Q2FY12 Result Update

November 24, 2011

HDFC Sec Scrip code	Industry	FV (Rs.)	CMP (Rs.)	Revised Price Target (Rs.)
NITFIREQNR	Fire-Protection Equipment	2	30.0	30-32

Company Background

Incorporated in 1995, NFPIL is one of the leading and established players in the area of fire protection and fire suppression systems and Building Management systems (end-to-end solutions). The company was promoted 25 years ago by Mr. Nitin Shah and has strong domain expertise in the fire protection business. The company raised Rs 644 mn through an IPO in 2007 (3.39 mn equity shares at Rs. 190). NFPIL's business activities can be categorized into i) Fire protection & security solutions and ii) High Pressure Seamless Cylinders for CNG & Industrial applications. The fire protection & security solution business accounts for ~85% of the total consolidated revenues, while the balance ~15% revenue comes from Cylinder business. The fire protection & security solutions include Fire Alarm Systems, Fire Suppression System, Fire Extinguishers and Intelligent Building & Security Management Systems. Project based work contribute ~85%, while fire extinguishers & maintenance work account for ~10% & ~5% respectively of the fire protection revenues. Fire protection equipments are sold under the brand name "NITIE".

NFPIL has facilities located at Navi Mumbai (3 facilities in TTC Industrial Area) and Vishakhapatnam for integration of various fire protection solution including manufacture of fire extinguishers. The Integrated manufacturing facility at Vishakhapatnam SEZ (A.P.) has an installed capacity of 5,00,000 cylinders per annum for CNG application. These cylinders were earlier manufactured by NFPIL's subsidiary, Nitin Cylinders, but now post the 60% stake sale to US based company 'Worthington Industries Inc' in Dec 2010, the manufacturing of the CNG Cylinders has now been transferred to Worthington Industries Inc. NFPIL generates almost 74% of its revenues from outside India (in Q1FY12; in FY11: 68.9%), while the balance revenue comes domestic market. Overseas, the company has presence across Europe, Middle East, East Africa and South East Asia. Malaysia, Indonesia, Singapore, Pakistan, Afghanistan, UK & UAE are NFPIL's major markets (Singapore, Malaysia, UK & UAE being the major ones). The company has a good track record of servicing marquee clients in the field of telecom, data centres, refineries, offshore oil platforms and institutions like BSE. The oil & gas and telecom are the two major industries which make up for ~45% of NFPIL's revenues (Oil & Gas: ~20%; Telecom: ~25%).

NFPIL has six subsidiaries (3 domestic & 3 Overseas) namely i) Alert Fire Protection Systems Pvt. Ltd. (India), ii) Eurotech Cylinders Pvt. Ltd. (India), iii) Logicon Building Systems Pvt. Ltd. (India), iv) Nitin Venture FZE (UAE), v) New Age Company LLC (UAE) and vi) Nitin Global Pte Ltd. (Singapore). NFPIL's previous wholly owned subsidiary Nitin Cylinders has now become its associate with 40% stake w.e.f December 29, 2010. In Q3FY11 NFPIL announced 40:60 JV agreement for Cylinder manufacturing business with US based Worthington Industries Inc, the world's leading global supplier of pressure cylinders.

Q2FY12 Results Review

Standalone:

Y-o-Y

- NFPIL's net sales de-grew by 45.8% to Rs. 264.7 mn [Q2FY11: Rs. 488 mn]. As per the management, the sharp drop was due to some portion of domestic business being shifted to foreign subsidiary (Rs. 280 mn shipment order from L&T & Essar India). However, the operating profit witnessed a sharp jump of 66% to Rs. 41.5 mn on the back of substantial decline in the material cost (down 56.5% Y-o-Y). OPM improved by 1056 bps Y-o-Y to 15.7%. However, employee cost & other expenses increased by 67.4% Y-o-Y & 64% Y-o-Y respectively, which restricted further margin expansion. Increase in the other expenditure was mainly because of huge expenditure incurred during the Delhi exhibition as well as increase in professional and admin fees as stated by the management.
- However, despite higher operating profit, NFPIL's PAT fell sharply by 48.3% Y-o-Y to Rs. 22.6 mn [Q2FY11: Rs. 43.7 mn] mainly on the back of substantially lower other income (down from Rs. 35 mn in Q2FY11 to Rs. 1.7 mn) and higher tax expenses (up 154.8% Y-o-Y). PAT margins fell by 42 bps Y-o-Y to 8.5%. EPS for the quarter stood at Rs. 0.1 vs Rs. 0.2 in Q2FY11.
- Inventories have risen from Rs. 394 mn in March 2011 to Rs. 491 mn in Sept 2011. This has been financed by increase in current liabilities.

