Research

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It's Advice, Not Adventure

January 12, 2017

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.

January 12, 2017

Linc Pen & Plastics (LINPEN)

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Linc Pen & Plastics (Linc) is a leading writing instrument company engaged in manufacturing and distribution of pens (ball point & gel), refills and pencils. Linc is also the sole distribution agent of Mitsubishi Pencils (Japan) in India and markets their popular brand *Uniball*. With rising literacy rates, a high proportion of school-going population, impressive capex in advanced stages of completion and Linc's focus on moving up the value chain (premiumisation), we expect sales, PAT to grow at a CAGR of 9.5%, 13.5%, respectively, in FY16-19E.

Price

₹ 250

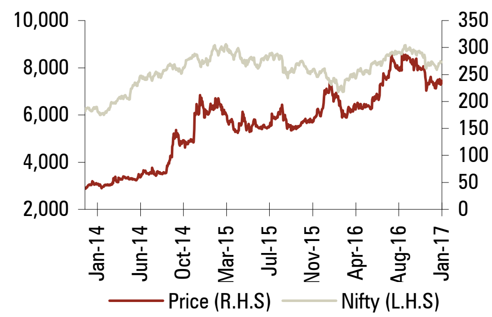
Recommendation

Buy

Fair value

₹ 300-315

Price performance



Highlights

- **Prominent player, innovation – key driver:** Linc is a leading writing instrument player in India with domestic sales accounting for 74% of its gross sales in FY16. It is among the top five brands (Cello, Reynolds, Luxor, Linc, Flair) with a market share of ~10% of the organised segment (total industry ~₹ 3300 crore, organised segment ~₹ 2500 crore). It is particularly strong in East, North East & Northern India. *Glycer* (MRP: ₹ 7/unit) is the largest selling brand of Linc with new product innovation being Linc Twin (MRP: ₹ 10/unit) & Linc Touch (MRP: ₹ 20/unit). It has been continuously innovating across the years with five to six new product launches due in CY17E, thereby ensuring continuity in operations & climbing up the premiumisation ladder, going forward
- **Impressive expansion on track; commissioning in Q1FY18:** Linc currently has a capacity to manufacture 76 crore pens annually and is operating at 90%+ capacity utilisations levels. Sensing the same, it is setting up a greenfield project in Gujarat to cater to its export markets. The said plant will have a capacity of 15 crore pens annually and is intended to clock ~12% EBITDA margins. The peak turnover from the facility will be ~₹ 60 crore with intended RoCE of ~20% on a total capex spend of ~₹ 26 crore. The execution is on track with commissioning expected in Q1FY18. This will ensure volume led growth, with sales volume CAGR of 7.1% to 88 crore pens in FY19E (72 crore pens in FY16)
- **Branded play, quality of earnings to improve:** On the back of volume led growth and premiumisation of its product profile, profitability is on an uptrend at Linc. We expect EBITDA to grow at a CAGR of 16.5% in FY16-19E to ₹ 50 crore in FY19E (₹ 31 crore in FY16). Corresponding improvement in EBITDA margins is expected at 190 bps. Consequent PAT growth is expected at 13.5% in FY16-19E. We have valued Linc at ₹ 300-315, i.e. 1.0x MCap/sales on FY18E-19E sales of ₹ 430-452 crore, respectively

Key risks-

Business specific

Limited volume growth: In the current digital age, the writing instrument industry is witnessing limited volume growth as the same is stagnant in developed countries while seeing a marginal up-tick in the developing world, including India and Africa. As per industry estimates, total industry CAGR (value) in CY09-13 is pegged at 4.1% with developed regions like North America & Europe witnessing ~2% CAGR while developing countries like India are witnessing upward of 6% CAGR in CY09-13. Going forward, therefore, as far as the global outlook for the writing instrument industry is concerned it is going to be a purely pricing led growth in developed markets like US & Europe and pricing + volume led growth in developing markets like India and Africa. Therefore, due to rising digitalisation, the scope for volume led growth for Linc is limited, going forward.

Company specific

Failure of new product launches: Linc has been a keen innovator with new product launches across the years to match the changing consumer (school going children) demand and taste. In the past, the company launched two new products viz. *Linc Twin* (MRP: ₹ 10) & *Linc Touch* (MRP: ₹ 20). It incurs high advertisement and brand promotion costs in these new product launches. Total brand building & promotional expense incurred FY16 was ₹ 11.5 crore (~3% of net sales). Hence, with a strong pipeline of five to six new product launches in CY17E, there is a risk of failure of these new products, which have the potential to dent margins. It will also lead to redundant brand promotion expenses, which is irrecoverable in nature.

