Coverage Stock: Shankara Building Products Ltd.

Best of both worlds

CMP INR 1,316 Target INR 1,575

Rating: BUY Upside: 20%

Date: 5th September 2017

Shankara Building Products (Shankara) is a leading organised retailer of home improvement and building products with presence across retail network of 114 stores in 9 states. The company caters to end-user segments in Tier 1, 2 and 3 towns, through its multi-channel sales approach, processing facilities and logistics capabilities. It ventured into the retail space in FY06 offering only steel-based products. However, the company realized the vast retail opportunity present in other home improvement and building products and has steadily expanded its SKUs in the retail channel to over 20,000 to become the leader. Expansion of product portfolio in favour of high margin offerings (plumbing, sanitary, flooring and electrical) and various macro tailwinds are potent enablers. We perceive Shankara to be an excellent proxy to play growth in the home building space as well as retail spurt in India. We, therefore, initiate coverage with 'BUY' recommendation and target price of INR 1,575.

Efficient retail model

Shankara offers structural steel, cement, roofing solutions, plumbing, tiles, sanitary ware, water tanks, plywood, kitchen sinks and lighting at its retail outlets. Apart from providing its own branded products (CenturyRoof, Ganga and Loha), the company also offers third party brands. It has dominant presence in South India via retail network of 115 stores, which is expected to increase by 20 stores p.a. Shankara has clocked 24% average SSG in the past 3 years along with margin improvement from 5% in FY14 to 10% in FY17 in retail.

Humongous opportunity in home improvement retail, to be aided by macro tailwinds

The building materials market is estimated to touch INR 8 lakh cr in FY21, of which 38% or roughly INR 2.5 lakh cr will be through the retail network, thus providing a massive growth opportunity. Government push for affordable housing, Smart Cities, implementation of RERA, falling interest rates along with increase in urbanization and disposable incomes are huge macro positives for Shankara.

Outlook and valuations: initiate with 'BUY'

Retail has driven Shankara's financial metamorphosis over the past 3 years and this segment (currently 46% of revenue) will continue to grow faster than the other 2 segments, which will help the company sustain its recent transformation. Strong SSG of 20%, minimal capex spends on new stores and efficient working capital management will ensure RoCE improvement. Factoring in the opportunity size and macro tailwinds, we have done an SOTP valuation, assigning 35x FY19E P/E to the retail business. We initiate coverage with an SOTP based target price of INR 1,575.

Year to March (Standalone)	FY15	FY16	FY17E	FY18E	FY19E
Revenues (INR Cr)	1979	2036	2310	2530	2809
Rev growth (%)	2.7	2.9	13.5	9.5	11.0
EBITDA (INR Cr)	90	120	154	186	219
Net Profit (INR Cr)	23	41	60	86	108
P/E (x)	121.2	67.2	47.3	33.1	27.4
EV/EBITDA (x)	33.8	24.7	19.5	15.9	13.3
RoACE (%)	14.9	20.3	25	26	27
RoAE (%)	9.3	15.0	17.6	19.7	20.3

Bloomberg:	SHANKARA:IN
52-week range (INR):	1,338 / 555
Share in issue (cr):	2.3
M cap (INR cr):	3,000
Avg. Daily Vol. BSE/NSE :('000):	30
Promoter Holding (%)	56.2

Kshitij Kazi
Research Analyst
Kshitij.kazi@edelweissfin.com

Praveen Sahay
Research Analyst
Praveen.sahay@edelweissfin.com

Retail has driven Shankara's financial metamorphosis over the past 3 years and this segment (currently 46% of revenue) will continue to grow faster than the other 2 segments, which will help the company sustain its recent transformation. Strong SSG of 22%, minimal capex spends on new stores and efficient working capital management will ensure RoCE improvement.

Perceive Shankara to be an excellent proxy to play growth in the home building space as well as retail spurt in India

	FY16	FY17	FY18E	FY19E
Revenue	2036	2310	2530	2809
EBITDA	120	154	186	219
EBITDA Margin	5.9	6.7	7.4	7.8
PAT	41	60	86	108

Efficient retail model

	FY16	FY17	FY18E	FY19E
RoACE (%)	20.3	25	26	27
Debt to Equity (x)	0.8	0.6	0.4	0.4

Humongous opportunity in home improvement retail, to be aided by macro tailwinds

	Multiple	Price Target
Shankara	35x P/E Retail	1,550

Entry = INR 1,250

+

Exit = INR 1,550

Total Return of 24%

Price Target	**INR 1,575**	Our TP is arrived at by assigning a 35x P/E multiple to the retail segment and 7x EV/EBITDA to the channel and enterprise segment. We are assuming an SSG of 20% for retail (below last 3 years average of 24% SSG) for both FY18E and FY19E
Bull	**INR 1,950**	Assuming a higher SSG of 25% for both FY18E and FY19E, and assigning a higher 40x P/E to the retail segment and 8x EV/EBITDA to the channel and enterprise segment on FY19E numbers, we arrive at a TP of 1,950
Base	**INR 1,575**	Assuming our base case scenario of 20% SSG (below last 3 years average of 24% SSG) for retail for both FY18E and FY19E. Giving a 35x P/E multiple to the retail segment and 7x EV/EBITDA to the channel and enterprise segment, we arrive at a target price of 1,550
Bear	**INR 1,225**	Assuming a lower SSG of 15% for both FY18E and FY19E, and assigning a lower 30x P/E to the retail segment and 6x EV/EBITDA to the channel and enterprise segment on FY19E numbers, we arrive at a TP of 1,225 and hence we feel that there is no significant downside from the current levels.

Shankara Building Products Ltd.

Average Daily Turnover (INR cr)			Stock Price				Relative to Sensex, CAGR (%)			
3 months	5 months	1 year	1 month	3 months	5 months	10 months	1 month	3 months	5 months	10 months
3.2	3.6	NA	22%	48%	98%	NA	-2%	2%	6%	NA

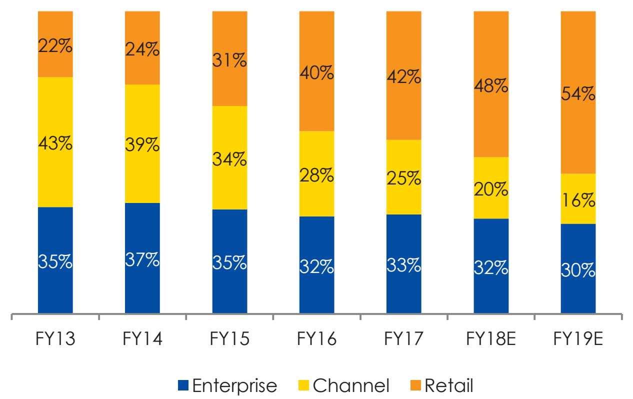
Business Value Drivers

Nature of Industry	Retail of home improvement and building material is still at a nascent stage with Shankara being the biggest organised player in this space.
Opportunity Size	Building materials industry is estimated to post 8.0-8.5% CAGR to INR 7 lac cr by FY21, of which ~35% will be sold through the retail network, thus entailing a market opportunity size of INR 2.5 lac cr.
Capital Allocation	Capex will be for debottlenecking of processing facilities, inventory and for the planned opening of 20 stores each year. Total capex could be between INR 30-40 Cr per year.
Predictability	Going by the past 3 years' performance, which has been consistent despite challenges like demonetization, GST and higher focus on turning around prior acquisitions, we believe the next 2-3 years should be predictable.
Sustainability	As Shankara has hardly tapped the vast opportunity size of this industry, we believe SSG of 20% plus and 25-30% top line growth in retail will be sustainable for the next few years on a small base.
Disproportionate Future	Retail has driven the financial transformation over the past 3 years and this segment (currently 46% of revenue) will continue to grow faster than the other 2 segments, which will help Shankara sustain its recent transformation. As the share of retail revenue continues to rise, we anticipate meaningful change in margins and return ratios in the future.
Business Strategy & Planned Initiatives	Shankara's core focus will remain on the retail segment, wherein the company is planning 20 store openings p.a. for the next few years. Existing stores are being simultaneously upgraded with new higher-margin products.
Near Term Visibility	Near-term visibility remains strong as SSG and new store addition should significantly aid top line in retail. With only 114 stores across South India, near-term growth should not be a concern.
Long Term Visibility	Although the company has not outlined long-term plans or targets, Shankara's retail model is definitely scalable in the long term.

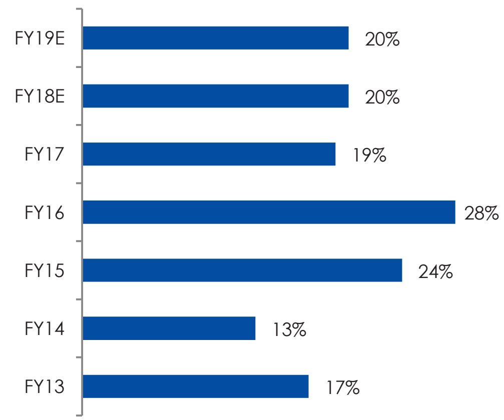
Source: Edelweiss Investment Research

Focus Charts – Story in a nutshell

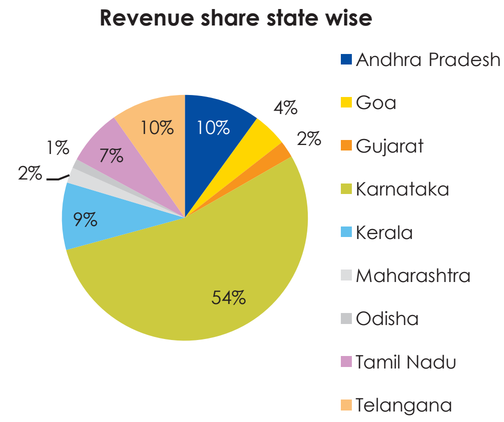
Share of Retail Revenues to increase



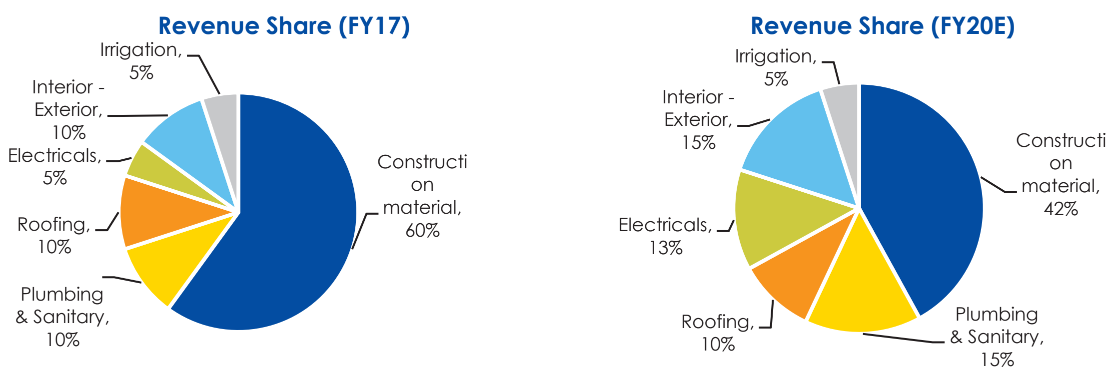
To be driven by strong SSG in retail



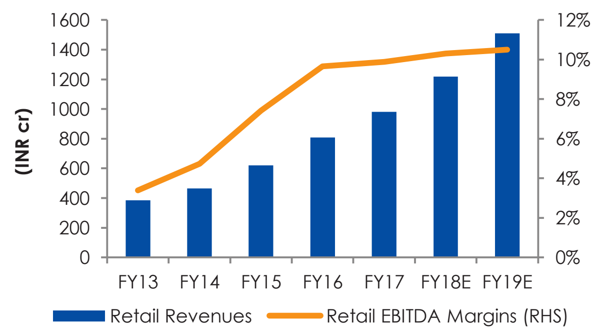
And vast untapped opportunity



Expansion of product portfolio in favour of high margin offerings to lead to higher gross margins (plumbing, sanitary, flooring and electrical)



