ICICI direct Research

April 25, 2018

Nano Nivesh

Key risks to investing in Nano stocks

- Nano stocks may not be in the limelight and inherently being micro cap in nature will have a high risk return profile

- We advise clients to be disciplined in investing at all times. Allocate only a small proportion of your investible income to these stocks and diversify well

- Try to diversify your exposure within the Nano stocks as well by investing equal proportions in several picks

- These stocks may have low volumes and trade infrequently

- Micro cap stocks the world over are, to a large extent, affected by the "Pump and Dump" phenomenon of inflated price buying and depressed price selling

- As explained above, the clients should be patient and trade only through limit orders on any side of the trade.

- The risk of volatility remains in such micro cap stocks as they can move up or down with large buy/sell orders

- The fair value of Nano stocks are subject to expected growth potential in the future. Though due diligence has been done to a fair extent, the actualisation of growth still has a degree of uncertainty attached to it

Nano stocks report tries to highlight companies with good and scaleable business models, dependable management and sound financials. However, these stocks may not be in the limelight and have a high risk high return potential. Please watch out for the following factors before investing in these stocks:

Allocate a small proportion of your investible income to these stocks and diversify well. If you choose to invest in these stocks, most of your assets allocated towards equity should remain in more stable investments like stocks of large companies. Moreover, try to diversify your exposure within the nano stocks as well by investing equal proportions in several picks. This will help you avoid losing too much of your total wealth if the investments do not turn out well. When you invest in micro-cap stocks there is a higher risk of impairment.

These stocks may have low volumes and trade infrequently. This can create a situation in which you may not be able to find any willing buyers for your stocks when you wish to sell. We advise our clients to be patient and trade only though limit orders to avoid volatile fluctuations, both while putting a buy and sell order in these stocks.

April 25, 2018

Shaily Engineering Plastics (SHAILY)

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SEPL has expertise in manufacturing precision components with high performance engineering polymers and earns ~75% of revenue from exports. It is one of the largest suppliers of home furnishing products to Swedish Furniture Retailer (SFR), which contributes ~55% to topline. SFR's robust expansion plan in India coupled with SEPL's focus on increasing utilisation of healthcare, FMCG business may drive revenue, earning at CAGR of ~33%, ~59%, respectively, in FY17-20E.

Price

₹ 1400

Recommendation

Buy

Fair value

₹ 1850

Highlights

- **Betting big on SFR's India expansion:** SEPL has been a preferred supplier to SFR's global retail stores for over 14 years. We believe SFR's robust expansion plan in India (~₹ 11,000 crore capex for ~25 stores by 2025) would strengthen ~55% (from SFR) of revenue visibility for SEPL. With 100% dedicated export oriented unit in Gujarat, SEPL has geared up to raise SKU numbers for SFR (almost doubled to 38 last year) for its upcoming stores globally. Despite rising contribution of other strategic business units (SBUs) in SEPL topline, we believe SFR will stay top contributor with furnishing segment revenue CAGR of ~30% in FY17-20E
- **Focus to increase utilisation of healthcare segment**
  SEPL was first to design and develop 100% plastic insulin pens in association with UK based IDC in 2006. The company serves ~16 customers in the healthcare segment, including top MNCs like Sanofi, Sun Pharma, Lupin etc. During FY18, the company received confirmation to develop and supply six different types of pens for different therapies/customers that would benefit the company in FY19E-20E. We believe low competitive intensity and higher compliance cost in the medical packaging, device space would benefit SEPL in terms of higher utilisation and better EBITDA margin compared to other business segments
- **Strong earnings visibility to drive valuation; recommend BUY!**
  With robust growth in healthcare and furnishing business (owing to expansion of SFR in India) we believe SEPL's revenue, earnings will record CAGR of 33%, 59%, respectively, in FY17-20E. Further, limited exposure to debt (debt to equity ~0.6x), higher profitability (~180 bps increase in EBITDA margin in FY17-FY20E) coupled with higher asset turnover (launch of various new products) is expected to translate to better RoCE and RoE of ~25% and ~23%, respectively (FY18E-20E average). We ascribe P/E multiple of 25x FY20E EPS of ₹ 74 to arrive a fair value of ₹ 1850 with a **BUY** recommendation.

Key risks-

Business specific

Systematic risk associated with overseas business: SEPL's export contributes ~75% to the topline. Its products are exported to various OEMs in different geographies. Hence, the company is prone to various systematic risks such as political, environmental and geographical.

