Redington India REDI.NS REDI IN

ENGINEERING & CONSTRUCTION

NOMURA
EQUITY RESEARCH

In-line Q2, strong growth outlook for H2

Quick Note

October 30, 2012

Rating Remains	**Buy**
Target price Remains	INR 101
Closing price October 29, 2012	INR 80

Redington's Q2 results were broadly in line with our estimates at the EBITDA level, but the key positive that emerged from the conference call was a solid outlook of "12-15%" growth at the consolidated level for FY13 (we are building in 11.9% for FY13F currently). Management's guidance, implies significant growth in the ~35-40% range in H2FY12F for the India business, driven mainly by: 1) iPhone sign up with Apple, where it expects to do ~INR11,000mn in the second half; 2) a pickup in government orders (has a UID-Aadhar project in Q3 which will get executed over the next 2-3 quarters) in the IT business; and 3) a pickup in the Blackberry business, boosted by the launch of Blackberry 10 in January 2013.

Results broadly in line at the EBITDA level, top-line beat

- Consolidated sales at INR58,597mn (y-y growth of 12.9%) were 7% ahead of our expectation driven by solid ~21% growth in the overseas business (constant currency growth of 9%), the result of strong performances at Lenovo, Toshiba and Acer in the Middle Eastern markets. This offset a muted top line in the India business which declined by 3.9% in the quarter (while the IT business grew at 2%, non-IT declined by 16% owing to a 40% decline in Blackberry sales.
- EBITDA including other income (which is a better metric than EBITDA before other income, in our view, as other income includes discounts that Redington gets from vendors) was INR1553mn, in line with our expectation of INR1575mn. EBITDA margin at 2.65% was lower than our expectation of 2.85% owing to relatively lower margins in the India business (we believe the miss was owing to a decline in the higher-margin Blackberry business).
- Profit before tax at INR1014mn was in line with our estimate of INR1019mn.
- Net income at INR729mn was ahead of our expectation of INR66.7mn primarily owing to a lower tax rate of 23.8% vs our expectation of 30%.

Strong growth outlook for the second half, management confident of a significant contribution from Apple iPhone sales

We are currently at the lower end of management guidance of 12-15% sales growth for FY13, which would imply 14-20% growth in H2 (H1FY13 sales growth was 10.3% y-y). Management has indicated that India's contribution in H2 will be ~52% versus ~46% in H1. In our view, management is suggesting a significant pickup in growth in the India business in the second half (implied growth of~35-40%) driven by:

- Incremental contribution of ~INR11000mn from Apple in the next 5 months owing to the addition of iPhone (~35-40% of its distribution agreement with Redington). While this is lower margin than Blackberry, returns are expected to be higher on account of low working capital days (receivable days are around 15 while they get a credit of around 30 days). This essentially suggests that they the

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See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

company expects the ex-Apple business in India to growth between 11-18%.

- Blackberry sales per month picked up from a run-rate of 60-70K in Q2 as per management to 80-90K in October. Management is also positive about an expected substantial pick up post the Blackberry 10 launch in January 2013. This, we believe, could mean that the decline will taper off in the second half (ex of a big pickup in sales post Blackberry 10, current run-rate would suggest a decline of ~18%)
- Management indicated that they have a large UID-Aadhar project in Q3 which will get executed over the next 2-3 quarters and should benefit the IT business. We expect the IT business to grow at 15%+ in 2HFY13F.
- The implied growth rate for the international business for 2HFY12F is in the range of -3% to 2%, to which we see upside potential given that the Samsung sales ramp up will be visible in the second half plus Redington has witnessed solid momentum in the Middle Eastern business on the back of strong performances at Lenovo, Toshiba and Acer.

Improvement in working capital, FCF, expect net debt to decline or stabilize

We estimate that working capital days came down by at least 2 days to ~44 days in 1HFY13 versus 1HFY12, driven primarily by a decrease in receivable days by around 11 days. Free cash flow improved significantly in 1HFY13 as it was negative INR340mn versus negative INR2490mn in 1HFY12. Management guided for net debt to come down or stabilize at ~INR17000mn (current level at INR18260mn, translates to a net debt/equity of ~1.23x; we are expecting this to come down to ~INR15127mn by end-FY13F).

Expect the stock to react positively as we foresee at least mid-single-digit upgrades in consensus EPS estimates

We believe that on the back of these numbers, consensus EPS FY13F estimates will likely move up by ~5% and inch towards our estimates, which are currently slightly higher than consensus.

Reiterate Buy on India's largest distributor of IT and electronics products

We reiterate our Buy rating on India's largest distributor of IT and electronic products. In our view, the potential of the Indian market should be seen in the context of a doubling of the middle-class population in the next 10 years (source: Dell), which is likely to mean increasing average disposable income and should drive IT/electronic penetration rates in India. The company has end-to-end coverage of the distribution value chain (procurement, warehousing, non-banking financial corporation's [NBFC] and after-sales services). It has impressive processes in place and a strong conservative management team, in our view. The company has a credible history of managing inventory and credit risk, which we consider key to success in the distribution business. Average provisions for inventory and receivables were 0.04% and 0.1% over FY08-FY12 for India and overseas business over the same period, respectively. The current valuation at 7.1x FY14F EPS (8.95x FY13F EPS) is a 39% discount (23% discount on FY13F) to its discount to its six-year average of 11.7x and is an attractive entry point, in our view.

