

# **N**ano **N**ivesh



## 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

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**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 through limit orders to avoid volatile fluctuations, both while putting a buy and sell order in these stocks.

## Camlin Fine Sciences (CAMFIN)

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Camlin Fine Sciences (CFS) is the world's largest manufacturer and marketer of food grade antioxidants TBHQ and BHA with ~50% and ~70-80% market share, respectively. Going ahead, CFS' focus would be on capitalising on the industrial segment (Diphenol downstream products) with the introduction of newer products in the industrial division.

### Highlights:

- **Dominant position in global antioxidant industry:** The market share of >50% in TBHQ and 70% in BHA makes CFS the dominant leader in the global food antioxidant (prevention of rancidity in edible oil & fats to increase shelf life of packaged foods) industry. CFS' capacity has got ramped up at a CAGR of 12% from ~2500 MTPA in FY09 to 4500 MTPA in FY14
- **Backward integration: Stability for margins/customer relationship:** In order to secure Hydroquinone (HQ, key raw material) to secure supplies and combat erratic price fluctuations, CFS acquired Borregaard Italy (CFS Europe now), with an installed capacity of 8000 MT, for €1.4 million in March 2011. The acquisition, therefore, led to a significant improvement in EBITDA margins that recovered from 8.7% in FY12 to 12.2% in FY14. Further, CFS via de-bottlenecking has increased capacity by 50% to 12000 MTPA
- **Growth to be led by new products in Diphenol downstream:** The acquisition of CFS Europe has also opened the gates for Catechol and Diphenol downstream products (Catechol is a by-product derived in the production of HQ). Given the low yield on sale of Catechol, CFS has been working on capitalising on the downstream products of Catechol such as Vanillin, Guaiacol, TBC, etc. The market size of these products is estimated at ₹ 2000 crore. This can be a scalable opportunity for CFS as industry segment sales (₹ 77 crore in FY14) are just 4% of the opportunity
- **Strong performance warrants re-rating:** Strong revenue, PAT CAGR of 23%, 22%, respectively, (in FY14-16E) on the back of new product launches in Diphenol downstream segment, entry into blends business (forward integration for TBHQ, BHA business) and consistent margins (12.5-12.8%) are expected to lead to a re-rating of the investment multiples in the range of 12-14x on FY16E EPS of ₹ 9.1.

Price

₹ 91

Recommendation

Buy

Fair Value

₹ 110 - 128

### Key risks-

#### Business specific

**Penetration into newer geographies:** Going ahead, CFS' focus would on capitalising on the industrial segment (Diphenol downstream products) with the introduction of newer products in the industrial division. We highlight that given the fact that the abovementioned segment would entail newer geographies, the success of the segment would hinge on penetration into those newer geographies.

#### Company specific

**Longer working capital cycle may increase debt burden:** CFS has a net working capital (ex-cash) of 85 days. Consequently, the company has a working capital debt of ~₹ 120 crore (out of total consolidated debt of ₹ 160 crore). While topline growth, going ahead, is expected at ~23% over FY14-16E (much lower than historical topline growth of ~37.3% over FY09-14), any further stretch in working capital could pose a key risk to the company's balance sheet (current net debt to equity at 1.5x).

## Description

Camlin Fine Sciences (CFS) is the world's largest manufacturer and marketer of food grade antioxidants tertiary butyl hydroquinone (TBHQ) and butyl hydroxy anisole (BHA) with ~50% and ~70-80% market share, respectively. CFS is mainly present in two segments – food and industrial. The food division focuses on enhancing the shelf life of food products that contain fats and oils with products such as TBHQ and BHA while the industrial division has products such as Diphenol downstream products such as Vanillin, Tert-Butyl Catechol (TBC), Guaiacol, Veratrole, etc. made from Catechol.

