Evaluating rural revival

Rains, grains and gains

3 March 2016

INDIA | Strategy

Meteorological models of various agencies (global and local) are pointing to a normal monsoon in FY17. Our analysis of the long-term historical trend of monsoon and agri-growth suggests that after a deficient monsoon year, the average agri-GDP (real) growth in a normal monsoon is 8.7%. While the Indian economy has been moving away from agriculture (agriculture/services/industrial at 17%/53%/30% of GDP), 58% of rural households are still agricultural.

Rural labour has suffered from low wages in the past two years, especially due to a fall in MNREGA spending. This trend has reversed in the last few months with revised estimates surpassing the budgeted amount. With a 17% increase in rural developmental expenditure projected in FY17, there is comfortable visibility for wage growth coming in rural areas. With an imminent recovery in rural economy in sight, this is the time to add rural stocks.

Case for a normal monsoon in 2016: According to the latest updates compiled by Australian Bureau of Meteorology, Climate Prediction Center (USA), and from the Indian Institute of Tropical Meteorology (IITM) – the El Niño condition started weakening in January and is likely to turn neutral in June-August 2016. IITM also forecasts Indian Ocean Dipole (Indian Niño) remaining neutral in the monsoons. Historically, there have never been three consecutive strong El Niño years and India has never experienced three consecutive droughts. The ENSO chart reveals that whenever El Niño has reverted to normal, India has had a normal monsoon. While modelling climatic patterns comes with its own set of forecast errors, these are encouraging signs. The final verdict on monsoons will come from IMD and Skymet in April 2016.

Agri-GDP posts strong recovery when monsoon reverts to normal from deficiency: In such a year, agri-GDP sees sharper growth (from a low base) of around 8.7%. With almost 64% of rural employment engaged in agriculture, an agrarian recovery has the potential to drive rural growth in FY17. Decent MSP growth (usually decided by the CACP before the monsoon kicks in) could front-load rural consumption.

Rural wages take-off a reality: Wage growth for rural labourers is important for the rural economy, as wages are a major source of income for 35% of agri-households. A major negative for rural India in FY16 was declining wage growth, which was at historical lows (when adjusted for inflation). Nominal rural wage growth was 3.6% in May 2015 (latest available RBI data). Rural CPI Labourers data, which roughly traces the same trend, saw an uptick in the later part of FY16, as wages expenditure under MNREGA– households availing work under the scheme saw a huge spurt from September 2015. The government has increased its planned expenditure under various rural development schemes by 17% in the FY17 budget – which should help sustain rural wage growth.

Similarities with FY11: The current scenario is reminiscent of FY11, when rural India bounced back from a drought year, thanks to 2% above-normal monsoons and the government's rural stimuli. In that year, agri-GDP saw 8% growth, tractors grew 20%, 2-wheelers grew by 19%, rural fmcg sales was growing at almost double of urban sales and ad revenue in print grew by 20%.

Rural plays: Mahindra & Mahindra, Hero Motocorp Ltd, Bajaj Corp, Dabur, Emami, Mahindra & Mahindra Financial services, Monsanto, Coromandel International, Finolex cables, DB Corp and Hindustan Media Ventures Ltd stand out to be major beneficiaries.

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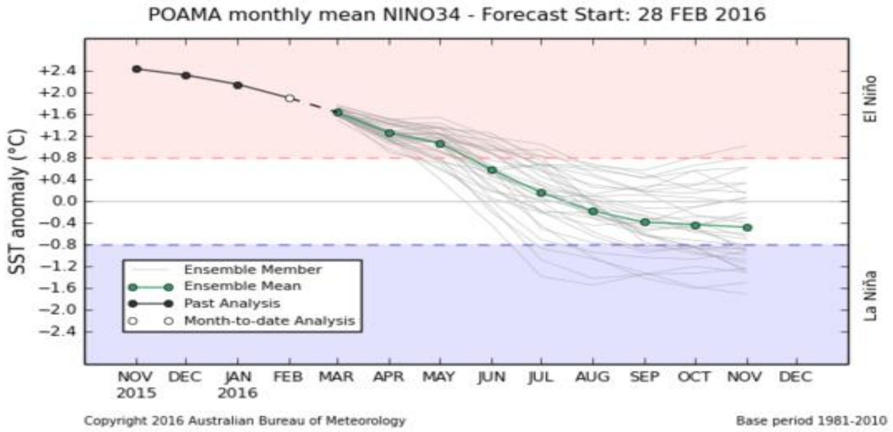
Likelihood of a normal monsoon is higher

Strong El-Nino occurrence in the past two years was the principal cause for India receiving sub-normal (below 10%) monsoon in FY15-16. However, latest data from various agencies points at El Nino weakening by June 2016.

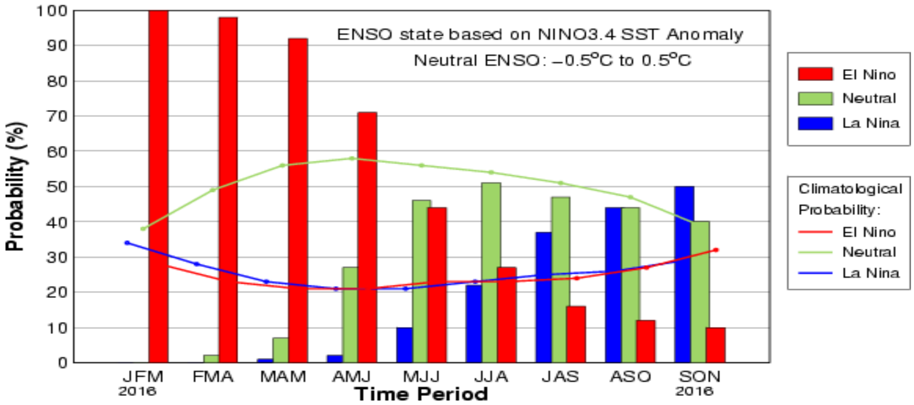
El Nino is likely to fall to the neutral zone by June 2016



Source: Australian Bureau of Meteorology (28th February 2016), PhillipCapital Research India

