November 24, 2011

Navneet Publications Ltd (NAVPUB)

₹ 58

Well balanced growth…

Navneet Publications, an established player in the supplementary book publishing and stationery segment, is poised for accelerated growth owing to the dual impact of impending syllabus change in the next two years and increasing presence in the e-learning segment. Visible evidence of increasing penetration of schools on a pan-India basis bodes well for demand in education ancillary segments like curriculum book publishing and stationery segment. Navneet, with its vast riches in content development and presence in major geographies of Maharashtra and Gujarat and with plans to expand into newer regions via inorganic route, appears to be well placed to capitalise on the growth opportunities that are expected to unfold over the next few years. We are initiating coverage with a BUY rating on the stock.

Education sector growth, lined up syllabus changes to boost revenues

The K-12 segment is expected to grow from $20 billion to $39 billion by FY14E. With a line up of syllabus changes in Gujarat and Maharashtra, we expect topline growth at a CAGR of 13.4% (FY11-13E) led by growth in the publication (13.4%) segment.

Expansion of EBITDA margin to aid profitable growth

Over the years, Navneet has maintained an EBITDA margin in excess of 20%. Going forward, we expect this to increase by 270 bps to 23.4% (FY13E) led by stabilisation of the stationery segment operating margin and improvement in the publishing segment operating margin.

E-Sense – the next big thing!

Navneet has set an ambitious target of tying up with 1000–1200 schools at the end of FY12E (from 487 schools in FY11). While this business is currently at a nascent stage and is yet to attain break-even, once it stabilises the incremental addition to the bottomline will be substantial as the cost of content creation will be a one-time cost.

Valuations

We have valued Navneet Publications at 15.0x FY13E EPS of ₹ 4.3 to arrive at a target price of ₹ 65. At the CMP, the stock is trading at 16.2x and 13.3x its FY12E and FY13E EPS of ₹ 3.5 and ₹ 4.3, respectively. We believe that Navneet Publications is a good play on the Indian education sector. We expect the topline, operating profit and bottomline to grow at a CAGR of 13.4%, 20.5% and 24.3%, respectively, during FY11-13E. We are initiating coverage with a BUY rating on the stock.

Exhibit 1: Valuation Metrics

	FY08	FY09	FY10	FY11	FY12E	FY13E
Net Sales (₹ crore)	411.1	515.3	531.6	560.8	629.8	721.6
EBITDA (₹ crore)	82.9	102.4	106.9	116.3	142.0	168.8
PBT (₹ crore)	74.4	84.6	98.4	106.8	128.2	155.6
Net Profit (₹ crore)	54.2	56.4	63.9	66.8	84.6	102.6
EPS (₹)	2.3	2.4	2.7	2.8	3.5	4.3
PE (x)	35.3	15.9	13.8	20.2	16.2	13.3
PBV (x)	1.4	0.9	3.0	4.2	3.7	3.2
EV/EBITDA (x)	4.8	2.9	8.8	12.1	10.0	8.4
ROCE (%)	27.0	27.4	29.1	29.8	32.4	34.3
RONW (%)	24.9	23.1	23.2	21.7	24.5	25.8

Source: Company, ICICIdirect.com Research

Rating Matrix

Rating	:	Buy
Target	:	₹ 65
Target Period	:	12 months
Potential Upside	:	12%

YoY Growth (%)

(YoY Growth)	FY10	FY11	FY12E	FY13E
Net Sales	3.2	5.5	12.3	14.6
EBITDA	4.3	8.8	22.1	18.9
Net Profit	13.4	4.4	26.6	21.4

Current & target multiple

	FY10	FY11	FY12E	FY13E
PE	13.8	20.2	16.2	13.3
Target PE	24.1	23.1	18.2	15.0
EV/EBITDA	8.8	12.1	10.0	8.4
Target EV/EBITDA	15.0	13.7	11.2	9.4
Price/BV	3.0	4.2	3.7	3.2

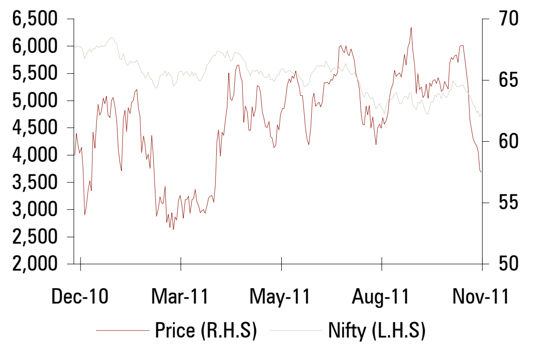
Stock Data

Bloomberg/Reuters code	NPI IN/ NAVN.BO
Sensex	15,858
Average volume	265,749
Market Capitalisation	1,370
EV	1,426
52 week H/L	70 / 50
Equity capital	₹ 47.6 crore
Face value	₹ 2
Promoter's stake (%)	61.8

Comparative return matrix (%)

Returns (%)	1m	3m	6m	12m
Navneet Pub.	(10.7)	(5.8)	(4.4)	(7.8)
Everonn Edu.	(19.5)	(30.0)	(42.9)	(54.4)
Educomp Sol.	(27.8)	(18.6)	(56.2)	(70.7)
Camlin	(18.5)	(46.7)	(50.6)	(8.3)

Price movement



Analyst's name

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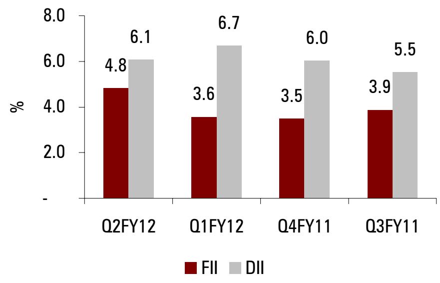
Shareholding pattern (Q2FY12)

Shareholder	Holding (%)
Promoters	61.8
Institutional Investors	10.9
General Public	27.3

FII & DII holding trend (%)



Company background

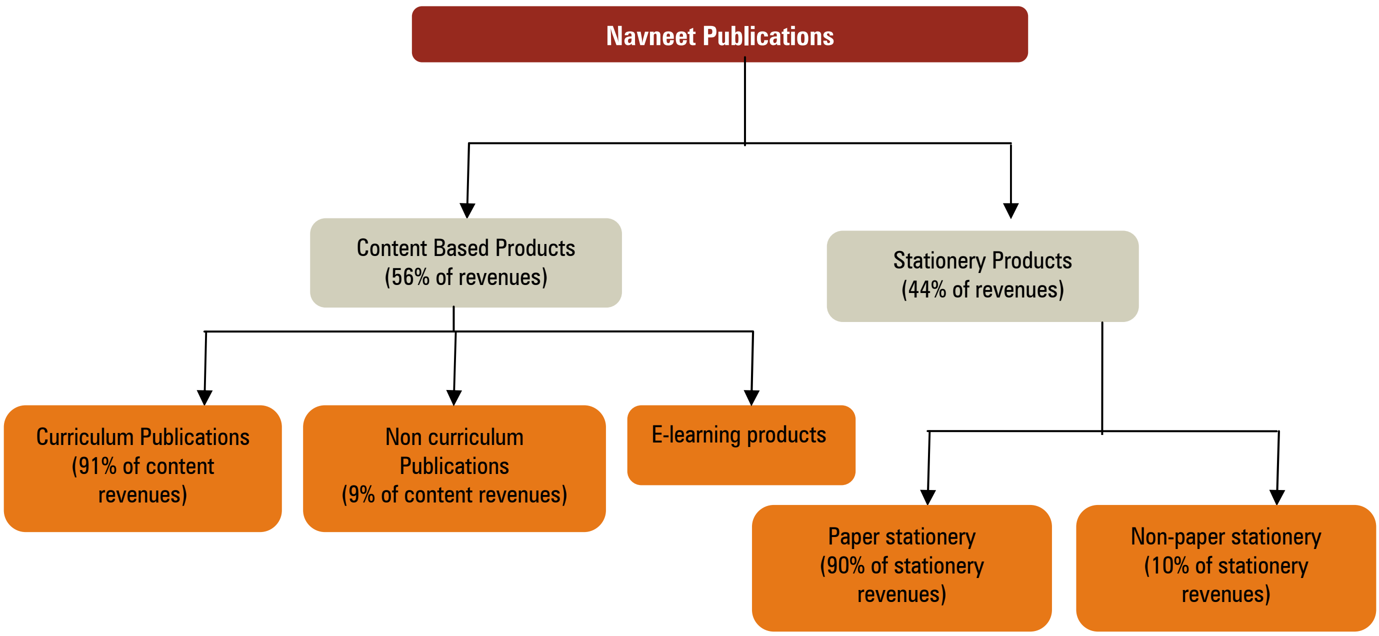
Navneet Publications (India) Ltd (Navneet), incorporated in 1959, is the flagship company of the Navneet and Gala group. The company is promoted by the Navneet group and is being professionally managed by the members of the Gala family. The promoters have an experience of over five decades in the publishing business.