Company specific

Overdependence on SFR, furnishing business: SFR's furnishing business contributes ~55% to SEPL's topline, which poses significant risk of higher reliance on single clients. Additionally, any delay in expansion of SFR in India would also dent SEPL's future expansion plan. We believe the furnishing business would remain top contributor to the topline of SEPL by FY20E.

Adverse raw material price movement: Polymer prices depend on the global supply demand scenario. Though the company works on a raw material price pass through mechanism with lag of a quarter, any sharp movement in raw material prices may dent SEPL's earnings in the short-term.

Delay in client validation: SEPL may face challenges in its new launches in case of a delay in client and regulator validation in the healthcare product category. The delay could translate into lower asset turnover.

Rise in competition: With over 30,000 plastic processing units, the Indian plastic processing industry is growing at a CAGR of 10-11% (in volume terms) annually. We believe SFR's expansion in India would attract competition for SEPL for its furnishing product categories.

Description

Started in 1987, Shaily Engineering Plastics (SEPL) is involved in manufacturing high precision injection moulded plastic components, assemblies, moulds and dies for OEM requirements. With expertise in precision engineering, SEPL successfully converted metal rods into plastic rods for Honeywell (used in luxury cars). It is also one of the very few suppliers of insulin pens globally. SEPL has a wide array of products catering to varied industries like home furnishings, medical, automotive, appliances, consumer goods, electrical, engineering applications, with marquee clients viz, Sanofi, Wockhardt, Sun Pharma, ABB, Gillette, Siemens, GE, Corvi LED Lights, Electrolux and Amvian Auto. With export revenue contribution of ~75%, SEPL clocked total revenue, earning of ~₹ 246 crore, ~₹ 15 crore, respectively, in FY17 with EBITDA margin of 16.7%.

History and track record

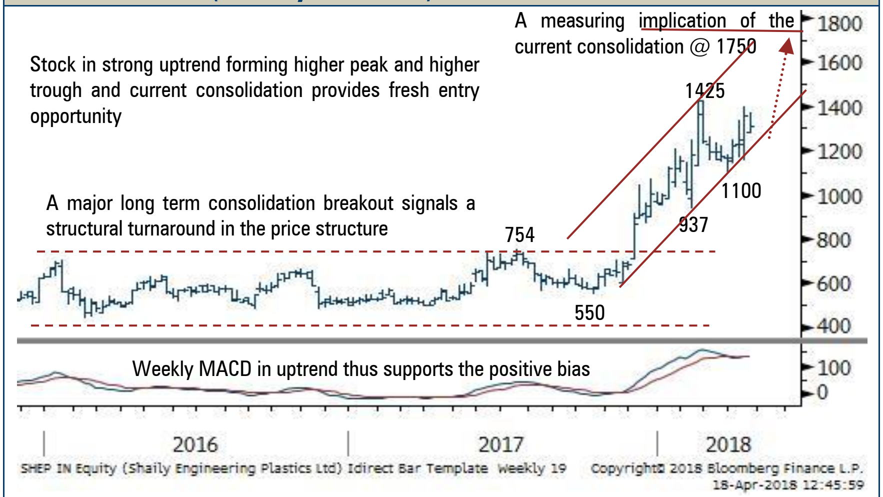
- SEPL has five manufacturing plants in Gujarat with one 100% dedicated to exports. It entered into a supply agreement with SFR in 2004 with a meagre contract value of ₹ 1 crore. SFR contributed ~55% (or ₹ 136 crore) to SEPL's topline of ~₹ 246 crore in FY17
- In 2006, SEPL successfully designed insulin pens for Wockhardt in collaboration with IDC, UK. The company started manufacturing insulin pens for Sanofi in 2012
- SEPL was first to convert three-piece metal rods to single piece plastic rods used in turbo chargers for Honeywell. Honeywell supplies turbo chargers with plastic rods to BMW, Audi, VW and GM. With plastic rods, productivity increased 300x whereas the cost reduced 40%
- It was the first company to join hands with Europe's Global Closure Systems (GCS) to set up a manufacturing unit of child resistant caps (CRC) in India in 2015 with a capex of ₹ 30 crore
- It recorded revenue, earning CAGR of ~19%, ~44% in FY13-17 to ~₹ 246 crore, ~₹ 15 crore, respectively, with EBITDA margin expansion of ~300 bps (to 16.7% in FY17) in the same period

Earnings estimates

₹ crore	FY17	FY18E	FY19E	FY20E
Net Sales	246.4	307.9	434.0	584.5
EBITDA	41.1	52.7	76.4	107.9
Net Profit	15.4	21.9	37.3	61.6
EPS (₹/share)	18.6	26.3	44.8	74.0

Source: Company, ICICI Direct Research

Technical Chart (Weekly Bar chart)



