May 23, 2016

Apcotex Industries (APCLAT)

₹ 283

Growth hinges on acquisition turnaround...

Apcotex Industries reported its Q4FY16 results, which were marginally subdued on a standalone basis. Consolidated numbers are not comparable due to the acquisition of 'Omnova Solutions India Pvt Ltd (OSIPL)' in the last quarter.

On a standalone basis, Q4FY16 revenues came in at ₹ 67.9 crore, down 11.9% YoY on account of a volume decline coupled with lower realisations. Raw material costs increased to 64.9% in Q4FY16 vs. 62.9%in Q4FY15 leading to lower realisations. EBITDA came in at ₹ 8.9 crore, down 18.9% YoY. EBITDA margins came in at 13.1% vs. 14.2% YoY on account of lower realisation and higher employee expenses. The company reported a PAT of ₹ 8.6 crore, up 48% YoY, on account on higher other income.

Last quarter, Apcotex Industries acquired a 100% stake in 'Omnova Solutions India Pvt Ltd (OSIPL)' in an all-cash deal (acquisition funded through internal accruals). The enterprise value of this transaction was ₹ 36 crore. The company plans to spend ₹ 40 crore on the planned acquisition. OSIPL (renamed as Apcotex Solutions India Pvt Ltd) is the only producer of nitrile rubber in India and the only second producer of high styrene rubber after Apcotex. The company plans to get tax benefits worth ₹ 10-14 crore due to accrued losses of the acquired company in addition to working capital benefits due to operational synergies.

Consolidated revenues came in ₹ 96 crore for Q4FY16, thus working out to ~ ₹ 28 crore topline for the acquired company. EBITDA came in at 11.6% for the quarter. Our calculations suggest ~7.1% margin for the acquired entity. PAT came in ₹ 22.4 crore mostly due to deferred tax assets created on account of accumulated unabsorbed depreciation. The company has declared a dividend of ₹ 4.5/share.

Utilisation to remain stable; next trigger to come from acquisition led growth

Our discussion with the management suggests that for FY17E, overall utilisation levels will be ~75% on a consolidated level. FY17E will see improved demand over FY16E mostly due to an up-tick in economic activity in domestic markets. AIL's debt free status post-acquisition, sound operating cash flow generation from the standalone business of ~₹ 50 crore over the next two years (FY17E & FY18E) will provide adequate cushion to the business model. However, we believe that successful turnaround of this acquisition holds the key for any future re-rating of the company. Thus, for now, we maintain the valuation multiple at 18x FY18E EPS of ₹ 18.4, to arrive at a target price of ₹ 330. We recommend **BUY**.

Rating matrix

Rating	:	Buy
Target	:	₹ 330
Target Period	:	12 months
Potential Upside	:	17%

What's changed?

Target	Changed from ₹ 230 to ₹ 330
EPS FY17E	Changed from ₹ 14.4 to ₹ 13.7
EPS FY18E	Introduced at ₹ 18.4
Rating	Changed from Hold to Buy

Quarterly performance

	Q4FY16	Q4FY15	YoY (%)	Q3FY16	QoQ (%)
Revenue	96.1	77.1	24.6	65.7	46.2
EBITDA	10.9	11.0	(0.8)	9.5	14.2
EBITDA (%)	11.3	14.2	-289 bps	14.5	-318 bps
PAT	22.4	5.8	288.5	4.7	380.0

Key financials

₹ Crore	FY15	FY16E	FY17E	FY18E
Revenues	355.1	296.5	469.0	505.6
EBITDA	41.5	39.4	47.1	60.9
Net Profit	24.7	38.5	28.3	38.1
EPS (₹)	11.9	18.6	13.7	18.4

Valuation summary

	FY15	FY16E	FY17E	FY18E
P/E	23.8	15.2	20.7	15.4
Target P/E	24.7	15.8	21.5	16.0
EV / EBITDA	13.8	14.6	12.4	9.7
P/BV	5.9	3.1	2.9	2.6
RoNW (%)	24.7	20.6	13.9	16.7
RoCE (%)	33.0	19.6	17.7	20.6

Stock data

Particular	Amount
Market Capitalization (₹ Crore)	610
Total Debt (FY17E) (₹ Crore)	27.0
Cash and Investments (FY17E) (₹ Crore)	12.0
EV (FY17E) (₹ Crore)	582
52 week H/L	360 / 182
Equity capital (₹ Crore)	10.4
Face value (₹)	5.0

