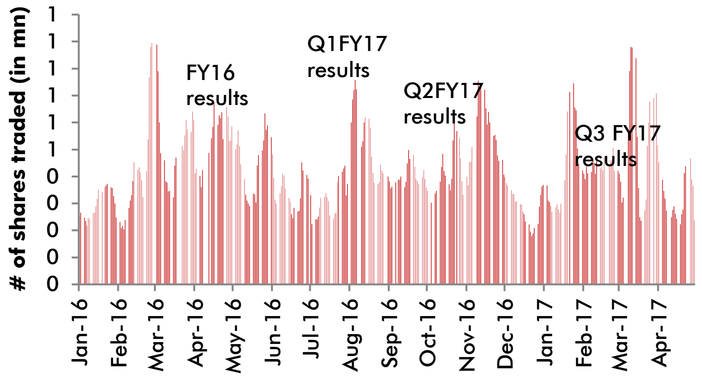
Source: Bloomberg, Ambit Capital Research Note: the share volume above is computed on a moving weekly average basis

Exhibit 2: L&T shares trading volume since Jan'16



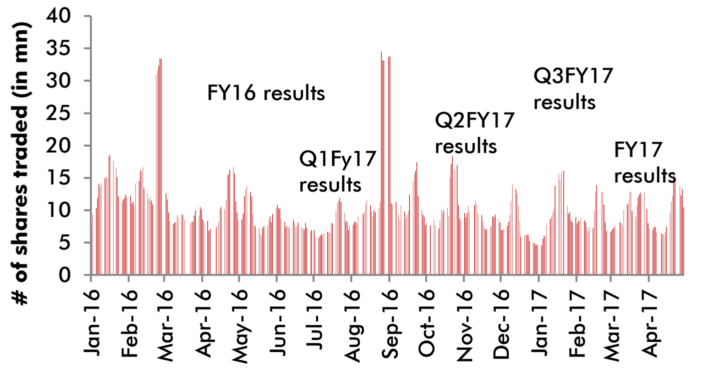
Source: Bloomberg, Ambit Capital Research Note: the share volume above is computed on a moving weekly average basis

Exhibit 3: Hero Moto shares trading volume since Jan'16



Source: Bloomberg, Ambit Capital Research Note: the share volume above is computed on a moving weekly average basis

Exhibit 4: Axis bank shares trading volume since Jan'16

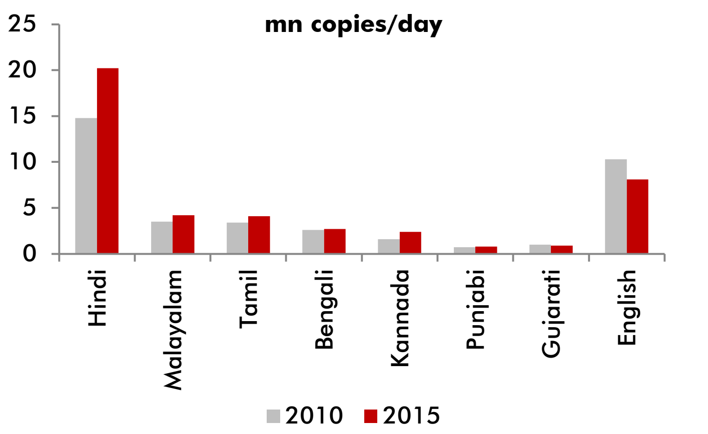


Source: Bloomberg, Ambit Capital Research Note: the share volume above is computed on a moving weekly average basis

How does our perception of the world around us change?

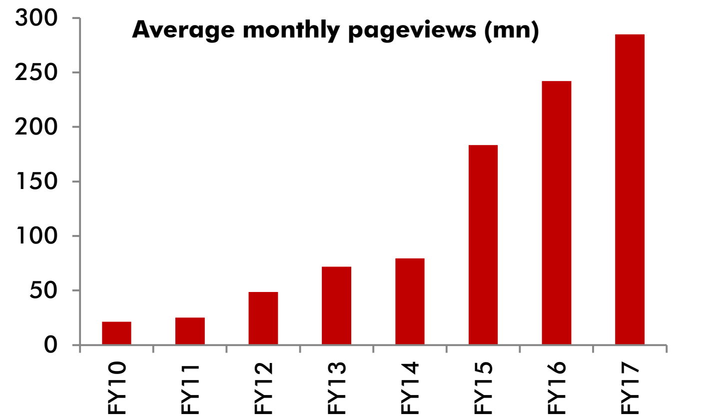
Leaving aside the obvious challenge that a reduction in newspaper reading poses for the publishers of English newspaper, as investors (retail and professional) read less in-depth material, read more bulleted emails and surf more websites, how does their perception of the world change?

Exhibit 5: English newspapers' circulation declined by 5% CAGR over 2010-2015…



Source: Company, Ambit Capital research

Exhibit 6: …whilst Moneycontrol.com pageviews surged at 45% CAGR over FY10-17



Source: Company, Ambit Capital research

Overconfidence: Psychologists have shown that across a range of fields, overconfidence is greatest for difficult tasks, for forecasts with low predictability, and for undertakings lacking fast, clear feedback. According to Brad Barber and Terence Odean, *"Selecting common stocks that will outperform the market is a difficult task. Predictability is low; feedback is noisy. Thus, stock selection is the type of task for which people are most overconfident."* (Source: Quarterly Journal of Economics, February 2001, http://faculty.haas.berkeley.edu/odean/Papers/gender/BoysWillBeBoys.pdf)

Why does it matter that investors fed an endless diet of data and news become overconfident? It matters because as numerous psychological studies have shown, *"…overconfident investors overestimate the precision of their knowledge about the value of a financial security. They overestimate the probability that their personal assessments of the security's value are more accurate than the assessments of others. Thus, overconfident investors believe more strongly in their own valuations, and concern themselves less about the beliefs of others. This intensifies differences of opinion. And differences of opinion cause trading."* (Source: Barber & Odean, Quarterly Journal of Economics, February 2001)

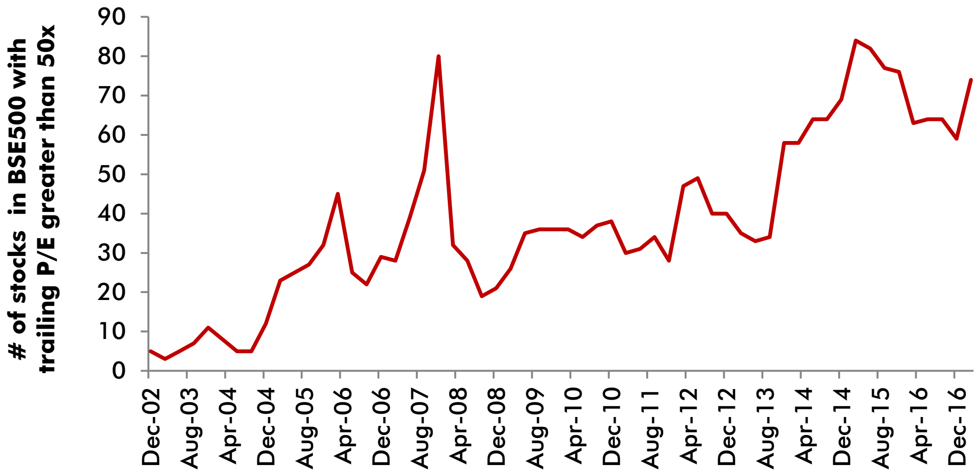
In effect, what seems to happen is that when investors are fed more data and more news, they are deluded into thinking that they actually have extra information. That illusion of knowledge prompts investors to trade more. That overtrading results in the investors earning lower returns; essentially, more information and the overconfidence that it engenders prompt investors to trigger low-quality trades and pay more in broking costs. High-frequency data and the illusion of control that it creates thus prompts investors to overestimate their ability to influence trajectories over which they have little control. Barber & Odean designed a famous boys vs girls study which highlighted this phenomenon.

"…Greater overconfidence leads to greater trading and to lower expected utility…. Psychologists find that in areas such as finance men are more overconfident than women. This difference in overconfidence yields two predictions: men will trade more than women, and the performance of men will be hurt more by excessive trading than the performance of women. To test these hypotheses, we partition a data set of position and trading records for over 35,000 households at a large discount brokerage firm into accounts opened by men and accounts opened by women. Consistent with the predictions of the overconfidence models, we find that the average turnover rate of common stocks for men is nearly one and a half times that for women. While both men and women reduce their net returns through trading, men do so by 0.94 percentage points more a year than do women." (Source: Barber & Odean, Quarterly Journal of Economics, February 2001)

More extreme views and excessive valuations: In fact, the impact of high-frequency data in triggering overconfidence is more profound than just prompting investors to overtrade. Dennis Dittrich, Werner Güth and Boris Maciejovsky showed in 2007 that *"overconfidence increases (i) with the absolute deviation from optimal choices, (ii) with task complexity involving the number of risky assets, and (iii) decreases with individual perceived uncertainty." (Source: European Journal of Finance, Volume 11, 2005, http://www.tandfonline.com/doi/abs/10.1080/1351847042000255643)*

In effect, our overconfidence makes us more prone to extreme views. We can see such extreme views fully displayed in the Indian market at present. In the BSE500 today, the number of stocks trading at greater than 50x trailing earnings is close to the all-time highs of 2008. Such investments mean that overconfident investors also hold riskier portfolios than do rational investors (with the same degree of risk aversion).

Exhibit 7: Number of BSE500 stocks trading at more than 50x trailing earnings is close to 2007-08 levels



Source: Bloomberg, Ambit Capital Research Note: The EPS is calculated on a rolling last 12 month basis

So far, we have focused on the impact of overconfidence on the individual investor. What does overconfidence do to the market as a whole? In a cleverly constructed paper, Kent Daniel and David Hirshleifer showed in 2015 that:

"Overconfident disagreement, combined with short-sale constraints, can also cause dynamic patterns of increasing overpricing…Scheinkman and Xiong (2003) present a model in which overconfidence generates disagreement among agents regarding asset fundamentals. Owing to short-sale constraints, investors buy stocks that they know to be overvalued in the hope of selling at even higher prices to more optimistic buyers. This magnifies the pricing effects of disagreement. Such bubbles should be more severe in markets with lower available supply of shares, or "float" (Hong, Scheinkman, and Xiong, 2006)… Overconfidence explains why investors who neglect important information would nevertheless trade aggressively, so that such neglect can influence price." (Source: Journal of Economic Perspectives, Fall 2015, http://www.kentdaniel.net/papers/published/JEP_15.pdf)

The market conditions that Daniel and Hirshleifer refer to – low liquidity, short selling constraints, investors who neglect important information – describe the Indian market quite well. That suggests that not only is the Indian market (and specific stocks in it) increasingly prone to significant overvaluation but also that "bubble like" conditions can persist in India longer than say in a mature stock market like the US.

Assets held without any rational justification: The news flow that investors are being fed shapes their view of the world. In such a context, when investors are repeatedly fed views from investment "gurus", they end up believing that such gurus have market beating insights not available to others. That leads investors to park their money in the gurus' funds even if the funds don't yield superior returns. As shown in the tables below, large cap mutual funds in India no longer generate meaningful alpha over very long investment horizons. In fact, the alpha generated by these funds over shorter periods of time has fallen sharply over the past six years. Click here for our detailed note published on 09 Mar 2017 on this topic.