Retail segment will continue to drive financial transformation of Shankara



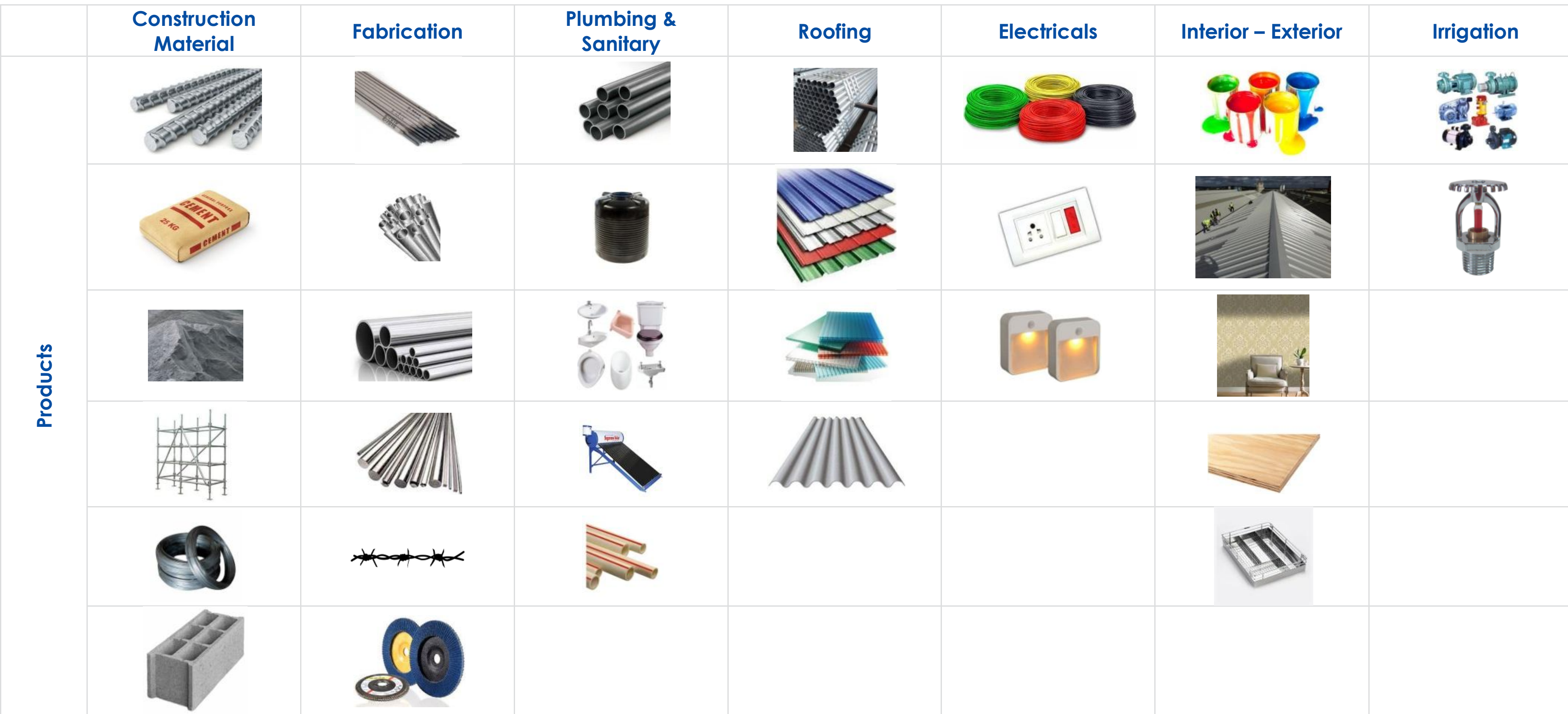
Source: Company, Edelweiss Investment Research

I. Shankara's retail segment: At nascent stage

A) One stop shop to capture full construction cycle

Although Shankara debuted in the retail segment in FY06 with first store, it has taken a while to scale up. The company was initially present only in retail of construction material and fabrication. However, gradually it has expanded its product portfolio to cover products required for the entire construction cycle of 18-24 months for a home owner building his house from scratch.

Shankara's comprehensive product range—SKUs scaled up from 6,800 in FY13 to 20,000 in FY17



Source: Company, Edelweiss Investment Research

Shankara Building Products Ltd.

Shankara currently sells most top brands in South India in each home improvement and building material segment. It is planning to soon house the top 3 pan-India brands in all its retail stores. Also, with expansion of its product portfolio, the company has seen rise in footfalls of end home owners (owners of houses of average 2000 sq ft) in its retail shops as its outlets have matured from a mere hardware store to a one-stop stop for all home improvement and building material. Retail clients include home owners, professional customers (architects, contractors, plumbers) and small enterprises.

Shankara's current 3rd party and own brands – 3rd party brands scaled up from 16 in FY13 to 100 in FY17

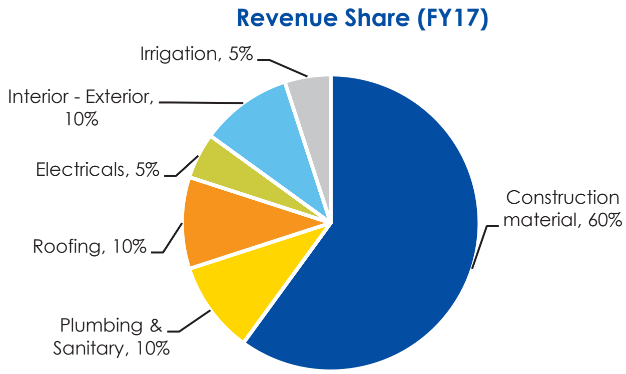
	Construction Material	Plumbing & Sanitary	Flooring	Electricals	Interior – Exterior	Irrigation	OWN
Some of Shankara's Brands	JSW Neosteel Pure TMT Bars	Somany	Kajaria	Philips Lighting	Alstone	Astral Pipes	Ganga
	ACC	hindware	Greenply Plywood	Havells	Futura Sinks That Think	Finolex gets people together	Taurus
	Zuari Cement Italcementi Group	ashirvad	Archidply	Crompton Greaves Everyday Solutions	Carysil	Vishakha Irrigation Pvt. Ltd	Prince wire
	UltraTech Building Products	Roca	Centuryply	GM Switch to a better world	Berger	Jindal Aluminium Ltd.	Prince Galva GI Pipes
	Essar Steel	Johnson Redefining Lifestyles, Worldwide.	Johnson Redefining Lifestyles, Worldwide.	Finolex gets people together	GEM Paints	APL Apollo Tubes for every reason	Shankara Solar
	Kamdhenu Steel	Parryware			Swastik Roofing	Supreme People who know plastics best	Loha
	Norton Saint-Gobain	Cera			Everest Roofing Solution		Century Roof
	Bosch	Texmo Pipes and Products Limited					
	Hitachi Inspire the Next	Sintex					

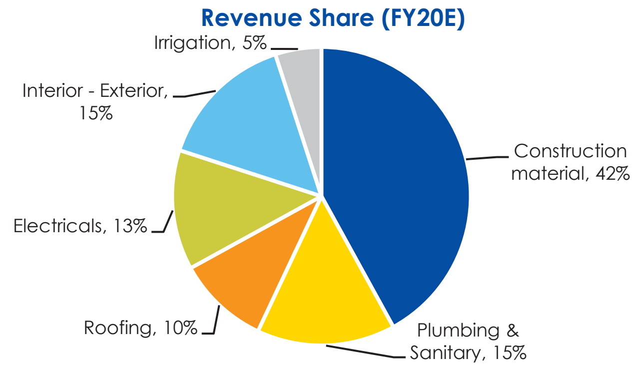
Source: Company, Edelweiss Investment Research

B) Widening and changing product mix: Gross margin kicker

Currently, own products/brands in the construction material and roofing segments (Shankara only processes/customizes products) contribute 55% to revenue of retail shops. This is expected to dip to 25% gradually post addition of new products such as plumbing, sanitary, flooring and electrical in new and old stores. Moreover, the company is planning to refresh at least 10% of SKUs every year to keep up with latest trends. Also, product mix in stores will depend on consumer preferences in a particular area as assortment of products will be key to generate higher SSG and ensure a moat for the business.

Revenue mix to change post addition of new product categories

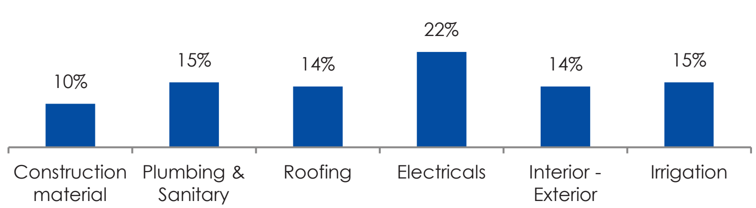


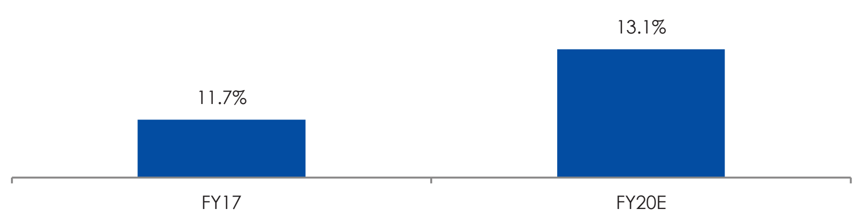


Source: Company, Edelweiss Investment Research

Margins in new product categories such as plumbing, sanitary, flooring and electrical are higher than traditional products, which will aid gross margin expansion. Shankara is upgrading all its stores with the extended product range—has upgraded 15 stores till now and on the anvil is upgrade of 30 more in FY18 and 70 stores by FY19. Only 2 of the 15 upgraded stores are marginally below target, to rectify which the company has already undertaken measures to improve customer proofing. It still sources from a distributor for most of its products. Scale has been achieved only in its traditional product segments such as basic construction material like different steel tubes & bars and in roofing. Post achieving scale in other products as well, the company will have higher bargaining power, which could aid gross margin expansion.

