

Nano **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

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.

EPC Industrie (EPCIND)

Chirag J Shah
shah.chirag@icicisecurities.com

Shashank Kanodia
shashank.kanodia@icicisecurities.com

EPC Industrie (EPC), a Mahindra & Mahindra (M&M) subsidiary, is a micro-irrigation system (MIS) and component manufacturer based out of Nashik, Maharashtra. The company was acquired by M&M in February 2011 and has been well capitalised over the years by M&M (net cash of ~₹ 8 crore in FY14 vis-à-vis net debt of ~₹ 30 crore in FY10). With savings arising from MIS & the government's thrust to augment its farmer reach, EPC is well poised for robust growth ahead.

Highlights

- **Micro-irrigation (MIS) - way forward for Indian agriculture:** MIS is essentially an irrigation technique wherein regulated quantum of water is applied to the most critical part of the plant i.e. roots. It is implemented through the drip & sprinkler irrigation techniques. The benefits of MIS vis-à-vis traditional method of irrigation include: increase in crop yield (~20-30%) and savings of labour (~30-50%), water (~30-40%) & power (~20-40%). Therefore, with increase in yields & associated savings, MIS is one of the most environment friendly way of increasing farm productivity
- **Under penetrated; niche segment; established players to gain:** The current domestic industry size of MIS is pegged at ~₹ 4000 crore with penetration merely at ~9% [6 million hectares (MH) out of the net irrigated area of ~70 MH]. The medium term potential of MIS is pegged at ~17 MH. It is essentially a niche segment with oligopolistic industry structure, the main players being Jain Irrigation, Netafim India & EPC Industrie
- **Strong parentage; balance sheet strength to lead growth:** The company was acquired by M&M in FY11 and has been well capitalised over the years. On the back of the government's thrust on augmenting MIS reach & strong parentage (M&M), we have built in sales, PAT CAGR of 14.8%, 34.5%, respectively, in FY14-17E, albeit on a low base. We expect EPC to clock sales of ₹ 264 crore in FY17E (₹ 175 crore in FY14) while PAT is expected at ₹ 19 crore in FY17E (₹ 8 crore in FY14). We value EPC at ₹ 215-240, i.e. 2.3-2.5x MCap/sales on FY17E sales of ₹ 264 crore. There also exists a possibility wherein the promoter group (M&M) may consolidate all its agri service businesses (crop care, seeds, fresh fruits exports) into EPC albeit in the long term. **Per se, the stock is a rare play on the MIS theme that can create wealth from a three to five year perspective, given trajectory of farmer awareness on MIS & subsequent capitalisation of opportunity by EPC**

Price

₹ 150

Recommendation

Buy

Fair Value

₹ 215-240

Key risks-

Business specific

Cut down of subsidy by Centre and state governments: Given the savings arising out of using MIS (namely water, power, fertilisers, labour etc.), a wide array of incentives are being provided by the central & state governments towards its implementation. The central government, in the past, has been promoting MIS through its flagship programme National Mission on Micro Irrigation (NMMI). It has been providing a subsidy of 50% (40% central government's share + 10% state government's share) of the cost of MIS to farmers (cap of 5 hectares per farmer). However, as of now, this stands reduced to 35% (25% central government's share + 10% state government's share). From April 1, 2014, NMMI has been subsumed under the National Mission on Sustainable Agriculture (NMSA) and is now being implemented as "On Farm Water Management" (OFWM). Any reduction in the quantum of subsidies by the central and/or the state governments may derail the growth of the MIS industry. (There does not exist any cap on the state government's subsidy share)

Company specific

Bloated account receivable days: Several state governments have been implementing MIS through project methods wherein subsidies are released in a prolonged manner, thereby leading to an increase in account receivables for domestic MIS players. The state following project method includes Andhra Pradesh & Tamil Nadu among others. EPC, however, has been cautious on this front with the company only focusing on Gujarat and Maharashtra where subsidies are released in a timely manner. However, given the huge potential domestically there exists a possibility of the management compromising the working capital discipline, which can lead to bloated account receivable days and leveraged capital structure, going forward

Description

EPC, a Mahindra & Mahindra (M&M) subsidiary, is a micro-irrigation system (MIS) and component manufacturer based out of Nashik, Maharashtra. The company was acquired by M&M in February 2011 (38% stake). Later, M&M increased its stake to 54.8% through a rights issue in FY13. EPC commands a market share of ~5% (sales of ₹ 175 crore in FY14) out of the total industry size, which is pegged at ~₹ 4000 crore as of FY14. EPC has recently ventured into the greenhouse farming & agri pumps segment with the aim of becoming a total agri solutions player.