Exhibit 8: Large-cap MFs enjoyed significant alpha over BSE100 in pre-2010 era…(analysis based on data from Jan'91-Dec'09)…

	Rolling One year		Rolling Three year		Rolling Five year		Rolling Ten year	
	Equity MFs	BSE 100	Equity MFs	BSE 100	Equity MFs	BSE 100	Equity MFs	BSE 100
Average returns	21.8%	15.3%	17.4%	14.2%	17.4%	14.3%	17.4%	13.3%
Median returns	18.6%	8.2%	17.3%	10.0%	14.5%	9.8%	**15.8%**	**14.7%**
Standard deviation	46%	37%	23%	19%	14%	14%	7%	5%
Sharpe ratio (average)	0.30	0.20	0.41	0.33	0.65	0.45	1.32	1.12
Sharpe ratio (median)	0.23	0.01	0.40	0.11	0.45	0.13	1.10	1.40

Source: www.mutualfundindia.com, Ambit Capital Research. There are 3635, 3133, 2659 and 1405 data points used to calculate the return parameters for 1, 3, 5 and 10 year holding horizons above.

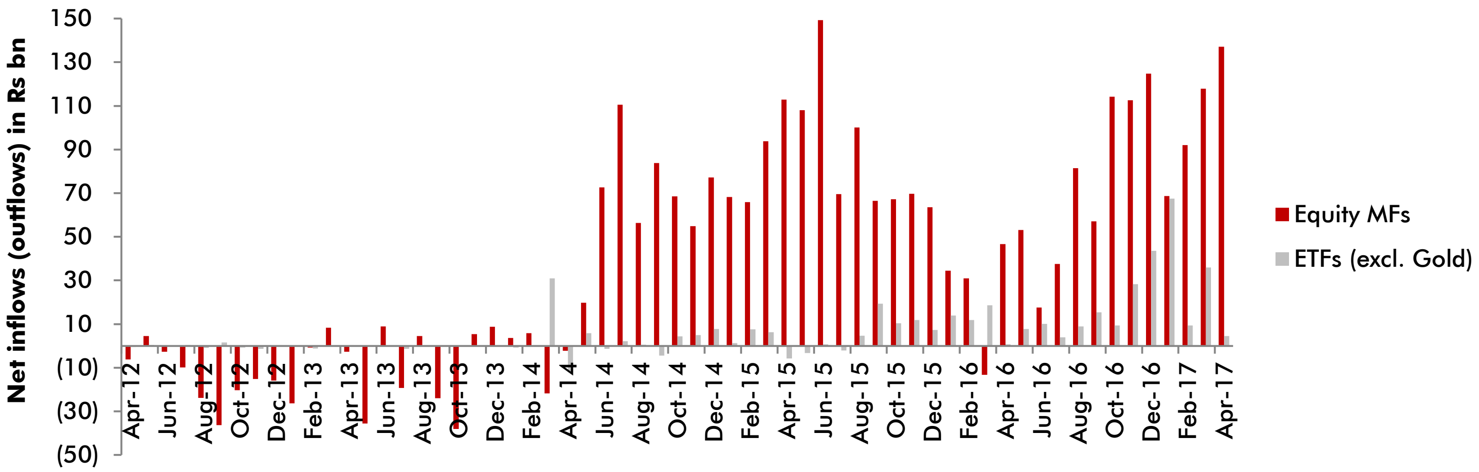
Exhibit 9: …but this alpha diminished significantly in the post-2010 period (analysis based on data from Jan'10-Feb'17)

	Rolling One year		Rolling Three year		Rolling Five year		Rolling Ten year	
	Equity MFs	BSE 100	Equity MFs	BSE 100	Equity MFs	BSE 100	Equity MFs	BSE 100
Average returns	16.6%	13.4%	12.3%	9.7%	11.8%	10.3%	**15.8%**	**15.8%**
Median returns	10.9%	9.2%	11.5%	9.3%	12.2%	9.9%	17.0%	16.5%
Standard deviation	23%	23%	7%	7%	5%	6%	3%	4%
Sharpe ratio (average)	0.38	0.24	0.60	0.25	0.69	0.39	2.25	2.16
Sharpe ratio (median)	0.13	0.05	0.48	0.19	0.76	0.31	2.57	2.34

Source: www.mutualfundindia.com, Ambit Capital Research. There are 1796 data points used to calculate the return parameters for 1,3,5 and 10 year holding horizons above

In such circumstances, one would expect low-cost index trackers to see elevated flows in India. Unfortunately, that hasn't happened. Indian retail investors continue to stuff their savings into actively managed large-cap funds which continue to have some of the highest expense ratios in the world.

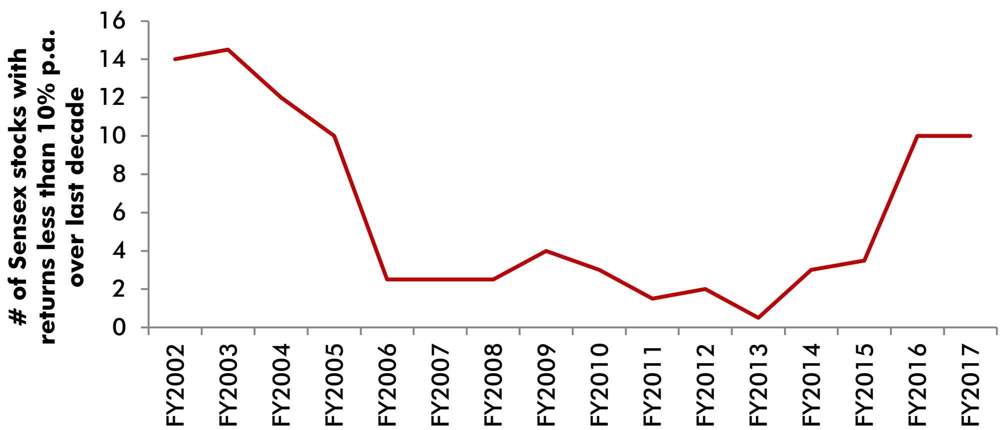
Exhibit 10: Equity ETFs continue to lag actively managed funds in attracting retail inflows



Source: AMFI, Ambit Capital Research Note: We assume 60% allocation of balanced funds as equity. The ETFs above include all ETFs except those tracking Gold

The same critique applies to investors' holding of several large-cap Indian stocks which haven't delivered meaningful returns over the past decade. As can be seen in the chart below, the number of Sensex stocks that have delivered less than 10% annualized returns over a ten-year period is at the highest level since 2005.

Exhibit 11: Sensex stocks returning less than 10% annualised (over a decade) are at highest level since 2005



Source: Bloomberg, Ambit Capital Research Note: Stocks with no price data over entire period of 10 years. To remove point to point returns calculation discrepancy, number of stocks have been computed by looking at returns through Mar(T-10)to Mar(T) and Sep (T-10) to Sep(T). The no. above is average of these calculations.

Less second-level thinking and the death of hedge funds: Several investment pundits from Howard Marks to James Montier have extolled the effectiveness of second-level thinking. In fact, Howard Marks has given us a definition of second-level thinking:

"Remember you goal isn't to earn average returns; you want to do better than average. Thus your thinking has to be better than that of others – both more powerful and at a higher level. Since others may be smart, well-informed and highly computerized, you must find an edge they don't have. You must think of something they haven't thought of, see things they miss, or bring insight they possess. You have to react differently and behave differently…For your portfolio to diverge from the norm, your expectations – and thus your portfolio – have to diverge from the norm, and you have to be more right than consensus. Different and better: that's a pretty good description of second-level thinking…Second-level thinking is deep, complex and convoluted. The second-level thinker takes many things into account:

- *What is the range of likely future outcomes?*
- *Which outcome do I think will occur?*
- *What's the probability I'm right?*
- *What does the consensus think?*
- *How does my expectation differ from consensus?*
- *How does the current price for the asset comport with the consensus view of the future, and with mine?*
- *Is the consensus psychology that's incorporated in the price too bullish or too bearish?*
- *What will happen to the asset's price if the consensus turns out to be right, and what if I'm right?" (Source: Howard Marks' 9th Sept 2015 memo, https://www.oaktreecapital.com/docs/default-source/memos/2015-09-09-its-not-easy.pdf?sfvrsn=2)*

As investors are exposed to less complex material (fewer long reads, fewer newspaper editorials) and as they are swamped with news flow, their ability and willingness to participate in second-level thinking reduces. That has several implications. For example, the gradual death of hedge funds as an asset class in the West is potentially because most hedge fund managers are no longer able to do second-level thinking; drowned in the same high-frequency data, they end up making the same crowded trades and thus fail to deliver alpha. Judging by current trends, the same fate will befall most large-cap mutual funds in India – since most of them make the same crowded trades, it is almost guaranteed that most of these funds will face intense competition from trackers in the years to come.

In contrast, most successful fund managers (of hedge funds and of mutual funds) tend to read a lot of books, newspaper editorials and blogs (here is an outstanding blog which demonstrates second-level thinking about the auto sector: http://ben-evans.com/benedictevans/2017/3/20/cars-and-second-order-consequences). A by-product of all this reading followed by second-level thinking is that the best fund managers end up making lonely trades (i.e. selling what everyone else is buying and vice versa) and then hold the lonely trade for very long periods of time.

Investment implications

As investors become submerged in high-frequency data and news flow, the alpha associated with investing over very long periods of time (say, five years or more) will become greater.

Conversely, as the vast majority of investors focus on the short term, the alpha associated with such investing will presumably reduce. Whether it is hedge funds in the Western context or large-cap mutual funds, the reduction in the number of curious investors who read extensively and think deeply will put downward pressure on active fund management fees. At the same time, the success of fund managers who use idiosyncratic, highly differentiated approaches to investing (say, using Artificial Intelligence or using very long-term investing approaches like the Coffee Can Approach – click here for our November 2016 note) will be outsized. Such funds will stand out even more than they do today in a world drowned in news and data.

Since psychological research has established that men are more prone to overconfidence than women, hiring more women in the fund management industry will help CIOs generate superior long-term returns. It might even be that pension fund consultants start looking at the men-to-women ratio at fund houses in the not too distant future.

Finally, and most obviously, reading less news and more in-depth analysis, worrying less about the here & now and more about the very long term, spending less time staring at the screen and more time thinking, spending less time in the office and more time out on the field are more likely to give investors a lasting edge in these data deluged times.

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Light Electricals

GST and summer blues

Channel checks reveal that primary sales have been severely hit since April as channel liquidation is at its peak. Channel participants target reducing inventory days from 60 to 15 by June-end given issues with: (a) lack of CENVAT credit on old unsold inventory (over one year old) and (b) GST to be paid on six-month-old VAT-paid inventory if returned. Moreover, demand for seasonal products is already weak given slow start to the summer in South and East India (pre-monsoon showers). New launches in real estate could decelerate if RERA implementation drives consolidation. Lastly, we don't expect significant shift in trade from unorganised to organised under GST given arbitrage of scrap copper and lower overheads for unorganised players. We maintain our cautious outlook on the sector given expensive valuations. Crompton is our top SELL.

