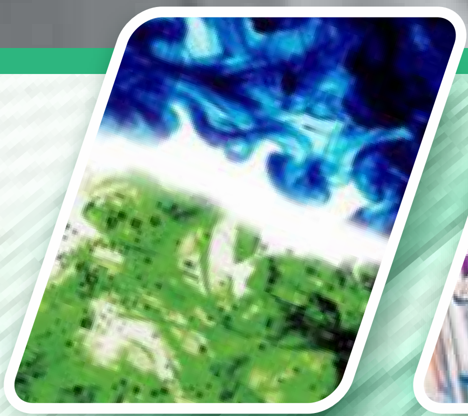
27th April 2018

MEGHMANI ORGANICS LIMITED

INITIATING COVERAGE REPORT



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Meghmani Organics Limited

Sector: Chemicals

CMP (INR) (As on 26th April 2018)	98.2
Target Price (INR)	140
Upside(%)	43%
Recommendation	**Strong Buy**

BSE Code	532865
NSE Code	MEGH
Reuter Code	MEGH.BO
Bloomberg Ticker	MEGH IN

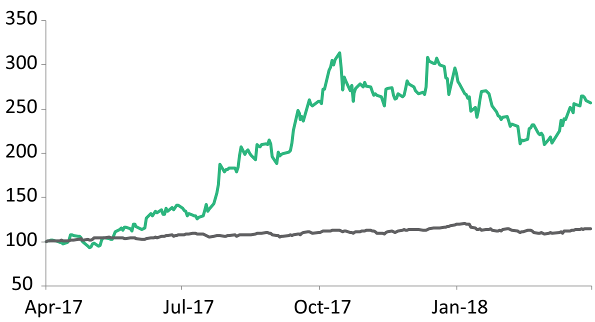
Stock Scan

Market cap (INR Cr.)	2497
Outstanding Shares (Cr.)	25.43
Face Value (INR)	1
Dividend Yield (%)	0.39
P/E(x)	22.45
Industry P/E(x)	24.21
Debt/Equity	0.17
Beta v/s Nifty	1.26
52 Week High/ Low (INR)	129.40/36.30
Avg. Daily Volume (NSE)/1Yr.	2971040

Shareholding Pattern (%)

	Mar-18	Dec-17	Sep-17
Promoters	50.39	50.48	50.93
Institutions	4.25	5.84	4.82
Non-institutions	45.36	43.67	44.26

Stock v/s Nifty (Relative Returns)



Source: Bloomberg

MOL: Gearing up for strong growth

Stewart & Mackertich Research initiates coverage on Meghmani Organics Ltd (MOL) with a **Strong Buy** rating. Meghmani Organics is an India-based company with diversified business interests ranging from pigments to pesticides as well as basic chemicals. The company enjoys strong global presence with exports accounting to almost 51% of net sales. The company has done mega capacity expansion in the past few years and is now ramping up the plants to optimum utilization. FY18 onwards all the segments are expected to gather steam and the operations will generate enough cash needed for future asset acquisition.

Investment Rationale Highlights

- Meghmani has a well-diversified product portfolio
- Vertically integrated across all value chains
- Pigments and agrochemicals enjoys strong global presence
- Meghmani to embark on major Capex to expand its chemical business
- Meghmani reduced its long term debt and will soon be a debt free company
- Meghmani is run by experienced and qualified management team and technical personnel

Valuation: The company has undertaken aggressive expansion plans in the past few years and we expect that the installed capacity if run at optimum level would clock net sales of around INR2100 crore by FY19. Several other macroeconomic indicators like the recent uptick in chlor-alkali prices due to supply shortage will also support the final product price and the overall revenue of the company. This could fuel big-time gains for the investors and considering all this we have valued the company on the basis of weighted average of Discounted Cash Flow (DCF), P/E and EV/EBITDA and arrive at a Target Price of **INR140.**

Financial Performance at a glance (Consolidated)