History and track record

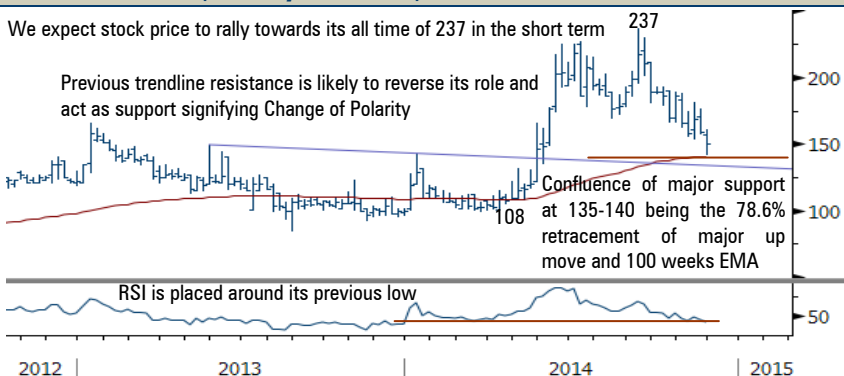
- EPC Industrie was established in 1981, by Mr K Khanna, a technocrat and an alumnus of IIT, Mumbai. EPC stands for Exomet Plastics & Chemicals. It pioneered micro-irrigation systems (MIS) in India in 1986 and was listed in December 1992; IPO @ ₹ 30/share
- On account of a working capital crunch (increase in announced subsidy by government without corresponding increase in grants), EPC filed for BIFR in 2001
- In 2006, it reached a one-time settlement (OTS) with its lenders and came out of BIFR in 2007. The company received a total investment of ₹ 40 crore, in 2007, from New York-based PE player Credit Renaissance Partners LLC
- Mahindra acquired EPC and made its foray into micro irrigation in February 2011 (through preferential issuance of equity shares @ ₹ 66/share). Credit Renaissance Partners' LLC stake got reduced from 43.6% to 32.4%. In FY11, the company clocked sales of ₹ 87 crore with EBITDA at ₹ 8 crore and PAT at ₹ 1 crore. However, post the acquisition by M&M, in FY12 the company clocked sales of ₹ 125 crore, EBITDA of ₹ 10 crore and PAT of ₹ 7 crore
- In FY13, through a rights issue (3:5; @ ₹ 40/share; total amount raised was ₹ 40 crore) M&M increased its stake further from 38.1% to 54.8%
- Currently, in FY15, EPC is registered in 15 states under subsidy programme in India. It has more than 600 channel partners and 11 regional offices & is expected to grow at a CAGR of 25% in FY14-17

Earning estimates

₹ crore	FY13	FY14	FY15E	FY16E	FY17E
Net Sales	161.4	174.7	183.4	220.1	264.1
EBITDA	7.5	10.4	7.3	17.6	23.8
EBITDA margin (%)	4.6	6.0	4.0	8.0	9.0
PAT	5.3	7.7	4.8	15.4	18.7
EPS	1.9	2.8	1.8	5.6	6.8

Source: Company, ICICIdirect.com Research

Technical Chart (Weekly Bar chart)



Source: Bloomberg, ICICIdirect.com Research

Stock data

Market Capitalization (₹ crore)	414.6
52 Week High / Low (₹)	237 / 92
Promoter Holding (%)	54.8
FII Holding (%)	1.4
DII Holding (%)	1.2
Dividend Yield (%)	0.0
12M / 6M stock return (%)	54 / 7
Debt (₹ crore)	16.4
Cash and Cash Equivalent (₹ crore)	24.3
Enterprise Value (₹ crore)	406.7
5 Year Revenue CAGR (%) (FY09-14)	22.9
5 Year EBITDA CAGR (%) (FY09-14)	69.2
5 Year PAT CAGR (%) (FY09-14)	LP

Valuation table

	FY14	FY15E	FY16E	FY17E
P/E	53.8	85.7	26.9	22.2
Target P/E	79.5	126.5	39.7	32.7
EV / EBITDA	39.1	54.6	22.5	16.6
P/BV	3.7	3.5	3.1	2.7
RoNW	6.8	4.1	11.6	12.3
RoCE	5.9	3.3	9.9	12.6