The company is in the business of publishing (both educational and non-educational books), stationery (paper and non-paper based) and E-learning. Navneet is the market leader in the supplementary education books publishing segment in Maharashtra and Gujarat (enjoying 60–65% market share). It has over 5000 titles in English, Hindi, Marathi, Gujarati and many other foreign languages. The company's manufacturing facilities are located at Vasai, Silvassa, Daman, Santej and Dantali and it has offices in Mumbai and Ahmedabad. The company has over 25 branches spread across the country.

In 1994, the company diversified into manufacture and export of paper based stationery items by setting up an export division at Vasai. In 2006, Navneet launched its non-paper stationery products under the brand name FfUuNn. It has also recently launched its office stationery under the brand name VOX.

Although the company's business is primarily concentrated in Western India, Navneet has established its presence in over 22 states through its non-educational books and stationery products. The company employs over 2,600 people and has a strong author base of 185 authors on royalty programmes.

Exhibit 2: Revenue composition (FY11)



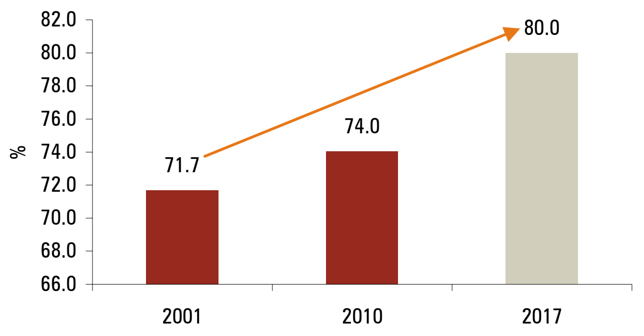
Source: Company, ICICIdirect.com Research

Investment Rationale

Increasing focus on need for education

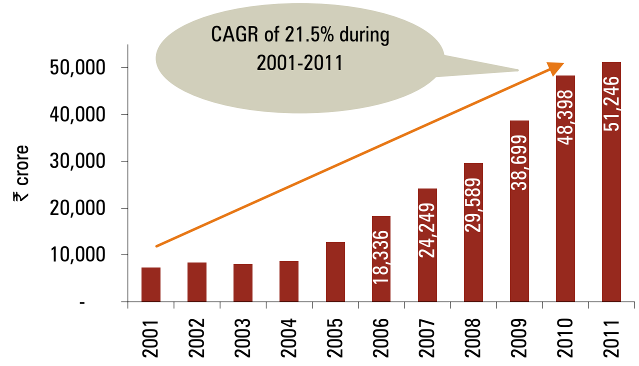
Education is one of the key sectors for transition of the Indian economy. The key focus of the HRD ministry is to increase the literacy rate from the current 74.0% to 80.0% by 2017. The same is also evident from the fact that the budgetary allocation for education has increased from ₹ 7,318 crore in 2001 to ₹ 51,246 crore in 2011, growing at a CAGR of 21.5% during the period. This clearly reinforces the government's thrust on education.

Exhibit 3: HRD ministry aims to increase literacy rate to 80% by 2017



Source: HRD ministry, ICICIdirect.com Research

Exhibit 4: Budgetary allocation for education

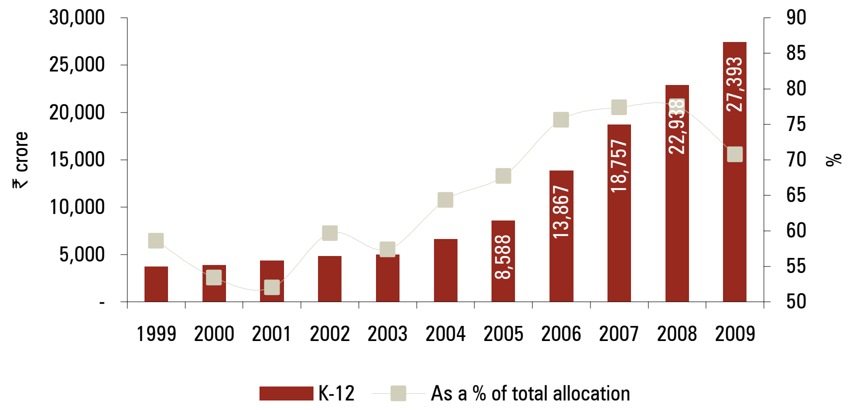


Source: Planning Commission & HRD ministry, ICICIdirect.com Research

Government aims to attain 100% enrolment in elementary schools by 2015

The gross enrolment ratio in the elementary education segment has improved from 51% in 2001-02 to 77% in 2007-08. The government aims to achieve 100% enrolment in elementary schools by 2015. In an effort to increase enrolment, the Indian government introduced its two flagship schemes – one of which is the Sarva Shiksha Abhiyan (SSA).

Exhibit 5: Budgetary allocation towards K-12 segment

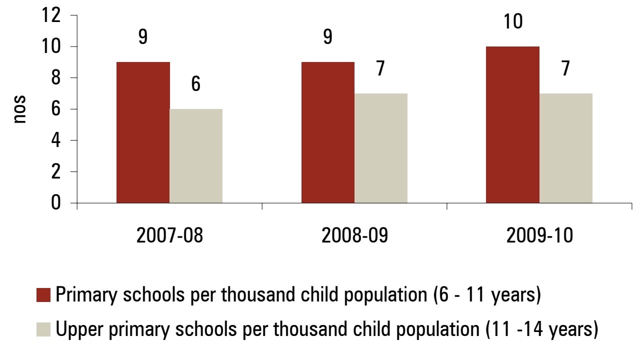


Source: Planning Commission, ICICIdirect.com Research

As observed in the chart above, the budgetary allocation for the K-12 segment increased at a CAGR of 22.0% during 1999-2009. The share of allocation to the segment (K-12) as a percentage of total allocation also increased from 58.6% in 1999 to 70.8% in 2009.

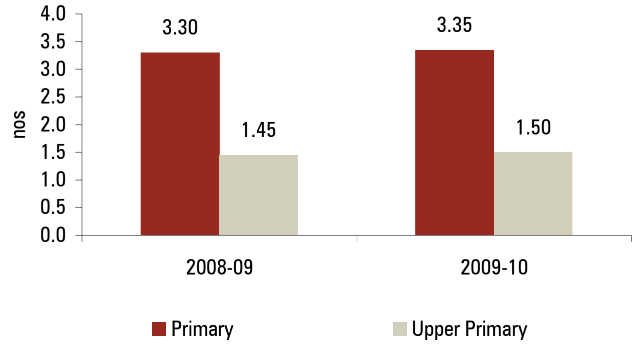
Increasing penetration of schools to enable achievement of goals

Exhibit 6: Increasing number of schools



Source: District Information System for Education, ICICIdirect.com Research

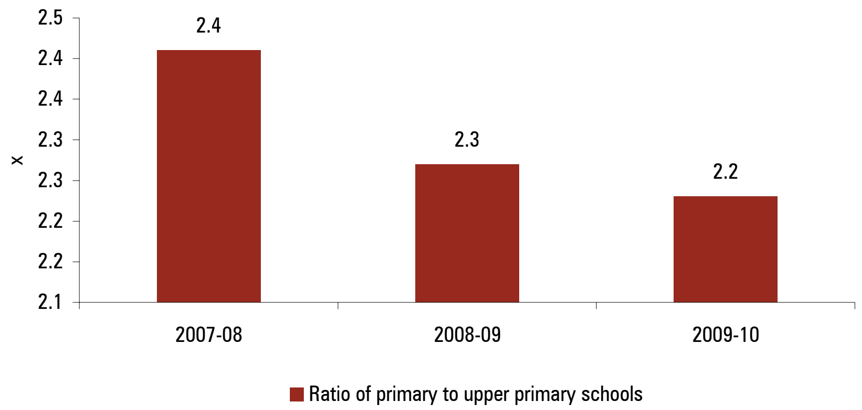
Exhibit 7: Density of schools per 10 sq km



Source: District Information System for Education, ICICIdirect.com Research

The data above clearly shows the growth in the Indian education sector. The number of schools per thousand child population in the primary (age: 6–11 years) and upper primary (age: 11–14 years) has been on the rise. Also, the density of schools per 10 sq km in the primary and upper primary segment increased from 3.30 to 3.35 and 1.45 to 1.50, respectively, in a span of one year.