Forecasts suggest significant El Nino weakening by June

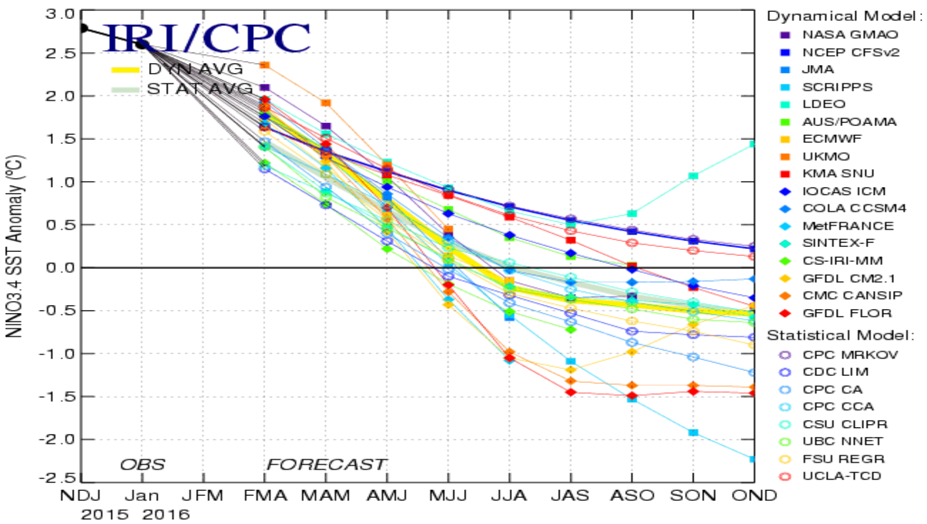
Consensus probability models of CPC/IRI (early February) suggest significant El Nino weakening by June, the beginning of Indian monsoon



Source: CPC-IRI, PhillipCapital Research India

NINO anomaly will fall below threshold considered for Neutral zone

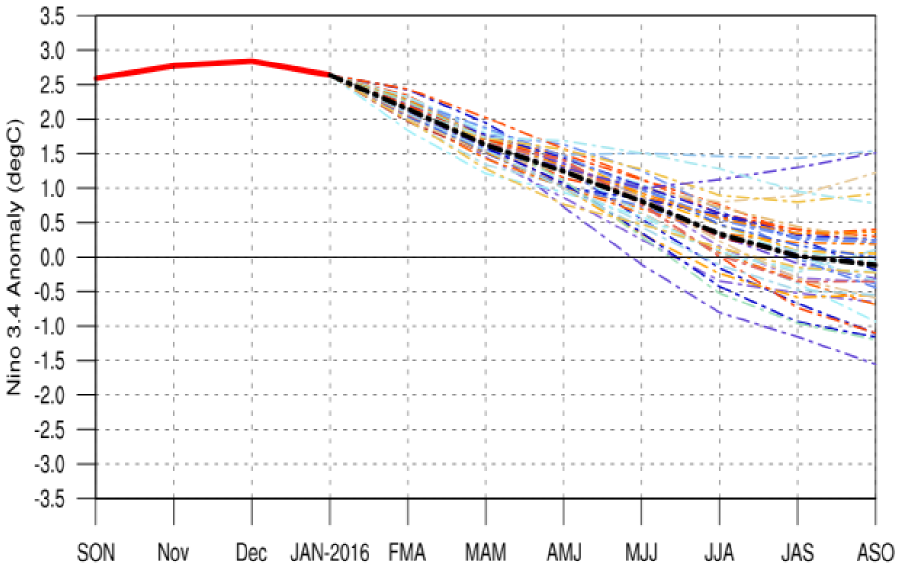
Majority of the models suggest that NINO anomaly will fall below 0.5 by JJA period, the threshold considered for Neutral zone



Source: CPC-IRI, PhillipCapital Research India

Dark blue is the median forecast of IITM, which too is below 0.5. This is the latest forecast published on Feb 10, 2016

Dark blue is the median forecast of IITM, which too is below 0.5 by June



Source: IITM, PhillipCapital Research India

In the last 65 years, El Nino was normal (Ocean Nino index between -0.5 and 0.5) in 34 instances during monsoon – India experienced deficient rainfall thrice (1966, 1979, and 2014) and below-normal rainfall in five instances.

Indian monsoon during all the neutral El Nino years

Year	Oceanic Nino Index	India monsoon deviation
1952	0	-6%
1959	-0.3	18%
1960	0	3%
1961	0.1	19%
1962	-0.1	2%
1966	0.2	-11%
1967	0	0%
1969	0.4	1%
1976	0.1	1%
1977	0.4	2%
1978	-0.4	6%
1979	0.1	-18%
1980	0.3	5%
1981	-0.3	0%
1983	0.3	12%
1984	-0.3	0%
1985	-0.4	-6%
1986	0.2	-9%
1989	-0.3	0%
1990	0.3	9%
1993	0.3	0%
1994	0.4	12%
1995	-0.2	3%
1996	-0.2	0%
2001	0	-7%
2003	0.1	7%
2005	0.1	-1%
2006	0.2	0%
2007	-0.3	6%
2008	-0.3	-1%
2011	-0.3	2%
2012	0.1	-7%
2013	-0.2	6%

Source: CPC- USA Weather Bureau, data.gov.in, PhillipCapital Research India

However, in the years succeeding the El-Nino years where EL-Nino receded to normal, drought was experienced only once (in 1966) out of seven times.