Increasing share of higher gross margin products and increasing bargaining power with suppliers to aid gross margins



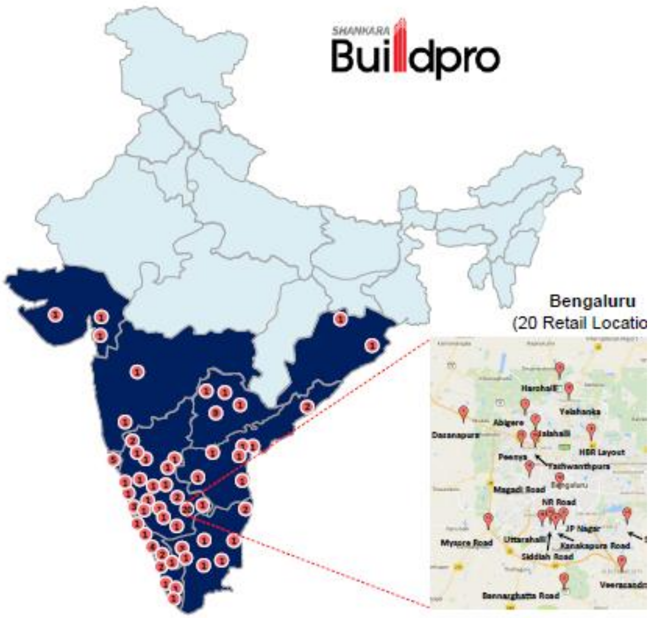


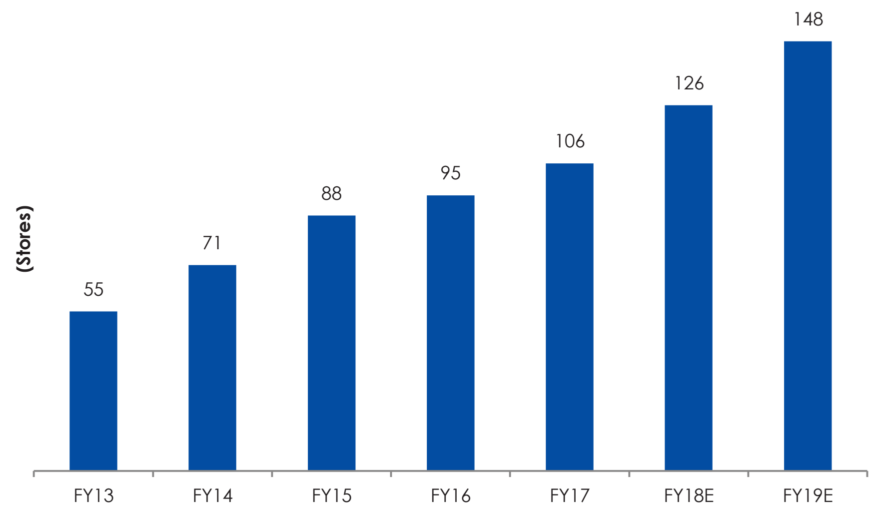
Source: Company, Edelweiss Investment Research

C) Ample headroom for retail revenue expansion

Shankara currently has 114 retail outlets across 9 states in South India. The company is planning to add 20 stores p.a. in the next 2-3 years, restricted to South India, depending on consumer behaviour and demand.

Shankara plans to add 20 stores every year to the 106 stores at the end of FY17

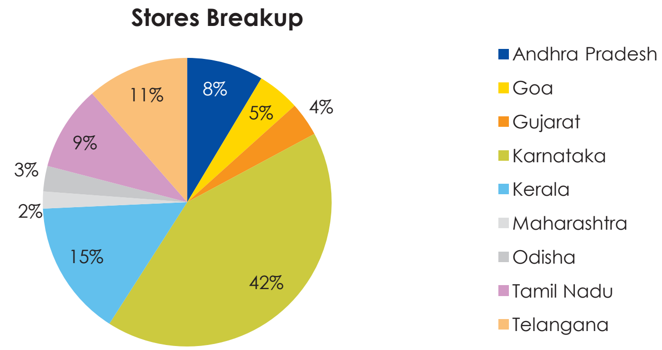


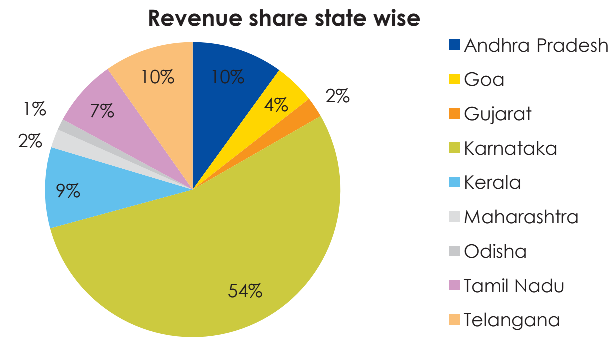


Source: Company, Edelweiss Investment Research

A deep dive analysis reveals that the company's revenues and stores are largely concentrated in Karnataka—41% stores and 54% revenue. Even within Karnataka, 20 of the 44 stores are present in Bengaluru, which currently generates INR 300 cr revenue with 20% growth. Veera Sankara, a 10,000 sq ft store in the Electronic City, clocks INR 50 cr sales p.a. and there is potential to have 40 stores in the garden city itself. Convenience is of prime important as consumers do not want to commute and hence there is ample head room to grow.

41% of Stores and 54% of revenues is currently from Karnataka only, thus providing lot of headroom for growth

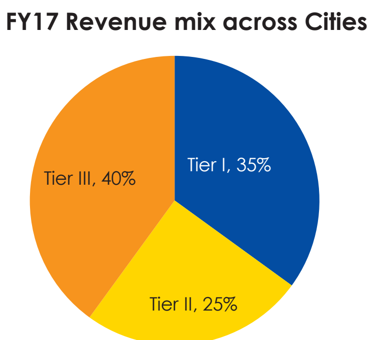




Source: Company, Edelweiss Investment Research

Revenue growth and store additions are likely across Tier 1, 2 and 3 cities, as seen historically. Shankara has opened the highest stores in Tier 3 towns over the past few years wherein its revenue share has increased from 30% to 40%. Tier 1 is the next strongest growth area for the company with Tier 2 yet to gain traction.

Tier 3 has been the strongest growth area for Shankara, followed by Tier 1



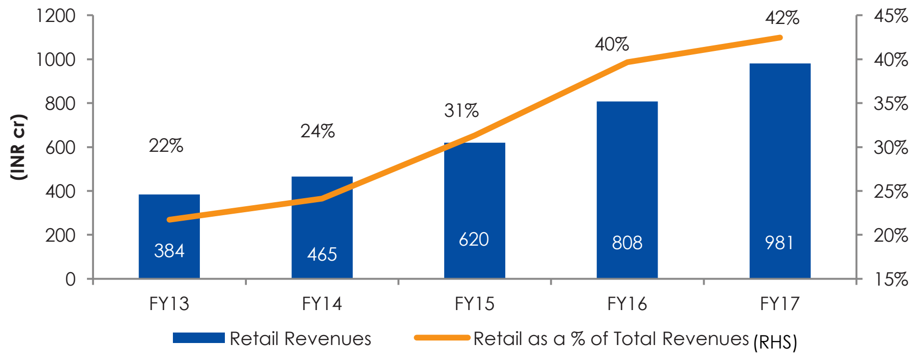
Tier 1	FY14	FY17
Stores	23	32
Revenues (INR Cr)	180	350
Revenue per store	7.8	10.9
Tier 2		
Stores	27	33
Revenues (INR Cr)	140	229
Revenue per store	5.2	6.9
Tier 3		
Stores	21	43
Revenues (INR Cr)	145	379
Revenue per store	6.9	8.8

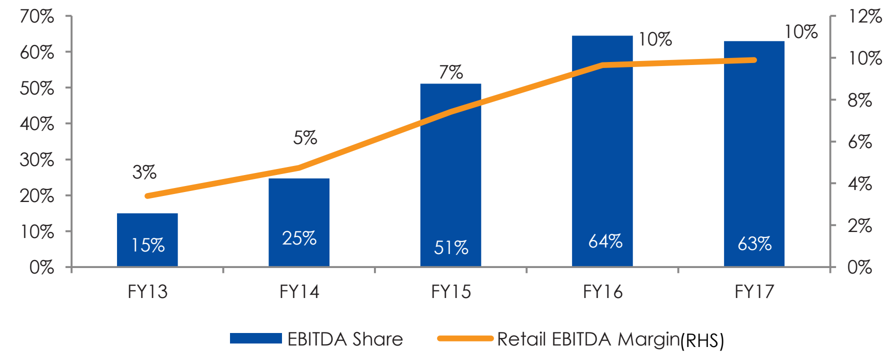
Source: Company, Edelweiss Investment Research

II.Shankara's retail segment has witnessed robust growth and profitability

Shankara has seen stupendous growth in top line and margin over the past few years. While retail top line has jumped 2.5x from INR 384 cr to INR 981 cr in 4 years, EBITDA margin has expanded from 3% in FY13 to 10% in FY17.

Retail Sales have grown 2.5x in 4 years and EBITDA has grown from INR 22 Cr in FY14 to INR 97 Cr in FY17





Source: Company, Edelweiss Investment Research

A) Various improving factors....

Shankara has provided details of per store dynamics and overall retail performance which shows improvement on all parameters over the years. From per store figures, to per sq ft figures, there is consistent growth. In fact, as new products are introduced, we estimate the growth trend to sustain for the next few years.