Source: ICICIdirect.com Research

Quarterly performance

(₹ crore)	Q3FY14	Q4FY14	Q1FY15	Q2FY15
Sales	43.5	43.1	47.2	32.9
EBITDA	1.9	3.2	3.3	-2.1
EBITDA Margin (%)	4.4	7.5	7.1	-6.4
Depreciation	0.7	0.7	0.7	0.7
Interest	0.5	1.0	0.5	0.5
Other Income	0.5	0.7	0.7	0.9
PAT	1.2	2.2	2.8	-2.4
EPS (₹)	0.4	0.8	1.0	NM

Source: ICICIdirect.com Research

Shareholding trend (%)

Key Shareholders	Q3FY14	Q4FY14	Q1FY15	Q2FY15
Promoter group	54.8	54.8	54.8	54.8
FII	0.0	0.0	1.1	1.4
DII	0.0	0.0	0.6	1.2
Non-institutional	45.2	45.2	43.5	42.6

Source: ICICIdirect.com Research

Technical View

The share price of EPC is in secondary corrective decline after the strong rally in May-September 2014 (₹ 108-237). The stock is currently trading near the major support area in the range of ₹ 135-140 being the confluence of the 78.6% retracement of the major rally from ₹ 108 to ₹ 237 and 100 weeks EMA.

The trend line joining previous high of May 2013 (₹ 149) and January 2014 (₹ 143), currently placed at ₹ 135 levels, is likely to reverse its role and act as support in the short-term signifying a Change of Polarity principle.

The stock is likely to test its all-time high of ₹ 237 in the short-term that was the high of September 2014

What's the story?

Micro-irrigation; niche segment; under penetrated domestically

As of 2011, according to the International commission on irrigation & drainage, the total area under irrigation is 223.6 MH while the area under micro-irrigation is 55.8 MH, implying a penetration of ~25%. Among regions, the penetration has saturated in Europe (61.7%) and America (50.9%) while the same remains low in Asia & Oceania at 13.7%. Among developing regions, the penetration in India stands at ~9% (6 MH under MIS out of total of 70 MH of irrigated area) while the same in China stands at ~8%, implying a huge untapped opportunity. In India domestically, it is more prevalent in Maharashtra, Gujarat, Rajasthan, Tamil Nadu and Andhra Pradesh. among others. The domestic industry has grown at a CAGR of 15% in FY09-14 to ~₹ 4000 crore in FY14. It is expected to grow at a CAGR of 20%, going forward, in FY14-17E. The payback period for farmers domestically is in the range of one or two years. With an increase in yields and associated savings, MIS is one of the most environment friendly ways of augmenting the farm productivity domestically.

Limited investing opportunity in listed space; EPC Industrie emerges as clear winner

The main credible players in the segment include Jain Irrigation, Netafim India and EPC Industrie. Out of the total industry size of ~ ₹ 4000 crore as of FY14, Jain Irrigation commands a market share of ~35% (MIS India sales of ₹ 1380 crore in FY14), Netafim India comes second with close to ~ 15-20% market share while EPC Industrie has ~5% market share (sales of ₹ 175 crore in FY14). With Netafim India being a private entity and Jain irrigation embroiled in its own leverage issues (debt-equity at ~2x FY14) with low promoter holding at ~29%, there exists a scarcity of credible names with a sound balance sheet in the listed MIS space. EPC Industrie, promoted by M&M (54.8% stake), and FY14 debt-equity at 0.1x emerges as the clear winner. On a net worth of ₹ 113 crore, EPC has a debt of ₹ 16 crore and cash of ₹ 24 crore, implying a cash rich balance sheet with net cash of ₹ 8 crore. It has balance sheet strength to grow both organically & inorganically, going forward.