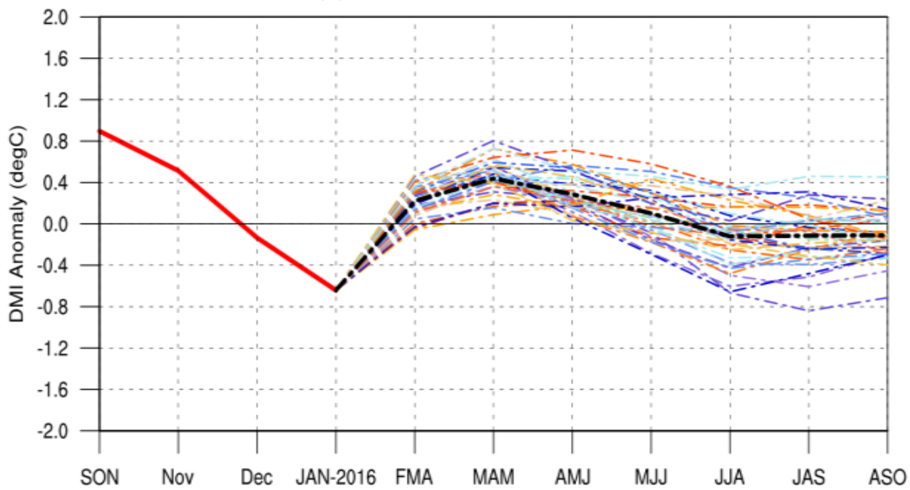
Indian monsoon has usually bounced back to normal in the year after El Nino weakens

Year	Oceanic Nino Index (JJA)	India monsoon deviation
1951	0.5	-14%
1952	0	-6%
1953	0.7	9%
1954	-0.5	4%
1957	1	-4%
1958	0.5	12%
1959	-0.3	18%
1963	0.7	3%
1964	-0.7	13%
1965	1	-20%
1966	0.2	-11%
1972	1.1	-24%
1973	-1	4%
1982	0.8	-13%
1983	0.3	12%
1987	1.4	-15%
1988	-1.2	19%
1991	0.7	-1%
1992	0.5	-4%
1993	0.3	0%
1997	1.4	-2%
1998	-0.7	0%
2002	0.8	-16%
2003	0.1	7%
2004	0.5	-13%
2005	0.1	-1%
2009	0.5	-21%
2010	-0.8	3%

Source: CPC-USA Weather Bureau, data.gov.in, PhillipCapital Research India

According to Indian climatologists, El Nino is not the only factor to govern Indian monsoon, but is a key component of their weather models. Indian Ocean Dipole (IOD) is another important phenomenon that can add/negate the impact of El Nino. While tracking of IOD is quite recent, an above normal IOD (surface temperature rising above 0.4˚C) is said to favour Indian monsoon winds. IITM model suggest that IOD is projected to be in the normal region and thus unlikely to aid or deter monsoons.

IITM's IOD model plot of its median and majority of contributors are in the normal zone

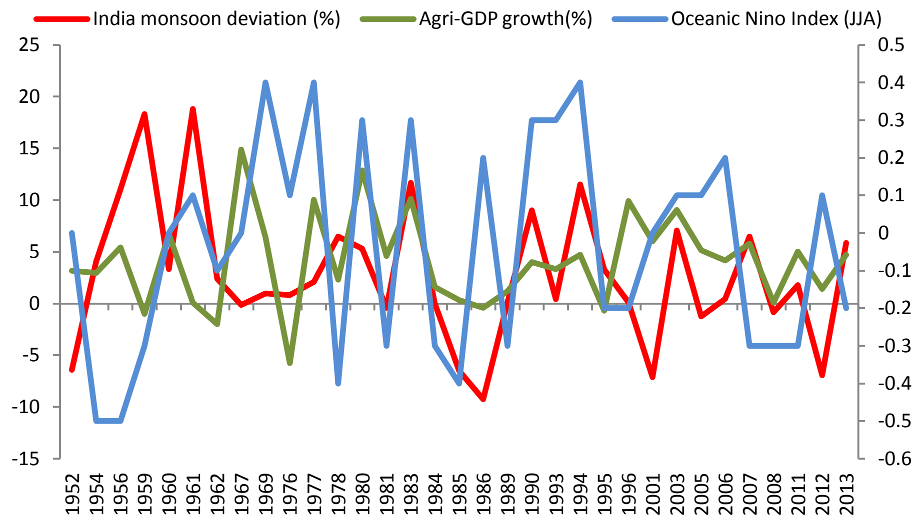


Source: IITM, PhillipCapital Research India

Impact of a normal monsoon subsequent to a deficient one

Indian Agriculture has been historically dependent on monsoon, due to lack of improvement in irrigation. The long-term data shows a 60% correlation of growth in agricultural GDP and deviation of monsoon from normal. The average agri-GDP growth in India for years of neutral El Nino was 4.1%.

Monsoon characteristics and agri-GDP growth in normal El Nino periods (rhs)

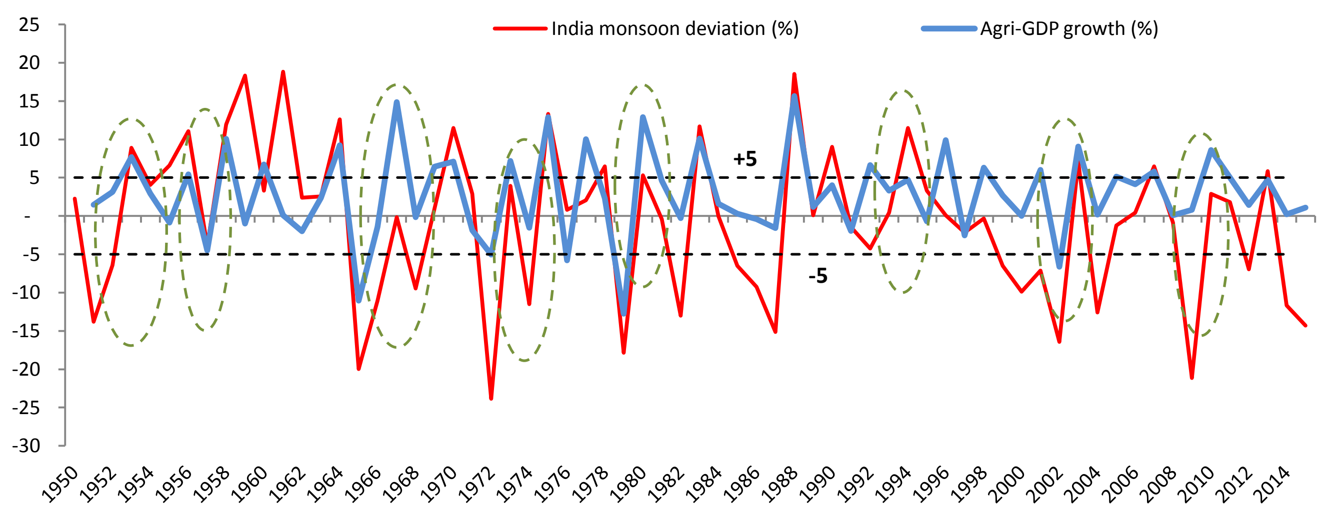


Source: CPC- USA Weather Bureau, RBI, PhillipCapital Research India

Note: This is a discrete time-series and considers the particular years when ONI effect was neutral to depict rainfall situation in those years. Neutral Nino is marked when ONI is between -0.5 and 0.5

The impact is felt all the more in the year following the drought year when monsoon returns to normal. While the long-term agri-GDP growth average in a non-deficient year is 5%, the same for the post-drought year not facing a drought is 10%, with the minimum being 3.2% in 1952. If we remove the four La Nina years following a drought year, the same average still remains a strong 8.7%. It is also pertinent to point out that in 2001, when the rainfall was 7% below normal after the near-drought situation in 2000, the corresponding growth was at 6%!! This suggest that the upside potential impact of a slight sub-normal monsoon too is HUGE!