Source: Bloomberg, ICICI Direct Research

Stock data

Market Capitalization (₹ crore)	1164.8
52 Week High / Low (₹)	1425 / 520
Promoter Holding (%)	51.1
FII Holding (%)	0.0
DII Holding (%)	11.1
Dividend Yield (%)	0.0
12M / 6M stock return (%)	147 / 128
Debt (₹ crore)	66.7
Cash and Cash Equivalent (₹ crore)	3.8
Enterprise Value (₹ crore)	1227.7
Revenue CAGR (%) (FY13-17)	18.9
EBITDA CAGR (%) (FY13-17)	24.7
PAT CAGR (%) (FY13-17)	43.7

Valuation

	FY17	FY18E	FY19E	FY20E
P/E	79.8	53.2	31.2	18.9
Target P/E	105.4	70.3	41.3	25.0
EV / EBITDA	29.9	23.5	16.3	11.6
P/BV	11.0	9.5	7.4	5.4
RoNW	14.6	17.9	23.7	28.6
RoCE	17.2	19.9	24.5	31.2
ROIC	16.9	19.8	25.1	30.2

Source: ICICI Direct Research

Quarterly performance

(₹ crore)	Q4FY17	Q1FY18	Q2FY18	Q3FY18
Sales	66.6	69.5	78.8	78.6
EBITDA	13.0	11.7	14.4	13.1
EBITDA Margin (%)	19.5	16.8	18.2	16.7
Depreciation	3.7	3.9	3.4	4.3
Interest	1.8	1.5	1.4	2.1
Other Income	2.3	0.5	0.5	0.6
PAT	7.2	4.4	6.4	5.9
EPS (₹)	8.7	5.3	7.7	7.1

Source: ICICI Direct Research

Shareholding trend (%)

Key Shareholders	Q4FY17	Q1FY18	Q2FY18	Q3FY18
Promoter group	54.1	54.1	51.1	51.1
FII	0.0	0.0	0.0	0.0
DII	8.3	8.3	10.6	11.1
Non-institutional	37.6	37.6	38.3	37.8

Source: ICICI Direct Research, BSE

Technical View

The share price of Shaily Engineering during November 2017 registered a breakout above the last 22 months' consolidation phase and rallied to an all-time high of ₹ 1425 during early February 2018. During the entire up move the stock maintained a higher peak and higher trough on the weekly chart signalling strength in the up move.

In the last two months, the stock has seen a corrective decline from the all-time high of ₹ 1425. It recently rebounded from the major support area around ₹ 1100 as it is the confluence of the lower band of the rising channel containing the entire up move since October 2017 and the 61.8% retracement of the previous up move (₹ 937-1425).

The stock has already taken more than eight weeks to retrace just 61.8% of the previous two week's up move from ₹ 937 to ₹ 1425. A slower retracement of the previous up move signals a robust price structure.

We expect the stock to head towards ₹ 1750 in the medium term as it is the measuring implication of the last two month's consolidation (₹ 1425- ₹ 1100) added to the previous all-time high ₹ 1425. Thus, it projects upside towards ₹ 1750.

What's the story?

Swedish Furnishing Retailer's expansion to drive fortune of SEPL

The ~€30 billion Swedish Furnishing Retailer (SFR) owns ~355 stores globally with each store of up to ~4,00,000 sq ft and able to accommodate ~9500 products. SFR sources from ~55 countries across the world of which India's contribution is meagre ~3% (₹ 2500 crore) of SFR's total outsourcing. Under the "Make in India" programme SFR has announced doubling of its outsourcing from India to ~₹ 5000 crore by FY20E. Currently, SFR has ~50 outsourcing partners from India with SEPL among the preferred partners for the supply of quality furnishing products. The SFR relationship started in 2004 with supply of goods worth ₹ 1 crore. Today, SEPL supplies ~38 SKUs in the furnishing products (for kitchen, children, cooking & eating, organising & storage) with order in hand of ~ ₹ 180 crore (to be executed in the near future). With topline contribution of ~55%, the furnishing product category of SEPL is likely to record strong revenue CAGR of ~30% in FY17-20E (in line with historical trend FY15-17) supported by rising demand from SFR for its stores globally and expansion in India. SFR plan to open ~25 stores India at an investment of ~₹ 11,000 by 2025 of which the first store is expected to commence by FY19 in Hyderabad.

