Q4FY10 & FY10 Result Update

May 20, 2010

We had initiated coverage on Nilkamal Limited (Nilkamal) on 31 March 2010 at Rs. 250.40 with a recommendation to buy the stock at the current market price and to add on declines to the Rs. 215-225 price band for sequential price targets of Rs. 305 and Rs. 329 over the next 1-2 quarters. Thereafter, the stock made a high of Rs. 284 on 13 April 2010 and a low of Rs. 242.25 on 17 May 2010. We present an update on the company post the Q4FY10 results and a discussion with the management.

Company Background

Promoted by the Parekh family, Nilkamal Ltd was incorporated in December 1985 as Creamer Plastic, a private limited company. The Parekh family has been in plastics business since four decades. Nilkamal manufactures and markets injection moulded plastic products like furniture, material handling equipment, custom mouldings & OEM supplies for specific customers. It is India's largest manufacturer of material handling plastic crates and a leader in moulded furniture. Additionally, the company is into lifestyle furniture business through '@home', a home solutions store.

The Nilkamal group consists of Nilkamal Ltd. in India, two companies in Sri Lanka viz Nilkamal Eswaran Plastics Pvt. Ltd. (NEPPL) and Nilkamal Eswaran Marketing Pvt. Ltd (NEMPL) and one in Bangladesh, namely, Nilkamal Padma Plastics Pvt. Ltd (NPPPL) – since exited. Further, Nilkamal also has a 100% subsidiary in the UAE, namely, Nilkamal Crates and Binds – FZE (UAE) and a 50:50 JV Nilkamal Bito Storage Systems Private Limited.

Key Highlights of the Q4FY10 Results

Standalone (Rs cr)	Q4FY10	Q4FY09	% Chg	Q3FY10	% Chg q-o-q	FY10 (E)	FY10	FY09	% Chg	FY11 (E)	% Chg
Net Sales	304.2	244.5	24.4%	248.5	22.4%	979.0	1028.1	889.1	15.6%	1162.0	13.0%
Other income	1.1	0.4	165.1%	2.4	-55.1%	4.0	4.8	1.8	168.4%	2.5	-47.6%
Total Income	305.3	244.9	24.7%	250.9	21.7%	983.0	1032.8	890.9	15.9%	1164.5	12.7%
Total Expenditure	280.0	226.7	23.5%	214.2	30.7%	850.8	910.1	808.2	12.6%	1018.2	11.9%
EBIDTA	25.3	18.2	39.1%	36.7	-31.1%	132.2	122.8	82.6	48.6%	146.3	19.2%
Interest	5.7	8.5	-32.8%	5.5	4.1%	25.8	24.7	39.6	-37.7%	28.0	13.4%
PBDT	19.6	9.7	102.4%	31.2	-37.3%	106.4	98.1	43.0	128.1%	118.3	20.6%
Depreciation	8.1	7.9	3.4%	8.1	0.4%	33.0	32.2	31.2	3.2%	35.0	8.8%
PBT	11.4	1.8	536.2%	23.1	-50.5%	73.4	65.9	11.8	457.2%	83.3	26.4%
Tax	4.3	2.3	87.1%	6.3	-31.4%	19.8	18.6	5.7	225.8%	23.4	25.2%
PAT	7.1	-0.5	1439.2%	16.8	-57.8%	53.6	47.2	6.1	674.3%	60.0	26.9%
EPS	5.5	-0.4		13.1		41.9	37.0	4.8		46.9	26.9%
Equity	12.8	12.8		12.8		12.8	12.8	12.8		12.8	
Face Value	10.0	10.0		10.0		10.0	10.0	10.0		10.0	
OPM %	7.9%	7.3%		13.8%		13.1%	11.5%	9.1%		12.4%	
NPM %	2.3%	-0.2%		6.7%		5.5%	4.6%	0.7%		5.1%	

(Source: Company, HDFC Sec)