Trend of Indian agri-GDP when monsoon comes back to normal from a deficient year



Source: data.gov.in, MOSPI, RBI, PhillipCapital Research India

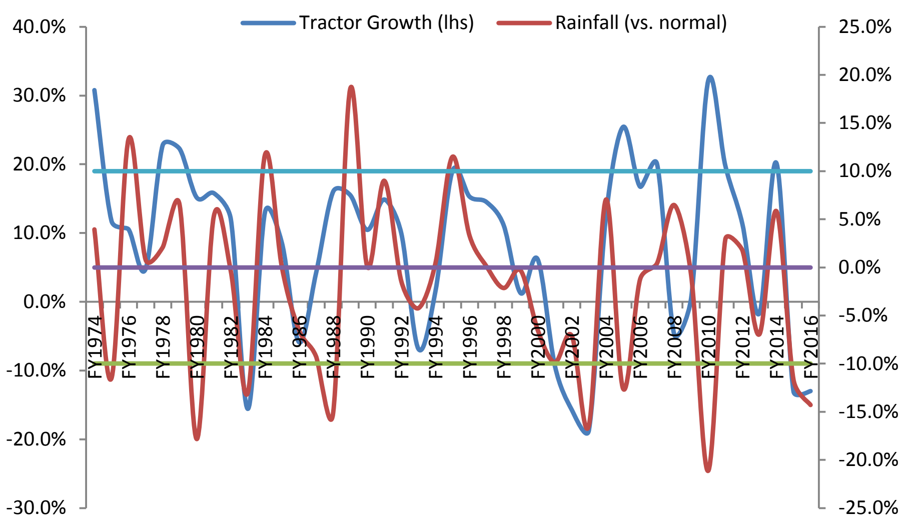
Agri-growth and food-grains output trend from a deficient year to a normal year

Year	India monsoon deviation (%)	Agri-GDP growth (%)	Food-grain production growth (%)	MSP growth - cereals (%)
FY1952	-13.8	1.5	2	NA
FY1953	-6.4	3.2	14	NA
FY1966	-20.0	-11.0	-19	NA
FY1967	-11.0	-1.4	3	NA
FY1968	-0.1	14.9	28	NA
FY1973	-23.8	-5.0	-8	NA
FY1974	3.9	7.2	8	NA
FY1975	-11.5	-1.5	-5	NA
FY1976	13.3	12.9	21	NA
FY1980	-17.8	-12.8	-17	8
FY1981	5.3	12.9	18	11
FY1983	-13.0	-0.3	-3	5
FY1984	11.7	10.1	18	5
FY1988	-15.1	-1.6	-2	3
FY1989	18.5	15.6	21	7
FY2001	-9.9	0.0	-6	5
FY2002	-7.1	6.0	8	5
FY2003	-16.4	-6.6	-18	0
FY2004	7.1	9.0	22	3
FY2005	-12.6	0.2	-7	2
FY2006	-1.3	5.1	5	2
FY2010	-21.1	0.8	-7	6
FY2011	2.9	8.6	12	2

Source: data.gov.in, MOSPI, RBI, PhillipCapital Research India

Tractor sales too have seen strong growth in periods when rainfall turns normal after a deficient one. Since 1974, in years that fit this scenario, average tractor sales growth was 13%. The only outlier was 2002, when tractor sales posted a decline of 16% despite agri-GDP growing 6% – this was because the season ended with rainfall at 7% below normal.

Tractor sales growth trends when monsoon returns to normal from deficient



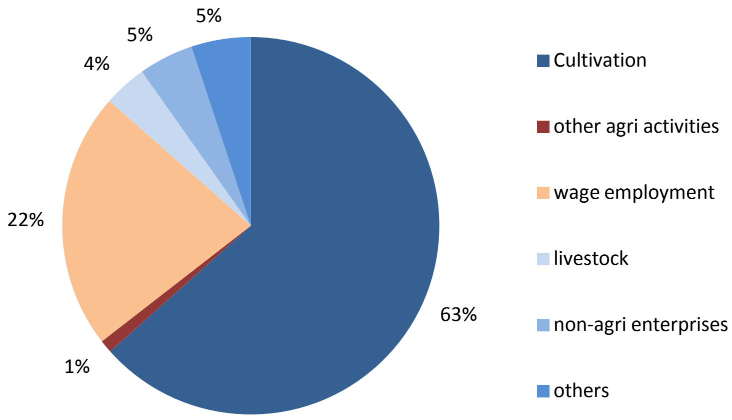
Source: MOSPI, RBI, PhillipCapital Research India

Our economist is expecting a 3% growth in agri-GDP in FY17 with the assumption of a normal monsoon. Statistically speaking, a positive surprise to this number is easier to achieve than a negative surprise, if the monsoon pans out normally.

De-constructing rural households

According to the NSS 70th round, 90 mn (58%) of 156 mn rural households are agricultural households; 63% of these households derive their principal source of income from agriculture.

Income distribution for agricultural households



Source: NSS 70th round, PhillipCapital Research India

Land possession is the principal determinant for the principal source of agricultural income. 34.5% of the 90mn agricultural households possess land size of less than 0.4 ha. For them, wage/ salary income is the principal source. Also, as it is the most indebted group, its consumption per month is less than average rural consumption. While rural wage growth is very important for these groups, that growth will benefit the rural consumer staples more.