Particulars (INR Cr.)	FY16A	FY17A	FY18E	FY19E	FY20E	FY21E
Net Sales	1332.1	1422.8	1819.4	2139.3	2517.1	2986.2
Growth(%)	2.7%	6.81%	27.87%	17.58%	17.66%	18.63%
EBITDA	260.7	288.7	449.8	561.8	681.2	850.9
EBITDA Margin (%)	19.6%	20.3%	24.7%	26.3%	27.1%	28.5%
Net Profit	111.1	115.9	219.0	289.8	379.2	501.1
Net Profit Margin (%)	8.3%	8.1%	12.0%	13.5%	15.1%	16.8%
EPS	4.37	4.56	8.61	11.40	14.91	19.71
BVPS	24.82	28.25	34.18	42.19	52.79	66.86
P/E(x)	22.5	21.6	11.4	8.6	6.6	5.0
P/BV(x)	4.0	3.5	2.9	2.3	1.9	1.5
EV/EBITDA(x)	11.6	10.5	6.7	5.4	4.4	3.6
ROAE(%)	18.8%	17.2%	27.6%	29.8%	31.4%	32.9%
ROACE(%)	24.7%	25.0%	37.0%	37.1%	39.3%	40.8%

Source: Company Data, SMIFS Research

Investment Rationale

Strategically expanding to higher margin products

Meghmani has a well-diversified product portfolio: The company started as a pigments manufacturing company and later diversified its operations into pesticides and other basic chemicals. All the three segments are growing well on both domestic and export fronts. Pigments are expected to grow further as the company is ramping up the Beta Blue plant. It is also developing specialty pigments for international markets. In agrochemicals, Meghmani is also witnessing demand for its higher-value products which is resulting in higher realizations and better margins. The caustic plant is also getting ramped up which is a key driver for profitable growth in Basic Chemicals. Overall all the segments are in good progress and if any segment's performance turns murky the other segments will provide cushion and ensure continuous rise in revenue.

Utilization increasing across all segments

Segment Details

Particulars (FY17)	Pigments	Agrochemicals	Basic Chemicals
Capacity (MTPA)	31890	27060	187600
Utilization	66%	60%	77%
Volume	14462	15624	138219
Revenue Mix	35%	32%	27%
End Users	Inks, paint and plastic manufacturers	Sold to Dealers, Retailers or directly to farmers	Pharmaceutical, soap, detergent, PVC, chemical and textile manufacturers

Source: Company Data, SMIFS Research

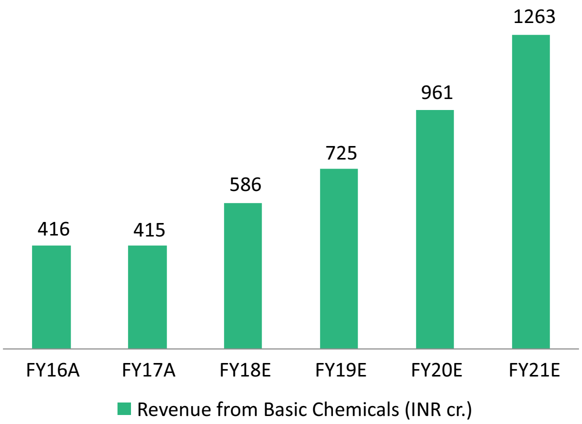
Vertical integration helps MOL effectively manage raw materials cost

Vertically integrated across all value chains: All the three business segments are vertically integrated. For pigments, the company has vertically integrated facilities manufacturing CPC Blue, an upstream product which is used as a raw material in production of Pigment Green and Pigment Blue. For Agrochemicals, the company is one of the few agrochemical companies who is fully integrated. It produces intermediates, technical as well as bulk and branded formulations. For Caustic production, power costs accounts for more than 60% of total raw material cost. Meghmani has a captive power plant of 60MW which provides power at lower cost resulting in higher margins. It also supplies caustic and chlorine via pipelines to selected buyers which further result in lower logistic cost. The company is also setting up a Chloro-methane plant of 40,000 MTPA soon which will also utilize the chlorine produced during the production of caustic soda to produce MDC a product mainly used in Pharma and Agro Chemical Industries. Chlorine has a negative to zero realization in India. The facilities are strategically located at close proximity to sources of raw materials that lowers procurement costs. The vertical integration helps the company effectively manage raw material cost and also ensure constant supply of raw materials.