Description

Linc is a leading writing instrument company engaged in manufacturing and distribution of pens (ball point & gel), refills and pencils. The company is also the sole distribution agent of Mitsubishi Pencils (Japan) in India and markets their popular brand *Uniball* domestically. In FY16, Linc clocked a total operating income of ₹ 344 crore with corresponding EBITDA at ₹ 31.4 crore (EBITDA margins at 9.1%) and PAT at ₹ 18.3 crore. Domestic sales in FY16 were at ₹ 240 crore while export sales were at ₹ 97 crore. In FY16, pens (₹ 282 crore) constitute a healthy ~83% of its total sales while refills constitute ~5% and the remaining ~12% comprises others (₹ 41 crore). Linc got listed on BSE in 1995 and NSE in March 2015.

History and track record

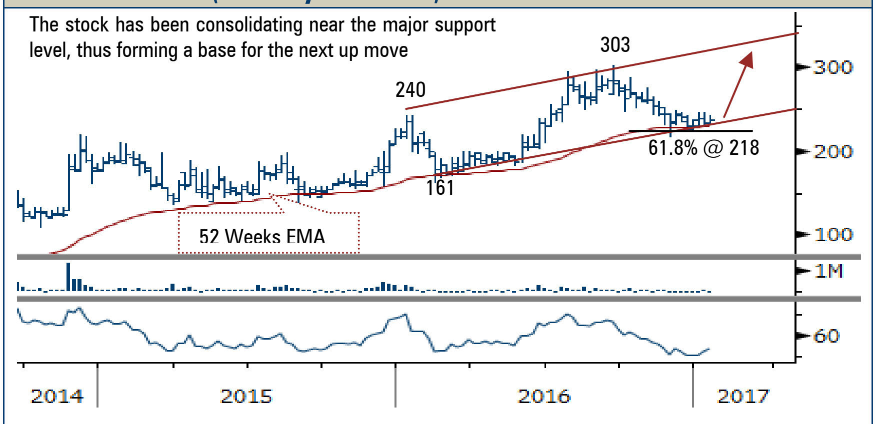
- Linc was established in 1994 and is a leading writing instrument player with a product basket of over 200 products; providing pens (ball point & gel), pencils, sketch pens, office stationary, etc
- In 2000, it launched gel pen “Hi-School” for ₹ 10/unit (prevailing price for gel pens was ₹ 15-20/unit). In 2002, Linc launched *Smart*, an oil based gel pen for ₹ 5. In 2003, it entered the global market through private label supplies to Wal-Mart
- In 2008, Linc roped in Bollywood superstar Shah Rukh Khan to endorse its products while in 2011 it roped in Katrina Kaif as the brand ambassador for promoting *Uniball* products in India
- In 2009, the company commenced production from its new manufacturing facility at Falta SEZ (near Kolkata)
- In 2012, Linc entered into a capital alliance with Mitsubishi Pencil Company (Japan) wherein Mitsubishi picked up a 13.5% stake (20 lakh shares) in the company (@ ₹ 100/share)
- Linc has an installed capacity to manufacture 76 crore pens annually (FY16). It is executing a greenfield expansion in Gujarat with a capex spend of ~₹ 26 crore and capacity of 15 crore pens
- It is currently being headed by Deepak Jalan (Managing Director) and NK Dujari (Chief Financial Officer)
- In FY16, Linc paid a dividend of ₹ 3/share

Earning estimates

₹ crore	FY15	FY16	FY17E	FY18E	FY19E
Total Operating Income	318.3	344.1	374.1	428.9	452.1
EBITDA	25.3	31.4	36.9	45.2	49.6
EBITDA margin (%)	7.9	9.1	9.9	10.5	11.0
PAT	14.3	18.3	19.0	22.3	26.7
EPS	9.7	12.3	12.9	15.1	18.1

Source: Company, ICICIdirect.com Research

Technical Chart (Monthly Bar chart)



Source: Bloomberg, ICICIdirect.com Research

Stock data

Market Capitalization (₹ crore)	369.7
52 Week High / Low (₹)	300 / 167
Promoter Holding (%)	60.5
FII Holding (%)	0.1
DII Holding (%)	1.9
Dividend Yield (%)	1.3
12M / 6M stock return (%)	3 / (1)
Debt (₹ crore)	17.8
Cash and Cash Equivalent (₹ crore)	1.7
Enterprise Value (₹ crore)	385.8
5 Year Revenue CAGR (%) (FY11-16)	6.3
5 Year EBITDA CAGR (%) (FY11-16)	14.6
5 Year PAT CAGR (%) (FY11-16)	16.9