Exhibit 8: Ratio of primary to upper primary schools



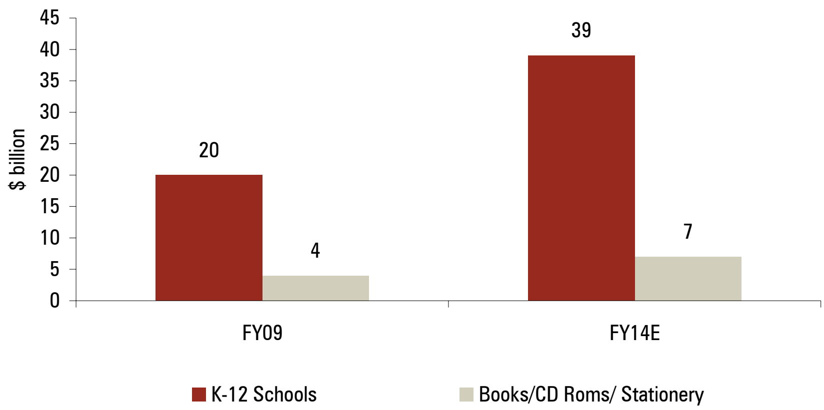
Source: District Information System for Education, ICICIdirect.com Research

The ratio of primary to upper primary schools decreased from 2.4 in 2007-08 to 2.2 in 2009-10 indicating an increase in the denominator. This clearly indicates that more and more students are not dropping out after the primary section and are opting for higher studies.

According to Educomp Solution's Investor presentation dated August 2011, the K-12 segment, which comprises ~50% of the overall education sector pie, is expected to grow at a CAGR of 14% from $20 billion in FY09 to $39 billion in FY14E. Also, the ancillary segment (books, CD ROMs, stationery, etc) is expected to grow at a CAGR of 12% to $7 billion by FY14E

Education sector to double to $80 billion by 2014

Exhibit 9: Growing size of Indian education sector



Source: Educomp Solution Investor Presentation – August 2011, ICICIdirect.com Research

The overall Indian education market is valued at $40 billion as on FY09 and the same is expected to double by FY14E. Of this, the K-12 segment (comprising ~50% of the overall pie) is expected to increase from $20 billion to $39 billion FY14E.

Navneet is present in this segment and is likely to be a key beneficiary of this growth considering its well established position in the publication segment.

Also, the book, CD Rom, stationery and multimedia segment is expected to grow from $4 billion to $7 billion by FY14E, thereby highlighting the scope that Navneet's stationery and e-learning business has.

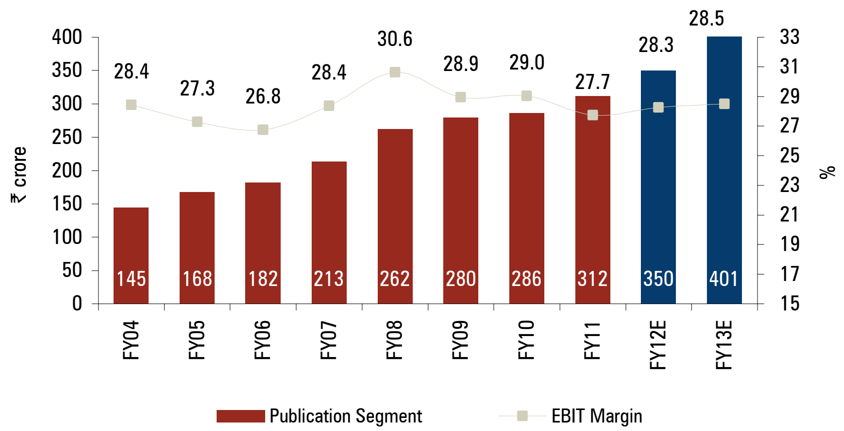
Publishing segment to continue to dominate revenue share

Publication segment expected to grow at 13.4% CAGR during FY11-13E

Considering the line-up of syllabus changes, we expect the publication segment to grow from ₹ 312 crore to ₹ 401 crore, growing at a CAGR of 13.4% during FY11-13E

Navneet has created a good brand image in Maharashtra and Gujarat over the last five decades and enjoys a strong market share of 60% in both these states. In FY11, the company derived 56% of its topline from the publishing segment and we expect this segment to continue to enjoy a lion's share in total revenues. With a continuous line-up of syllabus changes in FY12E and FY13E, we expect this segment to grow at a CAGR of 13.4% during FY11-13E.

Exhibit 10: Publishing segment revenue growth to continue to grow



Source: Company, ICICIdirect.com Research

Line-up of syllabus changes to further aid publishing segment growth

The state boards have mandated that the syllabus should be upgraded every five years so as to have updated content. It has been observed in the past that the growth in publishing segment attains a double digit number in years with a syllabus change

Typically, after every five years, the respective state boards tend to revise the syllabus for each standard. It has been witnessed in the past that the publishing segment posts a double digit growth in topline in years that have a syllabus change as compared to higher single digit growth in years of no syllabus change (see Exhibit: 11). The lag effect of this change also continues in subsequent years as the second hand books sales get affected after a change of syllabus.

Exhibit 11: Schedule of syllabus change in the past

	FY05	FY06	FY07	FY08	FY09	FY10	FY11
Maharashtra			1, 5, 9, 11	2, 6, 10, 12	3,7	4,8	9,12
Gujarat	8, 11	9, 12	10				
Publishing segment growth (%)	15.7	8.6	17.0	22.9	6.8	2.2	9.0

Source: Company, ICICIdirect.com Research

The Maharashtra State Board has already announced syllabus changes for some standards while the Gujarat board is yet to announce more changes. On the back of this, we expect the publishing segment to grow at a CAGR of 13.4% during FY11-13E. We expect the size of this segment to increase from ₹ 311 crore in FY11 to ₹ 401 crore in FY13E.

Navneet has recently test marketed its product offerings in Andhra Pradesh and plans to have full content ready by FY14E. It also plans to launch content for the CBSE Board

Expanding both state-wise and content-wise to fuel growth, going forward

After establishing a stronghold over Maharashtra and Gujarat, Navneet is planning to venture into Andhra Pradesh. Navneet's strategy is to focus on English speaking markets having synergies with the content of existing markets. Considering that it already has full fledged content for both Maharashtra and Gujarat, entering newer states will not be as difficult. The company has already started test marketing in Andhra Pradesh and is planning a full content launch in FY14E. This will help the company to increase its overall reach.

Apart from this, the company is also planning to launch content for the CBSE board (which is largely prevalent in northern India). To do this, the company does not need to incur higher capital expenditure as the authors are paid royalty based on sales. While we have not factored any of these ventures in our estimates, any incremental contribution from this will further boost our estimates.

Stationery segment – to help reduce seasonality of earnings

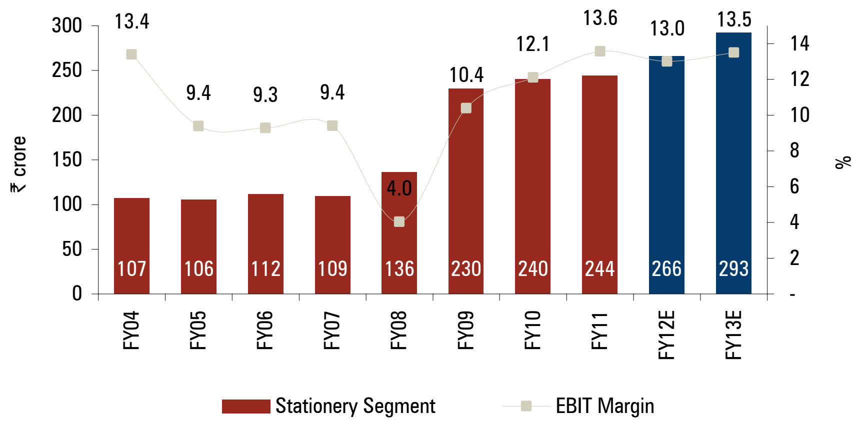
Owing to the seasonal nature of the business, Navneet makes bulk of its sales and profit in the first quarter of the fiscal. About 50–60% of the company's revenues and ~70% of the bottomline came through in the first quarter itself. Since schools begin the new academic year in June each year, bulk of the sales happen during the April–June period. However, with the increase in the scale of the stationery business, we expect this seasonality impact to come down marginally.

Navneet has undertaken a restructuring exercise and plans to focus on five to six states. This will improve the efficiency of this segment. We expect the company to maintain its EBITDA margin from this segment in the range of 11-13%

Restructuring of stationery business to help margin stabilisation

Navneet has undertaken a restructuring exercise in order to improve the scalability and profitability of the business. It plans to focus on five to six states rather than pan-India, which will improve efficiency in the years to come. We expect the stationery business to grow at a CAGR of 9.5% during FY11-13E. Unlike the publishing business, the stationery business is a high volume-low margin business. Also the company faces price pressure from cheaper Chinese products. However, on account of the restructuring activities undertaken by the company, we expect the EBITDA margin from this segment to be maintained in the range of 11–13%.