NEGATIVE

Quick Insight

Analysis	✓
News Note	
Meeting Note	

Key Recommendations

Havells	**SELL**
Target Price: 418	Downside: 15%
Crompton Consumer	**SELL**
Target Price: 134	Downside: 44%
Finolex Cables	**UR**
Target Price: NA	Downside: NA
V-Guard	**SELL**
Target Price: 109	Downside: 48%
Bajaj Electricals	**BUY**
Target Price: 351	Upside: NA

Visible stress in the channel in the run-up to GST

Liquidaton of channel inventory has already started since 1st April given the likelihood of implementation of GST by September. As per our discussion with a few distributors, their target is to reduce average inventory days from ~60 today to 15 by June-end. The reason for this reduction in inventory is uncertainty over taxation on unsold inventory post GST implementation. There are two aspects to this: **(a)** CENVAT credit is not allowed on old unsold inventory post GST implementation and **(b)** GST is to be paid even on VAT paid goods returned to companies.

- Under the GST rules, CENVAT credit is not allowed on inventory purchased before 12 months, i.e. 30 Jun'16 (if GST is implemented from 1st July). Hence, there is a rush to liquidate inventory purchased before 30th June'16. As a thumb rule, minimum 10-15% of the inventory in the system is more than one year old.
- Under the GST rule, the channel will have to pay GST on VAT paid goods returned to companies which were purchased 6 months before GST implementation date or returned after 6 months from implementation of GST.

There is another rumour within the channel that they will not be allowed CENVAT credit on opening inventory which is less than one year old if sold beyond the 60 days' window. Though we are not sure about this, the fear amongst channel partners will disincentivize them from stocking inventory.

The highest inventory liquidation, we believe, is likely to be in consumer products which entail high SKUs. These include small appliances, fans, lighting, etc.

"A registered taxable person will get VAT credit only if input invoices and /or other prescribed documents were issued not earlier than twelve months immediately preceding the appointed day."

- *Sec. 146 (1) (vi) of th Model GST Law*

"Where any goods on which duty had been paid under the earlier law at the time of removal thereof, not being earlier than six months prior to the appointed day, are returned to any place of business on or after the appointed day, no tax shall be payable. Provided that tax shall be payable by the taxable person returning the goods if the said goods are liable to tax under this Act and are returned after a period of six months from the appointed day."

- *Sec. 149 (1) of the Model GST Law*

Moreover, post GST, we believe the channel partners will demand higher commission given rising cost of operations. As the business shifts towards white from black, the cost of doing business increases (salaries paid to accounts, chartered accountants etc). Only time will tell if this extra commission paid by companies to channel partners can be offset by price increases. If not, then margins will come under pressure. We fear the latter given that with RERA implementation demand from new housing will decelerate as the sector goes through a massive consolidation phase.

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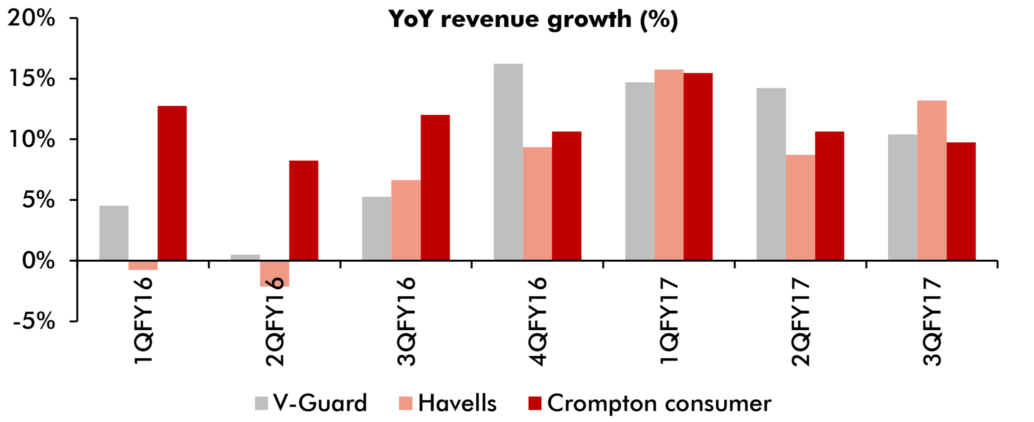
Tepid sales for seasonal products

Last year, sale of seasonal products (fans, stabilisers, coolers) was exceptional for the industry given the strong summer. Consequently, V-Guard, Crompton and Havells reported accreleration in YoY sales growth from 3%/11%/1% in 9MFY16 to 16%/11%/9% in 4QFY16 and 15%/15%/16% in 1QFY17.

Exhibit 1: Sales growth for V-Guard, Crompton and Havells accelerated in 4QFY16 and 1QFY17 due to the strong summer last year



Source: Company, Ambit Capital research

However, the demand for seasonal products has been mixed this year as the summer season has been slow to start in South and East India due to unseasonal rains (https://goo.gl/n4KCFB). Furthermore, price hikes of 3-6% by companies across product categories since April have led to postponement of purchases.

4Q expectations: Finolex and V-Guard may report EBITDA decline

Electricals sector result season will start with Havells on 11th May. We expect mixed results from the electrical companies this quarter. Whilst YoY revenue growth is likely to be strong at 17%/13%/16%/14% for Havells/Crompton/V-Guard/Finolex, EBITDA margin is liklely to come under pressure due to ~24% YoY increase in copper prices. Whilst EBITDA margin for Havells/V-Guard/Finolex is likely to decline by 140bps/200bps/680bps, for Crompton it can improve by 30bps due to a low base (merger-related expenses in 4QFY16). **We expect Finolex and V-Guard to report 26%/2% YoY decline in EBITDA**. Havells and Crompton are likely to report 6%/16% YoY growth in EBITDA.

Where do we go from here?

We maintain our cautious outlook on the sector given expensive valuations of ~44x FY18E EPS despite near-term headwinds pertaining to demand (channel liquidation risk due to GST, weak summer and weak demand in new housing) and margins (limited pricing power) due to increase in commodity prices. Whilst we are SELLers on Crompton, V-Guard and Havells, we have recently put our BUY stance on Finolex Under Review due to expensive valuations. Bajaj Electricals is our only BUY in the sector.

Exhibit 12: Light electricals sector - relative valuations

Company	CMP	Mcap	P/E (x)			P/B (x)			RoIC (%)			CAGR (FY17-19)	
	INR	US$mn	FY17	FY18	FY19	FY17	FY18	FY19	FY17	FY18	FY19	Revenue	EPS
Havells - standalone	495	4,615	53.1	47.4	38.9	10.5	9.5	8.5	56.3	66.8	79.4	16.4	16.7
Crompton consumer	240	2,245	52.3	44.2	35.6	29.5	23.1	18.8	39.0	44.2	57.0	13.6	21.3
Bajaj (non-E&P)	354	532	36.7	32.6	21.9	NA	NA	NA	NA	NA	NA	16.2	29.3
Finolex Cables	525	1,198	25.3	23.1	21.3	4.8	4.3	4.3	35.9	35.7	36.9	18.4	9.1
V-Guard	211	1,326	54.4	48.4	39.6	15.2	12.4	10.2	30.0	29.2	34.6	15.4	17.3
Sector			**52.3**	**44.2**	**35.6**	**12.8**	**11.0**	**9.4**	**37.5**	**40.0**	**46.9**	**16.2**	**17.3**

Source: Ambit Capital research, Note – prices as on 9 May 2017

Key investment thesis on electrical stocks

V-Guard (Mcap US$1.3bn; SELL; TP Rs109; 48% downside)

- **Increase in competition in core products:** V-Guard may lose market share in its core prducts, water heater (13% revenue; ~22% EBITDA) and stabiliser (13% revenue; ~34% EBITDA), due to increase in competitive intensity. In water heaters, Havells has been aggressive with its premium range of 'Arizona' series of in-house manufactured water heaters while Crompton is leveraging the channel experience of its MD Mathews Job (earlier MD of Racold) to gain market share. Also, Havells may enter into high-margin stabilisers (V-Guard earns 17-18% EBITDA margin) by leveraging Lloyd's distribution network (same chanel for AC and stabiliser as ~67% stabilisers sold with ACs).
- **No new launches since FY12:** V-Guard has not launched any new product since FY12 given challenges in scale-up of appliances and switchgears (launched in FY12) due to strong entry barriers of distribution and in-house manufacturing. Consequently, revenue growth is likely to decelerate from 20% over FY11-17E to 15% over FY17-19E (in-line with industry average).
- **Punchy valuations:** The stock is trading at an expensive valuation of 48x FY18E P/E despite headwinds to market share in core products and deceleration in revenue growth. The current multiple is at a 2% premium to Havells despite the latter being a more diversified franchise.

Crompton Consumer (Mcap US$2.2bn; SELL; TP Rs134; 44% downside)

- **Most exposed to EESL-led disruption:** Crompton is most exposed to EESL's price disruption strategy as fans contribute ~60% of Crompton's EBIT with high exposure to economy fans. EESL is rapidily expanding its fans reach. It has already got 2.5% market share (monthly run-rate of 1.25 lakh fans) and targets ~20% by FY19.
- **Domestic appliances not an easy ride:** Crompton would not be successful in product diversification given weak acceptance in small appliances and retail lighting. Crompton is facing challenges in appliances given high reliance on service network and fragmented sub-categories. Our channel checks suggest that, given the initial pushback from the channel, Crompton is now focusing only on water heaters in the domestic appliances.
- **Punchy valuations:** The stock currently trades at 44x/36x FY18/FY19 P/E, which is just a 7% discount to Havells despite the latter being a more diversified franchise with a strong execution history.

Havells (Mcap US$4.7bn; SELL; TP Rs418; 15% downside)

- **Turnaround of Lloyd unlikely:** Lloyd could disappoint street hype on attaining market leadership in ACs along with margin expansion. Market share would remain flat as Havells' channel magic won't work in hyper-competitive AC industry and AC premiumisation is tough (no precedent). Margins would also be flat as (a) price hikes may erode market share and (b) ad-spend (superstar ambassadors) will negate benefits of gross margin expansion.
- **Core franchise also facing growth challenges:** Havells' revenue growth decelerated from 19% in FY07-12 to 11% in FY12-17 as market share gain slowed from 150bps in FY07-12 to 60bps in FY12-17 (flat in cables /switchgears). Incremental market share gains will become challenge given: (a) limited avenue to enter new categories; (b) top four ranking in 8 categories; and (c) limited avenue for global expansion. Lastly, significant gains from unorganized under the GST regime is unlikely.
- **Valuations promise blue sky but ground reality grim :** Havells' trades at an all-time high valuation of 47x/39x FY18/FY19 standalone P/E; 163% premium to international peers despite similar financial performance and just 12% discount to Asian Paints despite weak sustainable competitive advantages– little advantage over No.2 electrical peer. Reverse DCF implies 20.7% revenue CAGR/350bps EBITDA margin over FY17-22; unwarranted as competition intensifies.