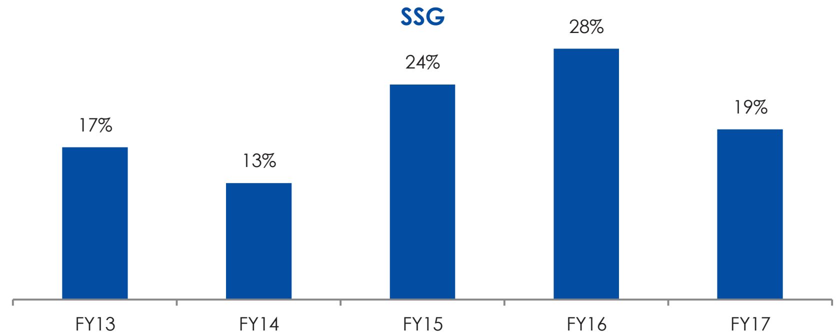
RETAIL	FY13	FY14	FY15	FY16	FY17
Per Store Revenue	7.0	6.5	7.0	8.5	9.3
Per Store EBITDA	0.2	0.3	0.5	0.8	0.9
Per Sq Ft Revenue	21333	21136	21379	25250	25816
Per Sq Ft EBITDA	722	1000	1586	2438	2553
Average Ticket Size (INR)	18545	20617	19358	20413	23244
Annual transactions	149947	225375	319935	395697	421926

Source: Company, Edelweiss Investment Research

B) Spearheaded by robust SSG surge

The improving financials on per store and per sq ft basis are due to strong SSG—~20% over the past 3 years. A deep dive analysis of SSG numbers indicates that new stores take time to mature and generate revenue, while sales per store of older stores have grown steadily from INR 6.1 cr in FY14 to INR 9.1 cr in FY17.

	FY14	FY15	FY16	FY17
Retail Sales	465	620	808	981
SS Sales	434	577	794	962
SSG	**13%**	**24%**	**28%**	**19%**
New addition Sales	31	43	14	19
Stores	71	88	95	106
Addition	16	17	7	11
Total	87	105	102	117
Sales (existing) Per Store	**6.1**	**6.6**	**8.4**	**9.1**
Sales (new) Per Store	1.9	2.6	2.1	1.8



Source: Company, Edelweiss Investment Research

C) Robust store level economics

Shankara's retail division is highly profitable due to robust store level economics of minimal capex and opex. Rent, which is generally one of the highest opex costs for modern retail, is less than 1% of revenue for Shankara as rather than leasing space in high street malls, the company leases land. The total initial capex per store is only INR 50 lac for fixtures and inventory each. Any store can be easily dismantled and relocated with only 10% loss to the original cost due to minimal fixture spends on a store. It has closed only 1 store till date.

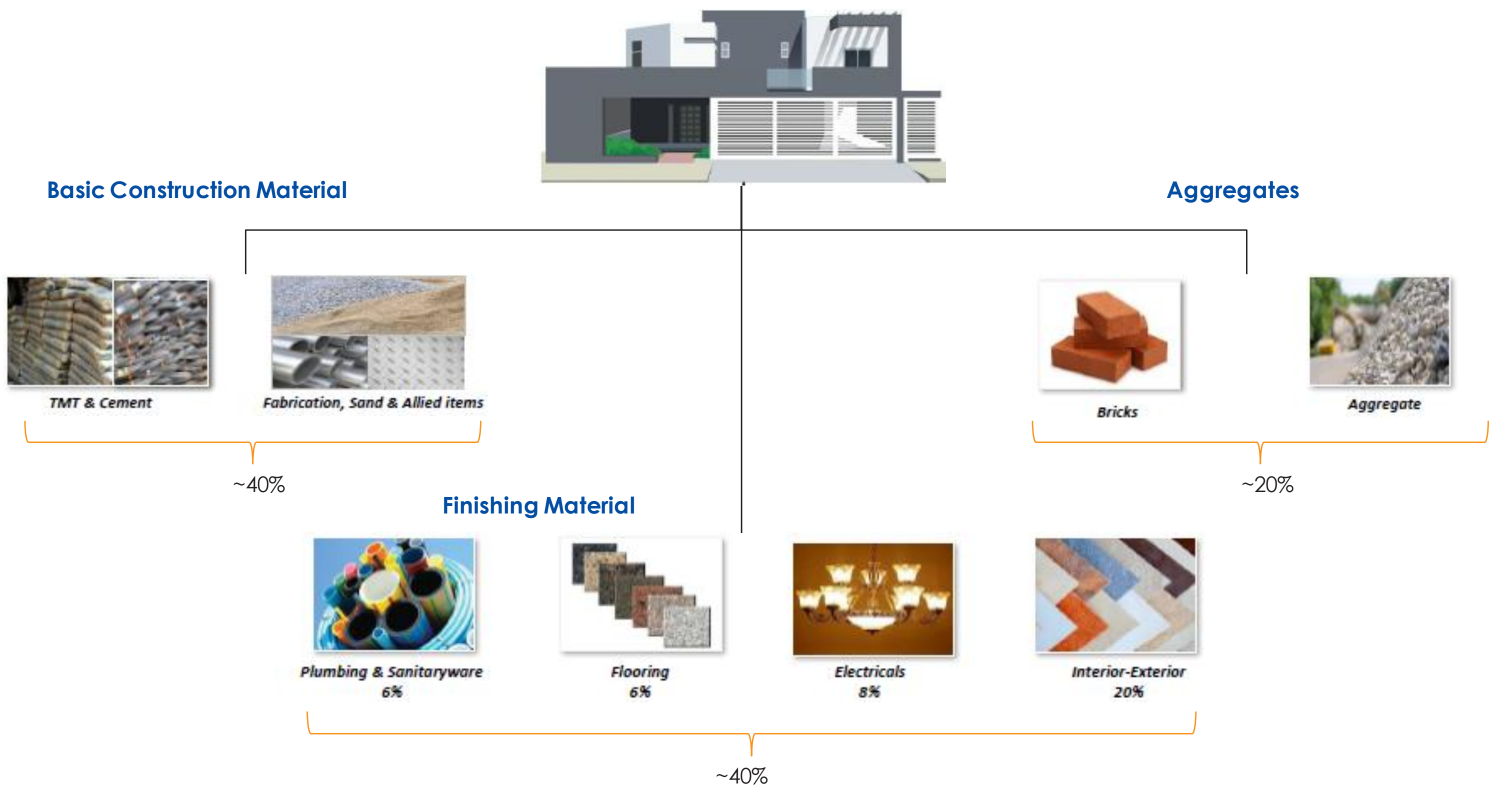
Store Dynamics (5000 sq ft)	New Store (1st year)	Mature Store (ended 2nd/3rd year)
Revenues (INR Lakh)	480	1560
Gross Margin	10%	12%
Gross Profit (INR Lakh)	48	187
Overhead (INR Lakh)	10	15
Lease Rental (INR Lakh)	13.4	14.1
EBITDA (INR Lakh)	24.6	158.2
EBITDA Margin	5.10%	10.20%
Capex (INR Lakh)	50	50
WC (INR Lakh)	50	100
Total Capex (INR Lakh)	100	150

III. Industry Overview: Big opportunity size with macro tailwinds and no formal competition

A) Huge scale up potential due to massive opportunity size

Shankara is present in the entire gamut of building materials in its retail network. Product assortment is different in different stores as per consumer demands and preferences, but every store will house materials used for the entire construction cycle of 18-24 months.

Materials required for a home construction - Shankara's retail network houses all of the following products



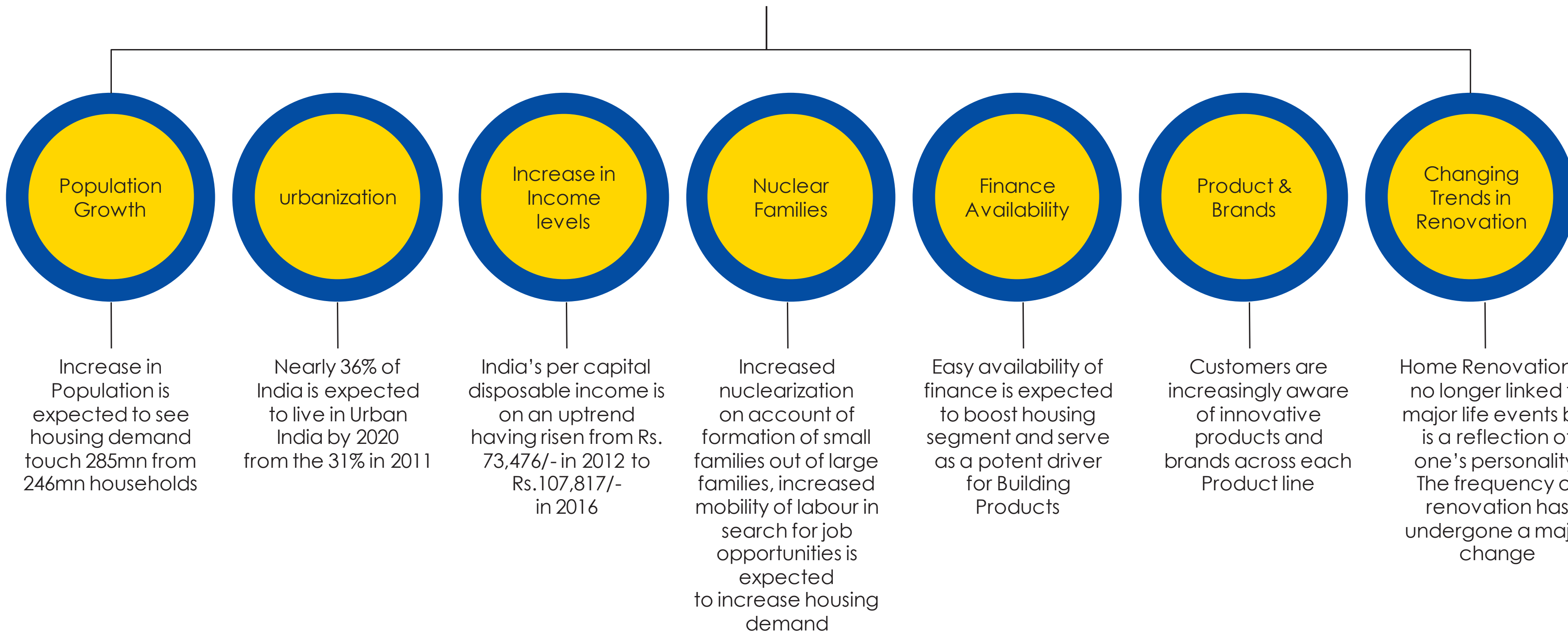
The market size of materials mentioned above is estimated to clock 8.0-8.5% CAGR to INR 7 lac crore by FY21, of which ~ 35% will be sold via the retail network, thus entailing a market opportunity of INR 2.5 lac crore pan India.