De-constructing agri households on the basis of land possession

land size (ha)	wage/ salary income as % of total	Cultivation as % of total	Animal farming as % of total	Non-farm business as % of total	Total income per month (Rs)	Consumption per month (Rs)	Estd households (mn)	% of total households	operated on agri-activities (%)	% having MGNREG job card
< 0.01	64%	1%	26%	10%	4,561	5,108	2	2.6%	46.6	38.3
0.01 - 0.40	57%	17%	15%	11%	4,152	5,401	29	31.9%	94.8	45.3
0.41 - 1.00	38%	41%	12%	9%	5,247	6,020	32	34.9%	99.4	46.3
1.01 - 2.00	24%	57%	11%	8%	7,348	6,457	15	17.2%	99.6	43.8
2.01 - 4.00	15%	69%	11%	5%	10,730	7,786	8	9.3%	99.8	41.4
4.01 -10.00	10%	78%	8%	4%	19,637	10,104	3	3.7%	99.6	36.1
10.00 +	3%	86%	6%	4%	41,388	14,447	0	0.4%	97.5	29.3
all sizes	**32%**	**48%**	**12%**	**8%**	**6,426**	**6,223**	**90**		**96.6**	**44.4**

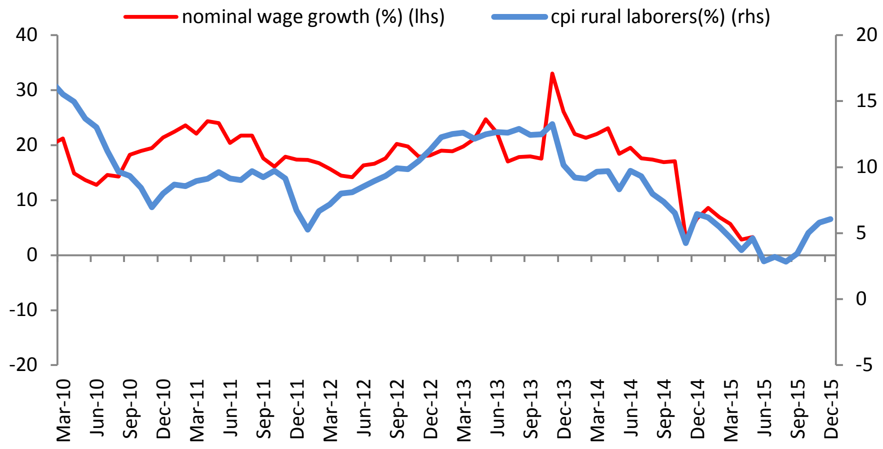
Source: NSS 70th round, PhillipCapital Research India

Most households that have spending power in the rural region derived it from agriculture. For them, a good monsoon is more important than growth in rural labour wages. Rural discretionary income will thus be more dependent on farm output.

Depressed rural wages can see take-off in FY17 – but depend on central budgetary allocation

Since October 2013, rural wage growth started to decline steadily from 15% yoy down to 3.6% in May 2015 (RBI data). However, tracking the data against Rural CPI Labourers, for which the latest data is available, there seems to be a marginal increase in wages recently thanks to the increased spending under MNREGA since August 2015.

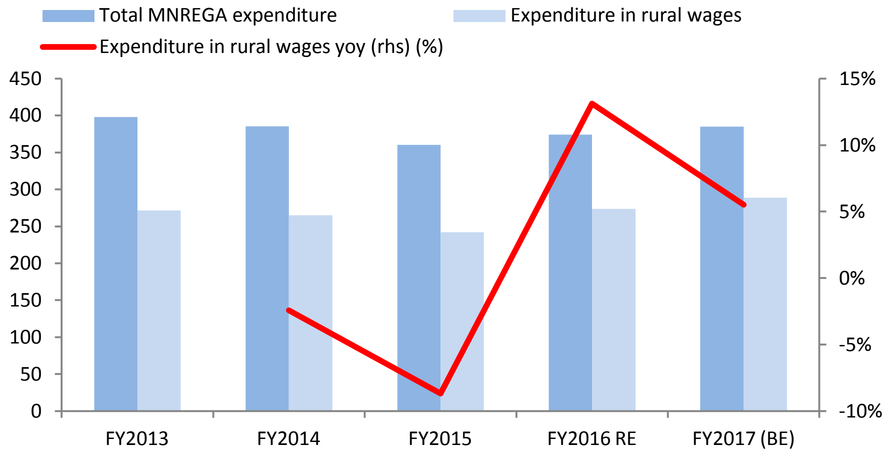
Rural wages declined sharply in mid-2014 and have been suppressed ever since



Source: RBI, Bloomberg, PhillipCapital Research India

MNREGA expenditure and the amount spent on rural wages were falling from FY13 to FY15. This trend has changed only recently in FY16. This declining trend was a major factor in deciding the base price in the rural labour economy, consequently keeping prices suppressed. Cumulative rural wages spend under MNREGA in FY16 until January was 3% higher yoy over the total expenditure in rural wages in FY15.

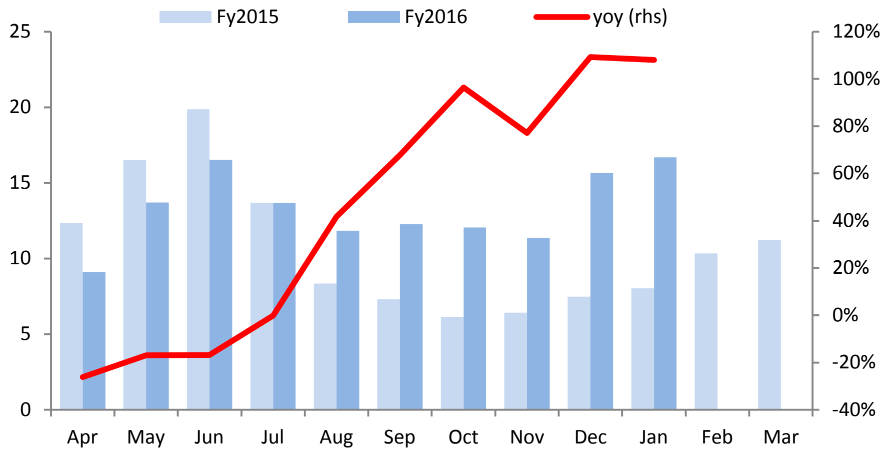
Spending trend under MNREGA (Rs bn) turned positive in FY16; the 2016 budget continues with this trend