## History and track record

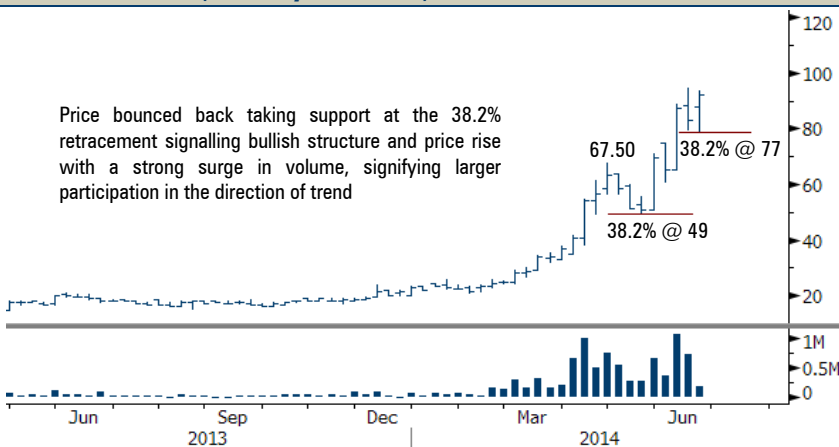
- Camlin Fine Sciences (erstwhile Camlin Fine Chemicals), the fine chemical and pharmaceutical division of Camlin (now Kokuyo Camlin), was demerged from its parent in December, 2006
- CFS caters to two segments, namely the food (average revenue share in standalone sales at 85% over FY11-14) and the industrial division
- It started the process of integration in FY11 with the acquisition of Borregaard Italia SpA. This critical backward integration enabled it to have a firm control over prices as well as supply of Hydroquinone (HQ), the basic raw material
- The topline and bottomline have grown at 37.3% and 63.6% CAGR, respectively, over FY09-14 aided mainly by its backward integration through the stable availability of its key raw materials HQ and consistent gains in TBHQ+BHA market share leading to 1.8x capacity increase over FY09-14
- CFS has exhibited strong average dividend payout of 56.5% over FY09-12. However, with the unfolding growth trajectory, the same has moderated to 17.7% over FY13-14
- The company had come out with a 3:5 right issues of shares in July, 2010 and had a share split of 1:5 in February, 2012. The promoters' shareholding over FY11-14 has risen from 50.8% to 52.6% currently

## Earning estimates

| ₹ crore           | FY12  | FY13  | FY14  | FY15E | FY16E |
|-------------------|-------|-------|-------|-------|-------|
| Net Sales         | 335.3 | 373.6 | 508.7 | 610.4 | 763.0 |
| EBITDA            | 29.3  | 47.0  | 61.6  | 76.3  | 97.7  |
| EBITDA margin (%) | 8.7   | 12.6  | 12.1  | 12.5  | 12.8  |
| PAT               | 3.8   | 15.1  | 28.7  | 31.6  | 42.9  |
| EPS               | 0.8   | 3.2   | 6.1   | 6.7   | 9.1   |

Source: Company, ICICIdirect.com Research

## Technical Chart (Monthly Bar chart)



Source: Bloomberg, ICICIdirect.com Research

## Stock data

|                                    |           |
|------------------------------------|-----------|
| Market Capitalization (₹ crore)    | 434.3     |
| 52 Week High / Low (₹)             | 95/ 15    |
| Promoter Holding (%)               | 52.6      |
| FII Holding (%)                    | 0.0       |
| DII Holding (%)                    | 0.0       |
| Dividend Yield (%)                 | 0.8       |
| 12M / 6M stock return (%)          | 482 / 440 |
| Debt (₹ crore)                     | 160.0     |
| Cash and Cash Equivalent (₹ crore) | 15.8      |
| Enterprise Value (₹ crore)         | 578.4     |
| 5 Year Revenue CAGR (%) (FY09-14)  | 37.3      |
| 5 Year EBITDA CAGR (%) (FY09-14)   | 36.2      |
| 5 Year PAT CAGR (%) (FY09-14)      | 63.6      |

## Valuation table

|             | FY13 | FY14 | FY15E | FY16E |
|-------------|------|------|-------|-------|
| P/E         | 28.6 | 15.1 | 13.7  | 10.1  |
| Target P/E  | 33.9 | 17.9 | 16.3  | 12.0  |
| EV / EBITDA | 11.4 | 9.4  | 7.5   | 6.0   |
| P/BV        | 6.6  | 4.6  | 3.6   | 2.7   |
| RoNW        | 23.1 | 30.2 | 25.9  | 27.1  |
| RoCE        | 17.5 | 19.5 | 22.7  | 24.2  |