Source: Company, Edelweiss Investment Research

B) Various tailwinds can aid Shankara

Shankara's expected SSG of 15-20% can materially improve in the future with the aid of various government initiatives such as *Housing for All, Smart Cities*, RERA, *Swacch Bharat Abhiyan*, etc. In addition, there are many macro economic factors that can spur SSG such as urbanisation, rising per capita disposable incomes, easy finance availablity, etc.

Retail Home Improvement Drivers



Source: Company, Edelweiss Investment Research

C) Very few segments penetrated by retail and that too is fragmented

Except for tiles and plywood, most other segments are under-penetrated in retail, resulting in lesser competition for Shankara. Retail channel sales are also currently fragmented, thus providing significant opportunity for a player like Shankara to rapidly capture market share.

Particulars	Market Size (IN INR bn) in 2015-16	Growth Forecast for next 5 years	Share of Organized vs. Unorganized	Typical levels of Customer involvement in purchase of products (Home Owners)	Indicative share of sales via retail channels
Cement	1,300-1,400	8.0%-8.5%			
Structural Steel	1,300-1,400	7.0%-8.0%			
Bricks	600-650	8.0%-10.0%			
Paints	385-395	12.0%-14.0%			
Plumbing – PVC Pipes	260-170	10.0%-12.0%			
Ceramics Tiles & Sanitaryware	250-255	10.5%-11.0%			
Plywood & Laminates	245-250	11.0%-11.5%			
Lighting	180-185	11.0%-13.0%			
Total	**4,520-4,805**				

Source: Company, Edelweiss Investment Research

IV. Processing facilities contribute ~50% of retail sales and cater to the enterprise segment

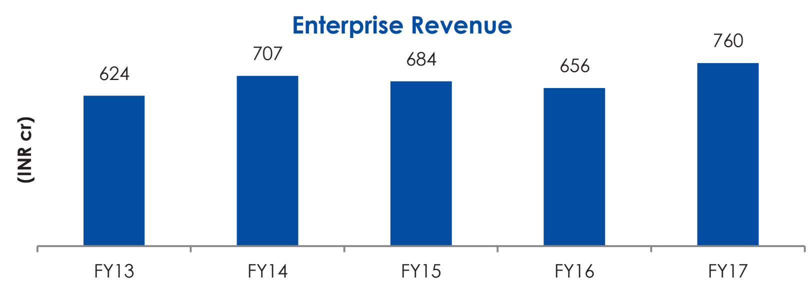
Facilities give presence across value chain alongwith strong vendor network and association with brands which helps in retail

Shankara has 12 backward integrated processing facilities with an installed capacity of ~3,25,000 TPA operating at 94% capacity utilization over the past few years. In these facilities, he company assembles and processes steel pipes, colour coated roofing sheets, bright rods, galvanized strips and cold rolled strips. It sells these products under its own brands like *Century Roof, Ganga, Loha, Taurus* and *Prince Galva*. These products contribute 50% to sales via the retail segment.

Facilities help cater to the enterprise segment which is expected to clock moderate growth

The below mentioned capacities and products help cater to bulk orders of contractors and OEMs, primarily for steel pipes and tubes. The India ERW steel pipe market is pegged at ~7 mt and INR 30,000 cr, but it is growing at a rapid pace as these pipes have found preference in modern infrastructure (airport, mall, metro, bus body and pre fabricated structure) versus traditional use in auto, oil & gas and water transportation, etc.

Capacity	FY14	FY15	FY16	FY17
Steel Pipe & Tube	1,13,000	1,51,400	1,98,600	2,31,600
Galvanized Strip	36,000	36,000	42,000	42,000
Roofing Sheet	10,000	19,200	27,600	32,800
Bright Rods	800	6,000	6,000	6,000
Cold Rolles Strips	8,000	10,000	12,000	1,20,000
Stainless Steel				1,200
Total	**1,67,800**	**2,22,600**	**2,86,200**	**3,25,600**



Source: Company, Edelweiss Investment Research

The customer base is spread across industries like auto ancillaries, boiler manufacturers, electrical panel boards, textile machinery, medical equipment & pharmaceuticals, plantation equipment, renewable energy, etc.. These customers regularly require customized products (kit based, cut-to-size, ready-to-use assembled products) with timely delivery. Shankara also caters to one-off requirements of projects, including space frames for airports, metro stations and malls, city skywalks, airport tubular structures and road dividers. Its dependence on any specific customer is very low, as Top 10 customers account for less than 10% of total revenue.

Robust back end infrastructure to support own products sales and enterprise segment

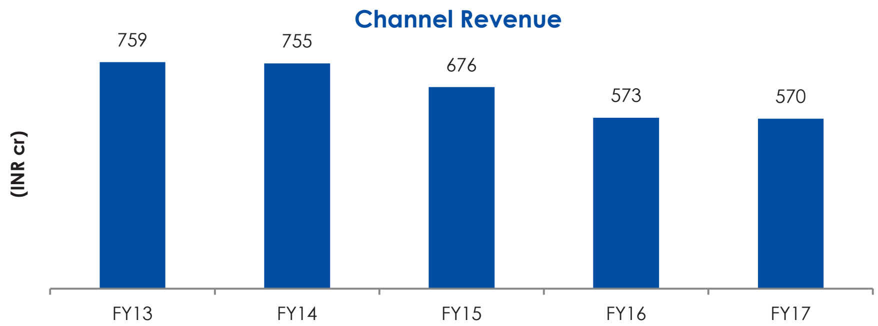
Shankara's supply chain and logistics network is through its 56 warehouses and 44 owned trucks. The company has a warehouse space of 0.59 mn sq ft, which is largely owned. The warehouses act as storage facilities for delivery of merchandise to stores and enterprise clients, ensuring timely delivery. GST has had a positive impact as it has enabled seamless movement across states.

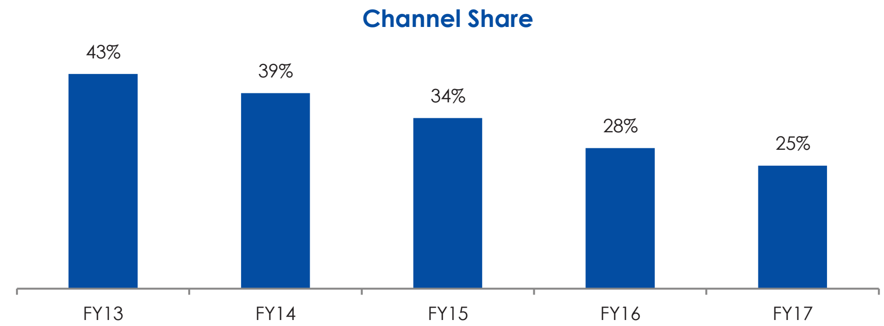
ERP and MIS controls across all segments

ERP and MIS controls are key to understanding customer preferences in different locations. For retail SSG, product assortment is key and hence coordination between teams is important. These systems help monitor inventory levels, allocation of products to stores and budget planning, which aids overall efficiency.

V. Channel segment though declining helps guage the market

Shankara curently has 1,924 dealers in its channel segment spread across central and South India. As margins in this business are declining, the company has taken a concious decision to dim focus on this segment—revenue contribution has plummeted from 43% in FY13 to 25% in FY17. However, it has not exited the channel segment as it helps the company have its fingure on the pulse for geographies for new stores, customer peferences and demand for new product segments, etc., and therefore aids retail expansion.