Exhibit 12: Stationery segment to gain traction after stabilisation



Source: Company, ICICIdirect.com Research

There are around 1,38,000 schools across Gujarat and Maharashtra, of which nearly 32,000 are private schools – which would form Navneet's target market. The company estimates that the potential market on e-learning or classroom teaching for private schools can be worth ₹ 650 crore

eSense – The next big thing!

Navneet had well anticipated the shift from paper (textbook and workbook) based learning to an electronic based learning module. Navneet launched its E-learning software – eSense in Gujarat and Maharashtra in 2008. From a small beginning of 250 schools in FY10 Navneet has tied up with 487 schools at the end of FY11.

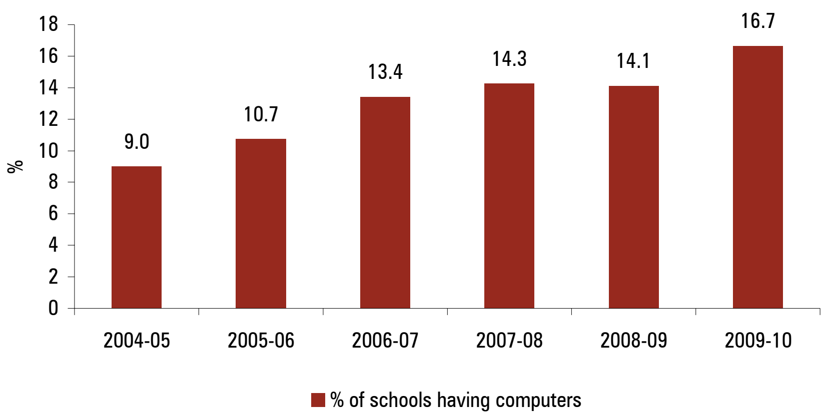
Exhibit 13: Potential of the e-learning segment

	FY10	FY11	FY12E	FY13E
No of schools (nos)	250	487	1,000	2,000
Revenue from eSense (₹ crore)	1.5	4.5	13.5	28.0
Revenue per schoool (₹)	58,684	92,813	135,000	140,000

Source: Company, ICICIdirect.com Research

There are around 1,38,000 schools across Gujarat and Maharashtra, of which nearly 32,000 are private schools – which would form Navneet's target market. The company estimates that the potential market on e-learning or classroom teaching for private schools can be worth ₹ 650 crore. Navneet has set an ambitious target of tying up with 1000–1200 schools at the end of FY12E and further expand this to 5,000 schools by FY15E. While this business is currently small in size and contributes 1-2% to the company's topline, we believe that, going forward, this business has a good scalability. Navneet being among the first movers to enter this segment will surely bear the fruits of the same, going forward. We expect revenues from the eSense segment to grow from ₹ 4.5 crore in FY11 to ₹ 28.0 crore in FY13E.

Exhibit 14: Percentage of schools with computers



Source: District Information System for Education, ICICIdirect.com Research

While this business is currently at a nascent stage and is yet to attain break-even, once it stabilises, the incremental addition to the bottomline will be substantial as the cost of content creation will be a one-time cost. Any upgradation to the same will not be as capital intensive.

Inorganic growth to aid revenue growth

Apart from the organic growth strategy planned by Navneet, the company also aims to achieve growth through the inorganic route. Navneet has decided to expand its horizon in areas where they do not have competencies. It has set aside a kitty of ₹ 50-100 crore for the same. On the lines of these plans, the company has recently announced its foray into school management services by investing ₹ 45 crore in K-12 Techno Services Pvt. Ltd. K-12 is a Hyderabad based school management company serving around 67 state board schools in Andhra Pradesh. It also manages twelve junior colleges and an international school. This move will give Navneet access to a new territory. Navneet and K-12 will also work closely with schools in Maharashtra and Gujarat. The equity for Maharashtra and Gujarat will be shared equally by Navneet and K-12. Considering that this development is at a nascent stage and that the benefits of the same will accrue beyond FY13E, we have not accounted for any of the benefits arising from this investment in our current estimates.

Risks & Concerns

Secondary market for books tends to hamper volumes

Second-hand book sales hamper Navneet's sales volumes. However, in a year of syllabus change this risk is mitigated. Navneet also launches upgraded books each year to mitigate the risk of second hand books

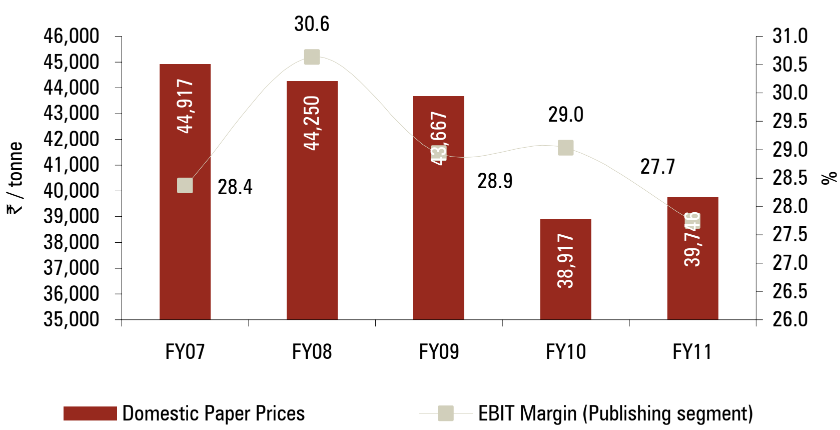
The second-hand book market is the biggest competitor for Navneet's publication segment. Textbook and workbook sellers tend to accept books back at the end of the year and refund close to 50% of the MRP. These books are then sold to the next batch of students at a discounted rate. This eats into the annual volume sales of Navneet. It is primarily on account of this that Navneet sees better sales growth in years of a syllabus change. However, with the increasing trend of nuclear families and rising disposable incomes, parents are more and more inclined to buy fresh books for their children. Navneet has also tried to mitigate this risk by launching upgraded version of the books each year. The upgraded version contains questions asked in last year's exams and the most likely questions to be asked in the current year's exam.

Increasing raw material prices

Increasing paper prices are a cause of concern for Navneet as paper accounts for ~90% of the overall cost. While the burden is more on the paper stationery segment (low margin business), the publication segment is lesser affected due to the company's strong brand image and the ability to pass on the impact of the same to the end user

Paper is a key input for Navneet's business and accounts for ~90% of the total expenses. Increasing paper prices do pose a threat to Navneet's operating margin. This could have a short-term impact especially on Navneet's stationery business as that is a lower gross margin business as compared to the publication segment. For the publications segment the impact is minimal on account of the strong content, relationship with schools and the better margin profile of that business. It has been witnessed in the past that the company has always been able to pass on the impact of the same to customers.

Exhibit 15: Impact of paper prices on operating margin



Source: Company, ICICIdirect.com Research

Limited acceptance in newer territories

Navneet has already started test marketing its products in the Andhra Pradesh market. Going forward, the company has plans to venture into more states. Slow or no acceptance of the products will hinder the company's growth plans.

Performance of Grafalco

The performance of Grafalco (Navneet's wholly owned Spanish subsidiary) continues to be a drag on the company's performance. As the prospects of the Spanish economy look gloomy, the performance of Grafalco will also continue to dent the group's overall performance. However, the company is adopting newer strategies to deal with the same and is hopeful of seeing some revival there.

Over the years, Grafalco's topline has increased from ₹ 1.85 crore (in December 2005) to ₹ 8.37 crore in December 2010. However, considering the weak situation of the European economy, the losses widened from ₹ 0.20 core in December 2005 to ₹ 7.69 crore in December 2010. The management is also considering restructuring this business by shifting the operations to India.

Import of cheap Chinese stationery poses a threat to Navneet's stationery segment

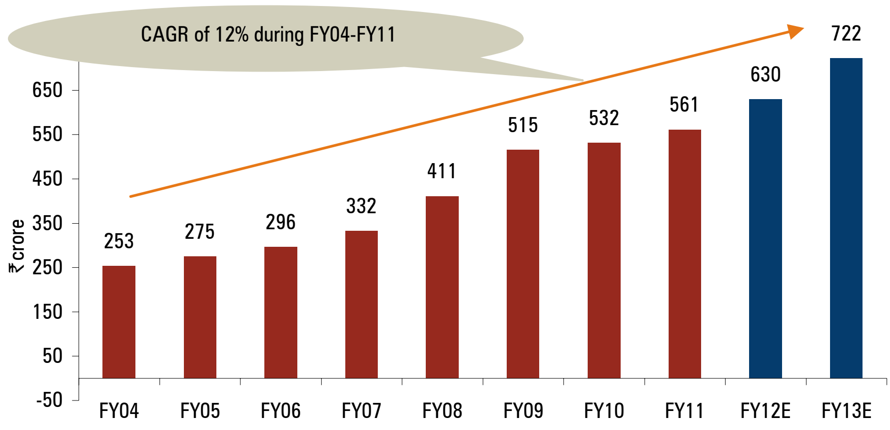
Import of cheap stationery from Chinese markets

The stationery segment in which the company operates is a highly fragmented one and is also dominated by a large number of unorganised players (both international and domestic). Apart from the domestic market, Navneet also faces a threat from the import of cheap stationery from China. This also eats into the company's business.