Important customers for Pigments includes Sun-DIC, Flint Group, Akzo Nobel, DuPont, and PPG Industries

Pigments and agrochemicals enjoys strong global presence: MOL has strong international presence with exports accounting to 51% of the net sales. For Pigments, the company is the largest manufacturer of Phthalocyanine based pigments with more than 100 customers from various countries in North America, Europe, Central and Latin America, and Asia-Pacific. Customers are mainly MNCs such as Sun-DIC, Flint Group, Akzo Nobel, DuPont, and PPG Industries. The relationship with customers is sticky and about 90% business comes from existing customers. The company has global networks of 70 overseas distributers. Its direct presence in few nations helps it to work closely with end-user customers. In agrochemicals, the company has 227 export registrations and more than 30 agrochemical customers. The Company exports technical as well as branded products to Africa, Brazil, LatAm, the US, and European countries.

Expected growth in revenue due to higher Capex



Source: Company Data, SMIFS Research

Meghmani to embark on major Capex to expand its chemical business: Meghmani in the last five years have invested INR6.5 Billion which resulted in margin expansion and healthy earnings. Now, Meghmani Finechem Ltd (MFL), a subsidiary of Meghmani Organics has started an INR5.4 Billion investment to expand the basic chemical business. MFL is 57% owned by Meghmani Organics. The Capex involves three projects which are expected to be completed over the next 2-3 years. The Capex is expected to generate significant cash in the years to come. The new caustic plant is expected to operate at optimum levels and will also enable the company to repay its debt and decrease the financial leverage.

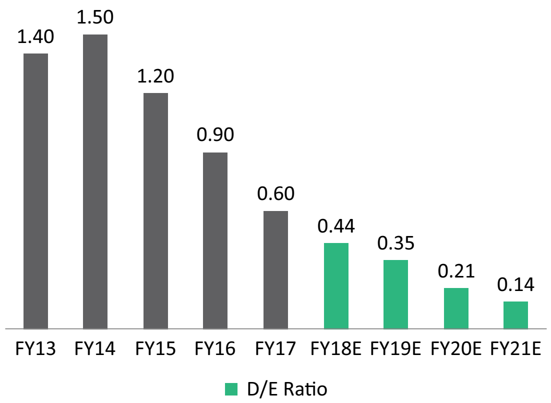
Details of INR5.4 Billion Capex

Projects	Capacity Addition	Investment	Potential Revenue from full year operation	Date of Commision	Advantages
CMS Project	from zero to 40,000 MTPA	INR1.4 Billion	INR1.2 Billion	Dec-18	I) Will help in captive Consumption of Chlorine II) Final Product will be MDC along with chloroform and Carbon Tetrachloride (CTC) used in Pharma and Agro Chemical Industries for which India is a net importer
Hydrogen Peroxide	from zero to 25,000 MTPA	INR1 Billion	3 Billion	Jun-19	Will help in Captive use of Hydrogen
Caustic Soda	From 166,600 MTPA to 2,40,000 MTPA per annum	INR3 Billion			Help in coping up with the rising demand of caustic soda

Source: Company Data

Meghmani reduced its long term debt and will soon be a debt free company: Meghmani is a growth oriented company and generates good amount of cash. In FY17, the company reduced its long term debt from INR217 Crore to INR122 Crore and planned to pay off INR91 Crore in FY18.The interest coverage ratio also improved to 4.13x from 3.32x in FY16, mainly due to better performance and lower cost of debt. The Company's total debt to equity ratio reduced to 0.6x in FY17 from 0.9x in Fy16. The Company maintains debt equity ratio well below 1 and we expect it to come down further as the company is planning to become debt free soon. This will significantly increase the profitability and help the company to increase operational efficiency and reduce financial leverage.

Total Debt to Equity Ratio



Source: Company Data, SMIFS Research

Meghmani is run by experienced and qualified management team and technical personnel: The management team led by founders has over 50 years of collective experience in the pigments and pesticides industry. The production and operations at each of the plants are managed by a team of skilled technical staffs who are highly qualified and trained and many have had working experience with MNCs and other large reputed Indian companies. The expertise and dedication of the strong workforce of more than 600 employees help the company to respond quickly to changing market trends and demands in the pigments and agrochemicals industry.