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Variance analysis – Standalone comparison

	Q4FY16	Q4FY16E	Q4FY15	YoY (%)	Q3FY16	QoQ (%)	Comments
Total Revenue	68.0		77.1	-11.9	65.7	3.4	Revenues declined YoY on account of lower volumes together with lower realisations. Volume degrowth due to higher imports from Europe, which, in turn, was due to lower product prices
Raw materials costs	43.6		48.3	-9.8	42.2	3.3	
Employees Cost	3.8		3.5	9.5	3.9	-1.1	
Other Expenses	11.7		14.4	-18.7	10.1	15.2	Lower other expenses on account of operational efficiencies
Total Expenditure	59.1		66.2	-10.7	56.2	5.2	
EBITDA	8.9		11.0	-18.9	9.5	-6.7	
EBITDA margins (%)	13.1		14.2	-113 bps	14.5	-142 bps	Lower margins due to lower realisations on account of a drop in prices
Depreciation	2.2		2.2	-1.0	2.2	-1.1	
Interest	0.7		0.6	25.4	0.8	-6.7	
Other Income	5.2		0.6	715.6	0.3	1,593.8	Higher other income on account of liquidation of on non-current investments ~₹ 30 crore. This was mostly used for funding the acquisition.
PBT after Exceptional Items	11.1		8.8	26.6	6.8	62.8	
Total Tax	2.6		3.0	-15.0	2.2	NA	
PAT	8.6		5.8	48.4	4.7	83.3	PAT was higher due to higher other income and lower taxes

Source: Company, ICICIdirect.com Research

Change in estimates

	FY17E			FY18E		
(₹ Crore)	Old	New	% Change	Old	New	% Change
Revenue	292.9	469.0	60.1		505.6	
EBITDA	42.5	47.1	10.9		60.9	
EBITDA Margin (%)	14.5	10.0	-445 bps		12.0	
PAT	25.9	28.3	9.4		38.1	
EPS (₹)	12.5	13.7	9.3		18.4	

Source: Company, ICICIdirect.com Research

Assumptions

			Current		Earlier	
	FY15	FY16	FY17E	FY18E	FY17E	FY18E
Sales Volume (tonnes)	49,000	47,000	61,000	65,000	57,950	
Capacity utilisation (%)	75	72	78	83	80	

Company Analysis

Acquisition – New growth driver

The company has acquired has acquired a 100% stake in Omnova Solutions India Pvt Ltd (OSIPL), the Indian arm of US-based specialty company Omnova Solutions Inc, for ₹ 36 crore. This is aligned to Apcotex' long term strategy to tap the full potential of the emulsion polymers industry, through organic and inorganic growth. Omnova Solutions is the only producer of nitrile rubber in India and only the second producer of high styrene rubber after Apcotex. Omnova Solutions has a factory in Valia (Gujarat), which it acquired in 2010 from France's Eliokem International. The French firm had bought the plant from Apar Industries in 2008.

The acquisition gives Apcotex an opportunity to grow in new adjacencies in emulsion polymers such as nitrile rubber, nitrile powder and nitrile/PVC blends, which find application in automotive components, rice de-husking rolls, rubber hoses, moulded rubber products, and other industrial products. Apcotex Industries plans to invest around additional ~₹ 40 crore in the acquired business in the short to medium term. The acquisition has been funded through internal accruals.

The management intends to leverage following synergies through this acquisition;

Cost optimization and financial synergies

The management intends to bring cost benefits via optimisation of the distribution network and reduction of common expenses. It also intends to bring in working capital efficiencies via contract renegotiations. The likely benefits due to working capital are expected to be in the range of ₹ 12-15 crore. The company is also likely to benefit on account of deferred tax benefit on account of accumulated losses of OSIPL. This will reduce the tax outgo at a the consolidated level to the tune of ₹ 10-14 crore in coming years. In Q4FY16, the company has already taken tax benefits to the tune of ₹ 11.4 crore.

Operational synergies

The company has been operating in the performance emulsion polymers industry for the past three decades. Hence, the management believes it will be able to bring-in manufacturing and operating synergies in the operations of the acquired company. The company's current capacity in synthetic rubber is at ~10,000 MTPA. OSIPL will add another ~9000 MTPA to this segment. Post the merger, the facilities are likely to be used for nitrile rubber (NBR). This will make the company the largest player in the synthetic rubber segment.