Source: NREGA website, Union Budget 2016, PhillipCapital Research India

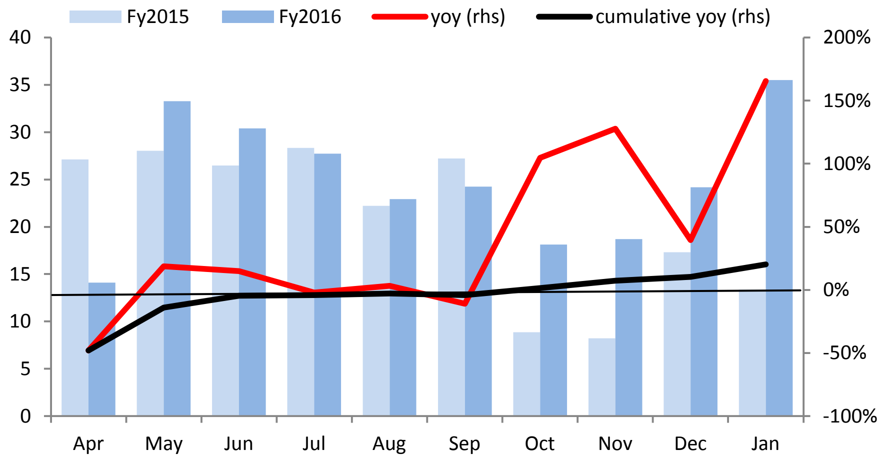
The recent spurt in the Rural CPI Labourers coincides with the increased spending focus under MNREGA. This was partly necessitated because it became clear by August 2015 that monsoon was going to be deficient. Cumulative wage expenditure increase until January for FY16 under MNREGA is now at 3% yoy. Revised estimates for FY16 show MNREGA to exceed allocated amount and the expenditure on rural wages is expected to increase by 13% in FY16.

Households (in mn) who availed jobs under MNREGA



Source: NREGA website, PhillipCapital Research India

Expenditure on rural wages (Rs bn) under MNREGA has also seen a marked jump towards end 2015



Source: NREGA website, PhillipCapital Research India

The recent fervour of MNREGA spending has continued – with increase in allocation for MNREGA and other rural schemes in the 2016 budget. Rural developmental expenditure has seen a 17% increase in budgetary allocation.

Budgetary allocation for rural developmental expenditure (major heads)

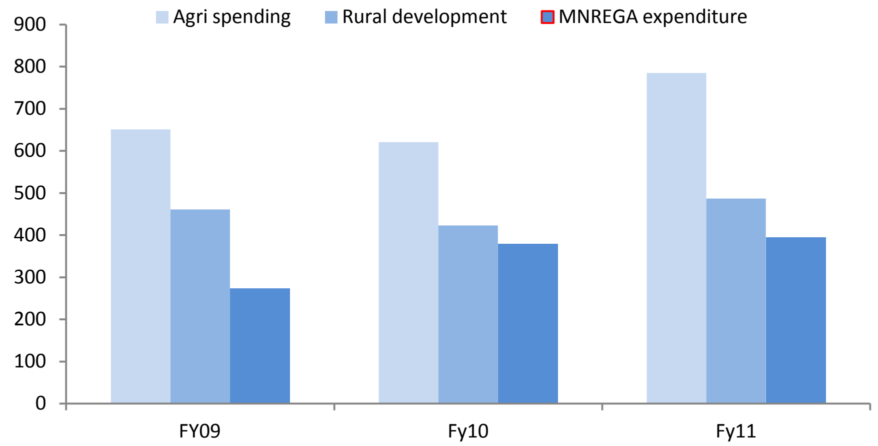
In Rs bn	FY17	FY16	yoy (%)
MGNREGA	385.0	347.0	11.0
National Livelihood mission (rural)	15.3	14.6	4.9
Rural housing (PMAY)	150.0	100.0	50.0
Rural roads (PMGSY)	175.8	151.9	15.8
Rural sanitation (Swachh bharat)	90.0	60.0	50.0
Irrigation (PMKSY)	58.4	53.0	10.2
DD Gram Jyoti Scheme	29.3	44.1	-33.6
Total	**903.8**	**770.6**	**17.3**

Source: Union Budget, PhillipCapital Research India

FY11 – lessons from the past

FY11 could provide insights into to how FY17 can pan out for the rural economy –2009 was a drought year; subsequently, FY10 was a difficult year for rural India with agri-GDP growing at 0.8% (similar to FY16's 1%). In the 2010 budget, spending in agriculture and allied services was increased 26% to Rs 780bn to alleviate rural pain, with 15% increase in rural development to Rs 487bn. While total expenditure under MNREGA increased by just 4% in FY11 to Rs 394bn, it was up 40% in FY10 to Rs 379bn from Rs 273bn in FY09.

Trend in central agrarian expenditure (Rs bn) in FY09-11

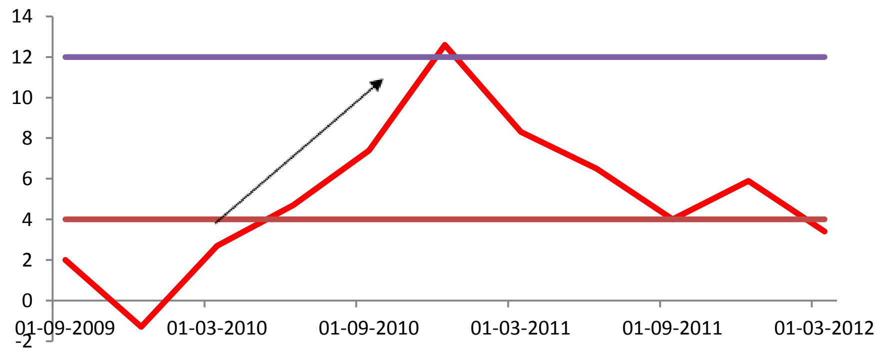


Source: RBI, NREGA website, PhillipCapital Research India

While expenditure through MNREGA saw marginal growth, Bharat Nirman, the flagship programme for rural infrastructure, saw 18% growth to Rs 480bn in FY11, after a 45% growth in FY10.