Bharti Infratel

Circumspect about consolidation

BHIN reaffirmed its right of first refusal for Idea/Vodafone stake in Indus. Also, there is no material progress on BHIN's deal talks with rivals. Whilst the company remains enthusiastic about tenancy growth due to telcos' data rollouts, commentary on future growth areas like small cells, IBS and infrastructure for Smart City projects remains hazy. In FY17, BHIN lost 2% tenancy due to HFCL's exit, leading to 8% rental revenue growth (down from 10% in FY16) and no margin expansion. Management commentary reinforces our view of uncertain inorganic growth for BHIN and persistent risks of dilution of bargaining power due to telco consolidation. Valuation premium to historical average remains unjustified. Given limited upside, we reiterate our SELL stance on Infratel.

No outcome of discussions with industry participants

BHIN commented that it is willing to utilise surplus cash and lever up its balance sheet to acquire businesses. The company reaffirmed its right of first refusal of Idea's and Vodafone's stake in Indus. Whilst the company claims an increase in its market share of incremental tenants, there isn't enough data to validate this. GTL Infra saw 13% growth in tenancy, higher than 8% tenancy growth for BHIN. Since incumbents have grown their networks, primarily through loading, it can be concluded that incremental tenancies were driven by Jio's rollouts. Looking at GTL Infra and BHIN's numbers, one can deduce that Jio has opted for the former despite a very low market share of overall towers given low base rentals. This provides a fresh lease of life to weak towercos, which can hold out much longer.

Rate freeze and exit of HFCL hurt rental revenue growth

BHIN mentioned that rental revenue growth was impacted by: (a) rate freeze, which resulted in Rs1.8bn revenue impact in FY17. Rate freeze will continue to impact revenue growth over FY18-19; (b) tenancy exits; in FY17 BHIN lost 2% of its tenants owing to the exit of two of its customers, Videocon and HFCL. Management believes that after the merger, Idea-Vodafone will require 225,000 network sites, which currently stands at 276,883. Assuming 75% of this rationalisation from Indus and Infratel towers, this implies a ~10% cut in BHIN's colocations. We are factoring in the same, resulting in subdued 6% tenancy CAGR over FY17-21E.

Continues to throw cash; new opportunities discussed

Total dividend payout for FY17 stood at Rs27bn (including dividend tax), up from Rs26bn in FY16. The company paid out its entire standalone profits, including dividend of Rs9.5bn from Indus. Management commented on a couple of growth opportunities: (a) Bhopal Smart City project: the company is rolling out fibre, smart poles and Wi-Fi hotspots. Whilst the investment is miniscule, the company will deploy this as a test case to showcase to telcos, which can later become potential customers. Management believes that this business can earn 13-16% internal rate of return over a 15-year time frame; (b) small cells, fibre, Wi-Fi and in-building solutions: these rollouts are outside the ambit of the Master Service Agreements that BHIN has with telcos. The company will institute new MSAs for these services. For both opportunities, the company refrained from outlining the addressable market and opportunities of capital deployment.

Where do we go from here?

Given the cloud around consolidation, we believe that it is too early for market to price in benefits of increased barraging power due to towerco consolidation. Also, prospects of inorganic growth are uncertain and protracted given that data rollouts will keep independent towercos afloat. Premium to historical averages and traded multiples in line with independent Indonesian towercos are over-optimistic. Reiterate SELL given limited upside.

SELL

Quick Insight

Analysis	
Meeting Note	✓
News Impact	

Stock Information

Bloomberg Code:	BHIN IN
CMP (Rs):	366
TP (Rs):	375
Mcap (Rs bn/US$ mn):	677/10.5
3M ADV (Rs mn/US$ mn):	3,475 /54

Stock Performance (%)

	1M	3M	12M	YTD
Absolute	5	15	(3)	7
Rel. to Sensex	5	9	(19)	(6)

Source: Bloomberg, Ambit Capital research

Ambit Estimates (Rs bn)

	FY17	FY18E	FY19E
Revenues	134.1	149.3	166.2
EBITDA	59.0	66.0	76.1
EPS (Rs)	14.7	16.3	19.3

Source: Bloomberg, Ambit Capital research

Research Analysts

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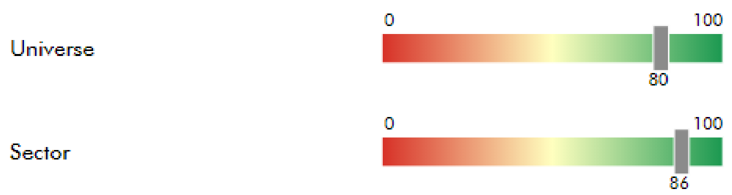
Exhibit 1: Explanation for our forensic accounting scores

Segment	Score	Comments
Accounting	**GREEN**	Infratel is in Ambit Hawk's 'Zone of Safety,' both within the sector as well as the BSE 500 on account of its top quartile performance on the following counts: (1) pre-tax CFO/EBITDA; (2) low contingent liabilities; (3) minimal CWIP to gross block; and (4) auditor remuneration growth with reference to revenue growth.
Predictability	**AMBER**	Due to stable cash flows and long-term tenancy arrangements, earnings predictability is very high. However, given the cloud around telco M&A and resultant loss of tenants for Infratel, we assign an Amber rating.
Earnings momentum	**AMBER**	Over the past month, consensus has marginally downgraded Bharti Infratel's FY19E earnings.

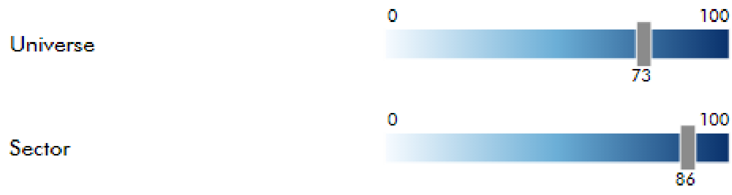
Source: Ambit Capital research

Forensic score percentile



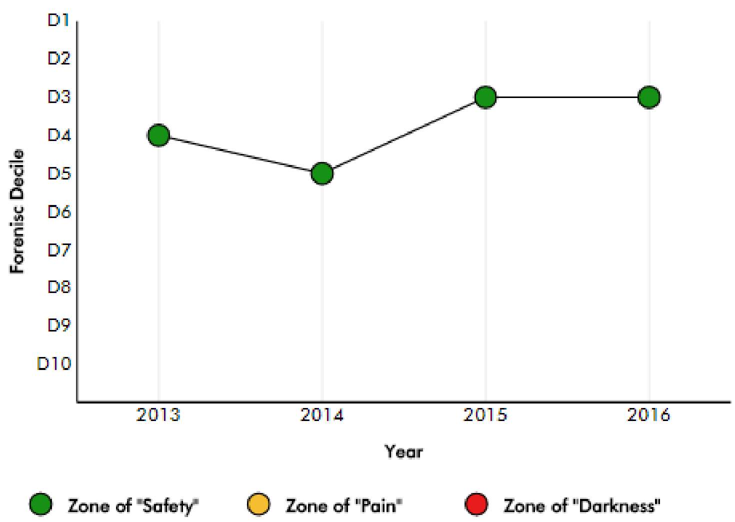
Source: Company, Ambit Capital research

Greatness score percentile



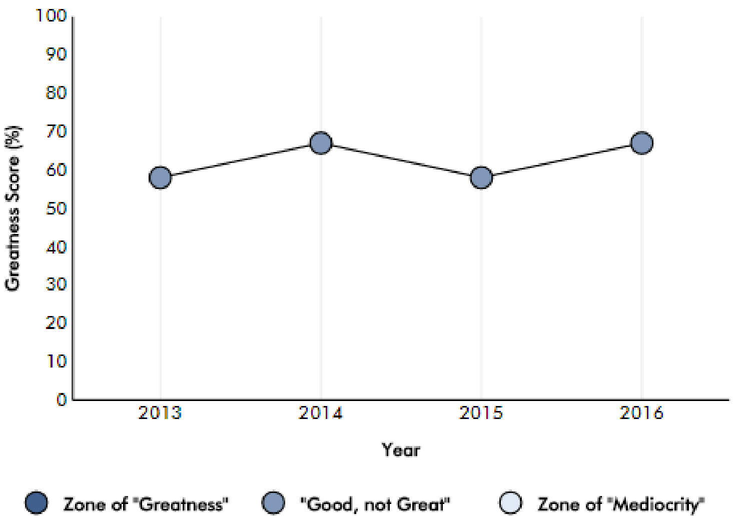
Source: Company, Ambit Capital research

Ambit 'Hawk' Forensic score



Source: Company, Ambit Capital research

Ambit 'Hawk' Greatness score



Source: Company, Ambit Capital research

[Click here](#) to access our 'HAWK' platform.

P&L and key valuation metrics (Rs bn)

Year to Mar (Consol)	FY16	FY17	FY18E	FY19E
Revenue	123.1	134.1	149.3	166.2
EBITDA	53.7	58.9	66.0	76.1
EBIT	31.0	37.4	40.9	49.9
PAT	23.8	28.3	30.4	35.9
Profit and loss ratios				
EBITDA margin (%)	43.6	43.9	44.2	45.8
EBIT margin (%)	25.2	27.9	27.4	30.0
Net profit margin (%)	19.4	21.1	20.4	21.6
Valuation metrics				
EV/EBITDA (x)	11.8	11.0	9.6	8.3
EV/Sales (x)	5.2	4.8	4.3	3.8
P/E (x)	29.9	24.0	21.7	18.4
P/B (x)	3.7	4.2	4.2	4.2
FCF yield (%)	3.2	5.0	6.1	5.1

Source: Company, Ambit Capital research

Balance sheet and key return ratios (Rs bn)

Year to Mar (Consol)	FY16	FY17	FY18E	FY19E
Total Assets	**221.6**	**193.6**	**193.9**	**194.1**
Fixed assets (incl. CWIP)	142.0	138.9	143.3	139.9
Other non-current assets	40.4	10.7	4.4	17.8
Net current assets	(10.1)	(36.3)	(35.4)	(35.3)
Cash and cash equivalents	49.2	38.0	51.1	56.3
Total liabilities	**221.6**	**193.6**	**193.9**	**194.1**
Debt	17.0	17.4	17.8	17.8
Non-current liabilities	22.2	21.4	21.4	21.4
Reserves and surplus	163.3	136.4	136.3	136.4
Total networth	182.3	154.9	154.8	154.9
Balance sheet metrics				
RoCE (%)	9.2	11.4	14.0	17.0
RoE (%)	13.5	16.3	19.7	23.2
Net debt/equity (x)	(0.6)	(0.3)	(0.5)	(0.5)
Net debt/EBITDA (x)	(0.2)	(0.1)	(0.2)	(0.2)

Source: Company, Ambit Capital research

Cash flow statement (Rs bn)

Year to March	FY16	FY17E	FY18E	FY19E
CFO	**43.9**	**57.0**	**67.7**	**59.2**
Growth capex	(16.2)	(16.7)	(19.7)	(18.5)
Maintenance capex	(5.0)	(5.1)	(5.2)	(4.9)
Investments and others	23.7	(22.1)	(4.5)	0.7
CFI	**2.5**	**(43.8)**	**(29.5)**	**(22.7)**
Borrowings	(0.1)	0.3	0.4	-
Interest income	4.2	5.9	5.1	4.4
Dividend and others	(10.4)	(30.5)	(30.5)	(35.8)
CFF	**(26.3)**	**(24.4)**	**(25.0)**	**(31.3)**
FCF	22.7	35.2	42.7	35.7
AFFO (EBITDA-maintenance capex)	**49.4**	**53.9**	**60.8**	**71.2**

Source: Company, Ambit Capital research

Bharti Airtel

Woes continue

4QFY17 results reiterated the weak trends witnessed in 3QFY17. As expected, revenue and EBITDA declined by 12% YoY and 14% YoY respectively. The voice business fared better, declining by 10% YoY, while non-voice and data revenues fared far worse, declining by 16% YoY. Non-wireless businesses witnessed steady trends, growing by 3-10% YoY. Management commentary was centred on predatory pricing by Reliance Jio that resulted in a decline in telecom revenue for the first time on a full-year basis. We leave our estimates unchanged and remain SELLers on Airtel as we expect sustenance of weak revenue growth and persistently high capital intensity.