Financials

Revenues to grow at CAGR of 13.4% during FY11-13E

Exhibit 16: Strong revenue growth to continue

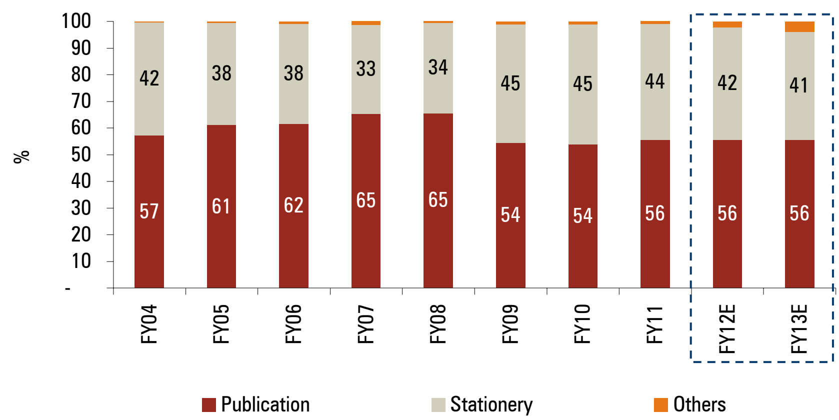


Source: Company, ICICIdirect.com Research

Revenues are expected to grow at a CAGR of 13.4% during FY11-13E led by a balanced growth across all segment. The e-learning segment will post higher growth numbers due to a smaller base

Navneet's topline is expected to continue to grow at 13.4% during FY11-13E on the back of lined up syllabus changes, scaling up of the stationery business and also exponential growth in the e-learning segment. We expected an all-rounded growth in all the segments that Navneet operates in. While the publication will continue to enjoy a dominant share in overall revenues, the other businesses viz. stationery and e-learning will continue to aid topline growth. Once the e-learning business gains critical mass, the contribution from that segment will also be considerable. Further, the inorganic growth plans of the company will also aid strong topline growth. As these talks are at a nascent stage we have not factored the same into our estimates. Bearing this in mind, we expect Navneet's revenues to grow from ₹ 561 crore in FY11 to ₹ 722 crore in FY13E.

Exhibit 17: Product mix, going forward

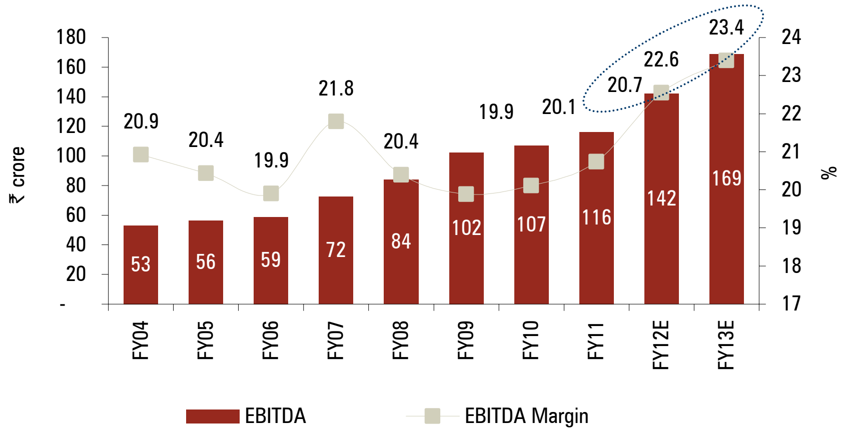


Source: Company, ICICIdirect.com Research

We expect the EBITDA margin to improve from 20.7% in FY11 to 23.4% in FY13E led by better margins in the publishing segment. Also, the re-shuffling of products in the stationery segment will aid margin expansion. Once the e-learning segment gains critical mass, we expect margins in this segment to improve to 60-80%

Operating margin to improve by 260 bps to 23.4% in FY13E

Exhibit 18: EBITDA growth to be maintained



Source: Company, ICICIdirect.com Research

Navneet's publication business has always been stable and has maintained an EBITDA margin range of 26-30%. While the stationery business is stabilising and the company's efforts to rejig the product mix (introduction of premium products) will yield positive results, going forward, we expect this segment to also enjoy a stable EBITDA margin in the range of 11-13%. Also, once the e-learning business gains critical mass, we expect operating leverage to kick in. We believe the e-learning segment has a significant potential to scale up the operating margin profile of the company as the e-learning business is based more on a fixed onetime cost basis. Once the initial costs are recovered, the business has the potential to earn an EBITDA margin of 60-80% once the content for all states and standards has been fully developed.

Navneet has a strong record of rewarding its shareholders by paying healthy dividends each year. It is a company policy to pay minimum 25% of its earnings as a dividend and it has always maintained a payout of over 40%

Strong track record of rewarding shareholders

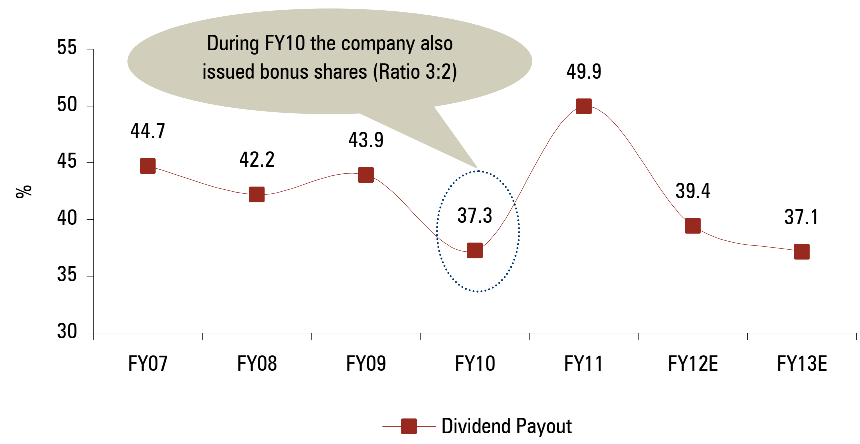
Navneet has a strong record of rewarding its shareholders by paying healthy dividends each year. The company has consistently maintained a strong dividend payout ratio of over 40%. We expect the company to maintain a payout in the range of 35-40%, going forward. Navneet has also come out with a bonus issue three times since listing.

Exhibit 19: History of bonus issues

Date	Equity Capital		Ratio of Bonus Issue
	Pre-Issue	Post-Issue	
June 24, 1996	6.35	9.53	1 : 2
April 24, 2000	9.53	19.06	1 : 1
September 8, 2009	19.06	47.64	3 : 2

Source: Company, ICICIdirect.com Research

Exhibit 20: Healthy dividend payout trend



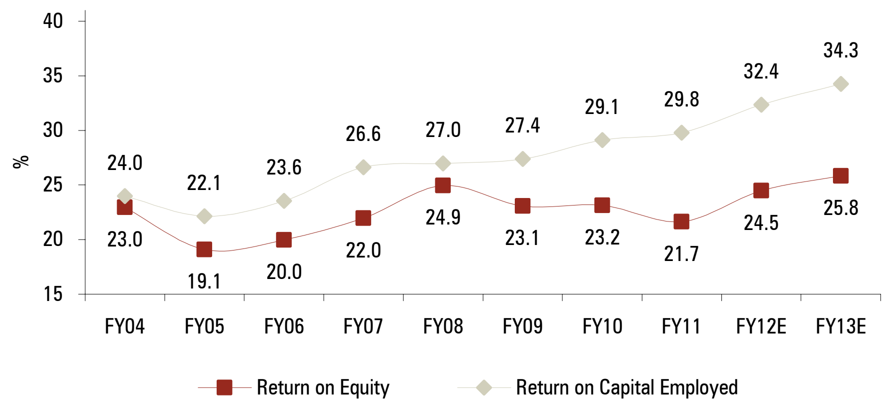
Source: Company, ICICIdirect.com Research

Historically healthy return ratios...to be maintained, going forward

Navneet's business model demands a lower working capital requirement. Also, due to the strong cash accruals of the business, the need for debt remains limited. Considering this, the company has a long maintained a track record of healthy return ratios. We expect the same to continue, going forward. Once the stationery and the e-learning business stabilise and the margin expansion comes through we expect the return ratios to improve from these levels. We expect the return on equity to improve from 21.7% in FY11 to 25.8% in FY13E. Also, the return on capital employed is expected to improve from 29.8% in FY11 to 34.3% in FY13E.