Focus to increase utilisation of healthcare segment

SEPL's healthcare segment consists of two segments: 1) medical devices and 2) primary packaging. Medical devices include manufacturing insulin pens and dermatology devices (used in skin care), asthma inhalers while primary packaging includes tablet bottles, packaging for liquid formations, dry powder inhalers and ophthalmic packaging (eye droppers). SEPL being an expert in innovations was first to design and develop 100% plastic insulin pens in association with UK based IDC for Wockhardt during 2006. Later in 2012, the company started manufacturing improved version of insulin pen for Sanofi. On the packaging front, SEPL tied up with GCS and licensed IPR to commence a plant (at a capex of ₹ 30 crore) for manufacturing CRC cap in 2015. The plant utilisation started improving from Q2FY18 after completion of various stages of validation with pharma customers. The company serves ~16 customers in the healthcare segment, including top MNCs like Sanofi, Sun Pharma, Lupin etc. We believe SEPL's healthcare segment, on a lower base, is likely to record ~43% revenue CAGR FY17-20E supported by increase in utilisation of devices and packaging units, going forward. We also believe low competitive intensity in the medical packaging space due to high compliance cost and intolerance towards the minute of errors would benefit SEPL in terms of earning better EBITDA margin than other business segment.

Rising healthcare customer base to reduce dependency on furnishing segment

Over the years, SEPL has added many clients from every segment from the top 100 MNCs list to its kitty only through innovative solutions and best services till the product reaches the market. As a result, SEPL has witnessed strong customer loyalty and sticks with the company for various products for over 20 years. The company's top six clients SFR, Sanofi, Gillette and P&G (for razors and Vicks), Amvian Automotive (for automotive products) and GE (plastic products for electrical goods) contribute ~ 80% to the topline. Out of top six clients, SFR (largely for furnishing products) alone contributes ~55% to the topline. However, the rising proportion of revenue from healthcare segment would result in lowering the revenue contribution of SFR to 50% by the end of FY20. The company has received inquiry from ~17 customers for CRC products while ~five customers are in the preliminary stage of signing the deal for derma applicator. We believe addition of new customers in the healthcare category would translate to a diversified customer base and lower risk of customer concentration in a single product category.

Better asset turn on incremental capex with margin improvement to reward shareholder!

SEPL's two-year average gross block turnover of ~1.3x was lower due to a slow pick-up in demand of healthcare packaging products. The company expects to achieve asset turn of over ~2.5x with incremental capex of ~₹ 90 crore (FY18E-20E) supported by increase in utilisation of healthcare packaging (led by CRC products) and FMCG product lines. With stable debt/equity (~0.6x), the capex would largely be funded internally with an average CFO/year of ₹ 40 crore in FY18E-20E. Further, an improvement in EBITDA margin by ~180 bps to 18.5% by FY20E over FY17 would be largely due to rising contribution of healthcare business that is relatively higher margin business than other five strategic business units (SBUs). With robust growth in the healthcare and furnishing business (owing to expansion of SFR in India) we believe SEPL's revenue, earning will record CAGR of 33%, 59%, respectively, in FY17-20E. Further, increased profitability and efficient working capital management would translate to better RoCE and RoE of ~25% and ~23% (FY18E-20E average), respectively, for SEPL. We ascribe P/E multiple of 25xFY20E EPS ₹ 74 to arrive a fair value of ₹ 1850 with a **BUY** recommendation. The company is listed only on the BSE with relatively lower trading volumes. Hence, we advise investors to buy the stock in a staggered manner.

Financial summary

Profit and loss statement ₹ Crore

(Year -End -March)	FY17	FY18E	FY19E	FY20E
Net sales	246.4	307.9	434.0	584.5
Growth (%)	9.2	25	41	35
Expenses				
Raw Material Expenses	151.1	186.3	260.4	345.8
Employee Expenses	26.7	30.8	43.7	58.8
Power & Fuel cost	13.2	16.6	25.0	35.1
Other Expenses	14.3	21.6	28.5	36.8
Total Operating Expenditure	205.3	255.3	357.6	476.5
EBITDA	41.1	52.7	76.4	107.9
Growth (%)	5.3	28	45	41
Other Income	3.4	4.0	4.7	12.2
Depreciation	13.4	15.4	19.5	23.4
Interest	7.9	8.4	9.9	10.4
PBT before Exc. Items	23.2	32.9	51.7	86.4
Less: Exc. Items	1.3	0.0	0.0	0.0
PBT after Exc. Items	21.9	32.9	51.7	86.4
Total Tax	7.3	11.0	14.4	24.7
Adjusted PAT	15.4	21.9	37.3	61.6
Growth (%)	2.6	42	70	65
EPS	18.6	26.3	44.8	74.0