EPC Industrie, quality play in micro-irrigation industry

EPC, post its acquisition by M&M in FY11 has traversed on the path of robust growth with sales and PAT growing at a CAGR of 26% and 75%, respectively in FY11-14 with FY14 sales at ₹ 175 crore, corresponding EBITDA at ₹ 10 crore (EBITDA margin at 6%) and PAT at ₹ 8 crore. The company is a major micro-irrigation player with drip irrigation contributing ~60% to its FY14 topline and sprinkler contributing the rest ~40%. It expects the share of drip to increase progressively, going forward. EPC is strongly footed in Gujarat, Maharashtra and Rajasthan. The company expects to clock sales of ~₹ 300 crore in the next two or three years out of the current gross block amounting to ₹ 65 crore. EPC, with the aim of de-risking its business profile, has also ventured into greenhouse farming & agricultural pumps, the percentage share of which in total sales is expected to reach ~20% in the long term (MIS share being reduced to 80%). Mahindra & Mahindra, apart from EPC, also has other active agri businesses wherein it operates under two segments. One segment, namely, ShubhLabh Services Ltd (gross turnover of ₹ 149 crore in FY14) operates in export of fresh fruits to Europe and other foreign countries while another segment agri inputs & advisory operates in the agrochemicals and seed space. The agri inputs division also operates Samridhi (a one shop stop for farmers for their agri needs) stores, which also helps EPC leverage the distribution network and create MIS awareness among farmer community.

Subdued FY15E; working capital discipline; poised for gains!!

EPC reported a subdued Q2FY15 (and likely muted FY15E) on account of policy indecisions by state governments of Tamil Nadu, Andhra Pradesh, Bihar, Telangana & Rajasthan post the submersion of NMMI under NMSA. The scenario, however, has improved as of now (October 2014), with the governments of Tamil Nadu & AP rectifying the new policy and also incorporating a long awaited price hike in the range of 8-10%. The net working capital of EPC was a bit stretched in FY14 with net working capital days coming in at 132 days vis-à-vis 96 days in FY13. Going forward, the management has guided at net working capital days being limited to 120 days. On the back of government's thrust on augmenting MIS reach & strong parentage (M&M), we have built in a sales, PAT CAGR of 21.6%, 35.9%, respectively, in FY14-17E. We have arrived at a fair value of ₹ 215-240 for EPC. We have valued the company on a market cap/sales basis since EPC is more of a macro opportunity call coupled with proven capabilities of the M&M group. The lower price of the price band is arrived at valuing the company at 2.25x FY17E market cap/sales while the upper price of the price band is arrived at using 2.5x FY17E market cap/sales. There also exists a possibility wherein the promoter group (M&M) may consolidate all its agri services related business (crop care, seeds, fresh fruits exports, etc) into EPC Industrie albeit in the long term. Per se, the stock is a rare play on the MIS theme, which can create wealth from a three to five year perspective, given the trajectory of farmer awareness of MIS and subsequent capitalisation of the opportunity by EPC.

Financial summary

Profit and loss statement		₹ Crore			
(Year-end March)	FY14	FY15E	FY16E	FY17E	
Net Sales	174.7	183.4	220.1	264.1	
Other Operating Income	0.0	0.0	0.0	0.0	
Total Operating Income	174.7	183.4	220.1	264.1	
Growth (%)	8.2	5.0	20.0	20.0	
Raw Material Expenses	114.2	121.1	140.9	169.1	
Employee Expenses	18.1	18.3	19.8	23.8	
Other Operating Expense	32.0	36.7	41.8	47.5	
Total Operating Expenditure	164.3	176.1	202.5	240.4	
EBITDA	10.4	7.3	17.6	23.8	
Growth (%)	38.7	-29.4	140.0	35.0	
Depreciation	2.8	3.0	3.2	3.4	
Interest	2.4	1.9	1.5	1.1	
Other Income	2.6	2.4	2.5	2.5	
PBT	7.8	4.8	15.4	21.7	
Exceptional Item	0.1	0.0	0.0	0.0	
Total Tax	0.0	0.0	0.0	3.0	
PAT	7.7	4.8	15.4	18.7	
Growth (%)	45.3	-37.1	218.6	21.4	
EPS (₹)	2.8	1.8	5.6	6.8	