Owing to the working capital light business model, Navneet has maintained return ratios well above the 20% mark

Exhibit 21: Return ratios trend



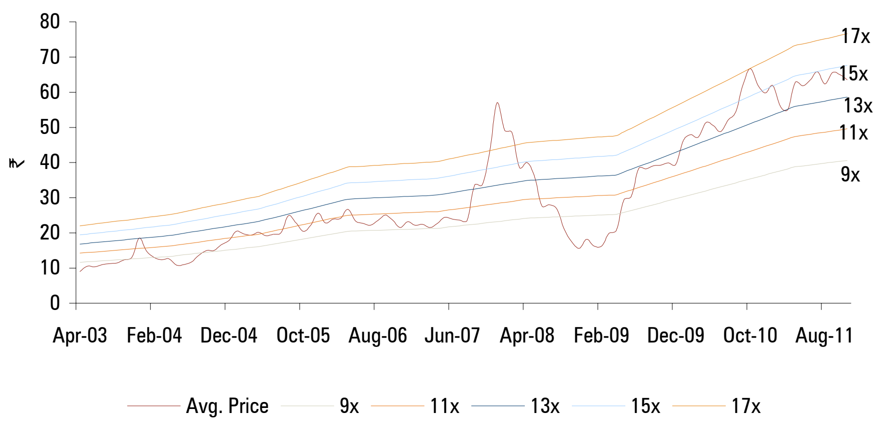
Source: Company, ICICIdirect.com Research

Valuation

Considering the excellent track record of the company, the healthy balance sheet, high cash generating and low capex requiring business model and strong market share in Gujarat and Maharashtra, Navneet has historically discounted its one year forward earnings by 13-15x.

Navneet has historically traded in the band of 13-15x one year forward earnings. Considering the healthy balance sheet, virtually debt-free status, healthy return ratios and increased free cash flow generation we believe that it should trade at the higher end (15.0x)

Exhibit 22: P/E Band Chart



Source: Company, ICICIdirect.com Research

We believe Navneet should trade at the higher end of the historical P/E band considering the below mentioned points:

Healthy balance sheet

Over the years, Navneet's balance sheet has always been strong. Consistent operating margins of ~20%, lower working capital requirements and high cash throwing business has enabled Navneet to maintain a virtually debt free status. In today's global environment, this seems to be an added positive for any company.

Exhibit 23: Healthy Balance Sheet

	Unit	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12E	FY13E
Debt/Equity	(x)	0.5	0.2	0.3	0.3	0.4	0.3	0.2	0.2	0.2	0.2
Current Ratio	(x)	8.2	7.1	8.8	12.1	8.2	4.5	9.7	6.0	7.7	6.9
Interest Coverage Ratio	(x)	23.3	19.1	21.7	38.5	24.1	21.0	45.0	32.5	32.6	46.8
Working Capital to Sales	(x)	0.6	0.5	0.6	0.5	0.5	0.4	0.5	0.4	0.5	0.4

Source: Company, ICICIdirect.com Research

Superior return ratios

Navneet's return ratios have always been far better than its peers. We expect the same to continue considering the changing product profile (which will yield better operating margins, going forward). Also, after the e-learning business stabilises the return ratios are likely to further improve after FY15E.

Expansion in operating margin after stabilisation of e-learning business

As discussed earlier, we believe the margin profile of the company will be upgraded once the e-learning business picks up. This will give a boost to the bottomline of the company.

Strong entry barriers

In the publication and e-learning business, content is king. Navneet has over five decades of experience in developing the content. It has an asset base of over 185 authors that create content and update the same timely. Even as an established player in this business its takes almost two years for Navneet to enter newer markets and takes even longer for it to set up, create content and build distribution channels.

Navneet has a long standing relationship with the state boards and also the schools. This is very important in this business as the state boards recommend which workbooks, guides, etc. should be used. Navneet also has a strong distribution channel, which enables easy distribution and supply of its products.

Markets reward strong return ratios, low debt and positive cash flows

Exhibit 24: Peer comparison (FY13E)

	Navneet Pub.	Everonn Edu.	Educomp Sol.	Camlin	Indsutry Avg.
P/E (x)	13.4	5.0	4.1	10.4	8.2
P/BV (x)	3.2	0.9	0.6	2.2	1.7
EV/EBITDA (x)	8.4	2.5	2.5	6.1	4.9
EBITDA Margin (%)	23.4	36.9	44.5	10.3	28.8
RoE (%)	25.8	18.9	16.0	15.2	19.0

Source: Company, ICICIdirect.com Research

Exhibit 25: Free cash flow analysis (FY11)

Free Cash Flow (₹ crore)	Navneet Pub.	Everonn Edu.	Educomp Sol.	Camlin
EBIT (post-tax)	64.2	82.6	425.7	13.9
Add: Depreciation	13.6	42.0	84.1	6.7
Less: Changes in working capital	(19.3)	(108.7)	(54.2)	(0.4)
Less: Capex	(40.6)	(224.9)	(816.6)	(15.3)
FCF	17.9	(209.0)	(361.0)	4.9

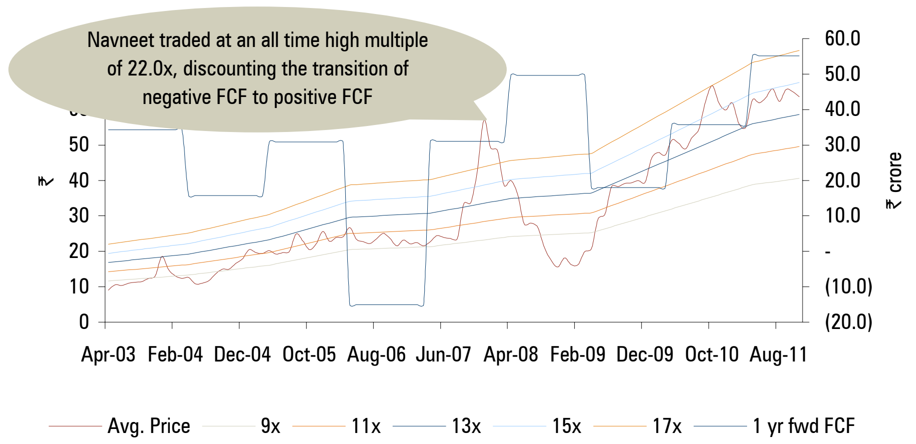
Source: Company, ICICIdirect.com Research

The above two tables indicate that the market gives a higher multiple to companies with higher return ratios and those generating positive free cash flows. Of the companies in the education space, Navneet and Camlin both trade at higher multiples as compared to their peers. Going forward, we expect the free cash flows for Navneet to strengthen.

It has been observed in the past that the market rewards a higher multiple in anticipation of an increase in free cash flows. The same is evident in the chart alongside

Growth in free cash flow makes our case stronger

Exhibit 26: Re-rating happens with higher FCF



Source: Company, ICICIdirect.com Research

It has been observed in the past that the market rewards a higher multiple in anticipation of an increase in free cash flows (FCF). In FY08, the company reported negative FCF of ₹ 15.0 crore and the same turned around to a positive ₹ 31.0 crore in FY09. Towards the end of FY08 (December 2007), Navneet traded at an all-time high multiple of 22.0x one year forward earnings. Going forward, we expect the free cash flows to grow fourfold from ₹ 17.9 crore in FY11 to ₹ 67.9 crore in FY13E. In the current market scenario, where higher interest costs are denting many companies' bottomline, we believe a company with high return ratios and balance sheet strength like Navneet provides a good investment opportunity.

Exhibit 27: Sum of the parts valuation

Segment	Basis of valuation	Equity Value	Value per share
Publication	10x FY13E EV/EBITDA	1,212	51
Stationery	8x FY13E EV/EBITDA	335	14
Total Value		**1,547**	**65**

Source: Company, ICICIdirect.com Research

We have valued Navneet Publications at 15.0x FY13E EPS of ₹ 4.3 to arrive at a target price of ₹ 65. At the CMP, the stock is trading at 16.2x and 13.3x its FY12E and FY13E EPS of ₹ 3.5 and ₹ 4.3, respectively. We believe Navneet Publications is a good play on the Indian education sector. We expect the topline, operating profit and bottomline to grow at a CAGR of 13.4%, 20.5% and 24.3%, respectively, during FY11-13E. We are initiating coverage with a **BUY** rating on the stock.