Segmental Revenue (Rs cr)	Q4FY10	Q4FY09	% Chg	Q3FY10	% Chg q-o-q	FY10	FY09	% Chg
Plastics	268.6	217.7	23.4%	219.5	22.4%	912.6	780.9	16.9%
Lifestyle Furniture & Furnishings	36.9	27.2	35.8%	30.0	23.0%	119.6	111.7	7.1%
Total	305.5	244.9	24.7%	249.5	22.4%	1032.2	892.6	15.6%
PBIT								
Plastics	25.2	19.5	29.3%	31.5	-20.1%	110.9	77.4	43.2%
Lifestyle Furniture & Furnishings	-3.3	-2.7	-23.4%	-2.8	-18.0%	-13.1	-12.5	-4.9%
Others	0.0	0.0	NA	0.0	NA	0.0	0.0	NA
PBIT %								
Plastics	9.4%	9.0%		14.4%		12.1%	9.9%	
Lifestyle Furniture & Furnishings	-9.0%	-9.9%		-9.4%		-11.0%	-11.2%	
Capital employed								
Plastics	405.5	372.9	8.7%	388.9	4.3%	405.5	372.9	8.7%
Lifestyle Furniture & Furnishings	64.6	76.7	-15.8%	67.5	-4.3%	64.6	76.7	-15.8%
Others	-218.9	-238.2	8.1%	-204.8	-6.9%	-218.9	-238.2	8.1%
Total	251.2	211.4	18.8%	251.6	-0.2%	251.2	211.4	18.8%

(Source: Company, HDFC Sec)

- In Q4FY10, Nilkamal's revenue jumped 24.4% y-o-y and 22.4% q-o-q on the back of robust volume growth. Volumes jumped by 25.1% y-o-y and 46.4% q-o-q to 10,251 MT in the material-handling segment while volumes increased 12.8% y-o-y and 2.5% q-o-q to 11,280 MT in the moulded furniture segment. Agricultural offtake of crates / material handling is generally higher in Q4 and thus the big jump in volumes in this segment. Overall, the growth in topline was led by an 18.4% rise y-o-y and 19.6% rise q-o-q in volumes. The rest came from value growth. Raw material prices increased by ~10% q-o-q and Nilkamal managed to pass on part of this rise as can be seen in the 22.4% q-o-q growth in value terms vs. the 19.6% growth in volume q-o-q.

- While Nilkamal passed on part of the rise in raw material costs, the rest has been/will be passed on with a lag. However, from Q1FY11 onwards, this rise in costs has been passed on entirely by the company. It was difficult for the company to pass on the full impact in Q4FY10 as Q4 is a volume driven quarter and the main offtake is from the agri sector, which is a price sensitive segment. Going ahead, the management indicated that as long as there is no sharp volatility in raw material prices, the company could pass on the costs over the next 1-1.5 months. Also, raw material prices have stabilized now and are expected to head southward during the later part of the year due to capacities coming up in the Middle East and China. Further, given the problems in Greece and other parts of Europe it is expected that commodity prices could remain soft. Overall, the management expects flat raw material prices for FY11.

- In Q4FY10, Nilkamal reported operating margins of 7.9%, up 60 bps y-o-y and down 580 bps q-o-q. On a q-o-q basis, raw material costs as a % of sales has increased from 32.3% to 39.8% due to the reasons highlighted above. Other than that Q4FY10, included a number of one-time items, which appear in other expenses. Other expenses have jumped 34.9% q-o-q to Rs. 70.5 cr. The same have been highlighted below.

One off items	Impact (Rs cr)
Divestment of stake in Bangladesh subsidiary - Nilkamal Padma Plastics Pvt Ltd	5.8
Service tax on rent liability for 2 years (contesting in SC but provided as a matter of prudence)	3.0
Decided not to open stores in Rajkot and Nagpur - took write off	0.7
Pilferage and damaged stocks in @ home	0.6
Write off on account of slow moving stock in the material handling business (trading)	3.5
Full write off of stores and spares (vs earlier system of providing 30% depreciation p.a)	2.3
Total	**15.9**

(Source: Company, HDFC Sec)

- Excluding the impact of these items, the operating margins in Q4FY10 could have been in the 13% range down by about 60 bps q-o-q primarily due to the rise in raw material costs. The management has indicated that there is no more such one off items for which it has not provided. Also, from the month of April onwards, margins have returned to the ~13% levels.