Corporate Team-Key Members

Name	Designation	Years of Experience	Details
Jayanti Meghjibhai Patel	Executive Chairman	More than 37 years' of experience in the dyes and Pigments industry and more than 20 years of experience in the Agrochemicals industry.	He holds a Bachelors of Chemical Engineering degree from Maharaja Sayajirao University, Baroda. He currently oversees the international marketing of the company and is responsible for all major policy decisions.
Ashish Natwarlal Soparkar	Managing Director	More than 37 years' of experience in the dyes and Pigments industry and more than 20 years of experience in the Agrochemicals industry.	He also holds Bachelor's degree in Chemical Engineering from Maharaja Sayajirao University of Baroda. He currently oversees the corporate affairs and finance matters of our Company
Natwarlal Meghjibhai Patel	Managing Director	More than 37 years' of experience in the dyes and Pigments industry and more than 20 years of experience in the Agrochemicals industry.	He holds a Master's of Science degree from Sardar Patel University, Gujarat. He currently oversees the technical matters of the Agrochemicals divisions, as well as the international and domestic marketing of our Agrochemical products.
Ramesh Meghjibhai Patel	Executive Director	He has 31 years of experience in the Pigments Industry and 20 years of experience in the Agrochemicals Industry.	He holds a Bachelors of Arts degree from Saurashtra University. He is currently in charge of overseeing purchases made by our Company (including domestic purchases and global imports) and is responsible for all liaisons between our Company and government authorities or other regulatory bodies.
Anand Ishwerbhai Patel	Executive Director	He has 28 years of experience in the Pigments Industry.	He currently oversees the manufacturing of Pigments at Vatva, and Panoli as well as the International & Domestic marketing of Pigments.

Source: Company Data

Company Overview

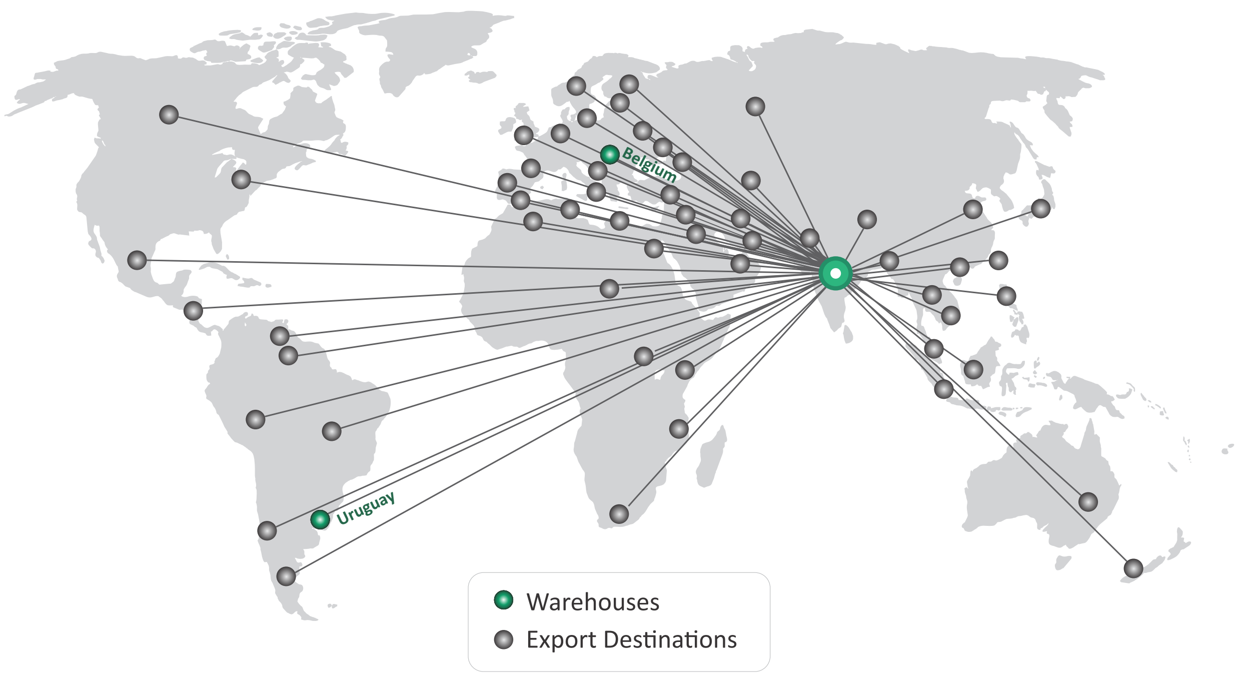
MOL has over 200 MNC Pigment customers and over 90 Agrochemical customers