Financial Tables

Exhibit 28: Profit & loss account

	FY08	FY09	FY10	FY11	FY12E	FY13E
Net Sales	**411.1**	**515.3**	**531.6**	**560.8**	**629.8**	**721.6**
% Growth	23.7	25.3	3.2	5.5	12.3	14.6
Raw Materials	201.6	261.6	263.2	274.4	311.7	357.2
Manufacturing Expenses	25.3	32.2	28.2	28.9	32.7	36.8
Employee Expenses	32.2	40.0	47.4	54.0	52.0	57.7
Sell. & Admin. Expenses	69.2	79.0	85.9	87.3	91.3	101.0
Total Exp.	**328.2**	**412.8**	**424.7**	**444.5**	**487.8**	**552.7**
% Growth	24.1	25.0	3.2	5.5	12.3	14.6
Operating Profit	**82.9**	**102.4**	**106.9**	**116.3**	**142.0**	**168.8**
Other Income	5.0	(0.9)	6.4	7.3	5.0	7.0
Depreciation	10.5	12.6	12.8	13.6	14.9	17.0
Interest expense	3.1	4.3	2.1	3.2	3.9	3.2
PBT	**74.4**	**84.6**	**98.4**	**106.8**	**128.2**	**155.6**
Tax	20.2	28.2	34.5	40.0	43.7	53.0
Net Profit	**54.2**	**56.4**	**63.9**	**66.8**	**84.6**	**102.6**
% Growth	27.3	4.0	13.4	4.4	26.6	21.4
Equity	19.1	19.1	47.6	47.6	47.6	47.6
Dividend %	120.0	130.0	50.0	70.0	70.0	80.0
EPS (₹)	**2.3**	**2.4**	**2.7**	**2.8**	**3.5**	**4.3**

Source: Company, ICICIdirect.com Research

Exhibit 29: Balance sheet

	FY08	FY09	FY10	FY11	FY12E	FY13E
Equity Share Capital	19.1	19.1	47.6	47.6	47.6	47.6
Reserves & Surplus.	211.7	239.3	246.3	275.0	320.5	378.6
Secured Loans	43.3	23.5	70.9	31.3	42.8	36.1
Unsecured Loans	45.0	50.0	-	35.0	31.5	28.9
Deferrred Tax	3.1	3.0	2.3	3.0	4.3	6.6
Total Liabilities	**322.3**	**334.9**	**367.3**	**392.0**	**446.8**	**497.7**
Net Block	89.9	91.2	89.1	118.9	134.0	155.0
CWIP	0.8	0.7	5.5	9.8	5.0	1.3
Investments	0.2	8.9	0.2	0.1	0.1	5.3
Inventories	171.9	197.1	179.3	177.1	190.8	206.2
Sundry Debtors	60.9	67.9	82.9	86.8	97.6	114.0
Cash & Bank	5.3	8.1	11.1	11.3	18.1	18.8
Loans & Adv.	25.1	27.4	30.5	40.9	47.2	54.1
Current Assets	263.2	300.5	303.8	316.1	353.8	393.1
CL & Prov.	32.2	66.5	31.4	53.0	46.0	56.9
Net Current Assets	231.0	234.0	272.5	263.1	307.7	336.2
Misc. Exp Not Written Off	0.4	-	-	-	-	-
Total Assets	**322.3**	**334.9**	**367.3**	**392.0**	**446.8**	**497.7**

Source: Company, ICICIdirect.com Research

Exhibit 30: Cash flow statement

	FY08	FY09	FY10	FY11	FY12E	FY13E
Net Profit Before Tax	**73.9**	**91.6**	**95.5**	**104.5**	**132.1**	**158.8**
Depreciation	10.5	12.6	12.8	13.6	14.9	17.0
Direct Tax Paid	(21.7)	(28.9)	(32.7)	(39.6)	(42.6)	(51.7)
CF before change in WC	62.7	75.4	75.6	78.5	104.4	124.1
Inc./Dec. in WC	(41.3)	(28.1)	(3.3)	(19.3)	(37.8)	(27.8)
CF from operations	**21.4**	**47.4**	**72.3**	**59.3**	**66.6**	**96.3**
Pur. of Fix Assets (net)	(37.9)	(13.4)	(21.0)	(40.6)	(25.2)	(34.3)
Purchase of Investments (net)	10.1	(6.9)	13.4	5.3	-	(5.2)
Income from Inv						
CF from Investing	**(27.8)**	**(20.4)**	**(7.6)**	**(35.3)**	**(25.2)**	**(39.4)**
Inc./(Dec.) in Debt	35.8	(14.8)	(2.6)	(4.6)	8.0	(9.4)
Inc./(Dec.) in Net worth	-	-	-	-	-	-
Dividend Paid	(26.6)	(0.7)	(56.6)	(16.8)	(39.0)	(44.6)
Interest Paid	(2.3)	(8.8)	(2.1)	(3.2)	(3.9)	(3.2)
Others	(0.0)	0.1	(0.4)	0.9	0.3	1.0
CF from Financing	**6.9**	**(24.2)**	**(61.6)**	**(23.7)**	**(34.6)**	**(56.2)**
Opening Cash balance	4.8	5.3	8.1	11.1	11.3	18.1
Closing Cash balance	**5.3**	**8.0**	**11.1**	**11.3**	**18.1**	**18.8**

Source: Company, ICICIdirect.com Research

Exhibit 31: Growth

YoY Growth %	FY08	FY09	FY10	FY11	FY12E	FY13E
Net Sales	23.7	25.3	3.2	5.5	12.3	14.6
EBITDA	16.1	21.8	4.3	8.8	22.1	18.9
Net Profit	27.3	4.0	13.4	4.4	26.6	21.4

Source: Company, ICICIdirect.com Research

Exhibit 32: Key Ratios

	FY08	FY09	FY10	FY11	FY12E	FY13E
Expenditure Break-up (%)						
Raw Material Expenses	48.9	50.8	49.5	48.9	49.5	49.5
Manufacturing Expenses	6.1	6.3	5.3	5.1	5.2	5.1
Personnel Expenses	7.8	7.8	8.9	9.6	8.3	8.0
Admin & Selling Expenses	16.8	15.3	16.2	15.6	14.5	14.0
Profitability Ratios (%)						
EBITDA Margin	20.4	19.9	20.1	20.7	22.6	23.4
PAT Margin	13.1	10.9	12.0	11.9	13.4	14.2
Per Share Data (₹)						
Revenue per share	43.1	54.1	22.3	23.5	26.4	30.3
EBITDA per share	8.8	10.7	4.5	4.9	6.0	7.1
EV per share	42.3	31.3	39.5	59.0	59.9	59.4
Book Value per share	24.2	27.1	12.3	13.5	15.5	17.9
Cash per share	0.6	0.8	0.5	0.5	0.8	0.8
EPS	2.3	2.4	2.7	2.8	3.5	4.3
Cash EPS	6.8	7.2	3.2	3.4	4.2	5.0
DPS	2.4	2.6	1.0	1.4	1.4	1.6
Return Ratios (%)						
RoNW	24.9	23.1	23.2	21.7	24.5	25.8
RoCE	27.0	27.4	29.1	29.8	32.4	34.3
RoIC	17.3	17.9	18.1	17.7	19.9	22.0

Source: Company, ICICIdirect.com Research

Exhibit 33: Key ratios

Financial Health Ratios	FY08	FY09	FY10	FY11	FY12E	FY13E
Operating Cash flow (₹ crore)	21.4	47.4	72.3	59.3	66.6	96.3
Free Cash flow (₹ crore)	(15.0)	31.0	49.7	17.9	35.7	55.1
Capital Employed (₹ crore)	319.1	331.9	364.9	389.0	442.5	491.2
Debt to Equity (x)	0.4	0.3	0.2	0.2	0.2	0.2
Debt to Capital Employed (x)	0.3	0.2	0.2	0.2	0.2	0.1
Interest Coverage (x)	24.1	21.0	45.0	32.5	32.6	46.8
Debt to EBITDA (x)	1.1	0.7	0.7	0.6	0.5	0.4
DuPont Analysis (x)						
PAT / PBT	0.7	0.7	0.6	0.6	0.7	0.7
PBT / EBIT	0.6	0.6	0.6	0.6	0.6	0.6
EBIT / Net Sales	0.2	0.2	0.2	0.2	0.2	0.2
Net Sales / Total Assets	1.3	1.5	1.4	1.4	1.4	1.4
Total Assets / Networth	1.4	1.3	1.2	1.2	1.2	1.2
Turnover Ratios						
Working Capital / Sales (x)	0.5	0.4	0.5	0.4	0.5	0.4
Inventory turnover (days)	152.6	139.6	123.1	115.3	110.6	104.3
Debtor turnover (days)	53.9	48.1	56.9	56.5	56.6	57.7
Creditor turnover (days)	37.6	35.4	26.3	24.6	25.0	26.0
Current Ratio (x)	8.2	4.5	9.7	6.0	7.7	6.9
Free Cash Flow (₹ crore)						
EBIT (post-tax)	53.7	59.9	61.1	64.2	83.8	100.1
Add: Depreciation	10.5	12.6	12.8	13.6	14.9	17.0
Less: Changes in working capital	(41.3)	(28.1)	(3.3)	(19.3)	(37.8)	(27.8)
Less: Capex	(37.9)	(13.4)	(21.0)	(40.6)	(25.2)	(34.3)
FCF	(15.0)	31.0	49.7	17.9	35.7	55.1
Valuation Ratios						
Price to earnings ratio (x)	35.3	15.9	13.8	20.2	16.2	13.3
EV / EBITDA (x)	4.8	2.9	8.8	12.1	10.0	8.4
EV / Sales (x)	1.0	0.6	1.8	2.5	2.3	2.0
Dividend Yield (%)	3.0	6.9	2.7	3.7	3.7	4.3
Price / BV (x)	1.4	0.9	3.0	4.2	3.7	3.2