- Other income jumped 165.1% y-o-y and was down 55.1% q-o-q at Rs. 1.1 cr. Q3FY10 includes an amount of Rs. 1.8 cr received due to the maturing of Keyman Insurance Policy, which is not a recurring feature.

- Interest costs decreased y-o-y by 32.8% due to lower utilization of debt and lower cost of debt. Q-o-Q, interest costs increased by 4.1% to Rs. 5.7 cr. Depreciation costs were up 3.4% y-o-y and flat q-o-q. Nilkamal carried out a capex of Rs. 23 cr in FY10.

- Nilkamal ended Q4FY10 with a PAT of Rs. 7.1 cr as against a loss of Rs. 0.5 cr in Q4FY09. PAT was lower by 57.8% q-o-q due to lower operating margins (rise in other expenses). Nilkamal reported an EPS of Rs. 5.5 for the quarter.

- Coming to the segmental results, the lifestyle furniture segment reported y-o-y and q-o-q growth of 35.8% and 23% to Rs. 36.9 cr. If one were to exclude the one time expenses from the @ home segment in Q4FY10, then this segment could be at breakeven. However, loss at the PBIT level after the one-off expenses was Rs. 3.3 for the quarter.

- In case of the plastics segment, turnover was at Rs. 268.6 cr, up 23.4% y-o-y and 22.4% q-o-q. PBIT margins were adversely impacted due to the one off items and a rise in raw material costs.

FY10 Results

- Nilkamal put up a decent show in FY10. The company closed FY10 with a topline of Rs. 1,028.1 cr, up 15.6% y-o-y (volume growth was even better at 26.8% y-o-y), operating margins of 11.5% as against 9.1% in FY09 and a PAT of Rs. 47.2 cr, up 674.3% y-o-y. The EPS for the year stood at Rs. 37.

- In terms of volumes, the material handling division reported growth of 18.5% y-o-y to 32,606 MT while the moulded furniture segment reported volumes of 41,993 MT, up 34.2% y-o-y.

- Taking into consideration the one-time expenses accounted for in Q4FY10, Nilkamal, could have reported even better operating margins in FY10 (9MFY10 operating margins were at 13%). FY10 included a positive impact of forex of about Rs. 2.5 – 3 cr.

- On a full year basis, the average utilization of debt was down by Rs. 66 cr and the average cost of debt was down by 1.67 percentage points at 9.6%. This resulted in full year interest cost being lower by 37.7% at Rs. 24.7 cr. The debt outstanding at the end of FY10 on a consolidated basis is Rs. 285 cr.

- During the year the company opened 3 @ home stores in Andheri, Ghatkopar and Thane and closed 2 stores in Kandivali and Faridabad taking the total number of stores to 16 spread across 12 cities.

- On a consolidated basis, Nilkamal reported a topline of Rs. 1,095 cr, up 15.1% y-o-y. Operating margins were at 12% vs 11.1% in the previous year. PAT stood at Rs. 51.5 cr, up 381.4% y-o-y (Rs. 4.3 cr higher than the standalone PAT in FY10 vs Rs. 4.6 cr higher than the standalone PAT in FY09). Nilkamal has divested its stake from its Bangladesh operations and made all necessary provisions for the same. The subsidiary in Sri Lanka continues to perform well.

- The JV - Nilkamal BITO Storage Systems Pvt. Ltd. is in manufacturing of storage systems of metal for providing intra-logistics solutions to the national and international market. In FY10, the JV reported a loss of about Rs 7 cr and a topline of about Rs. 40 cr as against a topline of Rs. 32.3 cr in FY09 and a loss of 2.9 cr. The loss widened in FY10 due to competition from regional players, inability to pass on price increases and tough competition from Godrej. The JV produced about 4,000 tonnes in FY10 (up about 40% y-o-y) and the management expects that 4,500 tonnes could be the breakeven level as it has been able to tackle the pricing issue now. Other measures taken to improve profitability include a shift from large sized orders to smaller ones and a shift from standardized orders to non-standardized orders.