Indian business' operating metrics worsen…: Wireless customers witnessed 9% YoY growth led by aggressive customer acquisition in rural markets. Voice traffic growth surged by 24% YoY, triggered by voice pricing decline of 27% YoY. Whilst the voice business was less affected by RJio, revenue declined by 10% YoY; down from 4% YoY growth in 1HFY17. Data subscribers declined by 1% YoY whilst growing 4% YoY. Data pricing was severely pressured, declining 32% QoQ/47% YoY as Airtel launched several new low-cost data bundles to counter RJio's freebies. Data revenue contracted by 18% YoY and 11% QoQ. We expect weakness in the Indian business' wireless operating metrics as RJio continue to weigh on the sector.

…resulting in poor financial metrics: Indian business' revenue sharply declined by 9% YoY, as healthy growth in Homes, Business and Digital segments was offset by a sharp 12% decline in mobile business. Network cost increased by 3% YoY, accounting for 24% of the Indian business revenue (up from 22% in 4QFY16). Free cash flow (EBITDA minus capex) improved as capex moderated across businesses. We expect competitive headwinds to result in continuation of weak revenue and profitability trends for the Indian business.

African business witnessed healthy trends: Following the sale of operations in three countries, Airtel's subscribers were flat during the quarter. African business' revenue declined by 5% QoQ in line with the seasonal decline in network traffic.

Consolidated EBITDA declines sharply: Despite declining non-network operating expenditure like access charges declining 16% YoY, employee cost reducing 15% YoY and sales and marketing expenses nose-diving 17% YoY, Airtel's EBITDA declined by 14% YoY, below our estimate. Improving profitability in homes, business and digital TV businesses offset the pain of significantly lower (down 19% YoY) EBITDA in the wireless business.

PAT declines sharply; high tax rate to blame: Airtel's PAT declined by 72% YoY due to higher depreciation expenses (up 3% YoY) and finance cost (up 15% YoY).

Conference call today at 2.30pm (dial +91 22 4444 9999). Key issues to discuss with the management: 1) capex guidance for FY18/19; 2) industry growth trajectory – when can growth resume?; 3) consolidation: how quickly can weak operators exit?

Where do we go from here?

We believe that Airtel's operating performance will remain weak driven by competitive pressures. We expect persistence of double-whammy; muted revenue growth and rising capital intensity for the telecom sector. Remain SELLers on Airtel with unchanged estimates and a DCF-based target price of Rs300.

SELL

Result Update

Stock Information

Bloomberg Code:	BHARTI IN
CMP (Rs):	345
TP (Rs):	300
Mcap (Rs bn/US$ bn):	1,380/21.5
3M ADV (Rs mn/US$ mn):	1,768/27.5

Stock Performance (%)

	1M	3M	12M	YTD
Absolute	0	(3)	(6)	13
Rel. to Sensex	(1)	(8)	(22)	1

Source: Bloomberg, Ambit Capital research

Ambit Estimates (Rs bn)

	FY17	FY18E	FY19E
Revenues	989	1,049	1,130
EBITDA	357	376	399
EPS (Rs)	8.8	9.0	12.9

Source: Bloomberg, Ambit Capital research

Research Analyst

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Exhibit 1: Consolidated financial results

(Rs mn)	4QFY17	4QFY16	YoY (%)	3QFY17	QoQ (%)	4QFY17E	Vs est (%)
Net Sales	**219,806**	**249,831**	**(12.0)**	**233,639**	**(5.9)**	**230,618**	**(4.7)**
License Fee	20,850	25,049	(16.8)	22,268	(6.4)	21,980	(5.1)
Access charges	22,761	26,948	(15.5)	24,386	(6.7)	23,898	(4.8)
Network cost	51,628	50,918	1.4	55,719	(1.9)	57,391	(10.0)
Employee cost	10,498	12,404	(15.4)	10,532	(0.3)	10,532	(0.3)
SG&A	35,009	43,155	(18.9)	35,637	(9.6)	35,637	(1.8)
Total Operating Expenses	**140,746**	**158,474**	**(11.2)**	**148,542**	**(5.2)**	**149,438**	**(5.8)**
EBITDA	**79,060**	**91,357**	**(13.5)**	**85,097**	**(7.1)**	**81,180**	**(2.6)**
Depreciation	49,418	48,163	2.6	48,350	2.2	48,834	1.2
EBIT	**29,642**	**43,194**	**(31.4)**	**36,747**	**(19.3)**	**32,347**	**(8.4)**
Finance cost	19,636	17,031	**15.3**	18,847	4.2	16,327	20.3
Exceptional (gain)/loss	6,055	2,999		2,040		-	
PBT	**3,951**	**23,164**	**(82.9)**	**15,860**	**(75.1)**	**16,327**	**(75.8)**
Tax	1,753	10,789	(83.8)	11,841	(85.2)	8,980	(80.5)
(Gain)/Loss from JV	(2,508)	(2,915)		(2,696)		-	
Minority Interest	972	2,095	(53.6)	1,678	(42.1)	-	
APAT	**3,734**	**13,195**	**(71.7)**	**5,037**	**(25.9)**	**7,347**	**(49.2)**
EPS (Rs/share)	**0.9**	**3.3**	**(71.8)**	**1.3**	**(26.2)**	**1.8**	**(49.4)**

Source: Company, Ambit Capital research

Exhibit 2: Consolidated margin analysis

As % of Net Sales	4QFY17	4QFY16	YoY (bps)	3QFY17	QoQ (bps)	4QFY17E	Vs est (%)
Licence Fee	9.5	10.0	(54)	9.5	(5)	9.5	(5)
Access charges	10.4	10.8	(43)	10.4	(8)	10.4	(1)
Network cost	23.5	20.4	311	22.5	96	24.9	(140)
Employee cost	4.8	5.0	(19)	4.5	27	4.6	21
SG&A	15.9	17.3	(135)	16.6	(65)	15.5	47
Total Opex	**64.0**	**63.4**	**60**	**63.6**	**45**	**64.8**	**(77)**
EBITDA Margin	**36.0**	**36.6**	**(60)**	**36.4**	**(45)**	**35.2**	**77**
EBIT Margin	13.5	17.3	(380)	15.7	(224)	14.0	(54)
PAT Margin	**1.7**	**5.3**	**(358)**	**2.2**	**(46)**	**3.2**	**(149)**
Tax Rate	**44.4**	**46.6**	**(221)**	**74.7**	**(3,029)**	**55.0**	**(1,063)**

Source: Company, Ambit Capital research

Bharti Airtel P&L statement and valuation metrics

Consol, Year to Mar (Rs bn)	FY16	FY17	FY18E	FY19E
Revenue	966	989	1,049	1,130
EBITDA	341	357	376	399
EBIT	166	151	153	164
PAT	47	35	36	51
Profit and loss ratios				
EBITDA margin (%)	35.3	36.1	35.8	35.3
EBIT margin (%)	17.2	15.3	14.6	14.5
Net profit margin (%)	4.9	3.6	3.4	4.6
Valuation metrics				
EV/EBITDA (x)	6.7	6.9	6.6	6.1
EV/Sales (x)	2.4	2.6	2.4	2.1
P/E (x)	28.1	31.0	38.9	27.1
P/B (x)	2.1	2.0	1.9	1.9
FCF yield (%)	0.6	2.2	3.1	3.2

Source: Company, Ambit Capital research

Balance sheet

Year to March (Rs bn)	FY16	FY17	FY18E	FY19E
Total assets	**1,732**	**1,930**	**1,931**	**1,915**
Fixed assets (incl. CWIP)	1,780	1,888	1,823	1,854
Other non-current assets	249	170	166	163
Net current assets	(363)	(127)	(58)	(101)
Cash and investments	67	30	93	41
Total liabilities	**1,732**	**1,930**	**1,931**	**1,915**
Debt	950	1,116	1,085	1,027
Non-current liabilities	60	66	71	74
Reserves and surplus	648	669	690	721
Total networth (incl. MI)	723	748	775	814
Balance sheet metrics				
RoCE (%)	4.8	4.4	4.3	5.1
RoE (%)	7.3	5.2	5.1	7.1
Net debt/equity (x)	1.0	1.2	1.5	1.3
Net debt/EBITDA (x)	2.1	2.5	3.0	2.6

Source: Company, Ambit Capital research

Cash flow statement

Year to March (Rs bn)	FY16	FY17	FY18E	FY19E
CFO	**283**	**325**	**322**	**342**
Tangible assets capex	(193)	(208)	(200)	(210)
Intangible assets capex	(81)	(132)	(25)	(90)
CFI	**(146)**	**(260)**	**(221)**	**(297)**
Borrowings	(72)	(20)	59	(9)
Interest paid	(33)	(85)	(86)	(76)
Dividend and others	(14)	(14)	(14)	(14)
CFF	**(119)**	**(120)**	**(41)**	**(100)**
FCF	**8**	**(14)**	**97**	**41**

Source: Company, Ambit Capital research

Interglobe Aviation

Focus on capacity building over profitability

Adjusted EBITDA of Rs4.3bn was 9% below our estimate as ASK, yields and load factor were 1% lower than expected. A 56% YoY decline in unitary PBT for the full year (FY17) clearly reflects high competitive intensity. Management upgraded Mar-18 capacity guidance from 154 planes to 170 despite the weak profitability, indicating focus on capacity addition over profitable growth. With this guidance, industry capacity addition could be 18-20% p.a. over FY18-20E, making fare hikes difficult for the sector. Whilst only time will tell if more than 15% passenger growth can be achieved without cutting fares, we optimistically factor in flattish yields in FY18 vs FY17. We cut FY18/FY19 yields by 6%/2%, resulting in 32%/13% cut in EBITDA and 29%/13% cut in PAT despite 6%/11% increase in ASK. We increase our target price to Rs870 from Rs760 as downgrade in near-term earnings estimates is more than offset by a stronger rupee (Rs64.5 per US$ vs Rs67 earlier). Our current estimates do not factor in any fleet additions from Indigo's likely entry into the smaller aircraft segment by Dec-17.