Source: Company, ICICIdirect.com Research

Appendix

Product profile

Navneet is primarily engaged in three broad business segments – publishing, stationery and e-learning. The publishing and e-learning business contribute 56% to the topline while the stationery business contributes the balance 44%

Navneet is primarily engaged in three broad business segments – publishing, stationery and e-learning. It provides supplementary educational books to students from KG to the 12th standard. Apart from supplementary educational books, Navneet also sells various children's activity and general books. The company also sells paper-based stationery products like notebooks and notepads and has also ventured into the business of non-paper based stationery products like pencils, erasers and sharpeners. It has also invested a sum of ₹ 25 crore in setting up four wind mills of 1.2 MW each in Gujarat.

In the supplementary educational books' segment, Navneet is a market leader in Gujarat and Maharashtra with a market share of ~60%. There are various other unorganised players like Chetana Publications, Balvidya, Amrita Learning, Reliable Publications, etc. However, these players do not pose a major threat to Navneet as the company has cornered a sizeable market share. Also, the players in the unorganised sector offer varied products and all of them are not in line with Navneet's offerings.

The company has also ventured into over 22 states, where it provides non-educational books and stationery products.

Under the publishing segment, Navneet caters to both the educational segment (in Gujarat and Maharashtra) and the non-educational segment (in over 22 states)

Publishing segment

Products under the publishing category include:

1. Supplementary educational books based on the curriculum of respective states
2. Children and general books, which include activity books for children, health series books, cookeries, mehendi, feng shui, etc.

Navneet owns over 5,000 titles in English and 11 other Indian languages. On an average, it adds around 200 titles every year. Navneet has a strong copyright protection mechanism in place.

Educational books

Navneet is engaged in selling a range of supplementary educational books like guides, workbooks and frequently asked/ model question sets. The company is a market leader in Gujarat and Maharashtra. After stabilising its hold in Gujarat and Maharashtra, Navneet started selling its books in Andhra Pradesh and Madhya Pradesh to increase its scope of business.

Whenever there is a change in the syllabus, revenues tend to increase 2.5x in the first year and by 1.5x in the following one or two years. As per government rules, the syllabus in each state should be changed every five years. Due to its presence in many states, Navneet's revenue growth is likely to be stable and the chances of a dip in revenue are minimal. Navneet has also ventured into publishing books in Urdu, which is the second highest used language in primary education in India.

Children books

In conjunction with educational books, Navneet also sells various story and children activity books. Though small in size, the segment is growing into a niche market on the back of rising income levels and the booming organised retail segment. In FY07, the company appointed distributors in Mauritius, Sri Lanka, Indonesia and Singapore to export its publications.

Stationery segment

In the stationery segment, the company's offerings include both paper and non-paper based stationery

The company also ventured into the stationery business in 1994. The stationery segment can be further classified as under:

1. Paper-based stationery products comprising notebooks, pads, etc
2. Non-paper based stationery products like pens, pencils, erasers, etc.

Navneet's stationery products are also sold through world renowned retail chains like Target, Tesco and Wal-Mart

Navneet sells these products in the domestic market and also exports them to the US, Europe and African countries. Navneet also exports its stationery products to worldwide retail majors like Wal-Mart, Target and Tesco.

Navneet is also planning to expand its stationery product portfolio by entering the office stationery segment. The company plans to offer both paper and non-paper stationery products in this sub-segment. Some of the products under development include highlighters, plastic file folders, scissors and calculators.

Navneet's stationery division offers about 300 products in the paper stationery segment and about 50 in the non-paper stationery category. The company holds around 20% market share in the branded student paper stationery market.

E-learning initiative - eSense

Through the e-learning segment, Navneet caters to both the institutional (schools) and retail (students) customers. While the 'Classroom teaching' module enables teachers to explain the concepts to students, the 'Top scorer' is targeted at students to enable them to revise what is taught in school. The 'Top scorer' also contains sections like Q&A, last minute revision, etc

Navneet recently started offering computer based teaching and learning solutions through its e-learning venture – e-Sense. The company has developed syllabus-based content called 'Classroom teaching' in English and other regional languages, which, as the name suggests, are meant for classroom use. The CD will enable teachers to explain the concepts to students with the help of animations. This will facilitate the learning process as visual/ photographic memory is far better than textual retention.

Navneet also plans to develop a student centric product – 'Top Scorer', which can be used by students at home. The home based product would have very little content that is similar to the classroom product and would focus more on interactive options like question and answers, last minute revision, etc.

Navneet has further extended its product offering in this segment. As a pilot project, it has tied up with a Pune-based coaching class and launched India's first E-learning enabled classroom. This involves extensive use of multimedia software to aid learning. Tools such as Visual Education, Smart Board, Electronic Voting System and Web profiles of each student will be some of the key features of this hi-tech classroom. Though this cannot replace teachers, this business can act as a supplementary tool to enhance learning.

Navneet's E-learning business has a remarkable scalability potential with increased adaptability (among teachers, parents and students) and enhanced reach. Though this segment is still at a nascent stage, we expect this division to contribute significantly to the topline and bottomline over the next few years. Over the last two or three years, Navneet has received an encouraging response to its classroom oriented modules.

As on FY11, Navneet has already tied up with 487 schools and expects to increase this to 1,000 schools at the end of FY12E and further to 1,200 by FY13E. Considering the high student-teacher ratio in India, we expect this business to be a well accepted concept in India.

Spanish acquisition – Grafalco Edicones SL

Grafalco, Navneet's Spanish acquisition is not performing as desired. However, Navneet has reworked the strategy and has decided to only distribute its products through a minimum team of employees

Navneet acquired Grafalco Edicones SL (Grafalco), a Spanish company, in June 2005, through acquisition of the tangible and intangible assets for ₹ 2.5 crore (€4,59,000). Grafalco sells children books in the Spanish language. Grafalco's focus has been on introducing new products and tying up with supermarkets with a presence across Spain. Navneet acquired this company with the intent of tapping all Spanish speaking communities across the globe. It also gave the company a new entry route in the European market.

Navneet has access to over 400 titles of the company. These can be converted to Indian languages for sale in India. Similarly, the Indian titles can also be converted into Spanish for sale in Spain.

Over the years, Grafalco's topline has increased from ₹ 1.85 crore (in December 2005) to ₹ 8.37 crore in December 2010. However, considering the weak situation of the European economy the losses widened from ₹ 0.20 core in December 2005 to ₹ 7.69 crore in December 2010. Navneet is well aware of this fact and is devising strategies to cope with the same. The company has closed down manufacturing in Spain and currently only distributes its products there. The management expects that from FY12E onwards this segment will also contribute positively to the bottomline.

Windmills

The windmills initiative helps the company to save ~₹ 50 lakh per annum. Navneet consumes ~30% of the power generated internally while the rest is sold to the Gujarat State Electricity Board @ ₹ 3.27 per unit

Navneet invested ₹ 25 crore in setting up four windmills of 1.2 MW each in Gujarat, all of which were operational in FY08. The company generates one crore units of power each year. Close to 30% of the power generated is used for captive consumption while the rest is sold to Gujarat State Electricity Board @ ₹ 3.27 per unit. The company expects to generate an IRR of 18% for the next 20 years. This initiative leads to savings of about ₹ 50 lakh per annum.

School management services

Navneet has recently announced its foray into school management services. Navneet has invested ₹ 45 crore in Sequoia capital backed K-12 Techno Services Pvt. Ltd. (K-12). K-12 is a Hyderabad based school management services serving over 67 state board schools in Andhra Pradesh. K-12 also manages eight junior colleges and an international school.

K-12 has been offering school management services such as school administration, curriculum development, infrastructure development, teacher recruitment & training, transport solutions, branding and marketing of respective schools, etc. Navneet and K-12 will also work closely with schools in Maharashtra and Gujarat to extend school management services to schools in these states using Navneet's market strength and K-12's expertise in this area.

K-12 also plans to launch its services across five different states and is aiming to manage over 200 schools in the next three or four years.

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