Redington India REDI.NS REDI IN

INDUSTRIALS

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Management interaction takeaways post Q3 result

Quick Note

January 30, 2012

Rating Remains	**Buy**
Target price Remains	INR 104
Closing price January 27, 2012	INR 80

Redington reported consolidated sales growth of ~ 24.7% in Q3, better than our & consensus estimates. This was driven by ~17% growth in the Indian operations and a solid 32% in its international business. Depreciation of INR versus mainly the USD boosted y-y growth in its overseas business by ~11%. Excluding Arena, a business in Turkey that was acquired in Q3FY11, overseas performance grew by 20% in Q3. Gross margins improved by ~37 bps y-y on account of better volume mix which tilted more towards the non-IT and value products. Our discussion with management suggested that non-IT contributed ~30% of total sales vs 27% in Q2FY12. EBITDA margin improved by ~22 bps y-y and ~16 bps q-q in Q3. Interest expenses increased to INR37.8, in line with our expectation largely on account of NBFC business. Consolidated PAT was reported at INR678mn which was marginally higher than our expectation driven by a lower tax rate of ~23.4%. Lower tax rate was driven by greater contribution of overseas business which includes low tax rate geographies Middle East and Singapore. We maintain BUY; our estimates are under review.

Margin expansion in both domestic & international business

- Domestic business: The company reported EBIT margin of ~3.3% for India business. This represents ~16 bps y-y and a 14 bps q-q increase. As per management, this has been on account of increased sales to government which has higher proportion of higher margin, value added products.
- Overseas business: The company reported an EBIT margin of ~2.0%. This represents an increase of ~33 bps y-y and 37 bps q-q on account of an increase in price realization. As per management, if the strong demand driven by the current level of oil prices persists in ME, 2% will be sustainable margin in overseas business but more clarity will emerge after Q4.

Successful negotiation with vendors on favourable credit terms

As we had earlier highlighted in our Q2FY12 note, the company is in negotiations with its key vendors to avail cash discount even for an extended credit period. Earlier the company was availing cash discount or an extended credit period which was stretching its working capital days. Given a strong internal focus on working capital (WC) and improving FCF, the company has negotiated and has availed cash discount and credit period on some products and vendors in Q3. Management indicated that the full benefit of this will be visible after 3-4 quarters when the company negotiates across all product lines and vendors. This highlights the strong management intent backed by action to reduce WC and make the company FCF positive, in our view.

Growth moderation in India: impact of slowdown in government decision making and muted consumer sentiment

- Growth in Indian operations slowed to 17% in Q3 against 36% in Q2FY12 and 39% in Q3FY11. Slowdown in India IT business can be attributed mainly because of the of projects business (dependent on

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government projects and corporate capex) which contributes ~20% to India sales and low consumer sentiment. Slowdown in government decision making has resulted in low sales to government in Q3. As per management, non-IT business (consumer durables) has not shown any sign of slowdown and has grown at ~70% in Q3.

- The Q3 outcome in India was also impacted by floods in Thailand which resulted in hard disk shortage for the domestic PC market and therefore temporarily impacted PC sales. We expect growth in PC business to be better in Q4FY12.
- International business continued to grow at a decent clip driven by a macro backdrop of high oil prices. All international geographies including Egypt & Singapore contributed strongly in Q3 as per management.

Arena – performance continues to be under pressure

Management suggested that the Arena, a business that they acquired in Turkey (contributed ~9% of the group top line in Q2 FY12) continues to be under pressure. Comparing on 9M basis, sales were almost flat y-y. Turkish Lira has depreciated by ~25% y-y and 95 q-q against USD. Government in Turkey continues to deter imports. Turkish Lira has started to appreciate in Jan'12, and we expect demand to improve in Turkey in Q4. As we had highlighted in our Q2FY12 note, vendors in Arena followed consignment model which is now creating problems for vendors when demand scenario is sluggish.