Valuation

	FY16	FY17E	FY18E	FY19E
P/E	20.2	19.4	16.5	13.8
Target P/E	25.5	24.5	20.8	17.4
EV / EBITDA	12.8	11.2	8.9	7.7
P/BV	3.7	3.2	2.8	2.5
RoNW	18.1	16.6	17.1	17.9
RoCE	15.8	14.2	18.1	22.0
ROIC	19.2	21.0	22.3	24.9

Source: ICICIdirect.com Research

Quarterly performance

(₹ crore)	Q3FY16	Q4FY16	Q1FY17	Q2FY17
Sales	72.2	105.0	87.0	87.0
EBITDA	6.4	10.6	8.4	8.3
EBITDA Margin (%)	8.8	10.1	9.6	9.6
Depreciation	1.5	1.6	1.9	1.9
Interest	0.5	0.7	0.6	0.7
Other Income	0.0	0.7	0.0	0.0
PAT	3.2	6.3	4.4	4.1
EPS (₹)	2.2	4.2	2.9	2.8

Source: ICICIdirect.com Research

Shareholding trend (%)

Key Shareholders	Q4FY16	Q1FY17	Q2FY17	Q3FY17
Promoter group	60.5	60.4	60.4	60.5
FII	0.3	0.1	0.1	0.1
DII	0.0	0.8	1.9	1.9
Non-institutional	39.2	38.7	37.6	37.5

Source: ICICIdirect.com Research

Technical View

The share price of Linc Pen & Plastics remains in a structural uptrend consistently forming rising peaks and troughs on the long term price charts. After a gradual corrective decline over the last few months, the stock has approached its key value area and provides a good entry opportunity for medium term investors with a favourable reward-risk set up to ride the next up move within the larger uptrend.

The stock has been consolidating around the major support level of ₹ 220 in the last eight weeks as it is the confluence of the 52 weeks EMA, the lower band of the rising channel in place since January 2016 and the 61.8% retracement of the previous major rally (₹ 161 to ₹ 303) indicating accumulation by stronger hands at the key value area.

Based on the above technical parameters, we believe the stock is set for its next up move after the recent base formation and is likely to head towards the all-time high ₹ 303 in the medium-term.

What's the story?

Global writing instrument industry pegged at US$ 9 billion; to witness largely pricing led growth!

As per industry estimates, the global writing instrument industry size is pegged at ~US$9 billion (~₹ 60,000 crore) out of which developed countries constitute ~46% while the developing world comprises the rest i.e. ~54%. Pens commands ~58% of the total industry size, followed by markers (~17%) and colouring instruments (~14%). In terms of geography, China has a market share of ~24%, followed by Europe (~17%), US (~16%) and Japan (~15) while India constitutes ~7% of the total industry size. As per industry estimates, the total industry CAGR (value) in CY09-13 is pegged at 4.1% with developed regions witnessing ~2% CAGR and developing nations witnessing upward of 6% CAGR in the aforesaid period. Going forward, therefore, as far as the global outlook for the writing instrument industry is concerned, in this digital age, it is going to be purely pricing led growth in developed nations and pricing & volume led growth in developing nations. Thus, we believe the current focus of Linc's management in chasing value led growth through premiumisation is in sync with the global trend, which should benefit Linc, going forward. We have modelled volume & value growth at 7.1% & 9.6% CAGR, respectively, in the pen segment in FY16-19E, implying realisation CAGR of 2.4% in the aforesaid period.

Linc - prominent brand, market leader domestically, poised for gains!

The total domestic writing instrument industry size is pegged at ~₹ 3300 crore, which is growing at a CAGR of ~6% in FY10-16. In India, pens constitute ~80% of the total writing instrument industry with pens less than ₹ 15/unit MRP constituting ~80% of the market size. In terms of end users, students form the majority i.e. ~55% of total industry end users. Major players in the domestic market include Cello with a market share of ~20%, Reynolds (13%), Luxor (~10%) and Linc (~ 10%). Cello is strong in greater than ₹ 10/unit MRP product category and is a private company owned by BIC (French, second largest player globally) while Reynolds is strong in less than ₹ 10/unit MRP product category and is a private company owned by Newell Rubbermaid (US, largest player globally). Linc with a market share of ~10% is a prominent brand domestically with a strong brand presence particularly in the east, North-East states of West Bengal & Bihar and northern states of Uttar Pradesh (UP), Delhi & Rajasthan. Thus, with rising literacy rates (74% as of 2011, vs. 18% in 1951), high proportion of school-going population (~40%) and pen being an integral tool in the learning process, the domestic writing instrument industry is on a strong footing. It is expected to grow at a CAGR of 6-8% in FY16-19E, boding well for Linc, going forward.