Q-o-Q

- Sequentially, the net sales de-grew by 9.8%, while operating profit & PAT decreased by 22% & 32.3% respectively. OPM fell by 246 bps Q-o-Q on the back of higher other expenses & employee cost (up 35.2% & 16.7% Q-o-Q). PAT margins fell by 285 bps Q-o-Q.

Consolidated:

Y-o-Y

- On a consolidated basis, the results were below our expectations mainly on the back of global economic slowdown, which impacted the company's domestic as well as overseas business, which witnessed a decline in their respective revenues. The net sales declined by 6.7% Y-o-Y to Rs. 1451.5 mn [Q2FY11: Rs. 1555.5], while the operating profit was up marginally by 1.1% Y-o-Y supported by sharp decline in the employee cost & other expenses (down 36.1% & 18.8% Y-o-Y respectively). OPM improved by 115 bps Y-o-Y to 14.8%.
- Higher other income (Rs. 14.9 mn vs. loss of Rs. 10.3 mn), lower depreciation (down 59.2% Y-o-Y) and lower effective tax rate on PBT (down from 8.9% in Q2FY11 to 2.3% in Q2FY12) boosted the PAT, which rose 25% Y-o-Y to Rs. 172 mn [Q2FY11: Rs. 137.6 mn]. PAT margins improved by 300 bps Y-o-Y to 11.8%. EPS for the quarter stood at Rs. 0.78 vs. Rs. 0.62 in Q2FY11.
- Debt has increased from Rs. 1455 mn in March 2011 to Rs. 1962 mn in Sept 2011. This has been used to bring down the current liabilities.

Q-o-Q

- Sequentially, the results were dull. Net sales de-grew by 10.1% Q-o-Q, while operating profit & PAT decreased by 19.8% & 27.2% Q-o-Q respectively. OPM fell by 179 bps Q-o-Q on the back of higher employee cost & other expenses (up 15.3% & 127.6% respectively), while PAT margins declined by 279 bps Q-o-Q due to lower other income (down 46.2% Q-o-Q) and increase in the interest cost (up 40.7% Q-o-Q).

Quarterly Financials

Standalone:

(Rs. in Million)

Particulars	Q2FY12	Q2FY11	VAR [%]	Q1FY12	VAR [%]	Q1FY11	Q4FY11	Q3FY11
Net Sales	264.7	488.0	-45.8	293.3	-9.8	271.0	525.4	180.6
Other Operating Income	7.6	0.0	-	1.5	406.7	0.7	10.1	1.0
Total Operating Income	272.3	488.0	-44.2	294.8	-7.6	271.7	535.5	181.6
Total Expenditure	230.8	463.0	-50.2	241.6	-4.5	222.8	437.2	157.4
Material Cost	190.8	438.8	-56.5	210.2	-9.2	199.2	382.7	137.3
Employee Expenses	15.4	9.2	67.4	13.2	16.7	8.7	13.6	11.4
Other Expenses	24.6	15.0	64.0	18.2	35.2	14.9	40.9	8.7
Operating Profit	41.5	25.0	66.0	53.2	-22.0	48.9	98.3	24.2
Other Income	1.7	35.0	-95.1	1.2	41.7	0.0	1.1	115.9
PBIDT	43.2	60.0	-28.0	54.4	-20.6	48.9	99.4	140.1
Interest	12	12.7	-5.5	13.8	-13.0	12.4	14.6	11.1
PBDT	31.2	47.3	-34.0	40.6	-23.2	36.5	84.8	129.0
Depreciation	0.7	0.5	40.0	0.8	-12.5	0.5	0.9	1.0

PBT	30.5	46.8	-34.8	39.8	-23.4	36.0	83.9	128.0
Tax (including DT & FBT)	7.9	3.1	154.8	6.4	23.4	3.1	22.6	16.7
Reported Profit After Tax	22.6	43.7	-48.3	33.4	-32.3	32.9	61.3	111.3
EPS (Rs.)	0.10	0.20	-48.3	0.15	-32.3	0.15	0.28	0.04
Equity (Ex Bonus)	441	441	0.0	441	0.0	441	441	441
Face Value	2.0	2.0	0.0	2	0.0	2	2	2.0
OPM (%)	15.7	5.1	206.0	18.1	-13.6	18.0	18.7	13.4
PATM (%)	8.5	9.0	-4.7	11.4	-25.0	12.1	11.7	5.0