Results overview: Indigo reported 4QFY17 revenues of Rs48.4bn, up 19% YoY as 26% RPK increase was offset by 4% decline in passenger yields and 18% decline in ancillary revenues per RPK. Revenues came in 2% below our estimates mainly due to 1% lower ASK, 1% lower load factor and 1% lower yields. Adjusted for forex gain, EBITDAR came in at Rs12.5bn, down 17% YoY and in line with our estimate. Reported PAT of Rs4.4bn was down 24% YoY as 47% YoY decline in EBITDA was partially offset by forex gain of ~Rs1.6bn during the quarter.

- **ASK and RPK in line:** ASK growth of 24% YoY coupled with PLF increase to 86.1% vs 85% in 4QFY16 resulted in 26% YoY increase in RPK. ASK and RPK were 1% and 2% below our estimates respectively.
- **Overall yields declined 6% YoY:** Management highlighted the 4% YoY decline in passenger yields was due to ~10% decline in January whereas yields recovered in February/March vs January. This coupled with 18% YoY decline in ancillary revenues per RPK resulted in an overall yield decline of 6% YoY.
- **Revenues up 19% YoY:** Revenues of Rs48.4bn, up 19% YoY, as 20% passenger revenue growth was offset by only 3% increase in ancillary revenues.
- **CASK (ex-forex gain) up 8% YoY; in-line with estimate:** CASK ex-fuel and ex-forex gain came in at Rs2.02/ASK, down 5% YoY and exactly in line with our estimate. Fuel cost per ASK increased 38% YoY due to rise in crude prices. Total CASK (including fuel) of Rs3.26/ASK was up 8% YoY and 1% below our estimate.
- **Adjusted EBITDAR in line; EBITDA lower than expected:** EBITDAR ex-forex gain came in at Rs12.5bn, down 17% YoY and in line with our estimate. EBITDA stood at Rs4.3bn, down 48% YoY and 9% below our estimate.
- **Fleet addition guidance upgraded sharply:** Indigo's Mar-17 fleet of 131 aircraft (vs guidance of 133) includes 19 A320neos (added 5 planes during the quarter, all of which were neos). The management upgraded the Mar-18 fleet target guidance to 170 aircraft from 154 earlier. Of the incremental 39 planes, 28 planes will be A320 neos and the remaining 11 could be bought from the secondary market.

SELL

Result Update

Stock Information

Bloomberg Code:	INDIGO IN
CMP (Rs):	1140
TP (Rs):	870
Mcap (Rs bn/US$ bn):	412/6.4
3M ADV (Rs mn/US$ mn):	621/9.7

Stock Performance (%)

	1M	3M	12M	YTD
Absolute	10	35	6	39
Rel. to Sensex	9	29	(11)	26

Source: Bloomberg, Ambit Capital research

Ambit Estimates (Rs mn)

	FY17	FY18E	FY19E
Revenues	185,805	232,217	288,381
EBITDA	21,433	19,678	28,005
EPS (Rs)	45.9	40.8	57.8

Source: Company, Ambit Capital research

Research Analyst

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Exhibit 1: Key performance indicators

	4QFY16	3QFY17	4QFY17	YoY (%)	QoQ (%)	Ambit	Deviation (%)
Ending fleet	107	126	131	22%	4%	133	-2%
ASK (available seat kilometers) in mn	11,370	14,390	14,124	24%	-2%	14,213	-1%
Passenger load factor	85.0%	87.3%	86.1%			87.0%	
RPK (revenue passenger kilometer) in mn	9,670	12,562	12,162	26%	-3%	12,365	-2%
Yields (Rs)	4.23	3.97	3.99	-6%	0%	4.02	-1%
RASK	3.60	3.47	3.43	-5%	-1%		
Summary of CASK							
Total other costs	1.37	1.30	1.31	-5%	0%	1.33	-2%
Lease rentals net + Dep + Interest	0.75	0.70	0.71	-5%	2%	0.68	5%
Total excluding fuel	**2.12**	**2.00**	**2.02**	-5%	1%	**2.01**	0%
Fuel	0.90	1.16	1.24	38%	7%	1.28	-3%
Total CASK	**3.02**	**3.17**	**3.26**	8%	3%	**3.29**	-1%
RASK (-) fuel	2.70	2.30	2.19	-19%	-5%	2.19	0%
PBT/ ASK	0.58	0.30	0.17	-70%	-42%	0.21	-17%

Source: Company, Ambit Capital research

Exhibit 2: Quarterly snapshot

Rs mn	4QFY16	3QFY17	4QFY17	YoY (%)	QoQ (%)	Ambit	Deviation (%)
Operating Income (Net)	**40,907**	**49,865**	**48,482**	19%	-3%	**49,691**	**-2%**
Expenses							
Purchase of stock in trade	325	347	226				
Changes in inventories of stock in trade	(0)	(19)	3				
Raw Material Consumed	**325**	**329**	**229**	-30%	-30%	**423**	-46%
Employee Cost	4,923	5,273	5,339	8%	1%	5,425	-2%
Other Cost (Landing, maintenance, S&D and others)	10,338	12,590	12,883	25%	2%	13,101	-2%
Total Expenditure	**15,585**	**18,193**	**18,451**	18%	1%	**18,949**	-3%
EBITDAR pre fuel	**25,321**	**31,672**	**30,031**	19%	-5%	**30,742**	-2%
Aircraft fuel expenses	10,236	16,712	17,505	71%	5%	18,127	-3%
EBITDAR	**15,085**	**14,960**	**12,526**	-17%	-16%	**12,615**	-1%
Margin	**36.9%**	**30.0%**	**25.8%**	-30%	-14%	**25.4%**	2%
Aircraft rental on operating lease – Gross	**7,692**	**9,678**	**9,741**	27%	1%	**9,559**	2%
Cash and non-cash Incentives	(903)	(1,514)	(1,499)	66%	-1%	(1,638)	-8%
Aircraft rental for operating lease – Net	**6,789**	**8,164**	**8,242**	21%	1%	**7,921**	4%
EBITDA	**8,296**	**6,797**	**4,284**	-48%	-37%	**4,694**	-9%
Depreciation	1,249	1,184	1,052	-16%	-11%	1,421	-26%
EBIT	**7,047**	**5,613**	**3,232**	-54%	-42%	**3,273**	-1%
Other Income	1,852	1,719	2,112	14%	23%	1,700	24%
Finance costs	723	759	777	7%	2%	252	209%
Adjusted PBT	**8,177**	**6,573**	**4,568**	-44%	-31%	**4,721**	-3%
Forex loss (gain)							
Other expenses		552	(796)				
Other income			(826)				
Reported PBT	**8,177**	**6,021**	**6,190**				
Provision for Tax	2,339	1,149	1,786	-24%	56%	944	89%
Profit After Tax	**5,838**	**4,873**	**4,403**	-25%	-10%	**3,777**	17%

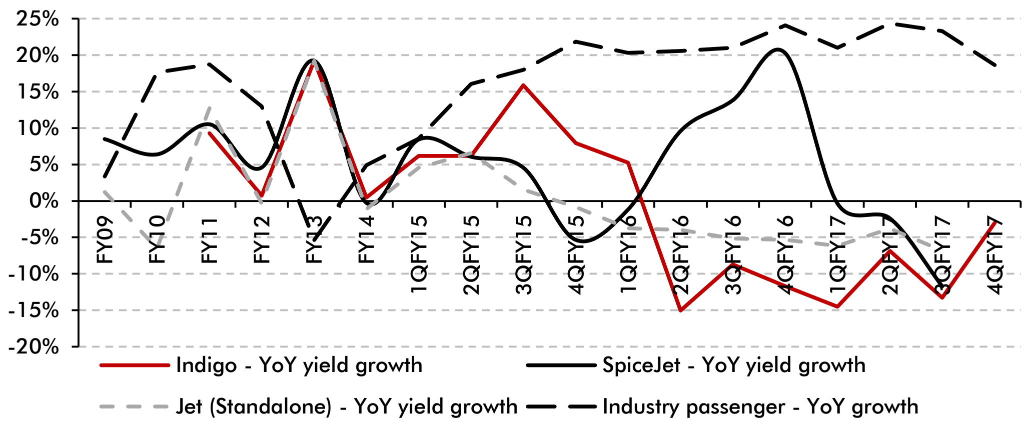
Source: Company, Ambit Capital research

Where do we go from here?

Industry capacity to grow at 18-20% CAGR: All the major airlines plan to add significant capacity over the next 3 years. Hence, we expect supply to increase at 18-20% CAGR over FY17-20E. We highlight that 18-20% capacity growth does not factor in capacity additions from any new international player such as Qatar Airways, which is considering an entry into the domestic aviation sector or Indigo's plans to enter into the smaller aircraft market.

No scope for increase in yields: Over the last 10 years, India's domestic airline passenger traffic has grown at a healthy 13% CAGR, implying an average GDP factor of 1.8x. Similarly, over the last 20 years, passenger growth in China has been ~13%, ar 1.5x of GDP. Against this, passenger growth in India has been ~20%+ p.a. over FY16 and FY17.

Exhibit 3: India's 20%+ passenger growth coincides with declining yields



Source: Company, Ambit capital research

As depicted in exhibit above, the 20%+ passenger growth coincides with a period of declining yields either due to lower crude prices (as seen in FY16) or lower margins of airline companies (as seen in FY17). This corroborates with our view that 15%+ passenger growth requires lower price points. Hence, there is no scope for increasing fares if operators want to maintain load factor.

We cut our FY18/19 estimates: Whilst only time will tell if more than 15% passenger growth can be achieved without cuts to fares, we optimistically factor in flattish yields in FY18 vs FY17. We cut FY18/FY19 yields by 6%/2%, resulting in 32%/13% cut in EBITDA and 29%/13% cut in PAT despite 6%/11% increase in ASK. Maintain SELL with a revised TP of Rs870/share vs Rs760 earlier; a Rs45/share cut to TP from lowering of near-term estimates is more than offset by upgrade of Rs155/share caused by a stronger rupee (we factor in Rs64.5/US$ vs Rs67 earlier). The stock trades at FY18E EV/EBITDAR of 11x (higher than global peer sector average of 6x). Our current estimates do not factor in any fleet additions from Indigo's likely entry into the smaller aircraft segment by Dec-17.

Sensitivity

- **Yield:** Every 1% decrease in yields has a negative impact of ~12% on FY18 EPS.
- **Utilisation:** Every 1% decrease in utilisation has a negative impact of ~12% on FY18 EPS.

