Pennar

From	:	26-03-2014
To	:	31-08-2017
Performance	:	225%
Recommendation	:	OPEN

Background & Business

Pennar's standalone business is divided into SBUs across segments such as Steel Products (19% of cons revs & 7% of cons EBITDA as per Q1FY18 nos.), Tubes (13%, 10%), Industrial Components (4%, 6%) & Systems & Projects (33%, 37%). The Consolidated entity comprises of 2 subsidiaries in addition to standalone entity; namely, Pennar Engineered Building Systems (PEBS; 28%, 22%) & Pennar Enviro (PEL; 2%, 18%). PEBS is present in segments such as Pre-Engineered Buildings, Custom designed Steel Structures & Engineering Services while PEL is into water treatment solutions, water treatment chemicals & fuel additives.

Investment Thesis

a) **Tubes and Systems & Projects business continue to steer top-line growth** (Tubes segment has picked up pace (38% YoY in Q1FY18) led by 25% increase in installed capacity which came on-stream in March 2017. Proportion of higher-margin CDW tubes has been growing continuously in the total pie. Order book for Solar & Railways segments continues to remain strong & PEBS continues to add new customers in both sub-segments. As specified by management, the solar sector in India is seeing capacity expansion across companies indicating robust potential going ahead).

b) **PEBS powering up led by Engineering Services Division (ESD)** (Higher-margin ESD saw revenue growth of 54% YoY in Q1FY18 while Solar revenues were up 330% YoY on a low base. PEBS has seen repeat orders from its clients, comprising half of its total orders, & is seeing improvement in order enquiry in solar, airports, warehousing, & high-rises).

c) **PEL listing could provide considerable value unlocking** (After successfully unlocking value through listing of its subsidiary PEBS, we expect that PEL, too could follow similar path. Listing of PEL, when it happens, could lead to considerable value unlocking for investors of Pennar & offer investors a chance to participate in growing water infrastructure story in India).

d) **Lowly leveraged balance sheet provides scope for debt-driven growth & expansion** (Gross consolidated D/E ratio of 0.56xs and Net consolidated D/E ratio of 0.35xs as on 31st March 2017).

Outlook

Over past few quarters, Pennar's financial performance has been impacted due to lack of recovery in IIP. In fact, the stock was extremely flat for a year up to Mar'17, after which the stock rallied (56% since 1st April 2017) due to a bulk deal involving Franklin Templeton AMC, which raised its stake in the company from 6.56% to 9.05%. As such the management used this period, to build on technological competencies such that Pennar is now in a position to cater to a vast segment of industries, it has also focused on moving up the value chain thereby ensuring improved margin profile, the operations have been kept under stringent cost controls with sharp focus on balance sheet management such that there is no increase in leverage be it due to capex &/or working capital. We value all of these steps very positively & have confidence in the business delivering as capex cycle resumes in the country. Our stand has been validated by the recent bulk deals and also strong performance during the Q1FY18 quarter. The stock at 12xs FY18E EPS and 9xs FY19E EPS factors in current industry-wide slowdown. We reckon any signal of improvement in IIP will be extremely positive on the stock. Pennar would then see twin benefits of both earnings expansion & multiple re-rating. Any investor with holding period of 3yrs will stand to benefit immensely from holding the stock. Given our preference for long-term wealth creators, we reckon the stock to have the potential of generating nearly 3.5xs returns over a 5year holding period.