Impressive expansion; new product launches; increasing exports, to aid growth!

Sensing the capacity constraints, Linc is setting up a greenfield project in Gujarat. The said plant will have a capacity of 15 crore pens annually and is intended to clock ~12% EBITDA margins. The peak turnover from the facility will be ~₹ 60 crore with intended RoCE of ~20% on a total capex spend of ~₹ 26 crore. Linc's management has also renewed its focus on moving up the value chain by offering greater value added higher MRP product. The share of the mass segment to the premium segment has also improved in favour of the premium segment over the years. In FY08, the mass & premium segment shares in the total sales mix was at 88% & 12%, respectively. However, the same in FY15 was at 67% & 33%, respectively. In FY15-16, Linc had launched two new innovative products *Linc Twin* & *Linc Touch*. Currently, the company realises ~30% of its sales from exports (₹ 97 crore) wherein they market their products in ~50 countries worldwide. Linc is aggressively targeting the exports markets with overall aim of increasing the share of export sales from ~30% currently to ~50% in the next few years. This is given the increasing penetration of writing instruments in the developing world (including Africa) and need for cost effective quality pens in the developed world, including Europe. This also explains the above average (7.1% CAGR) volume led growth for Linc vs. the industry growth rate of ~6% domestically.

Branded play; healthy B/S; robust return ratios, warrant re-rating, recommend BUY!

Linc is a prominent brand domestically with ~2500 distributors and product availability at 1 lakh retail outlets. It is indeed a branded play available at inexpensive valuations of ~1x MCap/sales vs. past transactions wherein its competitors domestically were valued at ~2.4-4.0x MCap/Sales. It has a lean balance sheet with debt: equity (FY17E) at 0.4x and is expected to decline in FY18E-19E. Its working capital requirements are also controlled with net working capital days at ~90 days. Linc also realises healthy return ratios with FY16 RoE & RoCE at 18% & 16%, respectively. Going forward, with demand drivers in place and increasing premiumisation, we expect sales to grow at a CAGR of 9.5% in FY16-19E to ₹ 452 crore in FY19E while EBITDA is expected to grow at 16.5% CAGR in FY16-19E to ₹ 50 crore in FY19E, building in ~200 bps improvement in EBITDA margins. Consequent PAT is expected to grow at a CAGR of 13.5% in FY16-19E to ₹ 27 crore in FY19E (₹ 18 crore in FY16). PAT growth CAGR lags the EBITDA growth CAGR on account of increase in effective tax rate to 30% in FY18E-19E (26% in FY16). We have valued Linc at ₹ 300-315, i.e. 1.0x MCap/sales on FY18E-19E sales of ₹ 430-452 crore, respectively.

Financial summary

Profit and loss statement				₹ Crore
(Year-end March)	FY16	FY17E	FY18E	FY19E
Net Sales	337.3	366.8	420.5	443.2
Other Operating Income	6.8	7.3	8.4	8.9
Total Operating Income	344.1	374.1	428.9	452.1
Growth (%)	8.1	8.7	14.7	5.4
Raw Material Expenses	218.8	237.5	274.5	289.3
Employee Expenses	18.6	20.3	22.5	24.9
Other Operating Expense	75.4	79.4	86.7	88.2
Total Operating Expenditure	312.8	337.2	383.8	402.4
EBITDA	31.4	36.9	45.2	49.6
Growth (%)	24.0	17.6	22.4	9.9
Depreciation	6.0	7.6	9.4	9.9
Interest	1.5	3.0	3.9	1.6
Other Income	0.6	0.0	0.1	0.1
PBT	24.5	26.3	31.9	38.2
Exceptional Item	0.0	0.0	0.0	0.0
Total Tax	6.3	7.3	9.6	11.5
PAT	18.3	19.0	22.3	26.7
Growth (%)	27.7	4.2	17.4	19.6
EPS (₹)	12.3	12.9	15.1	18.1