Exhibit 4: Revisions to estimates

	New estimates		Old estimates		% change	
	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Target Price (Rs/share)	**870**		**760**		**14%**	
Ending fleet	170	186	153	169	11%	10%
% growth	29.8%	9.4%	15.0%	10.5%		
Average fleet	151	178	143	161	5%	11%
% growth	26.5%	18.3%	19.2%	12.6%		
ASK (in millions)	69,039	81,655	65,158	73,360	6%	11%
% growth	26.5%	18.3%	19.2%	12.6%		
Passenger load factor	83.8%	83.8%	84.5%	84.5%		
RPK (in millions)	57,848	68,419	55,062	61,993	5%	10%
% growth	25.0%	18.3%	19.2%	12.6%		
ATF price/litre	45.2	46.1	46.4	47.3	-2%	-2%
% growth	4.4%	2.0%	7.0%	2.0%		
Yields (Rs)	4.01	4.21	4.25	4.36	-6%	-3%
% growth	0.0%	5.0%	6.0%	2.6%		
Unitary costs (Rs/ASK)						
Revenue	3.36	3.53	3.59	3.69	-6%	-4%
Fuel cost	1.19	1.19	1.21	1.21	-2%	-2%
Other costs	1.31	1.39	1.31	1.38	0%	1%
EBITDAR	**0.86**	**0.96**	**1.07**	**1.10**	-20%	-13%
Lease rentals - gross	0.67	0.72	0.73	0.78	-8%	-8%
Incentives	(0.09)	(0.10)	(0.10)	(0.12)	-7%	-10%
Lease rentals - net	**0.58**	**0.61**	**0.63**	**0.66**	-8%	-8%
EBITDA	**0.29**	**0.34**	**0.44**	**0.44**	-36%	-21%
Depreciation	0.07	0.07	0.09	0.09	-18%	-20%
EBIT	**0.21**	**0.27**	**0.36**	**0.35**	-40%	-22%
Interest	0.03	0.03	0.04	0.03	-3%	-8%
PBT	**0.18**	**0.25**	**0.32**	**0.32**	-44%	-23%
Profit & Loss (Rs mn)						
Total Revenues	232,217	288,381	234,142	270,468	-1%	7%
Expenditure ex- fuel and rentals	90,694	113,449	85,363	101,068	6%	12%
EBITDAR pre fuel	**141,523**	**174,932**	**148,779**	**169,400**	-5%	3%
Aircraft fuel expenses	82,021	96,902	78,966	88,672	4%	9%
EBITDAR	**59,502**	**78,030**	**69,813**	**80,728**	-15%	-3%
EBITDAR margin (%)	**25.6%**	**27.1%**	**29.8%**	**29.8%**	-14%	-9%
Aircraft rental– Gross	46,298	58,524	47,415	57,162	-2%	2%
Cash and non-cash Incentives	(6,473)	(8,499)	(6,560)	(8,480)	-1%	0%
Aircraft rental– Net	**39,825**	**50,025**	**40,855**	**48,682**	-3%	3%
EBITDA	19,678	28,005	28,958	32,047	-32%	-13%
EBITDA margin (%)	**8.5%**	**9.7%**	**12.4%**	**11.8%**	-31%	-18%
Depreciation	5,023	5,600	5,792	6,286	-13%	-11%
Other Income	7,331	8,122	6,967	9,014	5%	-10%
Finance cost	2,338	2,338	2,283	2,283	2%	2%
Profit Before Tax	**19,648**	**28,189**	**27,851**	**32,493**	-29%	-13%
Provision for Tax	4,912	7,329	6,963	8,448	-29%	-13%
Profit After Tax	**14,736**	**20,860**	**20,888**	**24,045**	-29%	-13%
EPS (Rs/share)	40.8	57.8	57.8	66.6	-29%	-13%

Source: Ambit Capital research

Income statement (Rs mn)

Particulars	FY15	FY16	FY17E	FY18E	FY19E
Total Revenues	139,253	161,399	185,805	232,217	288,381
Expenditure ex- fuel and rentals	43,549	57,359	69,703	90,694	113,449
EBITDAR pre fuel	**95,704**	**104,041**	**116,102**	**141,523**	**174,932**
Aircraft fuel expenses	57,485	47,793	63,415	82,021	96,902
EBITDAR	**38,219**	**56,247**	**52,687**	**59,502**	**78,030**
EBITDAR margin (%)	**27.4%**	**34.8%**	**28.4%**	**25.6%**	**27.1%**
Aircraft rental on operating lease – Gross	23,076	28,634	36,576	46,298	58,524
Cash and non-cash Incentives	(3,553)	(3,566)	(5,322)	(6,473)	(8,499)
Aircraft rental for operating lease – Net	**19,522**	**25,068**	**31,254**	**39,825**	**50,025**
EBITDA	18,697	31,180	21,433	19,678	28,005
EBITDA margin (%)	**13.4%**	**19.3%**	**11.5%**	**8.5%**	**9.7%**
Depreciation	3,022	5,055	4,573	5,023	5,600
EBIT	**15,675**	**26,125**	**16,860**	**14,655**	**22,405**
Other Income	3,838	5,151	7,065	7,331	8,122
Finance cost	1,155	3,041	3,308	2,338	2,338
Profit Before Tax	**18,357**	**28,235**	**21,443**	**19,648**	**28,189**
PBT margin (%)	**13.2%**	**17.5%**	**11.5%**	**8.5%**	**9.8%**
Provision for Tax	5,402	8,373	4,852	4,912	7,329
Profit After Tax	**12,956**	**19,862**	**16,592**	**14,736**	**20,860**

Source: Company, Ambit Capital research

Balance Sheet (Rs mn)

Particulars	FY15	FY16	FY17E	FY18E	FY19E
Share Capital	344	3,604	3,612	3,612	3,612
Total Reserves	3,918	14,739	16,594	26,025	39,376
Shareholder's Funds	**4,262**	**18,343**	**20,206**	**29,637**	**42,988**
Total debt	39,262	32,008	26,008	26,008	26,008
Deferred Tax Liabilities	4,091	5,180	5,180	5,180	5,180
Other Long Term Liabilities	20,359	26,994	29,499	27,319	28,709
Deferred Incentives	17,516	15,832	21,838	21,224	24,019
Sources of Funds	**86,014**	**99,167**	**118,278**	**110,179**	**127,715**
Total Fixed Assets	48,765	47,275	37,702	38,699	40,400
Current Assets					
Inventories	1,306	1,267	1,267	1,584	1,967
Sundry Debtors	1,046	1,571	1,571	1,964	2,439
Cash and Bank	19,994	37,187	68,522	65,321	88,296
Total Current Assets	**31,680**	**56,008**	**87,343**	**84,851**	**108,684**
Trade Payables	4,755	7,412	7,412	9,264	11,504
Other Current Liabilities	15,441	16,729	19,380	24,133	29,890
Total Current Liabilities	**21,724**	**31,024**	**33,676**	**40,280**	**48,278**
Net Current Assets	**9,956**	**24,984**	**53,667**	**44,570**	**60,406**
Application of Funds	**86,014**	**99,167**	**118,278**	**110,179**	**127,715**

Source: Company, Ambit Capital research

Cash flow statement (Rs mn)

Particulars	FY15	FY16	FY17E	FY18E	FY19E
Profit Before Tax	**18,357**	**28,235**	**21,443**	**19,648**	**28,189**
Depreciation	3,022	5,055	4,573	5,023	5,600
Interest & Dividend income	(2,704)	(5,151)	(7,065)	(7,331)	(8,122)
Trade & Other payables	8,607	2,658	(0)	1,852	2,241
Increase/(Decrease) in Deferred incentives	35	(1,684)	6,005	(614)	2,796
Taxes paid	(3,951)	(7,285)	(4,852)	(4,912)	(7,329)
CFO	**23,839**	**31,682**	**28,570**	**17,868**	**32,001**
CFI	**(9,406)**	**1,587**	**12,065**	**1,311**	**821**
Capex	(10,170)	(3,564)	5,000	(6,020)	(7,301)
Others	764	5,151	7,065	7,331	8,122
CFF	**(13,070)**	**(16,076)**	**(9,299)**	**(22,380)**	**(9,848)**
Borrowings	3,817	(7,254)	(6,000)	-	-
Dividends paid	(16,128)	(18,192)	-	(20,042)	(7,510)
Finance charges paid	(219)	(3,308)	(2,338)	(2,338)	(2,338)
Net Cash Inflow / Outflow	**1,363**	**17,192**	**31,335**	**(3,201)**	**22,975**
FCFF	**13,669**	**28,117**	**33,570**	**11,848**	**24,700**

Source: Company, Ambit Capital research

Margins / Ratios (Rs mn)

Particulars	FY15	FY16	FY17E	FY18E	FY19E
Unitary costs (Rs/ASK)					
Revenue	3.94	3.77	3.40	3.36	3.53
Fuel cost	1.63	1.12	1.16	1.19	1.19
Other costs	1.23	1.34	1.28	1.31	1.39
EBITDAR	**1.08**	**1.31**	**0.97**	**0.86**	**0.96**
Lease rentals – gross	0.65	0.67	0.67	0.67	0.72
Incentives	(0.10)	(0.08)	(0.10)	(0.09)	(0.10)
Lease rentals – net	**0.55**	**0.59**	**0.57**	**0.58**	**0.61**
EBITDA	**0.53**	**0.73**	**0.39**	**0.29**	**0.34**
Depreciation	0.09	0.12	0.08	0.07	0.07
EBIT	**0.44**	**0.61**	**0.31**	**0.21**	**0.27**
Interest	0.03	0.07	0.06	0.03	0.03
PBT	**0.41**	**0.54**	**0.25**	**0.18**	**0.25**
Margins					
EBITDAR margin %	27.4%	34.8%	28.4%	25.6%	27.1%
EBITDA margin %	13.4%	19.3%	11.5%	8.5%	9.7%
Adjusted net profit margin %	9.3%	12.3%	8.9%	6.3%	7.2%
Per share (Rs)					
EPS	42.2	58.1	45.9	40.8	57.8
DPS	35.2	44.3	34.0	12.2	17.3
Key drivers					
ASK (in millions)	35,327	42,830	54,589	69,039	81,655
Passenger load factor	79.8%	84.0%	84.8%	83.8%	83.8%
RPK (in millions)	28,177	35,970	46,286	57,848	68,419
Yields (Rs/RPK)	4.94	4.49	4.01	4.01	4.21
Valuation (x)					
P/E	30.2	20.2	24.8	27.9	19.7
EV/EBITDAR	15.9	10.8	11.5	10.2	7.8
EV/EBITDA	17.6	10.6	11.0	16.7	11.8