Source: Company, ICICIdirect.com Research

Balance sheet		₹ Crore			
(Year-end March)	FY14	FY15E	FY16E	FY17E	
Liabilities					
Equity Capital	27.6	27.6	27.6	27.6	
Reserve and Surplus	85.3	90.2	105.6	124.3	
Total Shareholders funds	113.0	117.8	133.2	152.0	
Total Debt	16.4	14.4	12.4	10.4	
Deferred Tax Liability	0.0	0.0	0.0	0.0	
Minority Interest / Others	0.0	0.0	0.0	0.0	
Total Liabilities	129.4	132.3	145.7	162.4	
Assets					
Gross Block	64.8	68.8	72.8	76.8	
Less: Acc Depreciation	32.7	35.7	38.9	42.3	
Net Block	32.1	33.1	33.9	34.5	
Capital WIP	0.0	0.0	0.0	0.0	
Total Fixed Assets	32.1	33.1	33.9	34.5	
Investments	0.0	0.0	0.0	0.0	
Inventory	35.9	32.7	39.2	47.0	
Debtors	58.6	60.3	69.4	83.2	
Loans and Advances	9.1	8.3	8.8	9.2	
Other Current Assets	2.6	1.8	2.2	2.1	
Cash	24.3	28.1	30.2	31.4	
Total Current Assets	130.5	131.1	149.8	173.0	
Current Liabilities	31.1	30.2	36.2	43.4	
Provisions	2.1	1.8	1.8	1.7	
Current Liabilities & Prov	33.2	32.0	38.0	45.2	
Net Current Assets	97.3	99.2	111.8	127.9	
Others Assets	0.0	0.0	0.0	0.0	
Application of Funds	129.4	132.2	145.7	162.4	

Source: Company, ICICIdirect.com Research

Cash flow statement		₹ Crore			
(Year-end March)	FY14	FY15E	FY16E	FY17E	
Profit after Tax	7.7	4.8	15.4	18.7	
Add: Depreciation	2.8	3.0	3.2	3.4	
(Inc)/dec in Current Assets	-31.3	3.1	-16.5	-22.1	
Inc/(dec) in CL and Provisions	8.1	-1.2	6.0	7.2	
Others	2.4	1.9	1.5	1.1	
CF from operating activities	-10.3	11.6	9.6	8.3	
(Inc)/dec in Investments	0.0	0.0	0.0	0.0	
(Inc)/dec in Fixed Assets	-3.6	-4.0	-4.0	-4.0	
Others	0.0	0.0	0.0	0.0	
CF from investing activities	-3.6	-4.0	-4.0	-4.0	
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0	
Inc/(dec) in loan funds	2.7	-2.0	-2.0	-2.0	
Dividend paid & dividend tax	0.0	0.0	0.0	0.0	
Inc/(dec) in Share Cap	-0.2	0.0	0.0	0.0	
Others	-2.5	-1.9	-1.5	-1.1	
CF from financing activities	0.0	-3.9	-3.5	-3.1	
Net Cash flow	-13.9	3.7	2.1	1.2	
Opening Cash	38.2	24.3	28.1	30.2	
Closing Cash	24.3	28.1	30.2	31.4	

Source: Company, ICICIdirect.com Research

Key ratios					
(Year-end March)	FY14	FY15E	FY16E	FY17E	
Per share data (₹)					
EPS	2.8	1.8	5.6	6.8	
Cash EPS	3.8	2.8	6.7	8.0	
BV	40.9	42.6	48.2	55.0	
DPS	0.0	0.0	0.0	0.0	
Cash Per Share (Incl Invest)	8.8	10.2	10.9	11.4	
Operating Ratios (%)					
EBITDA Margin	6.0	4.0	8.0	9.0	
PAT Margin	4.4	2.6	7.0	7.1	
Inventory days	75.0	65.0	65.0	65.0	
Debtor days	122.4	120.0	115.0	115.0	
Creditor days	65.0	60.0	60.0	60.0	
Return Ratios (%)					
RoE	6.8	4.1	11.6	12.3	
RoCE	5.9	3.3	9.9	12.6	
RoIC	7.2	4.2	12.5	15.6	
Valuation Ratios (x)					
P/E	53.8	85.7	26.9	22.2	
EV / EBITDA	39.1	54.6	22.5	16.6	
EV / Net Sales	2.3	2.2	1.8	1.5	
Market Cap / Sales	2.4	2.3	1.9	1.6	
Price to Book Value	3.7	3.5	3.1	2.7	
Solvency Ratios					
Debt/EBITDA	1.6	2.0	0.7	0.4	
Debt / Equity	0.1	0.1	0.1	0.1	
Current Ratio	3.9	4.1	3.9	3.8	
Quick Ratio	2.8	3.1	2.9	2.8	

Source: Company, ICICIdirect.com Research

RATING RATIONALE

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

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

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Pankaj Pandey

Head – Research

pankaj.pandey@icicisecurities.com

**ICICIdirect.com Research Desk,
ICICI Securities Limited,
1st Floor, Akruiti Trade Centre,
Road No. 7, MIDC,
Andheri (East)
Mumbai – 400 093**

research@icicidirect.com

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