In terms of MSP for paddy, FY11 had seen a 5% reduction after a 17% increase in FY10. This was offset because of a 12% growth in crop yields. These were the major drivers behind India realising an 8.6% growth in agri-GDP in FY11.

Quarterly trend in agri-GDP growth during the boom period of FY11



Source: Bloomberg, PhillipCapital Research India

Thus, FY11 was one of the rosy years for rural consumption. Two-wheeler sales grew 26% in FY11, buoyed by rural growth (then declined sharply afterwards). Tractor sales grew 20%. Rural sales of FMCG companies were almost double of urban and ad revenue growth for print media was at 20%.

Focus Stocks

Valuation Summary

	Reco	PC Estimates Fy16	Fy17	Fy18	P/E Fy17	Fy18	EPS growth Fy17	Fy18	ROE Fy17	Fy18	Performance (%) 1 month	3 month	1 year
M&M	NEU	57	66	75	19	17	16	13	16	16	3	-7	-1
Hero MotoCorp	BUY	158	175	199	15	13	11	13	36	34	5	-0	0
MMFS	NEU	10	13	17	16	12	38	28	12	14	4	-8	-12
SKS MicroFinance	NEU	24	34	43	15	12	45	26	28	28	-8	11	15
Bajaj Corp	BUY	17	19	22	21	18	9	16	53	50	-2	-10	-12
Dabur	BUY	7	8	9	29	26	15	14	30	28	-4	-13	-8
Emami	BUY	25	33	38	30	26	33	15	43	43	-3	6	4
Coromandel	BUY	12	17	22	10	8	47	30	16	18	2	-12	-38
Monsanto	BUY	46	55	80	29	20	21	45	25	32	-29	-30	-51
Finolex Cables	BUY	14	17	19	14	13	18	11	17	16	4	-5	-11
DB Corp	BUY	18	23	27	14	12	28	17	27	26	-1	-5	-19
HMVL	BUY	24	28	32	9	8	17	14	19	18	-7	-10	11

Source: Company, PhillipCapital India Research Estimates

Hero Motorcorp

HMCL IN | RATING: BUY

- We believe that the two-wheeler industry is set for a gradual recovery in FY17/18 and foresee industry volume growth at 7-8% in FY17, led by improvement in rural demand.
- Rural India contributes close to 50% of its volumes.
- Hero Motocorp will maintain its market share, supported by its flagship brands (Splendour/Passion), best distribution and servicing network, robust branding activities, and a slew of new launches.
- Benefits of its 'LEAP' cost-saving program are clearly visible with EBITDA margins sustaining at over 15.8% in FY16 (till date).
- Trading at 14x FY17 earnings, Hero is a lucrative play on the rural recovery.

Mahindra and Mahindra: Challenges persist

MM IN | RATING: Neutral

- FY17 should be a better year for M&M (with new launches in the market driving overall UV volumes and M&M's tractor business bottoming out due to a low base).
- M&M generates ~55% of revenues from rural regions and would also benefit from revival in rural demand.
- However, M&M has been consistently losing its footing in the SUV segment, given its ageing product portfolio and no new major launches even as its tractor segment is seeing rising competition.
- Near-term could look good due to tractor growth (on a low base) and UV growth (on new launches). However, long-term pressures are evident with the tractor segment seeing cutthroat competition and no new launches in UVs.

Mahindra Finance

MMFS IN | RATING: NEUTRAL

- Increased allocation to rural/ farm sector in the budget will improve cash flows in the rural geography. With 80% of the MMFS branches in rural regions, the company will be a direct beneficiary of any pick up in rural economy. However, effective execution remains the key for any meaningful revival in the demand for vehicles. We expect AUMs to see 12% CAGR over FY15-17.

- Asset quality is likely to remain under pressure as the company moves to 90dpd NPL recognition norms over the next two years.
- Competition may heat up as banks increase presence in MMFS' stronghold. Over FY07-09, banks opened 11,000 branches, out of which only 12% were in tier-5 and 6 centres. However, over FY12-14, banks opened 27,000 branches across India, out of which 41% were in tier-5 and 6 centers.
- While increased rural focus in the budget bodes well for MMFS, asset quality challenges are likely to persist in the near to mid-term as the company tightens NPL recognition norms. Recovery in business and improvement in asset quality hinges on effective execution of budget proposals and good monsoon. At CMP, the stock trades at 2.4x/2.0 our FY17/ FY18 ABV.

Dabur India Limited

DABUR IN | RATING: BUY

- 45% of Dabur's sales come from rural India and the company is a key beneficiary of rural revival.
- Nepal blockade problem resolved. Supply of juices will resume and Dabur will not have problems supplying peak summer demand. Channel filling in Q4 and Q1FY17 could surprise positively.
- Patanjali risks are unnecessarily amplified; impact is likely to be limited to one category – honey – because of steep discount. In other categories, Dabur is much better positioned to tackle competition.
- Highest ad-spend-to-volume-growth sensitivity bodes well in the current deflationary environment. 9MFY16 ad spends-to-sales are at 15.3% vs. last five-year average of 13.5% – this indicates volume growth will pick up.
- Trades at 29x FY17 earnings vs. sector average of 33x. As concerns are waning, the stock can re-rate over the medium term, with improving revenue visibility.
- Estimate earnings CAGR of 14% over FY16-18. Considering low base of FY16 and revival of rural demand from FY17 – positive surprise is likely. We value the company at 35x FY17 earnings.

Emami

HMN IN | RATING: Buy

- 45% of Emami's sales are from rural India.
- Q4 results may surprise positively due to an extended winter season, which could help regain some lost sales from Q3.
- Gross margins will continue to see healthy expansion due to subdued commodity costs and price hikes.
- Emami will keep benefiting from low input prices without having to pass on significant benefits to consumers. Rural revival in FY17 could lead to a positive earnings surprise.
- We value Emami at 36x FY17 earnings.