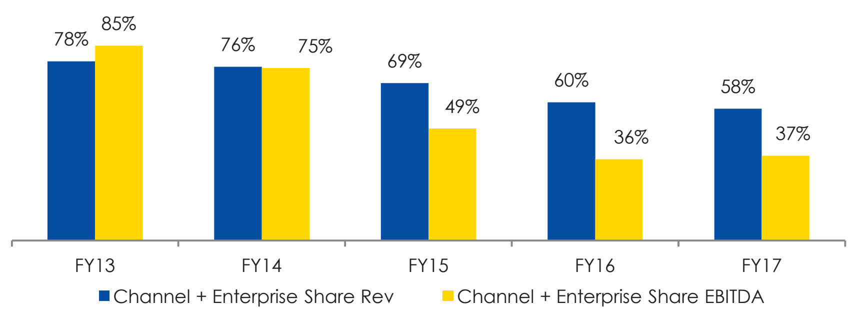


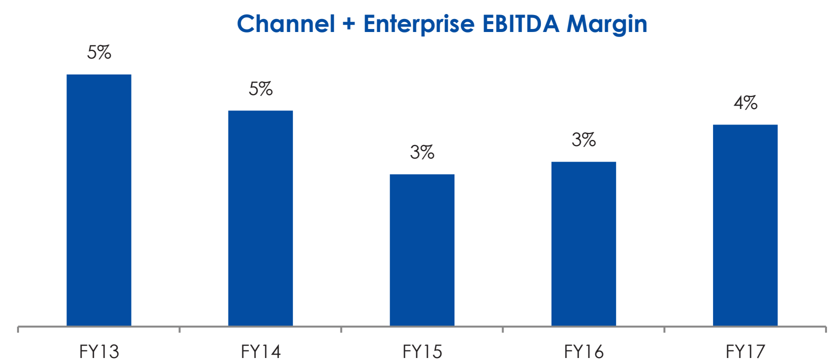


Source: Company, Edelweiss Investment Research

Channel and enterprise share to continue to decline

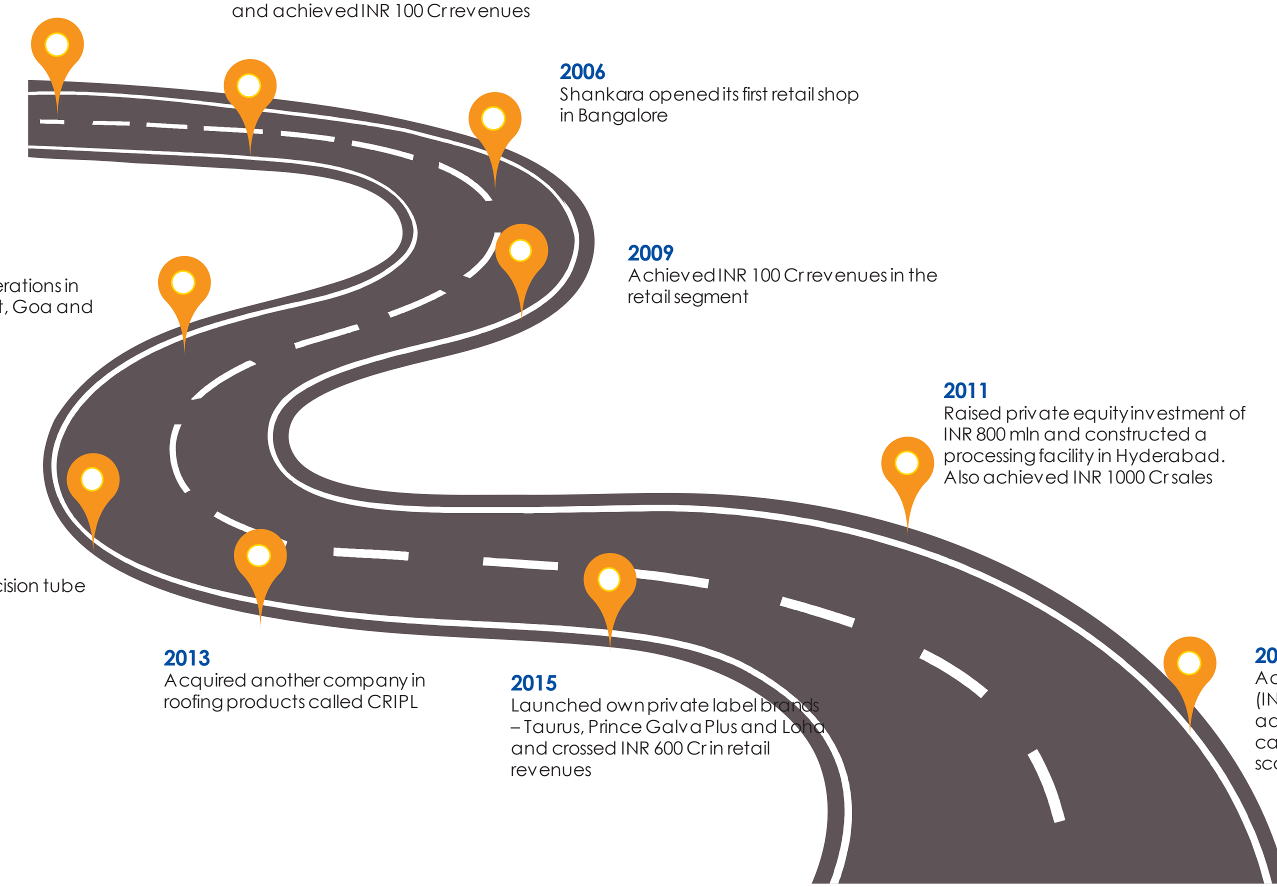
Over the past few years, channel and enterprise margins have been flattish due to higher focus on working capital. Going forward as well we do not expect any big uptick in margins of these segments. Also, as retail share keeps expanding, share of channel and enterprise segments will continue to decline. As these are lower margin and RoCE segments compared to retail, it bodes well for Shankara's overall financials.





Source: Company, Edelweiss Investment Research

TIMELINE



1995
Started as a distributor of steel pipes and tubes

2003
Opened an integrated warehousing facility of 55,000 sq.ft. in Bangalore and achieved INR 100 Cr revenues

2006
Shankara opened its first retail shop in Bangalore

2007-08
Commenced retail operations in other states like Gujarat, Goa and Orissa

2009
Achieved INR 100 Cr revenues in the retail segment

2010
Acquired VPSPL - a precision tube processing unit

2011
Raised private equity investment of INR 800 mln and constructed a processing facility in Hyderabad. Also achieved INR 1000 Cr sales

2013
Acquired another company in roofing products called CRIPL

2015
Launched own private label brands – Taurus, Prince Galva Plus and Loha and crossed INR 600 Cr in retail revenues

2016
Achieved INR 2000 Cr turnover (INR 800 Cr in retail) and added new products categories – cement, tiles, scaffolding and solar products

VI. Valuations & Peers

Retail has driven Shankara's financial transformation over the past 3 years, which has helped the company clock PAT growth of 28% with company level margin improving from 4.6% in FY14 to 6.7% in FY17. The retail segment (currently 46% of revenue) will continue to grow faster than channel and enterprise segments, which will help Shankara sustain its recent transformation. Strong SSG of 20%, minimal capex spends on new stores and efficient working capital management will ensure improvement in RoCE. Factoring in the opportunity size and macro tailwinds, we have done an SOTP valuation assigning 35x FY19E P/E to Shankara's retail business. We initiate coverage with an SOTP based target price of INR 1,575 and believe it is the best proxy to play the anticipated growth in building materials and retail in India.

	FY19E		FY19E
Retail PAT (INR Cr)	92	Enterprise + Channel EBITDA (INR Cr)	58
P/E	35	EV/EBITDA	7
Retail Market Cap (INR Cr)	3234	EV (INR Cr)	409
		Less:Debt (INR Cr)	120
		Enterprise + Channel Market Cap (INR Cr)	289

Combined target market cap - FY19E (INR Cr)	Current Market Cap (INR Cr)	Potential Upside
3,588	**3,000**	**20%**

Our domestic peer universe includes home building material players and retailers as there is no pure play competition. International players like Home Depot and Lowe which are in similar line of business as Shankara (retail of home building materials) have been included in the peer comparison below. However, Shankara's bottom line growth along with robust capital efficiency in the retail segment are superior to most peers inspite of which it trades at a discount to most of them.

	Revenue Growth (FY17-19E)	PAT Growth (FY17-19E)	ROCE (FY19E)	P/E (FY19E)	EV/ EBITDA (FY19E)
D Mart	30%	37%	20%	71x	33x
Home Depot	5%	18%	31%	18x	11x
Lowe	4%	14%	16%	14x	8x
Kajaria	15%	26%	24%	28x	14x
Asian Granito	20%	45%	20%	18x	8x
Havells	25%	25%	32%	32x	20x
Finolex	12%	8%	22%	17x	11x
Shankara (Retail)	**25%**	**40%**	**50%**	**26x**	**15x**

Key Management

Name	Designation	Profile
Mr. Sukumar Srinivas	*Managing Director*	Mr. Sukumar Srinivas is the promoter and has 33 years of experience in the building products industry. He holds a bachelor's degree in commerce from Loyola College, Chennai, University of Madras, and a PGDBM from the IIM, Ahmedabad.
Mr. C. Ravikumar	*Executive Director*	Mr. C. Ravikumar has 29 years of experience in the steel pipes and building products industry. He holds a bachelor's degree in science from Bangalore University and has been associated with Shankara since 1995 and was appointed as a director of the company in 2001.
Mr. Siddhartha Mundra	*CEO*	Mr. Siddhartha Mundra was appointed CEO in June 2017 after having served as a nominee director of Fairwinds to the Board of the Company since 2011. He holds a bachelor's degree in engineering with specialisation in computer science from NIT, Warangal (formerly REC, Warangal) and a PGDBM from the IIM, Ahmedabad.
Mr. Alex Varghese	*CFO*	Mr. Alex Varghese joined the company on October 13, 1995. He holds a bachelor's degree in commerce from MG University and has been associated with Shankara for over 20 years

Key Risks

a. Dependent on third-party suppliers and sub-contractors

b. Slowdown in real estate

c. Increase in competition

d. Working capital challenges

Business Overview

Company Brief

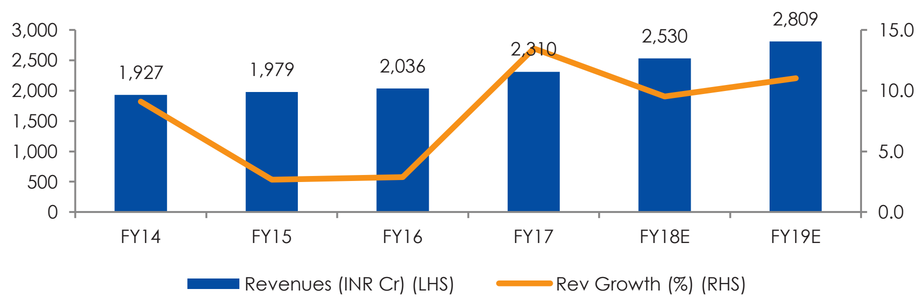
Shankara is a leading organised retailer of home improvement and building products with presence across a retail network of 114 stores across 9 states in India. The company caters to various end-user segments in urban and semi-urban markets through its multi-channel sales approach, processing facilities, supply chain and logistics capabilities. Apart from providing its own branded products (CenturyRoof, Ganga and Loha), it also offers products of third party brands like Johnson, Sintex, APL Apollo, Astral Pipes, etc. Shankara also has 12 processing facilities with an installed capacity of 3,24,200 tpa which can be scaled up as per requirement. To cater to this growing retail network, the company has a strong logistics network comprising 56 warehouses and a fleet of 44 owned trucks to boost last mile delivery.

Business Model	The company has 3 segments. 1) Retail 2) Enterprise 3) Channel
Strategic Positioning	The company is the leader in home improvement and building materials retail in India
Competitive Edge	Understanding of consumer behaviour and demand of various products in home improvement and building materials Scale through its 114 stores present in 9 states Efficient supply chain and inventory management Minimal capex spend on stores ensures robust return ratios
Financial Structure	Growth in top line and bottom line will be driven through growth in the retail segment which will help boost margins and return ratios and help generate higher free cash flow
Key Competitors	Unorganised competition
Industry Revenue Drivers	Various government initiatives and macroeconomic tailwinds with a massive opportunity size
Shareholder Value Proposition	Our TP of 1,575 is arrived at by assigning a 35x P/E multiple to the retail segment and 7x EV/EBITDA to the channel and enterprise segment. We are assuming an SSG of 20% for retail (below last 3 years average of 24% SSG) and a 24% topline growth for both FY18E and FY19E

VII. Financial Analysis

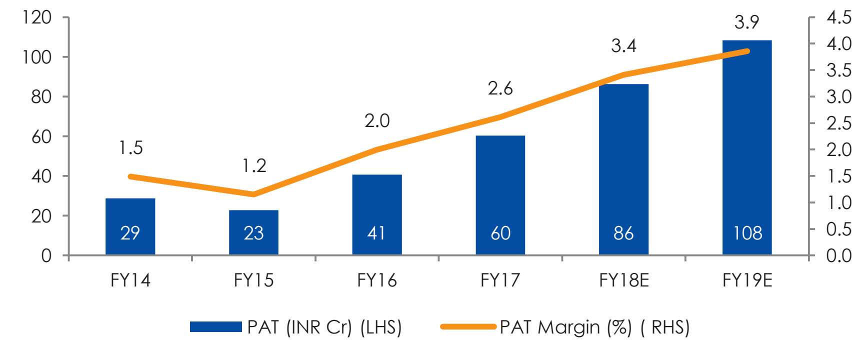
Revenue growth to be driven by the retail segment

Revenues should grow at a CAGR of 10-12% as the channel segment will degrow while the enterprise segment is expected to show flattish growth. We are expecting a strong growth in the retail segment of 24% CAGR over the next few years driven by SSG of 20% (below last 3 years average of 24% SSG).