Product and customer expansion

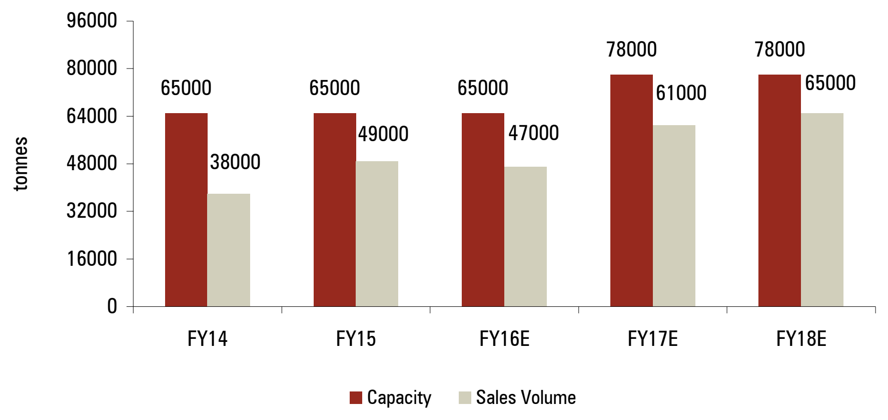
OSIPL acquisition is likely to give the company entry into new industries like automotive, footwear, LPG tubing and wire & cables. This is on the back of OSIPL nitrile latex products of which the company is the only producer. This segment is mostly catered through imports. The management intends to tap this opportunity via cost competitiveness through localised manufacturing.

AIL reported robust margins of 14.5% in Q3FY16 on the back of sustained lower input costs. We believe the company will continue to enjoy margins in the range of 13-14% over the coming years (13.9% in FY17E and 13.8% in FY18E). Positive commentary from the management, efficient inventory management, history of strong cash flow generation and improvement in business environment makes us reasonably confident about the management's ability to turn around the acquired company.

Capacity expansion to help drive topline growth

In the past five years (FY10-16), AIL witnessed capex growth of 13.1% CAGR, though mostly driven by the latex segment. Capacity in the synthetic latex segment has grown at ~17.4% CAGR in FY10-16, driven by steady growth rates in consuming industries like paper (~8.5-9%), construction (~15%) and carpet segment (8-12%). With the acquisition of OSIPL, the company has added capacity of 7000 MTPA in the high styrene rubber segment and 13000 MTPA capacity in nitrile rubber. Going forward, the company intends to scale the production of nitrile rubber, which is currently at ~7000 MTPA.

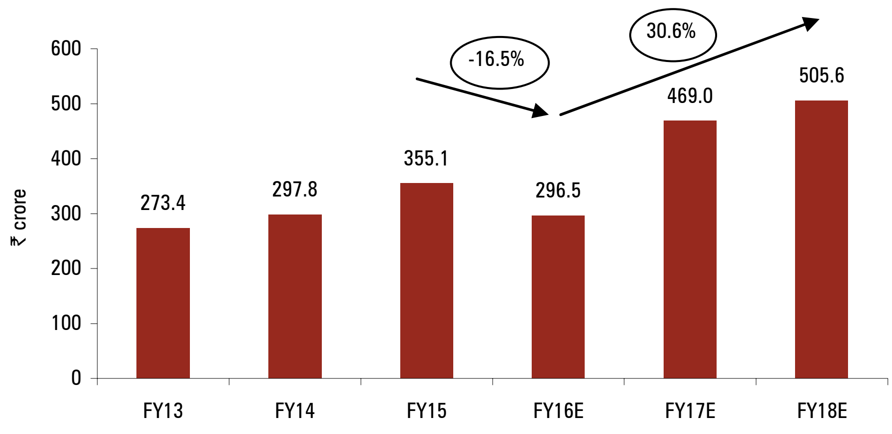
Exhibit 1: Capacity & sales volume trend



Source: Company, ICICIdirect.com Research

Revenues in FY16E declined year-on-year on account of lower volumes and lower realisations. Volumes declined due to higher imports from Europe, which, in turn, was due to drop in prices of products. However, going forward, we expect revenues to materially improve on account of OSIPL acquisition and growth in standalone business. Thus, revenues are expected to grow 30.2% CAGR over FY16E-18E on a consolidated basis.