Source: Company, Ambit Capital research

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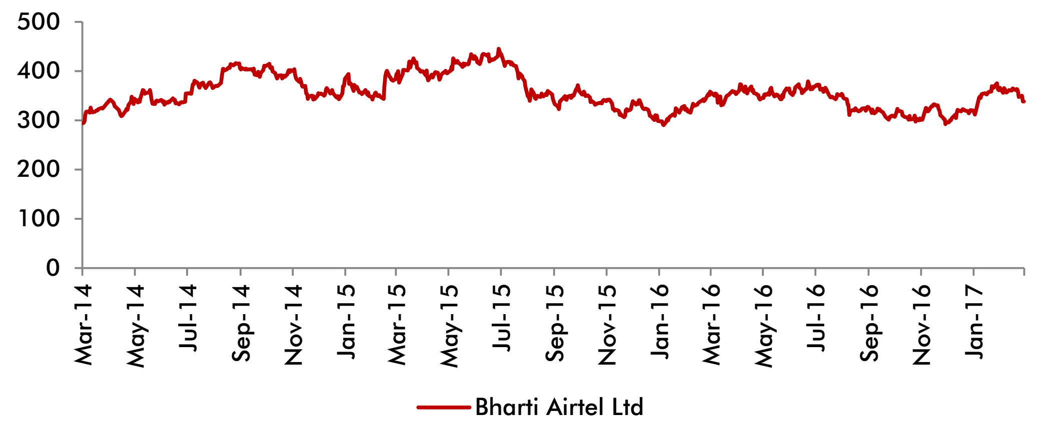
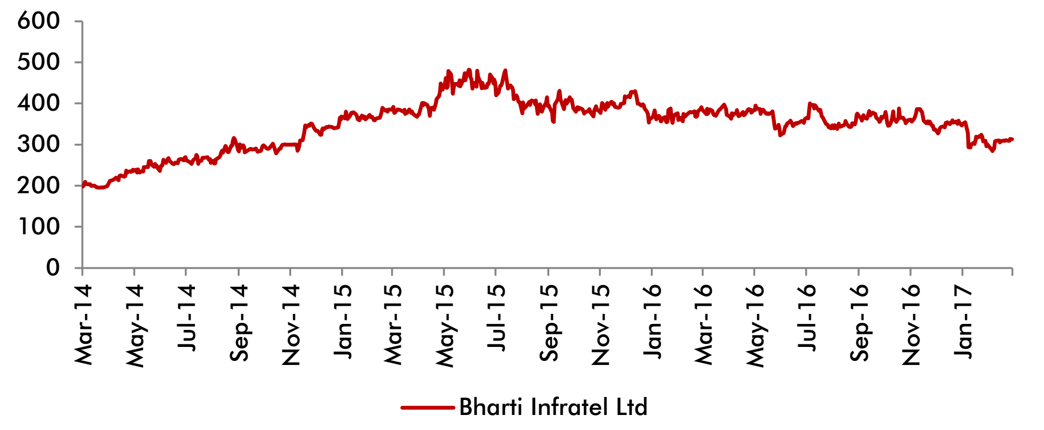
Bharti Airtel Ltd (BHARTI IN, SELL)



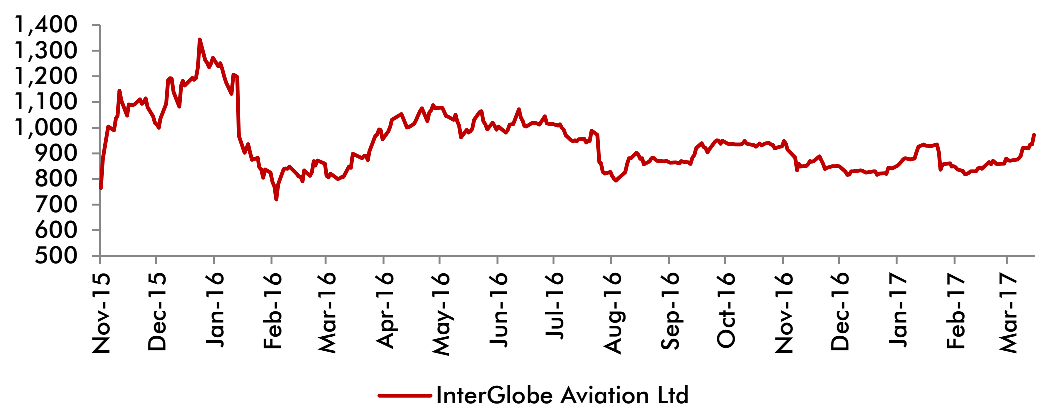
Source: Bloomberg, Ambit Capital research

Bharti Infratel Ltd (BHIN IN, SELL)



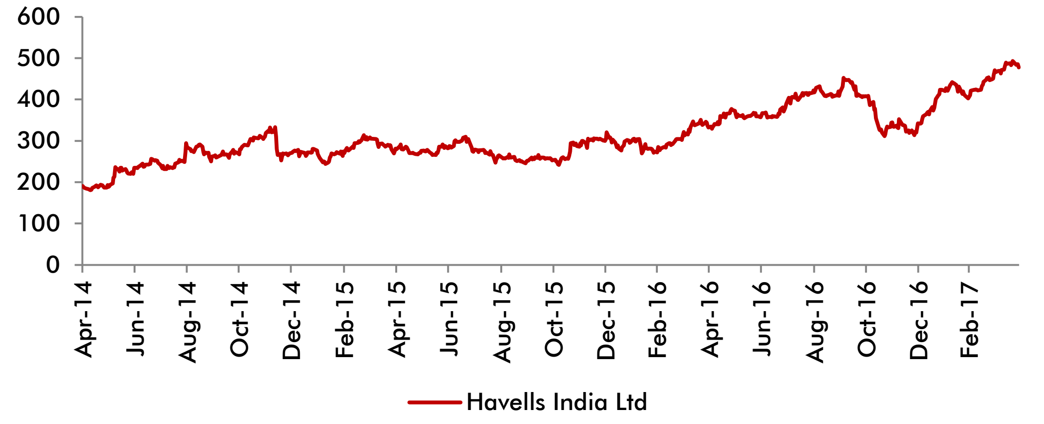
Source: Bloomberg, Ambit Capital research

Interglobe Aviation Ltd (INDIGO IN, SELL)



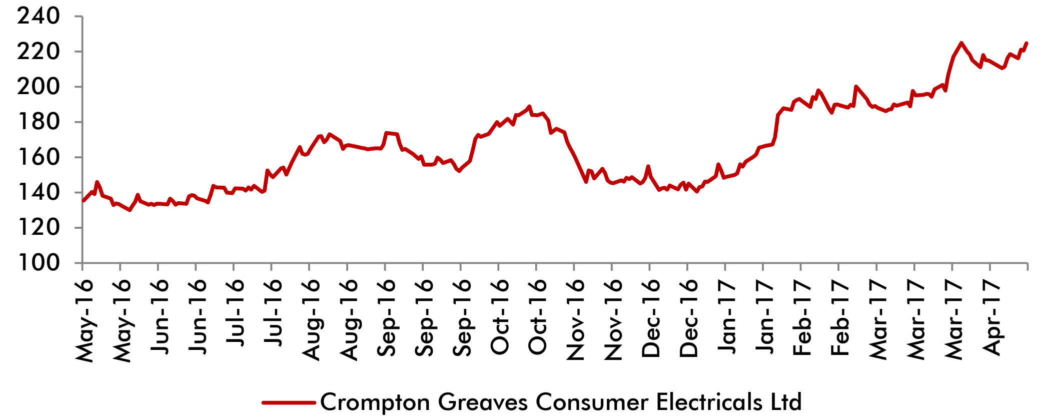
Source: Bloomberg, Ambit Capital research

Havells India Ltd (HAVL IN, SELL)



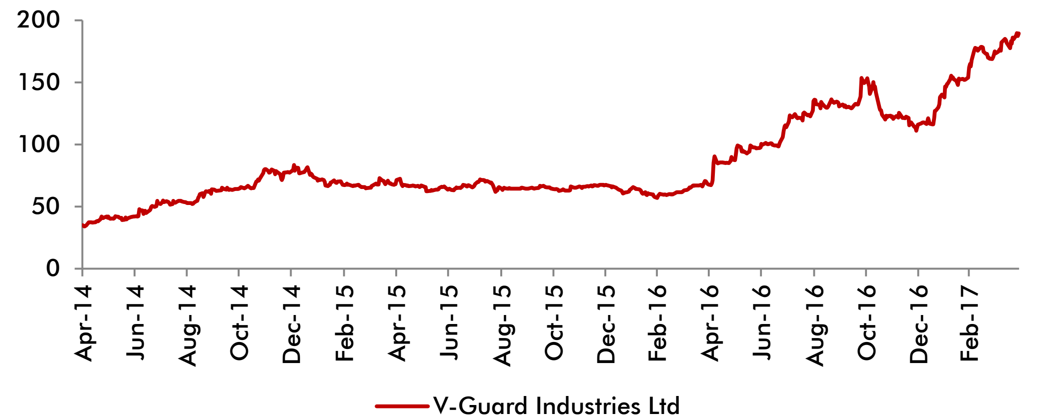
Source: Bloomberg, Ambit Capital research

Crompton Consumer Electricals Ltd (CROMPTON IN, SELL)



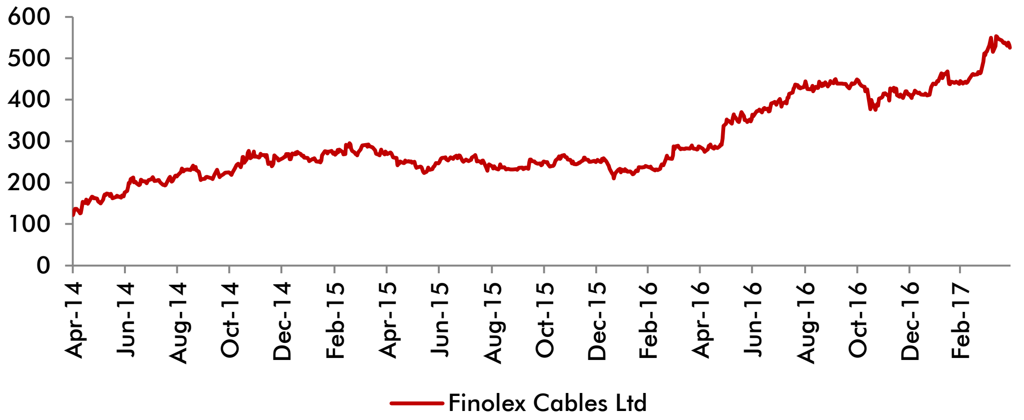
Source: Bloomberg, Ambit Capital research

V-Guard Industries Ltd (VGRD IN, SELL)



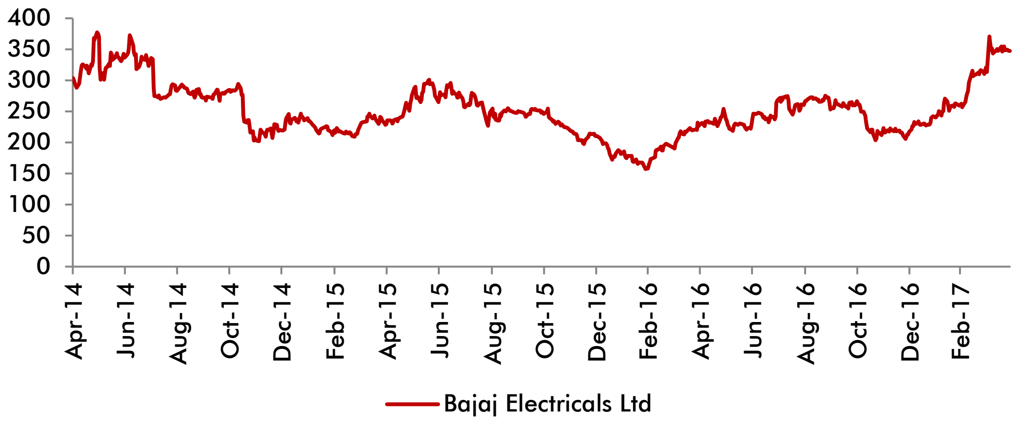
Source: Bloomberg, Ambit Capital research

Finolex Cables Ltd (FNXC IN, UNDER REVIEW)



Source: Bloomberg, Ambit Capital research

Bajaj Electricals Ltd (BJE IN, BUY)



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Explanation of Investment Rating

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NOT RATED	We do not have any forward looking estimates, valuation or recommendation for the stock
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