Working capital days and gross debt at same level

- Working capital day at end of Q3 is at 45 days for Indian business and 47 days at consolidated level. This is at same level as of Q2. We believe that with the company negotiating for favourable credit terms and increasing share of non-IT business having lower WC requirement (like Blackberry & Apple product), WC days should improve further.
- Net debt at ~ INR13bn at end of Q3 is at same level as Q2. This clearly indicates we believe that the company has been able to finance additional requirement of working capital internally which is required for growth. This is positive, in our view.

NBFC business continues to perform well

As per management, NBFC business reported net income growth in excess of 50% with zero NPA. Current book size is ~INR6bn with cost of borrowing at ~10%.

Fig. 1: Q3FY12 - performance

INR mn	Q3FY11	Q2FY12	Q3FY12				
			Actual	Nomura	Difference(%)	Consensus	Difference(%)
Sales	45,942	54,340	57,297	53,132	8%	54,786	5%
- growth	*30.0%*	*39.8%*	*24.7%*	*15.7%*		*19.3%*	
EBITDA	1,132	1,370	1,540	1,441	7%	1,534	0%
- Margin	*2.5%*	*2.5%*	*2.7%*	*2.7%*		*2.8%*	
PAT	527	613	678	649	5%	696	-3%
EPS	1.33	1.54	1.70	1.63	4%	1.71	0%

Source: Company, Bloomberg, Nomura estimate

Fig. 2: Geographical performance – growth slowdown in India business while overseas performance inflated due to INR depreciation & Arena

INR mn	Q3FY11	Q2FY12	Q3FY12
India Business			
Sales	21,613	27,683	25,204
- growth	*39.1%*	*35.6%*	*16.6%*
EBIT	670	864	822
- Margin	*3.1%*	*3.1%*	*3.3%*
Overseas Business			
Sales	24,403	26,819	32,332
- growth	*22.5%*	*44.8%*	*32.5%*
EBIT	410	441	651
- Margin	*1.7%*	*1.6%*	*2.0%*

Source: Company, Nomura research

Appendix A-1

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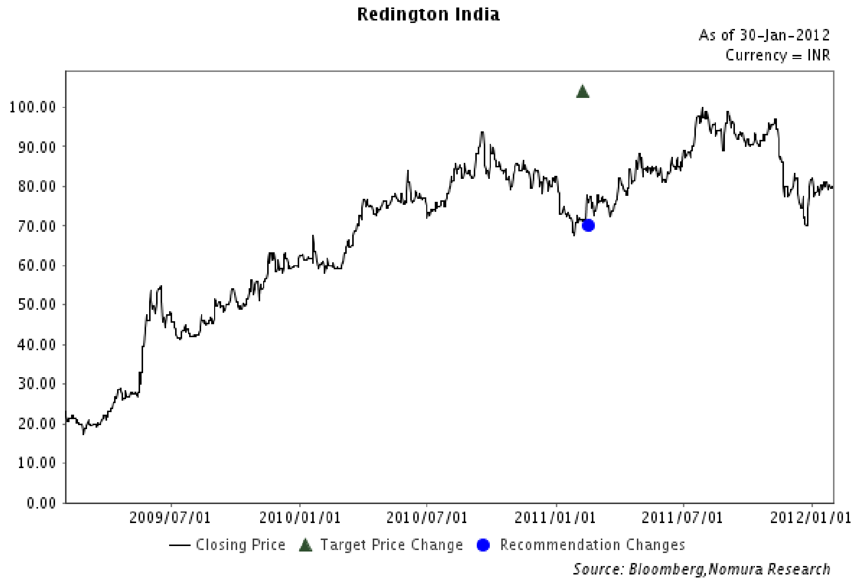
Issuer name	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Redington India	REDI IN	INR 80	27-Jan-2012	Buy	Not rated	

Previous Rating

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

Redington India (REDI IN) **INR 80 (27-Jan-2012)** Buy (Sector rating: Not rated)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
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 We have valued the stock at 11x one-year forward P/E, which is a 10% discount to the 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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STOCKS

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STOCKS

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