Exhibit 2: Revenue trend, grows 2.8% FY12-FY17E

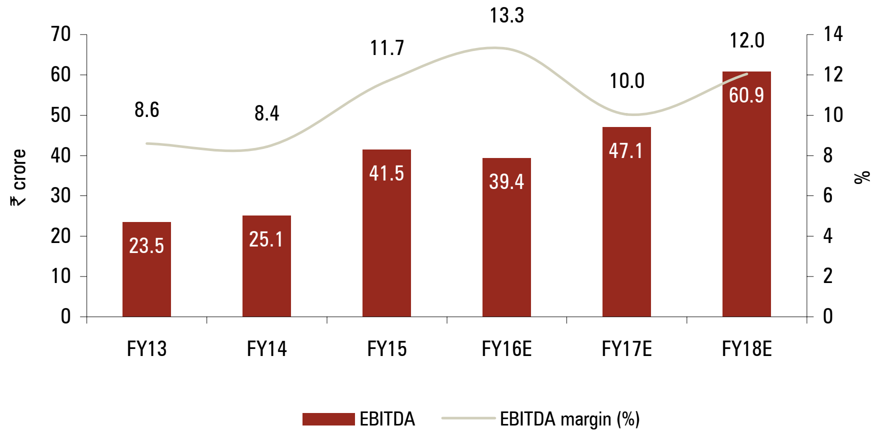


Source: Company, ICICIdirect.com Research

New products & client stickiness to help maintain margins

AIL keeps introducing newer products in the emulsion polymer segments, which helps it to command better margins. The company also offers customisation in new and existing products to its existing clients leading to higher client stickiness. Given the consistent product quality and higher client stickiness, AIL has been able to manage the volatility of raw material prices well. The same is evident from the fact that from quarterly pricing of input and final product, the company has been successful in getting a monthly revision of inputs and final products. Going forward, we expect consolidated EBITDA margins to drop to 10% in FY17E from 13.3% in FY16E. This is because of the lower EBITDA margins of the acquired company. Our calculations suggest EBITDA margins for OSIPL at 7%. Our interaction with management suggests that, the same could to be increased to ~10% by FY18E. Accordingly, on a consolidated basis, we estimate the company will report EBITDA margins of 12% in FY18E.

Exhibit 3: Trend in EBITDA & EBITDA margin

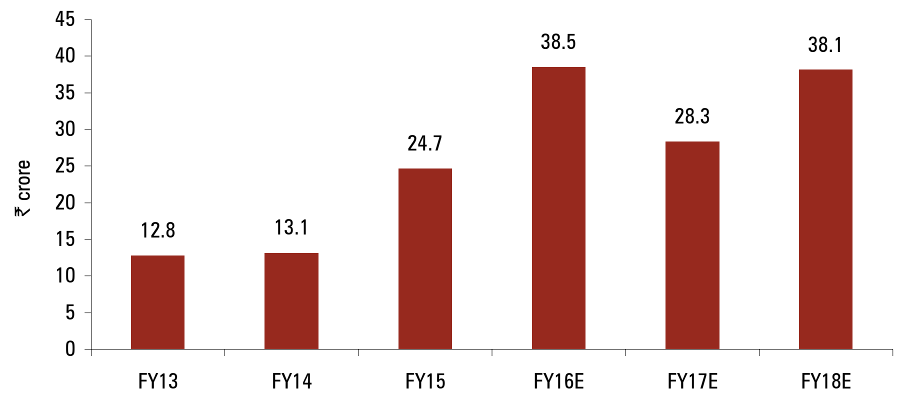


Source: Company, ICICIdirect.com Research

PAT expected to remain flat over FY16E-18E

We expect PAT to remain flat for FY16E-18E despite growth in EBITDA over the same period on account of lower other income and higher tax rate in FY17E and FY18E. AIL booked other income of ₹ 8.3 crore in FY16E on account of sale of non-current investments. The non-current investments, which are at ₹ 17.8 crore are unlikely to be liquidated any further, as working capital requirements are likely to be serviced by short-term loans or through internal accruals. Also, we have estimated tax rate for FY17E and FY18E at 25% and 28%, respectively (tax rate for FY16 at -7.4%). Any positive surprise on the tax rate front may lead to upside risks to our profitability estimates.