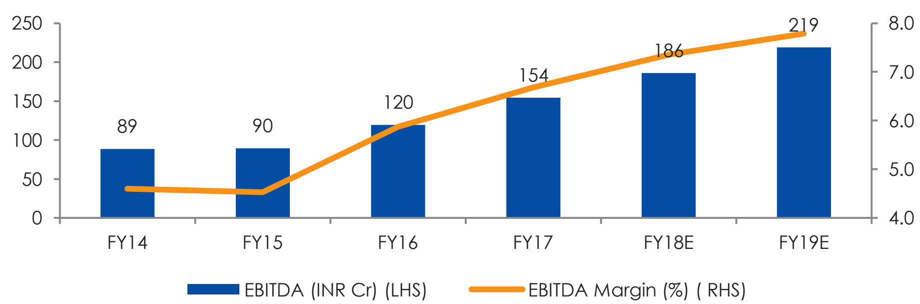
PAT and PAT margin to improve substantially

Topline growth coupled with margin expansion and debt reduction will result in a significant growth in PAT and PAT margins. We are expecting PAT to increase from INR 60 Cr in FY17 to INR 109 Cr in FY19E.



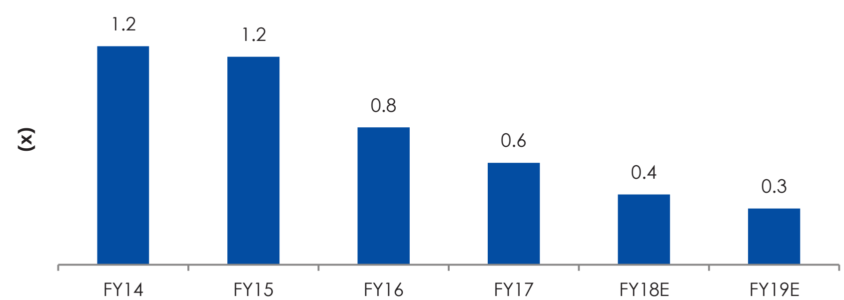
Increasing retail share to continue gradual uptrend of margins

We expect the share of retail revenues to grow from 42% in FY17 to 55% in FY19E (already 46% in Q1FY18). As retail margins are currently more than 2x of channel and enterprise margins, we expect company level margins to improve from 6.7% in FY17to 7.8% in FY19E.



Debt to dip

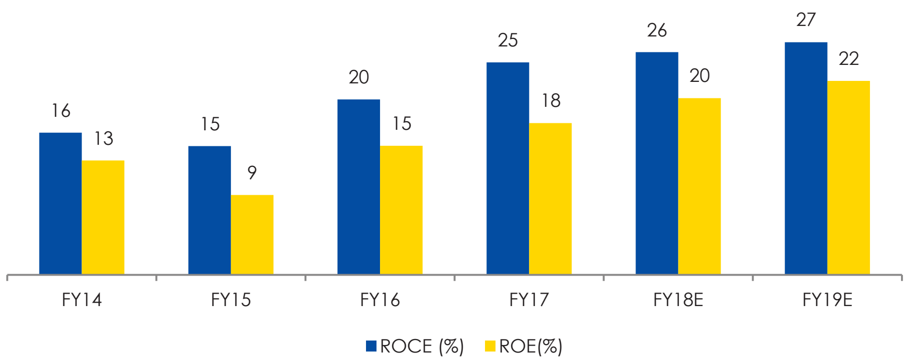
Shankara already has a low debt to equity ratio of 0.6x in FY17. We expect Shankara to pay off a small portion of its debt and thus expect the debt to equity ratio to futher reduce in the next 2 years.



Source: Company, Edelweiss Investment Research

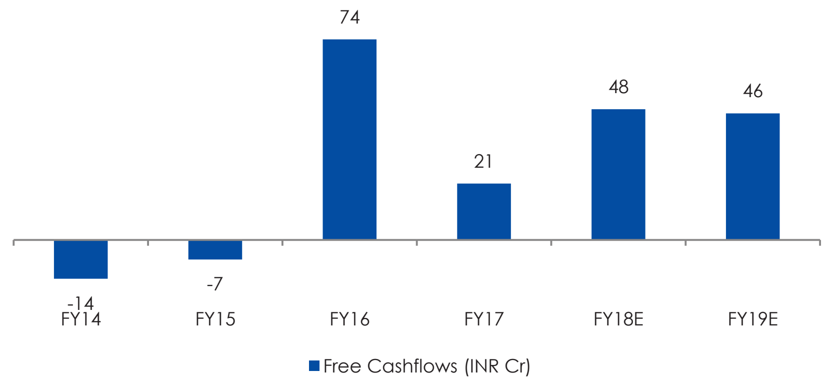
Return ratios to improve

As retail share increases, we expect return ratios to improve further as the retail segment has a higher capital efficiency as compared to the channel and enterprise segment.



Free cash flow generation to increase due to minimal capex

Shankara expects a capex outlay of INR 30-40 Cr each for the next 2 years of which INR 20 Cr will be for new retail stores and the balance will be for maintanance capex of processing facilities.



Source: Company, Edelweiss Investment Research

Financials

Income statement (Standalone) (INR cr)

Year to March	FY15	FY16	FY17	FY18E	FY19E
Income from operations	1,979	2,036	2,310	2,530	2,809
Direct costs	1,768	1,778	1,993	2,170	2,402
Employee costs	34	41	49	54	65
Other expenses	122	138	163	174	188
Total operating expenses	1,889	1,916	2,156	2,344	2,590
EBITDA	90	120	154	186	219
Depreciation and amortisation	9	10	11	13	14
EBIT	81	110	143	173	204
Interest expenses	47	46	51	41	41
Profit before tax	35	65	93	132	164
Provision for tax	12	24	32	46	56
Core profit	23	41	60	86	108
Profit after tax	23	41	60	86	108
Adjusted net profit	23	41	60	86	108
Equity shares outstanding (mn)	2	2	2	2	2
EPS (INR) basic	10.3	18.6	26.4	37.8	47.4
Diluted shares (Cr)	2.2	2.2	2	2	2.29
EPS (INR) fully diluted	10.3	18.6	26.4	37.8	47.4

Common size metrics- as % of net revenues

Year to March	FY15	FY16	FY17	FY18E	FY19E
Operating expenses	95.5	94.1	93.3	92.6	92.2
Depreciation	0.4	0.5	0.5	0.5	0.5
Interest expenditure	2.4	2.3	2.2	1.6	1.4
EBITDA margins	4.5	5.9	6.7	7.4	7.8
Net profit margins	1.2	2.0	2.6	3.4	3.9

Growth metrics (%)

Year to March	FY15	FY16	FY17	FY18E	FY19E
Revenues	2.7	2.9	13.5	9.5	11.0
EBITDA	1.0	33.6	29.1	20.5	17.6
PBT	(17.8)	87.5	42.9	43.1	24.0
Net profit	(21.4)	80.4	48.1	43.1	25.5
EPS	(21.4)	80.4	41.9	43.0	25.5

Balance sheet (Standalone)

As on 31st March	FY15	FY16	FY17	FY18E	FY19E
Equity share capital	22	22	23	23	23
Reserves & surplus	231	269	371	457	565
Shareholders funds	253	291	394	480	588
Secured loans	293	208	209	194	194
Unsecured loans	0	15	15	15	15
Borrowings	293	223	224	209	219
Sources of funds	**547**	**514**	**617**	**689**	**807**
Gross block	241	279	315	355	395
Depreciation	36	45	56	68	83
Net block	205	233	259	286	312
Total fixed assets	205	233	259	286	312
Inventories	232	256	279	306	340
Sundry debtors	260	281	312	342	380
Cash and equivalents	2	2	66	99	155
Loans and advances	12	12	13	14	16
Total current assets	506	551	671	761	891
Sundry creditors and others	159	257	295	323	359
Provisions	10	15	19	20	21
Total CL & provisions	168	272	314	343	379
Net current assets	338	279	357	419	511
Net Deferred tax	-10	-13	-16	-16	-16
Uses of funds	**547**	**514**	**617**	**689**	**807**
Book value per share (INR)	116	133	172	210	257

Cash flow statement

Year to March	FY15	FY16	FY17	FY18E	FY19E
Net profit	22	41	60	86	108
Add: Depreciation	9	10	11	13	14
Add: Misc expenses written off/Other Assets	-2	-0	-3	17	0
Add: Deferred tax	2	3	3	0	0
Add: Others	-0	-0	-0	-0	-0
Gross cash flow	31	53	72	116	123
Less: Changes in W. C.	0	-58	14	29	36
Operating cash flow	31	112	58	88	86
Less: Capex	38	38	37	40	40
Free cash flow	**-7**	**74**	**21**	**48**	**46**

Ratios

Year to March	FY15	FY16	FY17	FY18E	FY19E
ROAE (%)	9.3	15.0	17.6	19.7	20.3
ROACE (%)	14.9	20.3	24.6	25.9	26.8
Debtors (days)	48	50	49.3	49.3	49.3
Current ratio	3.0	2.0	2.1	2.2	2.3
Debt/Equity	1.2	0.8	0.6	0.4	0.4
Inventory (days)	43	46	44.2	44.2	44.2
Payable (days)	29	46	46.6	46.6	46.6
Cash conversion cycle (days)	61	50	46.9	46.9	46.9
Debt/EBITDA	3.3	1.9	1.4	1.1	1.0
Adjusted debt/Equity	1.1	0.8	0.4	0.2	0.1

Valuation parameters

Year to March	FY15	FY16	FY17	FY18E	FY19E
Diluted EPS (INR)	10.3	18.6	26.4	37.8	47.4
Y-o-Y growth (%)	*(21.4)*	*80.4*	*41.9*	*43.0*	*25.5*
CEPS (INR)	14.3	23.0	31.4	43.4	53.7
Diluted P/E (x)	121.2	67.2	*47.3*	*33.1*	26.4
Price/BV(x)	10.8	9.4	7.3	6.0	4.9
EV/Sales (x)	1.5	1.5	*1.3*	*1.2*	*1.0*
EV/EBITDA (x)	33.8	24.7	19.5	15.9	13.3
Diluted shares O/S	2.2	2.2	2.3	2.3	2.3
Basic EPS	10.3	18.6	26.4	37.8	47.4
Basic PE (x)	121.2	67.2	*47.3*	*33.1*	26.4

Edelweiss Broking Limited, 1st Floor, Tower 3, Wing B, Kohinoor City Mall, Kohinoor City, Kirol Road, Kurla(W)
Board: (91-22) 4272 2200