Source: Company, ICICI Direct Research

Cash flow statement ₹ Crore

(Year -End -March)	FY17	FY18E	FY19E	FY20E
Profit/(Loss) after taxation	14.6	21.9	37.3	61.6
Add: Depreciation & Amortization	13.4	15.4	19.5	23.4
Add: Interest Paid	7.9	8.4	9.9	10.4
Cash Flow before working capital changes	35.8	45.7	66.7	95.4
Net Increase in Current Assets	-19.4	-18.9	-41.9	-58.8
Net Increase in Current Liabilities	-0.5	8.9	14.0	16.7
Net cash flow from operating activities	15.9	35.7	38.8	53.4
Cash flow from Investing Activities				
(Purchase)/Sale of Fixed Assets	-13.4	-30.0	-30.0	-35.0
Others	-4.9	-2.4	-4.8	-5.8
Net Cash flow from Investing Activities	-18.3	-32.4	-34.8	-40.8
Cash flow from Financing Activities				
(Payment) of Dividend and Dividend Tax	0.0	-2.5	-2.5	-3.3
Interest Paid	-7.9	-8.4	-9.9	-10.4
Others	0.8	7.3	10.0	0.0
Net Cash flow from Financing Activities	-7.1	-3.6	-2.4	-13.7
Net Cash flow	-9.5	-0.3	1.6	-1.1
Cash and Cash Equivalent at the beginning	13.1	3.6	3.3	5.0
Cash and Cash Equivalent at the end	3.6	3.3	5.0	3.8

Source: Company, ICICI Direct Research

Balance sheet ₹ Crore

(Year -End -March)	FY17	FY18E	FY19E	FY20E
Equity Capital	8.3	8.3	8.3	8.3
Reserve and Surplus	97.3	114.0	148.8	207.1
Total Shareholders funds	105.6	122.3	157.1	215.4
Total Debt	66.7	76.7	86.7	86.7
Deferred Tax Liability	6.4	6.4	6.4	6.4
Other Non Current Liabilities	1.8	1.8	1.8	1.8
Others Total	8.1	8.1	8.1	8.1
Total Liability	180.4	207.1	251.9	310.2
Gross Block	180.7	210.7	240.7	275.7
Accumulated Depreciation	86.6	102.0	121.5	144.9
Net Block	94.1	108.7	119.1	130.7
Capital WIP	3.7	3.7	3.7	3.7
Total Fixed Assets	97.7	112.3	122.8	134.4
Liquid Investments	0.2	0.2	0.2	0.2
Current Asset				
Inventory	27.5	33.7	47.6	67.3
Debtors	46.4	58.4	82.0	112.1
Loans and Advances	20.9	21.6	26.0	35.1
Cash	3.6	3.3	5.0	3.8
Total Current Assets	98.5	117.0	160.6	218.2
Current Liability				
Creditors	22.4	29.5	41.6	56.0
Provisions	3.0	4.7	6.7	9.0
Total Current Liabilities	25.4	34.3	48.3	65.0
Net Current Assets	73.1	82.8	112.3	153.2
Other Assets	9.4	11.8	16.6	22.4
Total Asset	180.4	207.1	251.9	310.2

Source: Company, ICICI Direct Research

Key ratios

(Year -End -March)	FY17	FY18E	FY19E	FY20E
Per Share Ratio				
EPS	18.6	26.3	44.8	74.0
Cash EPS	33.6	44.8	68.3	102.1
DPS	0.0	3.0	3.0	4.0
BV	126.9	147.0	188.8	258.9
Operating ratio				
EBITDA Margin	16.8	17.1	17.6	18.5
PAT Margin	6.3	7.1	8.6	10.5
Return Ratios				
RoCE	17.2	19.9	24.5	31.2
RoE	14.6	17.9	23.7	28.6
RoIC	16.9	19.8	25.1	30.2
Valuatin Ratios				
EV / EBITDA	29.9	23.5	16.3	11.6
P/E	75.4	53.2	31.2	18.9
EV/Net Sales	5.0	4.0	2.9	2.1
Mcap/sales	4.8	3.8	2.7	2.0
P/BV	11.0	9.5	7.4	5.4
Turnover Ratios				
Gross Block turnover	1.4	1.5	1.8	2.1
Inventory Days	41.1	40.0	40.0	42.0
Debtor Days	69.3	69.3	69.0	70.0
Creditor Days	33.4	35.0	35.0	35.0
Solvency Ratios				
Debt/Equity	0.6	0.6	0.6	0.4
Debt/Ebitda	1.6	1.5	1.1	0.8
Current Ratio	3.7	3.3	3.2	3.3
Quick Ratio	2.7	2.3	2.2	2.3

Source: Company, ICICI Direct Research

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