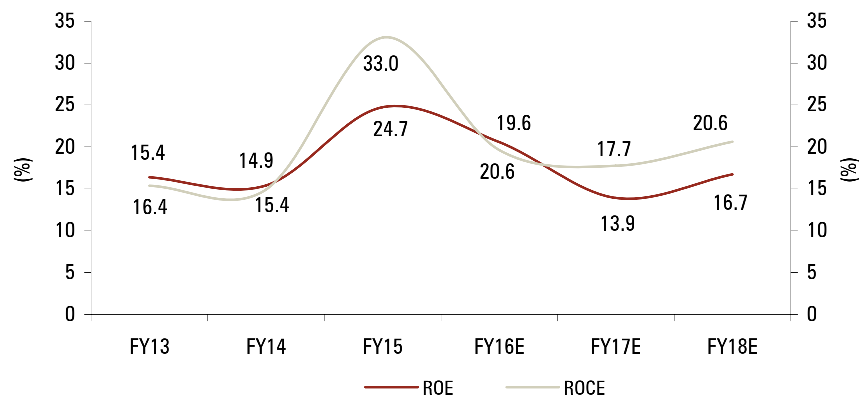
Exhibit 4: Trend in PAT



Source: Company, ICICIdirect.com Research

We expect a drop in return ratios in FY17E due the full effect of acquisition. However, we expect RoEs and RoCEs to recover to 16.7% and 20.6%, respectively, in FY18E.

Exhibit 5: Return ratios trend



Source: Company, ICICIdirect.com Research

Valuation

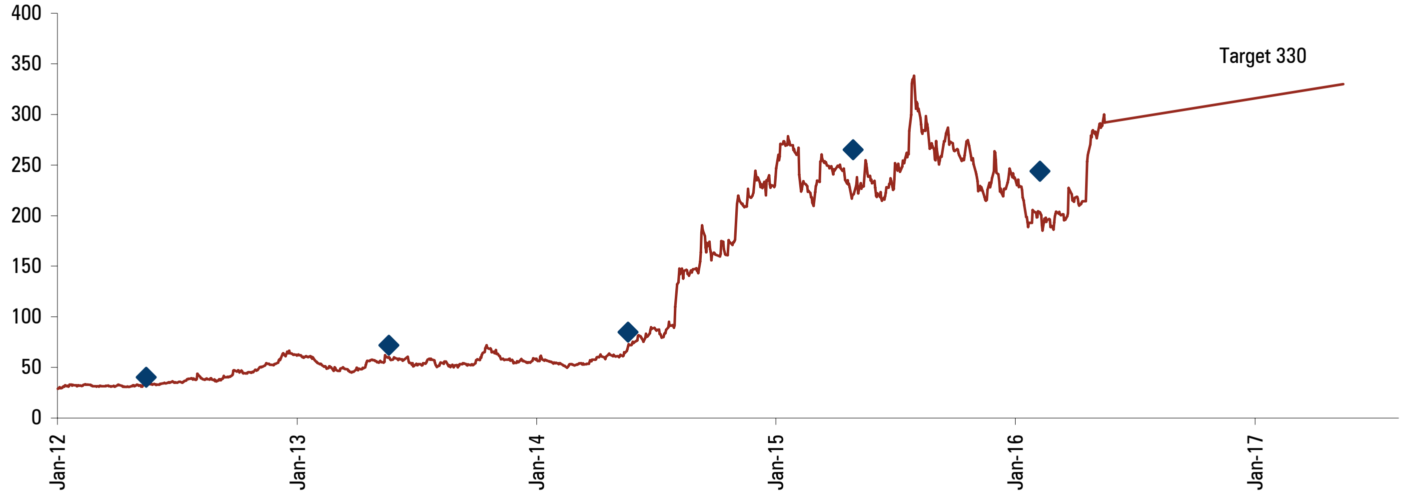
We believe the company will continue its growth momentum and take approximately two years to turnaround the acquired company. Accordingly, we have revised our EPS estimates for FY17E & FY18E to ₹ 13.7 and ₹ 18.4, respectively. AIL's low gearing ratio of 0.2x, strong operating cash flow generation of over ₹ 50 crore (FY17E-18E), progressive dividend policy and reasonable return ratios makes us reasonably confident on the business model, going ahead. Thus, we value the consolidated business of the company at 18x FY18E EPS of ₹ 18.4, to arrive at a target price of ₹ 330. We recommend **BUY**.