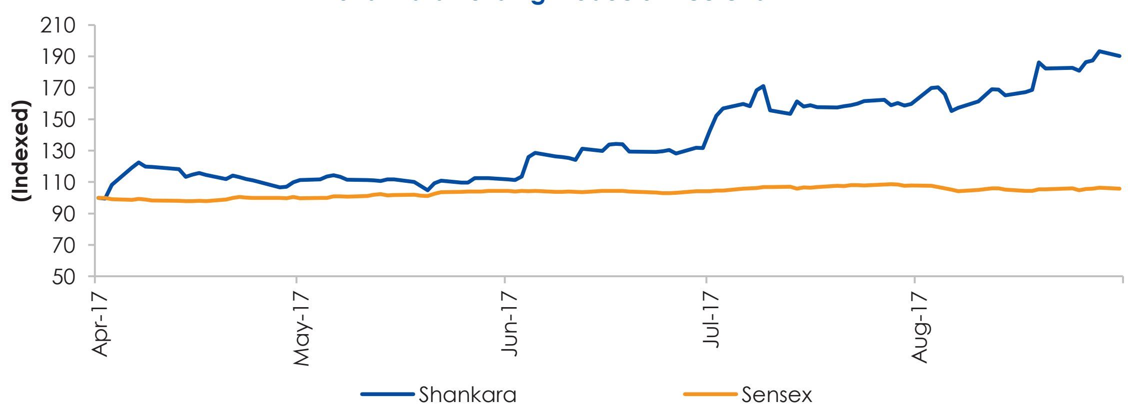
Vinay Khattar

Head Research

vinay.khattar@edelweissfin.com

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate between 5-15% over a 12-month period
Reduce	Return below 5% over a 12-month period

Shankara Building Products Price chart



Disclaimer

Edelweiss Broking Limited ("EBL" or "Research Entity") is regulated by the Securities and Exchange Board of India ("SEBI") and is licensed to carry on the business of broking, depository services and related activities. The business of EBL and its Associates (list available on www.edelweissfin.com) are organized around five broad business groups – Credit including Housing and SME Finance, Commodities, Financial Markets, Asset Management and Life Insurance.

Broking services offered by Edelweiss Broking Limited under SEBI Registration No.: INZ000005231; Name of the Compliance Officer: Mr. Brijmohan Bohra, Email ID: complianceofficer.ebl@edelweissfin.com Corporate Office: Edelweiss House, Off CST Road, Kalina, Mumbai - 400098; Tel. 18001023335/022-42722200/022-40094279

This Report has been prepared by Edelweiss Broking Limited in the capacity of a Research Analyst having SEBI Registration No.INH000000172 and distributed as per SEBI (Research Analysts) Regulations 2014. This report does not constitute an offer or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. The information contained herein is from publicly available data or other sources believed to be reliable. This report is provided for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. The user assumes the entire risk of any use made of this information. Each recipient of this report should make such investigation as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult his own advisors to determine the merits and risks of such investment. The investment discussed or views expressed may not be suitable for all investors.

This information is strictly confidential and is being furnished to you solely for your information. This information should not be reproduced or redistributed or passed on directly or indirectly in any form to any other person or published, copied, in whole or in part, for any purpose. This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject EBL and associates / group companies to any registration or licensing requirements within such jurisdiction. The distribution of this report in certain jurisdictions may be restricted by law, and persons in whose possession this report comes, should observe, any such restrictions. The information given in this report is as of the date of this report and there can be no assurance that future results or events will be consistent with this information. This information is subject to change without any prior notice. EBL reserves the right to make modifications and alterations to this statement as may be required from time to time. EBL or any of its associates / group companies shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. EBL is committed to providing independent and transparent recommendation to its clients. Neither EBL nor any of its associates, group companies, directors, employees, agents or representatives shall be liable for any damages whether direct, indirect, special or consequential including loss of revenue or lost profits that may arise from or in connection with the use of the information. Our proprietary trading and investment businesses may make investment decisions that are inconsistent with the recommendations expressed herein. Past performance is not necessarily a guide to future performance .The disclosures of interest statements incorporated in this report are provided solely to enhance the transparency and should not be treated as endorsement of the views expressed in the report. The information provided in these reports remains, unless otherwise stated, the copyright of EBL. All layout, design, original artwork, concepts and other Intellectual Properties, remains the property and copyright of EBL and may not be used in any form or for any purpose whatsoever by any party without the express written permission of the copyright holders.

EBL shall not be liable for any delay or any other interruption which may occur in presenting the data due to any reason including network (Internet) reasons or snags in the system, break down of the system or any other equipment, server breakdown, maintenance shutdown, breakdown of communication services or inability of the EBL to present the data. In no event shall EBL be liable for any damages, including without limitation direct or indirect, special, incidental, or consequential damages, losses or expenses arising in connection with the data presented by the EBL through this report.
We offer our research services to clients as well as our prospects. Though this report is disseminated to all the customers simultaneously, not all customers may receive this report at the same time. We will not treat recipients as customers by virtue of their receiving this report.

EBL and its associates, officer, directors, and employees, research analyst (including relatives) worldwide may: (a) from time to time, have long or short positions in, and buy or sell the securities thereof, of company(ies), mentioned herein or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as a market maker in the financial instruments of the subject company/company(ies) discussed herein or act as advisor or lender/borrower to such company(ies) or have other potential/material conflict of interest with respect to any recommendation and related information and opinions at the time of publication of research report or at the time of public appearance. EBL may have proprietary long/short position in the above mentioned scrip(s) and therefore should be considered as interested. The views provided herein are general in nature and do not consider risk appetite or investment objective of any particular investor; readers are requested to take independent professional advice before investing. This should not be construed as invitation or solicitation to do business with EBL.

EBL or its associates may have received compensation from the subject company in the past 12 months. EBL or its associates may have managed or co-managed public offering of securities for the subject company in the past 12 months. EBL or its associates may have received compensation for investment banking or merchant banking or brokerage services from the subject company in the past 12 months. EBL or its associates may have received any compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past 12 months. EBL or its associates have not received any compensation or other benefits from the Subject Company or third party in connection with the research report. Research analyst or his/her relative or EBL's associates may have financial interest in the subject company. EBL, its associates, research analyst and his/her relative may have other potential/material conflict of interest with respect to any recommendation and related information and opinions at the time of publication of research report or at the time of public appearance.

Disclaimer

Participants in foreign exchange transactions may incur risks arising from several factors, including the following: (i) exchange rates can be volatile and are subject to large fluctuations; (ii) the value of currencies may be affected by numerous market factors, including world and national economic, political and regulatory events, events in equity and debt markets and changes in interest rates; and (iii) currencies may be subject to devaluation or government imposed exchange controls which could affect the value of the currency. Investors in securities such as ADRs and Currency Derivatives, whose values are affected by the currency of an underlying security, effectively assume currency risk.

Research analyst has served as an officer, director or employee of subject Company: No
EBL has financial interest in the subject companies: No

EBL's Associates may have actual / beneficial ownership of 1% or more securities of the subject company at the end of the month immediately preceding the date of publication of research report.
Research analyst or his/her relative has actual/beneficial ownership of 1% or more securities of the subject company at the end of the month immediately preceding the date of publication of research report: No

EBL has actual/beneficial ownership of 1% or more securities of the subject company at the end of the month immediately preceding the date of publication of research report: No
Subject company may have been client during twelve months preceding the date of distribution of the research report.

There were no instances of non-compliance by EBL on any matter related to the capital markets, resulting in significant and material disciplinary action during the last three years.
A graph of daily closing prices of the securities is also available at www.nseindia.com

Analyst Certification:
The analyst for this report certifies that all of the views expressed in this report accurately reflect his or her personal views about the subject company or companies and its or their securities, and no part of his or her compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this report.

Additional Disclaimer for U.S. Persons
Edelweiss is not a registered broker – dealer under the U.S. Securities Exchange Act of 1934, as amended (the"1934 act") and under applicable state laws in the United States. In addition Edelweiss is not a registered investment adviser under the U.S. Investment Advisers Act of 1940, as amended (the "Advisers Act" and together with the 1934 Act, the "Acts), and under applicable state laws in the United States. Accordingly, in the absence of specific exemption under the Acts, any brokerage and investment services provided by Edelweiss, including the products and services described herein are not available to or intended for U.S. persons.

This report does not constitute an offer or invitation to purchase or subscribe for any securities or solicitation of any investments or investment services and/or shall not be considered as an advertisement tool. "U.S. Persons" are generally defined as a natural person, residing in the United States or any entity organized or incorporated under the laws of the United States. US Citizens living abroad may also be deemed "US Persons" under certain rules.

Transactions in securities discussed in this research report should be effected through Edelweiss Financial Services Inc.

Additional Disclaimer for U.K. Persons
The contents of this research report have not been approved by an authorised person within the meaning of the Financial Services and Markets Act 2000 ("FSMA").
In the United Kingdom, this research report is being distributed only to and is directed only at (a) persons who have professional experience in matters relating to investments falling within Article 19(5) of the FSMA (Financial Promotion) Order 2005 (the "Order"); (b) persons falling within Article 49(2)(a) to (d) of the Order (including high net worth companies and unincorporated associations); and (c) any other persons to whom it may otherwise lawfully be communicated (all such persons together being referred to as "relevant persons").

This research report must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this research report relates is available only to relevant persons and will be engaged in only with relevant persons. Any person who is not a relevant person should not act or rely on this research report or any of its contents. This research report must not be distributed, published, reproduced or disclosed (in whole or in part) by recipients to any other person.

Disclaimer

Additional Disclaimer for Canadian Persons

Edelweiss is not a registered adviser or dealer under applicable Canadian securities laws nor has it obtained an exemption from the adviser and/or dealer registration requirements under such law. Accordingly, any brokerage and investment services provided by Edelweiss, including the products and services described herein, are not available to or intended for Canadian persons.

This research report and its respective contents do not constitute an offer or invitation to purchase or subscribe for any securities or solicitation of any investments or investment services.

Disclosures under the provisions of SEBI (Research Analysts) Regulations 2014 (Regulations)

Edelweiss Broking Limited ("EBL" or "Research Entity") is regulated by the Securities and Exchange Board of India ("SEBI") and is licensed to carry on the business of broking, depository services and related activities. The business of EBL and its associates are organized around five broad business groups – Credit including Housing and SME Finance, Commodities, Financial Markets, Asset Management and Life Insurance. There were no instances of non-compliance by EBL on any matter related to the capital markets, resulting in significant and material disciplinary action during the last three years. This research report has been prepared and distributed by Edelweiss Broking Limited ("Edelweiss") in the capacity of a Research Analyst as per Regulation 22(1) of SEBI (Research Analysts) Regulations 2014 having SEBI Registration No.INH000000172.