Source: ICICIdirect.com Research

## Quarterly performance (Standalone)

| (₹ crore)         | Q1FY14 | Q2FY14 | Q3FY14 | Q4FY14 |
|-------------------|--------|--------|--------|--------|
| Sales             | 77.9   | 94.6   | 91.2   | 110.6  |
| EBITDA            | 13.3   | 14.0   | 16.3   | 15.0   |
| EBITDA Margin (%) | 17.0   | 14.8   | 17.9   | 13.6   |
| Depreciation      | 2.1    | 2.1    | 2.8    | 2.3    |
| Interest          | 5.0    | 4.8    | 6.4    | 6.2    |
| Other Income      | 0.8    | 0.5    | 0.4    | 0.6    |
| PAT               | 5.0    | 5.8    | 4.8    | 3.4    |
| EPS (₹)           | 0.9    | 1.1    | 0.9    | 0.6    |

Source: ICICIdirect.com Research

## Shareholding trend (%)

| Key Shareholders  | Q1FY14 | Q2FY14 | Q3FY14 | Q4FY14 |
|-------------------|--------|--------|--------|--------|
| Promoter group    | 52.7   | 52.8   | 52.7   | 52.6   |
| Non-institutional | 47.3   | 47.2   | 47.3   | 47.4   |

Source: ICICIdirect.com Research

## Technical View

The stock has been in a secular uptrend forming higher peak and higher trough in all time frame. It has seen a multifold rally since the bottoming out in August 2013 (15.00) going from strength to strength.

Recently in May 2014, the stock bounced back taking support at the 38.2% retracement of the previous major up move from ₹ 21 to ₹ 67.50 signalling a bullish structure and continuance of the positive momentum in the short-term.

Volume behaviour during the recent rally signals larger participation in the stock as the up move was accompanied by almost seven times the 52 week average volume (1.3 lakh shares per week).

## What's the story?

Camlin Fine Sciences (CFS) has come a long way by maintaining its dominant market share in the global antioxidants industry [50% share in Tertiary Butyl Hydroquinone (TBHQ) and 70-80% share in Butyl Hydroxy Anisole (BHA)]. To break into newer geographies and enhance its product offering, CFS bifurcated its business into two strategic segments: a) food division- The division focuses on enhancing the shelf life of food products containing fats & oils with products such as TBHQ & BHA. The food division has been growing at a healthy CAGR of 24% while average revenue share, in standalone sales, was 85% over FY11-14. b) The industrial segment is still in a nascent stage as revenues for FY14 were at ₹ 77 crore or 21% of standalone sales. Going ahead, CFS' focus would be to capitalise on the industrial segment (Diphenol downstream products) with the introduction of newer products in the industrial division. CFS has already launched three new high potential products in FY13, namely Vanillin, TBC and Guaiacol.

A key milestone in CFS' history was securing raw material supply and becoming 100% backward integrated in procuring Hydroquinone (HQ), which forms ~55% of the raw material cost. Given the tight demand-supply dynamics, prices of HQ appreciated more than 100% in FY11. Hence, to shield EBITDA margins and customer relationships, CFS acquired Borregaard Italia SpA (CFS Europe), one of the five global manufacturers of HQ with a capacity of 8,000 MTPA, for a sum of ₹1.4 million and spent an additional ₹1 million on overhauling the plant. The acquisition led to a significant improvement in EBITDA margins, which recovered from 8.7% in FY12 to 12.2% in FY14. Furthermore, CFS via de-bottlenecking also increased the capacity by 50% to 12,000 MTPA in FY14, which can further provide volume growth impetus for CFS as they have the lever to manufacture TBHQ and BHA up to 7000 MTPA (5100 MTPA licensed capacity and 2000 MTPA via contract manufacturing).