Exhibit 6: Valuations

Year	Sales (₹ Crore)	Sales Gr. (%)	EPS (₹)	EPS Gr. (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY15	355.1	19.3	11.9	87.8	23.8	13.8	24.7	33.0
FY16E	296.5	-16.5	18.6	56.1	15.2	14.6	20.6	19.6
FY17E	469.0	58.2	13.7	(26.5)	20.7	12.4	13.9	17.7
FY18E	505.6	7.8	18.4	34.5	15.4	9.7	16.7	20.6

Source: Company, ICICIdirect.com Research

Company snapshot



Source: Bloomberg, Company, ICICIdirect.com Research

Key events

Date/Year	Event
12-May	Increases synthetic latex capacity from 30,000 tonnes to 40,000 tonnes
13-May	Stock split in 1:1 ratio
14-May	Increases synthetic latex capacity from 40,000 tonnes to 55,000 tonnes
15-Apr	Strong FY15 performance with 20% YoY growth in revenues and 88% YoY growth in PAT led by expansion in EBIDTA margins by 320 bps primarily due to a decline in raw material prices & better inventory management. Increase in capacity utilisations & good volume growth also contributed to the strong performance
15-Jul	Apcotex board approves bonus in 1:1 ratio
16-Feb	Acquires 100% stake of Omnova Solutions India Pvt Ltd (OSIPL) at EV of ₹ 36 crore. The acquisition gives Apcotex an opportunity to grow in new adjacencies in emulsion polymers. The company plans to invest around additional ₹ 40 crore in the acquired business

Source: Company, ICICIdirect.com Research

Top 10 Shareholders

Rank	Name	Latest Filing Date	% O/S	Position	Change
1	Trivikram Investments & Trading Co., Ltd.	31-Dec-15	0.19	3.95M	0.0
2	Dhumraketu Investments & Trading Co., Ltd.	31-Mar-16	0.16	3.34M	+0.02M
3	Choksey (Atul Champaklal)	31-Mar-16	0.07	1.37M	-2.86M
4	Saldhar Investments & Trading Company Pvt. Ltd.	31-Dec-15	0.05	1.13M	0.0
5	Choksey (Parul Atul)	31-Dec-15	0.03	0.54M	0.0
6	Choksey (Abhiraj Atul)	31-Dec-15	0.02	0.35M	-0.17M
7	Shah (Mita Dipak)	31-Dec-15	0.01	0.24M	0.0
8	Kedia (Vijay Kishanlal)	31-Dec-15	0.01	0.23M	0.0
9	Apco Enterprises, Ltd.	31-Dec-15	0.01	0.11M	0.0
10	Choksey Chemicals Pvt. Ltd.	31-Dec-15	0.00	0.00M	0.0

Source: Reuters, ICICIdirect.com Research

Shareholding Pattern

(in %)	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
Promoter	57.6	57.6	57.6	57.6	57.9
FII	0.0	0.0	0.0	0.0	0.0
DII	0.0	0.0	0.0	0.0	0.0
Others	42.4	42.4	42.3	42.3	42.1

Recent Activity

Buys			Sells		
Investor Name	Value	Shares	Investor Name	Value	Shares
Dhumraketu Investments & Trading Co., Ltd.	+0.08M	+0.02M	Choksey (Atul Champaklal)	-9.25M	-2.86M
			Choksey (Abhiraj Atul)	-0.61M	-0.17M

Source: Company, ICICIdirect.com Research

Financial summary

Profit and loss statement (₹ Crore)

₹ crore	FY15	FY16E	FY17E	FY18E
Net Sales	353.4	294.9	466.7	503.1
Other Operating Income	1.7	1.5	2.3	2.5
Total Revenue	355.1	296.5	469.0	505.6
Raw Material Expenses	250.2	193.8	326.7	352.2
Employee Expenses	14.1	17.1	24.3	24.7
Other Expenses	49.3	46.1	70.9	67.9
Total Operating Expenditure	313.6	257.0	421.9	444.7
EBITDA	41.5	39.4	47.1	60.9
Interest	3.2	2.4	2.6	2.3
Other Income	5.6	8.3	4.0	6.0
PBDT	43.8	45.3	48.6	64.6
Depreciation	9.0	9.4	10.8	11.6
Total Tax	10.1	(2.7)	9.4	14.8
PAT	24.7	38.5	28.3	38.1
EPS	11.9	18.6	13.7	18.4