Source: Company, ICICIdirect.com Research

Cash flow statement				₹ Crore
(Year-end March)	FY16	FY17E	FY18E	FY19E
Profit after Tax	18.3	19.0	22.3	26.7
Add: Depreciation	6.0	7.6	9.4	9.9
(Inc)/dec in Current Assets	-26.0	-17.4	-11.2	-3.1
Inc/(dec) in CL and Provisions	10.5	6.6	8.4	3.5
Others	1.5	3.0	3.9	1.6
CF from operating activities	10.2	18.8	32.8	38.7
(Inc)/dec in Investments	0.0	0.0	0.0	0.0
(Inc)/dec in Fixed Assets	-18.9	-24.0	-10.0	-10.0
Others	0.9	0.0	0.0	0.0
CF from investing activities	-18.0	-24.0	-10.0	-10.0
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0
Inc/(dec) in loan funds	13.1	14.0	-12.0	-17.0
Dividend paid & dividend tax	-5.3	-5.3	-6.2	-8.0
Inc/(dec) in Share Cap	0.1	-0.1	0.0	0.0
Others	-1.5	-3.0	-3.9	-1.6
CF from financing activities	6.4	5.5	-22.1	-26.6
Net Cash flow	-1.4	0.4	0.7	2.1
Opening Cash	1.7	0.3	0.7	1.4
Closing Cash	0.3	0.7	1.4	3.5

Source: Company, ICICIdirect.com Research

Balance sheet				₹ Crore
(Year-end March)	FY16	FY17E	FY18E	FY19E
Liabilities				
Equity Capital	14.8	14.8	14.8	14.8
Reserve and Surplus	86.3	99.9	116.0	134.8
Total Shareholders funds	101.1	114.7	130.8	149.6
Total Debt	30.9	44.9	32.9	15.9
Deferred Tax Liability	2.8	2.8	2.8	2.8
Minority Interest / Others	0.0	0.0	0.0	0.0
Total Liabilities	134.8	162.4	166.5	168.3
Assets				
Gross Block	87.7	91.4	118.4	128.4
Less: Acc Depreciation	45.7	53.3	62.7	72.6
Net Block	42.0	38.1	55.7	55.8
Capital WIP	1.8	22.0	5.0	5.0
Total Fixed Assets	43.7	60.1	60.7	60.8
Liquid Investments	0.0	0.0	0.0	0.0
Other Investments	0.0	0.0	0.0	0.0
Goodwill on Consolidation	0.0	0.0	0.0	0.0
Inventory	77.3	85.4	97.9	97.1
Debtors	47.7	60.3	63.4	66.8
Loans and Advances	16.2	12.8	8.4	8.9
Other Current Assets	0.2	0.4	0.4	0.4
Cash	0.3	0.7	1.4	3.5
Total Current Assets	141.8	159.6	171.6	176.7
Creditors	43.8	50.2	57.6	60.7
Provisions	6.9	7.0	8.1	8.5
Current Liabilities & Prov	50.7	57.3	65.7	69.2
Net Current Assets	91.1	102.3	105.9	107.5
Others Assets	0.0	0.0	0.0	0.0
Application of Funds	134.8	162.4	166.5	168.3

Source: Company, ICICIdirect.com Research

Key ratios				
(Year-end March)	FY16	FY17E	FY18E	FY19E
Per share data (₹)				
EPS	12.3	12.9	15.1	18.1
Cash EPS	16.4	18.0	21.5	24.7
BV	68.4	77.6	88.5	101.2
DPS	3.0	3.0	3.5	4.5
Cash Per Share (Incl Invst)	0.2	0.5	1.0	2.3
Operating Ratios (%)				
EBITDA Margin	9.1	9.9	10.5	11.0
PBT / Total Op. income	7.1	7.0	7.4	8.4
PAT Margin	5.3	5.1	5.2	5.9
Inventory days	83.6	85.0	85.0	80.0
Debtor days	51.6	60.0	55.0	55.0
Creditor days	47.4	50.0	50.0	50.0
Net Working Capital days	87.9	95.0	90.0	85.0
Return Ratios (%)				
RoE	18.1	16.6	17.1	17.9
RoCE	15.8	14.2	18.1	22.0
RoIC	19.2	21.0	22.3	24.9
Valuation Ratios (x)				
P/E	20.2	19.4	16.5	13.8
EV / EBITDA	12.8	11.2	8.9	7.7
EV / Net Sales	1.2	1.1	1.0	0.9
Market Cap / Sales	1.1	1.0	0.9	0.8
Price to Book Value	3.7	3.2	2.8	2.5
Solvency Ratios				
Debt/EBITDA	1.0	1.2	0.7	0.3
Debt / Equity	0.3	0.4	0.3	0.1
Current Ratio	2.8	2.8	2.6	2.5
Quick Ratio	1.3	1.3	1.1	1.1

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;
Hold: Up to +/-10%;
Sell: -10% or more;

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