Fig. 1: Consolidated performance in Q2FY13 – in line at the operating level

INR mn	Q2FY12	Q1FY13	Q2FY13				
			Actual	Nomura	Difference(%)	Consensus	Difference(%)
Sales	51,890	53,716	58,597	54,667	7%	59,353	-1%
- growth	*39.8%*	*7.6%*	*12.9%*	*5.4%*		*14.4%*	
EBITDA	1,350	1,427	1,452	1,514	-4%	1,636	-11%
- Margin	*2.60%*	*2.66%*	*2.48%*	*2.77%*		*2.76%*	
EBITDA after other Income	1,386	1,488	1,553	1,575	-1%		
- Margin	*2.67%*	*2.77%*	*2.65%*	*2.88%*			
PAT	612.7	635	729	667	9%	793	-8%
EPS	1.54	1.59	1.83	1.67	9%	1.99	-8%

Source: Company data, Bloomberg, Nomura estimates

Fig. 2: Standalone performance in Q2FY13

INR mn	Q2FY12	Q1FY13	Q2FY13
Sales	26,765	24,413	25,399
- growth	*31.7%*	*3.2%*	*-5.1%*
EBITDA	684	701	717
- Margin	*2.56%*	*2.87%*	*2.82%*
EBITDA after other Income	*742*	*971*	*759*
- Margin	*2.77%*	*3.98%*	*2.99%*
PAT	356	552	339
EPS	0.89	1.28	0.85

Source: Company data, Nomura research

Fig. 3: Geographical performance in Q2FY13 – growth in domestic business impacted due to lower Blackberry sales

INR mn	Q2FY12	Q1FY13	Q2FY13
India Business			
Sales	27,052	25,190	26,608
- growth	*32.5%*	*5.4%*	*-1.6%*
EBIT	864	885	868
- Margin	*3.19%*	*3.51%*	*3.26%*
Overseas Business			
Sales	24,983	28,702	32,357
- growth	*34.9%*	*9.5%*	*29.5%*
EBIT	441	515	587
- Margin	*1.77%*	*1.79%*	*1.81%*

Source: Company data, Nomura research

Appendix A-1

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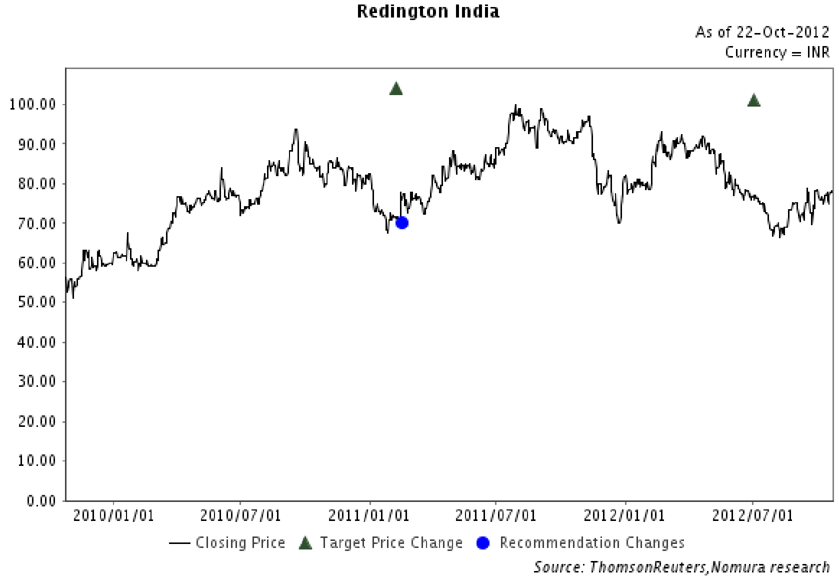
Issuer name	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Redington India	REDI IN	INR 80	29-Oct-2012	Buy	Not rated	

Previous Rating

Issuer name	Previous Rating	Date of change
Redington India	Not Rated	08-Feb-2011

Redington India (REDI IN) **INR 80 (29-Oct-2012)** Buy (Sector rating: Not rated)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
02-Jul-12		101.00	77.05
08-Feb-11	Buy		71.55
08-Feb-11		104.00	71.55

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology Our target price of INR101 is based on 9x one-year forward P/E (applied to our FY14 estimates), which is at a 25% discount to its historical average.

Risks that may impede the achievement of the target price Slowdown in IT sector as Redington derives around 80% of its revenue from the IT sector. The company also has Currency risk as it has a presence across 18 countries, mainly in the Middle East and Africa. It is working capital intensive and so it also faces Interest rate risk. Loss of relationships with major vendors as company derives ~55% of total revenue from its top five vendors.

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