Source: Company, ICICIdirect.com Research

Cash flow statement (₹ Crore)

₹ crore	FY15	FY16E	FY17E	FY18E
Profit/(Loss) after taxation	24.7	38.5	28.3	38.1
Add: Depreciation & Amortization	9.0	9.4	10.8	11.6
Add: Interest Paid	3.2	2.4	2.6	2.3
Cash Flow before WC changes	36.9	50.4	41.7	52.1
(Increase)/Decrease in inventory	1.9	(28.1)	(14.5)	2.4
(Increase)/Decrease in debtors	3.0	(35.1)	19.6	(18.9)
Change in loans and advances	(1.1)	(6.3)	1.6	(1.3)
Net cash flow from operations	38.9	8.7	32.1	29.9
(Purchase)/Sale of Fixed Assets	(5.2)	(39.0)	(25.0)	(20.0)
Net CF from Investing Activities	(11.0)	(44.3)	(26.8)	(22.0)
Proceeds/(Repayment) Loans	(16.9)	(5.7)	10.0	10.0
Dividend and Dividend Tax	(8.7)	(10.9)	(12.1)	(13.3)
Interest Paid	(3.2)	(2.4)	(2.6)	(2.3)
Net CF from Financing Activities	(28.9)	40.9	(4.7)	(5.7)
Net Cash flow	(1.0)	5.2	0.6	2.3
Cash at the beginning	7.1	6.1	11.4	12.0
Cash at the end	6.1	11.4	12.0	14.2

Source: Company, ICICIdirect.com Research

Balance sheet (₹ Crore)

₹ crore	FY15	FY16E	FY17E	FY18E
Equity Capital	5.2	10.4	10.4	10.4
Reserve and Surplus	94.5	176.8	193.0	217.8
Total Shareholders funds	99.7	187.3	203.5	228.2
Secured Loan	22.8	17.1	27.1	37.1
Deferred Tax Liability	5.6	-	-	-
Total Liabilities	129	206	232	267
Gross Block	121.7	160.0	184.5	204.0
Accumulated Depreciation	58.5	67.8	78.6	90.3
Net Block	63.3	92.2	105.9	113.8
Capital WIP	1.9	2.5	5.0	5.0
Total Fixed Assets	65.1	94.7	110.9	118.8
Investments	30.8	17.8	19.6	21.5
Inventory	15.2	43.3	57.8	55.4
Debtors	48.7	83.8	64.2	83.1
Loans and Advances	11.8	18.0	16.4	17.7
Cash	6.1	9.8	12.0	14.2
Total Current Assets	86.2	162.7	158.9	179.5
Creditors	20.3	34.1	51.4	48.5
Provisions	11.1	16.4	15.4	14.5
Total Current Liabilities	51.2	82.4	66.8	63.0
Net Current Assets	35.0	80.3	92.1	116.5
Total Assets	129	206	232	267

Source: Company, ICICIdirect.com Research

Key ratios

	FY15	FY16E	FY17E	FY18E
Per Share Data				
Reported EPS	11.9	18.6	13.7	18.4
Cash EPS	16.2	23.1	18.9	24.0
BV per share	48.1	90.3	98.1	110.1
Dividend per share	7.0	4.5	5.0	5.5
Operating Ratios				
EBITDA / Net Sales	11.7	13.3	10.0	12.0
PAT / Net Sales	7.0	13.0	6.0	7.5
Return Ratios				
RoE	24.7	20.6	13.9	16.7
RoCE	33.0	19.6	17.7	20.6
RoIC	29.0	15.4	19.5	22.8
Valuation Ratios				
EV / EBITDA	13.8	14.6	12.4	9.7
P/E (Adjusted)	23.8	15.2	20.7	15.4
EV / Net Sales	1.6	1.9	1.2	1.2
Market Cap / Sales	1.7	2.0	1.3	1.2
Price to Book Value	5.9	3.1	2.9	2.6
Turnover Ratios				
Asset turnover	3.1	1.5	2.1	1.9
Solvency Ratios				
Debt / Equity	0.2	0.1	0.1	0.2
Current Ratio	2.6	3.0	2.2	2.6

Source: Company, ICICIdirect.com Research

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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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