(Source: Company, HDFC Sec)

Consolidated:

(Rs. in Million)

Particulars	Q2FY12	Q2FY11	VAR [%]	Q1FY12	VAR [%]	Q1FY11	Q4FY11	Q3FY11
Net Sales	1451.5	1555.5	-6.7	1614.5	-10.1	897.2	835.7	1090.1
Other Operating Income	7.9	2.4	229.2	1.6	393.8	0.7	11.1	11.4
Total Operating Income	1459.4	1557.9	-6.3	1616.1	-9.7	897.9	846.8	1101.5
Total Expenditure	1244.3	1345.2	-7.5	1348	-7.7	769.1	658.7	960.5
Raw Material Consumed	956.5	998.6	-4.2	1196.8	-20.1	256.9	558.7	811.6
Stock Adjustment	-72.3	22.8	-	-143	-	10.4	-29.6	-3.6
Purchase of Finished Goods	199.3	111.9	78.1	201.7	-1.2	414.5	0	0
Employee Expenses	51.1	80	-36.1	44.3	15.3	26.1	43.3	57.4
Other Expenses	109.7	131.9	-16.8	48.2	127.6	61.2	86.3	95.1
Operating Profit	215.1	212.7	1.1	268.1	-19.8	128.8	188.1	141
Other Income	14.9	-10.3	-244.7	27.7	-46.2	25.3	-29.7	144.3
PBIDT	230	202.4	13.6	295.8	-22.2	154.1	158.4	285.3
Interest	33.2	27.7	19.9	23.6	40.7	32.4	25.5	32.4
PBDT	196.8	174.7	12.7	272.2	-27.7	121.7	132.9	252.9
Depreciation	6.9	16.9	-59.2	6.5	6.2	12.9	6.9	16.7
PBT	189.9	157.8	20.3	265.7	-28.5	108.8	126	236.2
Tax (including DT & FBT)	4.3	14.1	-69.5	21.1	-79.6	12.5	-17.5	39.7
Reported Profit After Tax	185.6	143.7	29.2	244.6	-24.1	96.3	143.5	196.5
Min Interest & Share of Profit / Loss in Associates	13.6	6.1	123.0	8.2	65.9	0	37.3	3.1
PAT (net of Minority Interest)	172.0	137.6	25.0	236.4	-27.2	96.3	106.2	193.4
EPS (Rs..)	0.78	0.62	25.0	1.07	-27.2	0.44	0.48	0.41
Equity (Ex-Bonus)	441	441	0.0	441	0.0	441	441	441

FV	2	2	0.0	2	0.0	2	2	2
OPM (%)	14.8	13.7	8.4	16.6	-10.8	14.4	22.5	12.9
PATM (%)	11.8	8.8	34.0	14.6	-19.1	10.7	12.7	8.4

(Source: Company, HDFC Sec)

Other Key Highlights:

- The share of loss of NFPIL in Q2FY12 in the 40:60 JV Worthington Nitin Cylinders (shown under Profit / Loss in Associates) stood at Rs. 10 mn (to the extent of 40% share). The loss has increased from Rs. 5.6 mn in Q1FY12. While NFPIL is gradually exiting the low margin CNG cylinder business with 60% stake sale to US based Worthington industries, it still holds 40% stake through Nitin Cylinders. This business has not been doing well on the profitability front and the prospects could deteriorate further due to oversupply & intensifying competition.
- Consequent to part sale of equity stake in Worthington Nitin Cylinders Ltd, in December 2010, the company has taken over an outstanding claim of a derivative contract amounting to Rs. 50.1 mn (excluding interest). Based on the legal opinion, the company has filed a petition in the Hon'ble Court of Bombay challenging the legality of the contract. Pending decision, no provision has been made in the books of accounts for this claim. In case this case is ultimately decided against the company, it would impact its cash flow and profitability in that year.