Given the sizeable presence in the foods division, CFS now focuses on improving the yield of HQ from Phenol as CFS has been continuously working on its research & development (R&D, average R&D spend has been around 0.7% of standalone sales). CFS now aims to improve the current yield ratio of 45:55 (HQ: Catechol) in favour of HQ by raising the yield ratio to 65:35. This will allow CFS to forward integrate into customised antioxidant blends, which have superior realisation and market size. The base business i.e. TBHQ and BHA industry is expected to grow at ~10% and ~3%, respectively. CFS has already set up a blending plant in Brazil, which is currently the fastest growing blend market.

The big growth driver, in our view, will be a ramp up of revenues in the Diphenol downstream products. The potential products include, Vanillin (market: 20000 MTPA; realisation: ~\$13/kg), Guaiacol (market 5000 MTPA; realisation: ~\$5.5/kg), Veratrole (market: 2000 MTPA; realisation: ~\$6/kg) and TBC (market: 5000 MTPA; realisation ~\$5.5/kg), going ahead, as Catechol is in a glut situation with lower realisation (\$3-3.5/kg). Back of the envelope calculations peg the market size at ₹ 2000 crore. This can be a robust opportunity for CFS to scale up as current industrial segment revenues contribute merely ~₹ 80 crore (~4% of the opportunity size). CFS envisaged sale of 2000 MTPA of vanillin (contract manufacturing in China) by FY16E, which alone has the potential to add ₹ 150 crore alone to consolidated revenues.

## Strong performance warrants re-rating

CFS has exhibited a strong financial performance, aided mainly by its backward integration, which boosted its margins and topline growth through stable availability of its key raw material HQ. The leverage, which had grown to 2.2x in FY12 (vs. 1.5x in FY11), led by the acquisition of CFS Europe, also returned to 1.5x given the strong earning growth (175.2% over FY12-14).

Going ahead, we expect topline growth of 20% and 25% in FY15E and FY16E, respectively, on the back of strong growth in the industrial segment (expected to grow to ~₹ 200 crore in FY16E vs. ~₹ 77 crore currently) through the foray into downstream products, namely Vanillin, Guaiacol, Veratrole, etc. We expect the improvement in the operating margin to continue from 12.1% in FY14 to 12.8% in FY16E as we believe industry segment revenues have the potential to grow 2.5x over FY14-16E. Consequently, we expect a strong PAT CAGR of 22.4% over FY14-16E to ₹ 42.9 crore. RoEs are expected to remain strong in the range of 26-27%.

Historically, CFS has traded at an average one year forward P/E of ~9.1x. We highlight that given the size of the company, the multiples had always remained at a modest level. However, given the size of the opportunity, going ahead (~₹ 2000 crore in the Diphenol downstream product), the dominant position in the global antioxidant market, strong earnings growth and return ratios, CFS is well poised for a re-rating. With increasing scale and growth momentum, we use the PEG ratio as the right valuation yardstick and ascribe 0.5-0.7x on the earnings CAGR. Hence, we arrive at a fair value of ₹ 110 – 128 based on a P/E multiple of 12-14x on FY16E EPS of ₹ 9.1/share.

## Financial summary

| Profit and loss statement   |       | ₹ Crore |       |       |  |
|-----------------------------|-------|---------|-------|-------|--|
| ₹ crore                     | FY13  | FY14    | FY15E | FY16E |  |
| Net Sales                   | 373.6 | 508.7   | 610.4 | 763.0 |  |
| Other Income                | 10.2  | 9.7     | 3.0   | 3.0   |  |
| Total Revenue               | 383.8 | 518.3   | 613.4 | 766.0 |  |
| Raw Material Expenses       | 164.6 | 275.7   | 335.7 | 419.7 |  |
| Employee Expenses           | 30.2  | 35.5    | 39.7  | 47.3  |  |
| Other Expenses              | 131.8 | 135.8   | 158.7 | 198.4 |  |
| Total Operating Expenditure | 326.6 | 447.0   | 534.1 | 665.3 |  |
| EBITDA                      | 47.0  | 61.6    | 76.3  | 97.7  |  |
| Interest                    | 20.1  | 24.7    | 28.1  | 34.3  |  |
| PBDT                        | 37.1  | 46.7    | 51.2  | 66.4  |  |
| Depreciation                | 13.6  | 11.8    | 12.2  | 13.4  |  |
| PBT                         | 23.5  | 34.9    | 39.0  | 53.0  |  |
| Total Tax                   | 8.4   | 6.1     | 7.4   | 10.1  |  |
| PAT before MI               | 15.1  | 28.7    | 31.6  | 42.9  |  |
| Minority Interest           | -     | -       | -     | -     |  |
| Profit from Associates      | (0.0) | (0.0)   | -     | -     |  |
| PAT                         | 15.1  | 28.7    | 31.6  | 42.9  |  |
| EPS                         | 3.2   | 6.1     | 6.7   | 9.1   |  |