Other Updates

- In FY11, the company expects 15-20% volume growth and 11-13% value growth in topline. While moulded furniture could grow by about 20% y-o-y to Rs. 600 cr (gross), material handling is expected to grow by about 10% y-o-y to Rs. 540-550 cr (gross). The management expects @ home to grow north of 30% y-o-y.

- Nilkamal spent Rs. 23 cr on capex in FY10 and expects to incur a capex of Rs. 80-85 cr in FY11. This could be funded via a mixture of internal accruals and debt. However, the management also indicated that it is considering coming out with a QIP issue of about Rs. 60 cr. However, the timing is uncertain and dependent to a large extent on market conditions.

- Of the total capex amount of Rs. 80-85 cr for FY11, Nilkamal plans to spend about Rs. 10-12 cr on 4-5 new @ home stores. Next, Nilkamal plans to put up a 5,500 MT plant at a cost of Rs. 30 cr in the South that could ready for operations by end Dec 2010 (as opposed to earlier expectations of June 2010). Nilkamal is setting up a pallet manufacturing line at its current plant in Sinnar (Maharashtra) at a capex of Rs. 9 cr, which could be ready by July 2010. Lastly, the company plans to spend Rs. 15 cr on the development and purchase of new moulds.

- In FY11, the effective tax rate could increase 30% as another one of Nilkamal's plants loses tax benefits. Only the Jammu plant has tax benefits from FY11 onwards.

Concerns

- **Prices of the raw materials** used for manufacturing plastic are highly volatile and linked to crude prices to a certain extent. If the company is unable to pass on price increases to its customers, it may adversely affect its profitability. Further, Nilkamal imports its raw material and is thus also exposed to forex fluctuation. Nilkamal currently takes ~50% forward cover and leaves 50% unhedged.
- **Economic slowdown** maybe a threat to the business as home furniture spending involves large disposable incomes.
- It may take a long time for the organized players to gain higher market share at the cost of **regional and unorganized players**.
- **Poor monsoon** could adversely impact Nilkamal's sales in rural India due to lower income.
- Any **slowdown in the overall economy** could affect volume growth of the material handling business and also adversely impact Nilkamal.
- Nilkamal has ventured into new business like **@ home which will take time to breakeven** and this could negatively impact the bottomline until then.
- Nilkamal's **JV with Bito could take longer than expected to break even** due to pricing pressures.
- **Depreciation of the Sri Lankan Rupee** is a concern as it could reduce the consolidated profitability.
- **Other risks** include economy risk, quality risk, pricing risk, brand risk, limited product portfolio risk, inadequate distribution infrastructure and supply chain risk.

Recommendation

Nilkamal's results in Q4 were below our expectations due to a number of one off items accounted for during the quarter as highlighted earlier. Nonetheless, the company closed FY10 with a topline of Rs. 1,028.1 cr, up 15.6% y-o-y (volume growth was even better at 26.8% y-o-y), operating margins of 11.5% as against 9.1% in FY09 and a PAT of Rs. 47.2 cr, up 674.3% y-o-y. The EPS for the year stood at Rs. 37 and at the CMP Nilkamal is available at 6.8x its FY10 earnings.

Nilkamal with a strong market presence and brand value continues to dominate the industry in its plastic business. We expect new product launches, rise in volume growth in the moulded furniture segment and capacity expansion to drive growth going ahead. Further, the losses at @ home stores is also expected to reduce in FY11 that could aid profitability. Nilkamal trades at 5.3x its FY11 (E) EPS of Rs. 46.9. We feel that the current market cap and EV of Rs. 320 cr and Rs 586 cr respectively does not fully capture the value of Nilkamal's brand and distribution network. We maintain our original recommendation on the stock.

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