Conclusion

NFPIL's Q2FY12 results were below our estimates on the back of global economic slowdown, which impacted the company's domestic as well as overseas business. The slowdown was much larger than we had anticipated. The management has stated that Q3FY12 is likely to be better. While the long-term growth prospects of NFPIL look good, we feel that in the near term (over the next 3-4 quarters), the company could witness a slowdown in its order inflows and in execution. Recurrence of slowdown in the Gulf (especially in oil & gas sector) could impact the overseas operations significantly. Out of 3 overseas subsidiaries, 2 are based in UAE (Nitin Venture & New Age), which contribute around 65% to the total revenues outside India. Further the ongoing slowdown in US & UK could also impact NFPIL's international operations. Locally, the Indian economy is also facing signs of slowdown along with inflation continuing to remain at high levels. This could impact the company's domestic business sharply in the near term. Higher debtors collection & inventory holding period, which were anyways a concern, have shown no signs of coming under control at standalone or consolidated levels.

Another issue is that the law of Maharashtra Fire Act 2006 was expected to be gazetted by end of September 2011. This would have empowered NFPIL to carry out inspection & audit of its clients, which could have led to increase in the projects for fire protection solution and also high margin maintenance contracts going forward. However, this has been delayed and timing of the implementation is uncertain. Further, the progress on the Rajasthan oil block is slow. Delay in the commencement of commercial production of crude oil in Rajasthan block could delay the company's share of profits in FY13. While the management expects the production to commence by April 2012, we feel it is unlikely to commence on time.

Historically, second half of the fiscal is weaker for NFPIL as compared to first half. Worthington JV could surprise negatively in the near term. Large amount of pledge by promoters - though unchanged over the quarter - (26% of promoters holding, which equals to 18.3% of NFPIL's equity) also creates scare in the current market conditions.

Based on the above concerns, looking at Q2FY12 results and the extent of ongoing slowdown in the global economy we feel the need to downgrade our estimates. The global economic uncertainty could continue for a few more quarters, which could impact the demand for company's product and in turn impact its revenues & profits. Hence, we are revising our net sales, operating profit & profit estimates lower by 8.6%, 16% & 8.5% respectively for FY12 & by 10.4%, 16.6% & 15.9% respectively for FY13. Accordingly, the revised EPS is likely to be Rs. 3.3 & Rs. 4 in FY12 & FY13 respectively (compared to Rs. 3.6 & Rs. 4.8 respectively projected earlier).

In our management interaction note dated September 16, 2011, we had recommended investors to buy this scrip at Rs. 140.5 (cum bonus; ex-bonus Rs. 40.1) and to average it on dips in the price band of Rs. 118-126 (cum bonus; ex-bonus Rs. 34-36) for a price target of Rs. 168 (cum bonus; ex-bonus Rs. 48) over the next one to two quarters. Thereafter the stock touched a high of Rs. 47.4 (ex-bonus) on September 22, 2011, thus almost achieving our target, and subsequently it fell sharply to Rs. 22.5 on Nov 22. Such sharp fall in the stock price could be partly attributable to some slowdown witnessed by the company in Q2 and partly due to weak market sentiments, which has resulted in de-rating in the valuations of small cap companies (BSE small cap index, which includes NFPIL) to the extent of 15% since the time we recommended this stock. If the global sentiments continue to remain weak, then there could be some more valuation de-rating in the near term.

We are comfortable with the broad macro trigger and the place occupied by NFPIL in the industry. However, we are cautious on the near term performance of NFPIL and the valuations that such companies could get in the near term. Based on the above concerns, we are assigning a lower PE of 7.5-8xFY13E EPS compared to PE of 10xFY13E EPS assigned earlier. This gives us revised price target of Rs. 30-32 and we feel that the stock is unlikely to get re-rated unless it surprises the street with impressive Q3FY12 results and the market conditions improve. Hence we advise investors, who have not exited earlier, to exit the scrip on rises to Rs. 30-32.

Financial Estimations: (Consolidated)

(Rs. in Million)

Particulars	FY09	FY10	FY11	FY12OE	FY13OE	FY12RE	FY13RE
Net Sales	2460	3139	4379	6635	8127	6066	7279
Operating Profit	501	573	671	1075	1287	903	1074
Adjusted PAT	347	409	431	799	1060	731	892
EPS (Rs.)	1.6	1.9	2.0	3.6	4.8	3.3	4.0
OPM (%)	20.4	18.3	15.3	16.2	15.8	14.9	14.8
NPM (%)	14.1	13.0	9.9	12.0	13.0	12.0	12.3
PE	19.1	16.2	15.3	8.3	6.2	9.1	7.4

(Source: Company, HDFC Sec Estimates)

* OE - Original Estimates; RE - Revised Estimates

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