Source: Company, ICICIdirect.com Research

| Balance sheet            |       | ₹ Crore |       |       |  |
|--------------------------|-------|---------|-------|-------|--|
| ₹ crore                  | FY13  | FY14    | FY15E | FY16E |  |
| Liabilities              |       |         |       |       |  |
| Equity Capital           | 9.4   | 9.4     | 9.4   | 9.4   |  |
| Reserve and Surplus      | 56.0  | 85.7    | 112.6 | 149.0 |  |
| Total Shareholders funds | 65.3  | 95.1    | 122.0 | 158.5 |  |
| Minority Interest        | -     | -       | -     | -     |  |
| Total Debt               | 125.7 | 160.0   | 160.0 | 190.0 |  |
| Deferred Tax Liability   | 3.2   | (4.0)   | (4.0) | (4.0) |  |
| Total Liabilities        | 194.2 | 251.1   | 277.9 | 344.4 |  |
| Assets                   |       |         |       |       |  |
| Total Gross Block        | 251.0 | 284.9   | 294.9 | 324.9 |  |
| Less: Acc Dep            | 167.8 | 179.5   | 191.7 | 205.2 |  |
| Net Block                | 83.3  | 105.4   | 103.2 | 119.7 |  |
| Total CWIP               | 0.8   | 0.8     | 0.8   | 0.8   |  |
| Investments              | 1.2   | 1.2     | 1.2   | 1.2   |  |
| Inventory                | 149.0 | 109.2   | 128.9 | 161.1 |  |
| Debtors                  | 87.1  | 101.3   | 119.6 | 146.3 |  |
| Loans and Advances       | 21.4  | 23.8    | 28.5  | 35.7  |  |
| Cash                     | 25.7  | 15.8    | 22.8  | 40.4  |  |
| Other Current Assets     | 1.0   | 8.1     | 8.1   | 8.1   |  |
| Total Current Assets     | 284.2 | 258.2   | 307.9 | 391.6 |  |
| Current Liabilities      | 162.7 | 99.4    | 117.3 | 146.6 |  |
| Provisions               | 12.6  | 15.1    | 17.8  | 22.3  |  |
| Net Current Assets       | 108.9 | 143.7   | 172.8 | 222.7 |  |
| Total Assets             | 194.2 | 251.1   | 277.9 | 344.4 |  |

Source: Company, ICICIdirect.com Research

| Cash flow statement                 |        | ₹ Crore |        |        |  |
|-------------------------------------|--------|---------|--------|--------|--|
| ₹ crore                             | FY13   | FY14    | FY15E  | FY16E  |  |
| Profit after Tax                    | 15.1   | 28.7    | 31.6   | 42.9   |  |
| Depreciation                        | 13.6   | 11.8    | 12.2   | 13.4   |  |
| Interest                            | 20.1   | 24.7    | 28.1   | 34.3   |  |
| Cash Flow before wc changes         | 48.8   | 65.2    | 71.9   | 90.6   |  |
| Net Increase in Current Assets      | (60.4) | 16.0    | (42.7) | (66.1) |  |
| Net Increase in Current Liabilities | 70.7   | (60.7)  | 20.6   | 33.8   |  |
| Net cash flow from op activities    | 59.1   | 20.5    | 49.8   | 58.3   |  |
| (Purchase)/Sale of Fixed Assets     | (21.6) | (33.9)  | (10.0) | (30.0) |  |
| Other Investments                   | 0.0    | -       | -      | -      |  |
| Others                              | (0.2)  | (7.2)   | -      | -      |  |
| Net Cash flow from Inv Activities   | (21.7) | (41.1)  | (10.0) | (30.0) |  |
| Change in Equity Capital            | 0.0    | 0.1     | -      | -      |  |
| Change in Loan Fund                 | 0.9    | 34.3    | -      | 30.0   |  |
| Interest                            | (20.1) | (24.7)  | (28.1) | (34.3) |  |
| Others                              | (2.6)  | 1.0     | (4.7)  | (6.4)  |  |
| Net Cash flow from Fin Activities   | (21.9) | 10.7    | (32.8) | (10.7) |  |
| Net Cash flow                       | 15.5   | (9.9)   | 7.0    | 17.6   |  |
| Opening cash & cash equivalent      | 10.2   | 25.7    | 15.8   | 22.8   |  |
| Closing cash & cash equivalent      | 25.7   | 15.8    | 22.8   | 40.4   |  |