Bajaj Corp

BJCOR IN | RATING: Buy

- Bajaj Corp has a strong rural portfolio and 40% of its sales are from rural India.
- It has the ability to take price hikes in a deflationary environment and maintain margins. Its complete dominance in almond hair-oil provides it economies of scale in distribution and ad spends. It will continue to benefit as consumers switch from unbranded to branded oils and from heavy oils to light oils.
- During our Ground View tour across India, we observed that Bajaj Corp has a strong presence in the retail channels – both rural and urban – which gave us further confidence in its growth potential.

- Currently trades at 21x our FY17 vs. sector PER of 34x. While the stock has historically traded at a discount to the sector as it is a single category play, the significant discount undervalues its long-term growth potential and we maintain Buy.

Monsanto India: Amaiz(e)ing investment opportunity

MCHM IN | RATING: Buy | CMP: Rs 2098 | TARGET: Rs 4000 | UPSIDE: 90%

- Subdued MSP hikes and inadequate monsoons have led to lower corn planting. Weak glyphosate prices have pressured earnings further in FY16. However, our checks suggest that glyphosate prices have stabilised and volumes are also recovering. With a recovery in monsoons next year, and improved market share, we expect growth resuming (EPS of Rs 60 in FY17).
- Monsanto derives a sustainable competitive advantage from its technological superiority and market reach, making it a promising long-term investment opportunity (it is in the final leg of submitting its field trial data on GM corn to Indian regulators – submission likely in mid H1FY16 (i.e. July-September) – which will be viewed very positively.
- Cash and investments form 35% of its balance sheet – ideally the stock shouldn't fall below Rs 2000 (30x FY17 EPS of Rs 60 + 180/cash per share). Its CMP is not considering any option value for GM maize (discounted value of the opportunity is Rs 3500 per share).

Coromandel International

CRIN IN | RATING: Buy | CMP: Rs 165 | TARGET: Rs 250 | UPSIDE: 52%

- Coromandel International seems on track for a rebound in earnings after a difficult period in FY13-16 (industry-wide challenges and acquisition of Sabero and Liberty, which dampened earnings and returns).
- Expensive inventory and poor offtake pressured margins in 9MFY16; however, incremental impact would be limited (as most impact already accounted in 9M) thus expect margins and earnings to rebound
- With capacity utilisation rising, and debt being paid down, earnings could potentially jump 50% in FY17, leading to a pick-up in RoE to 16-18% in FY17/18 from 12% in FY16. At our SOTP based PT of Rs 250, the valuation corresponds to PER of 14x FY17 EPS and 2.4x PBR.

Finolex Cables

FNXC IN | RATING: BUY | CMP: Rs 229 | TARGET: Rs 305 | UPSIDE: 33%

- Spending on the Deendayal Uppadhyay Gram Jyot Yojana is expected to generate demand for electrical items like wire & cable, switches, fans & lights. This is expected to benefit electrical players. We like Finolex because of its distribution reach and its valuation discount to peers, despite comparable cash flows
- Shown resilience in sales of electrical wires and cables, despite a sluggish economic environment. Maintained conversion spread over copper, despite sliding commodity prices – indicating a tight working capital cycle.
- Telecom cables business remains healthy due to annual execution of Rs 1bn p.a. in FY16-17. Profitability has improved in this vertical due to better capacity utilisation.
- Working capital has seen a slight increase due to creation of new depots in electrical cables and elongated receivables in telecom cables.
- Capex is underway in electrical cables; will set up a greenfield unit for fans. BIS approval for the company's switchgear portfolio is expected in the next few quarters, which could boost revenues and profitability (not accounted in our estimates).
- We value FNXC at 18x our FY17 EPS of Rs 18.7.

DB Corp Ltd.

DBCL IN | RATING: BUY

- The company's strategy to increase ad yield within a weak macro-environment has compounded weakness in ad revenue growth (9M ad revenue declined by 6% yoy vs. industry growth rate of 10-12%).
- Aggressive spending by e-commerce players, launch of 4G service by TSPs, and recovery in interest-rate sensitive sectors should help ad spend recovery in FY17 – expected to grow at 12%.
- DBCL's average cover price across all editions was Rs 3.55 per copy in H1FY16 and the company plans to increase it to Rs 4.75 per copy in the next two years. Hence, the company hopes to continue its double-digit circulation revenue growth in FY17 as well. We are forecasting 12% circulation revenue growth in FY16-18, primarily driven by yield improvement.
- We estimate EBITDA margin to increase by 280bps over the next two years, despite higher level of investments in the digital business, due to softness in newsprint prices and uptick in ad revenue.
- We estimate FCF of Rs 4.5bn in FY17 (7.5% yield) and Rs 5.1bn (8.5% yield) in FY18. DBCL has consistently maintained a dividend pay-out of 45% and we believe that scope of higher pay-outs exists, as cash generation improves.

Hindustan Media Ventures Ltd .

HMVL IN | RATING: BUY

- HMVL's two-year ad revenue CAGR of 14% is much higher than the print industry's CAGR of 10% – primarily driven by market share gains in UP due to an increase in ad yield.
- This outperformance should continue into FY17 and FY18 as the discount between its UP-market ad yields and the market leader Dainik Jagran's yields narrows (as older contracts get negotiated at a higher price).
- Aggressive ad spend by ecommerce players, launch of 4G service by TSPs, and continued ad spend by the FMCG sector should support ad-revenue growth – we estimate 13% over FY16-18.
- Newsprint costs will remain soft over the medium term, aiding gross margin expansion of 100bps over FY16-18. Similarly, due to (yield improvement driven) ad-revenue and circulation-revenue growth, we expect EBITDA margins to improve 250bps and EBITDA to register a 19% CAGR over FY16-18.
- We expect EBITDA/PAT CAGR of 19%/15% over FY16-18. At the CMP, the stock trades at 9x one-year forward earnings vs. five-year historical average of 10x.We expect the company to generate Rs 2.5bn of free cash over the next couple of years, implying a free-cash-flow yield of 8-9%.

Rating Methodology

We rate stock on absolute return basis. Our target price for the stocks has an investment horizon of one year.

Rating	Criteria	Definition
BUY	>= +15	Target price is equal to or more than 15 of current market price
NEUTRAL	-15 > to < +15	Target price is less than +15 but more than -15
SELL	<= -15	Target price is less than or equal to -15.

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