Source: Company, ICICIdirect.com Research

| Key ratios                      |  | FY13 | FY14 | FY15E | FY16E |
|---------------------------------|--|------|------|-------|-------|
| Per Share Data                  |  |      |      |       |       |
| EPS                             |  | 3.2  | 6.1  | 6.7   | 9.1   |
| Cash EPS                        |  | 6.1  | 8.6  | 9.3   | 11.9  |
| BV                              |  | 13.9 | 20.2 | 25.9  | 33.6  |
| Operating profit per share      |  | 10.0 | 13.1 | 16.2  | 20.7  |
| Operating Ratios                |  |      |      |       |       |
| EBITDA / Total Operating Income |  | 12.6 | 12.1 | 12.5  | 12.8  |
| PAT / Total Operating Income    |  | 4.0  | 5.6  | 5.2   | 5.6   |
| Return Ratios                   |  |      |      |       |       |
| RoE                             |  | 23.1 | 30.2 | 25.9  | 27.1  |
| RoCE                            |  | 17.5 | 19.5 | 22.7  | 24.2  |
| RoIC                            |  | 19.9 | 21.3 | 25.2  | 27.8  |
| Valuation Ratios                |  |      |      |       |       |
| EV / EBITDA                     |  | 11.4 | 9.4  | 7.5   | 6.0   |
| P/E                             |  | 28.6 | 15.1 | 13.7  | 10.1  |
| EV / Net Sales                  |  | 1.4  | 1.1  | 0.9   | 0.8   |
| Market Cap / Sales              |  | 1.2  | 0.9  | 0.7   | 0.6   |
| Price to Book Value             |  | 6.6  | 4.6  | 3.6   | 2.7   |
| Turnover Ratios                 |  |      |      |       |       |
| Asset turnover                  |  | 2.0  | 2.3  | 2.3   | 2.5   |
| Debtors Turnover Ratio          |  | 4.3  | 5.0  | 5.1   | 5.2   |
| Creditors Turnover Ratio        |  | 2.3  | 5.1  | 5.2   | 5.2   |
| Solvency Ratios                 |  |      |      |       |       |
| Debt / Equity                   |  | 1.9  | 1.7  | 1.3   | 1.2   |
| Current Ratio                   |  | 1.6  | 2.3  | 2.3   | 2.3   |
| Quick Ratio                     |  | 0.8  | 1.3  | 1.3   | 1.4   |
| Debt / EBITDA                   |  | 2.7  | 2.6  | 2.1   | 1.9   |

Source: Company, ICICIdirect.com Research

## RATING RATIONALE

ICICIdirect.com endeavours to provide objective opinions and recommendations. ICICIdirect.com assigns ratings to its stocks according to their notional target price vs. current market price and then categorises them as Strong Buy, Buy, Hold and Sell. The performance horizon is two years unless specified and the notional target price is defined as the analysts' valuation for a stock.

Strong Buy: > 15%/20% for large caps/midcaps, respectively, with high conviction;

Buy: > 10%/ 15% for large caps/midcaps, respectively;

Hold: Up to +/-10%;

Sell: -10% or more;



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## ANALYST CERTIFICATION

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