Meghmani Organics is an India-based company with diversified business interests ranging from pigments to pesticides as well as basic chemicals. It is a leading manufacturer of pigments and pesticide products in the country. The company started its operations as a pigment manufacturing company under the name of Gujarat Industries. Later in the year 2007, it established Meghmani Finechem Ltd with IFC participation and started production of basic chemicals.

MOL has over 200 MNC pigment customers across the globe- North America, Europe, Central and Latin America, and Asia-Pacific. It caters to wide range of industries such as printing inks, plastics, paints, textiles and leather, paper and rubber. For Agrochemicals, they have over 90 customers, including leading pesticides manufacturers in North America, Europe, Latin America, Asia and end users in the domestic Indian market.

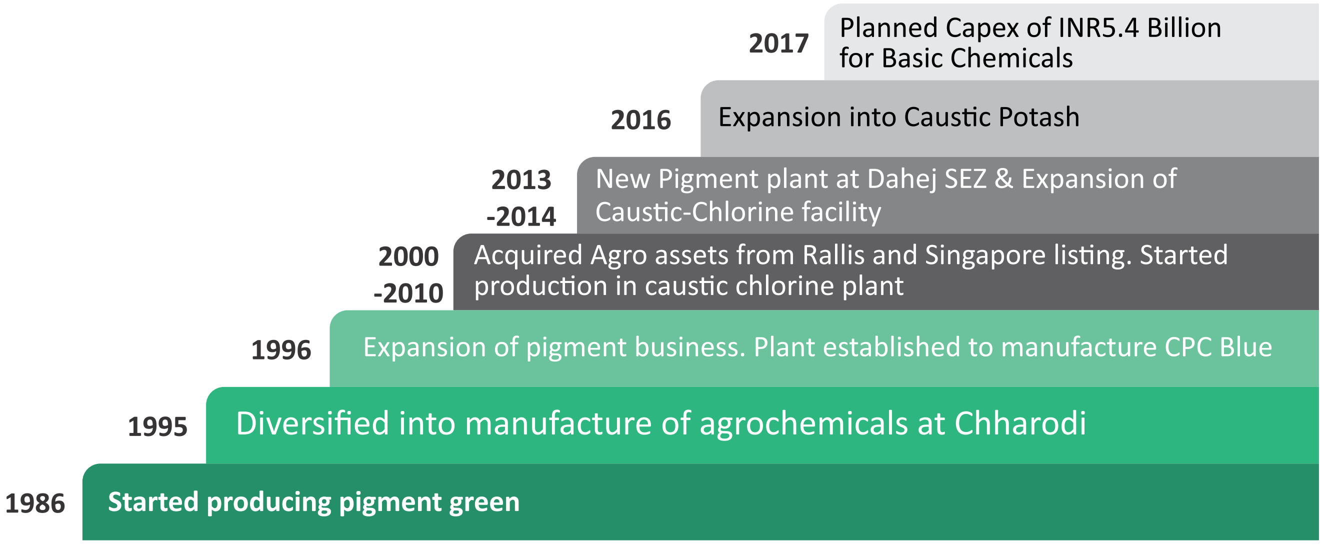
The company also has a strong global marketing network and has warehouses in Belgium, Uruguay, China, Russia, Germany the U.S. Columbia. It has an extensive network of 20 overseas distributors worldwide.

Export Locations



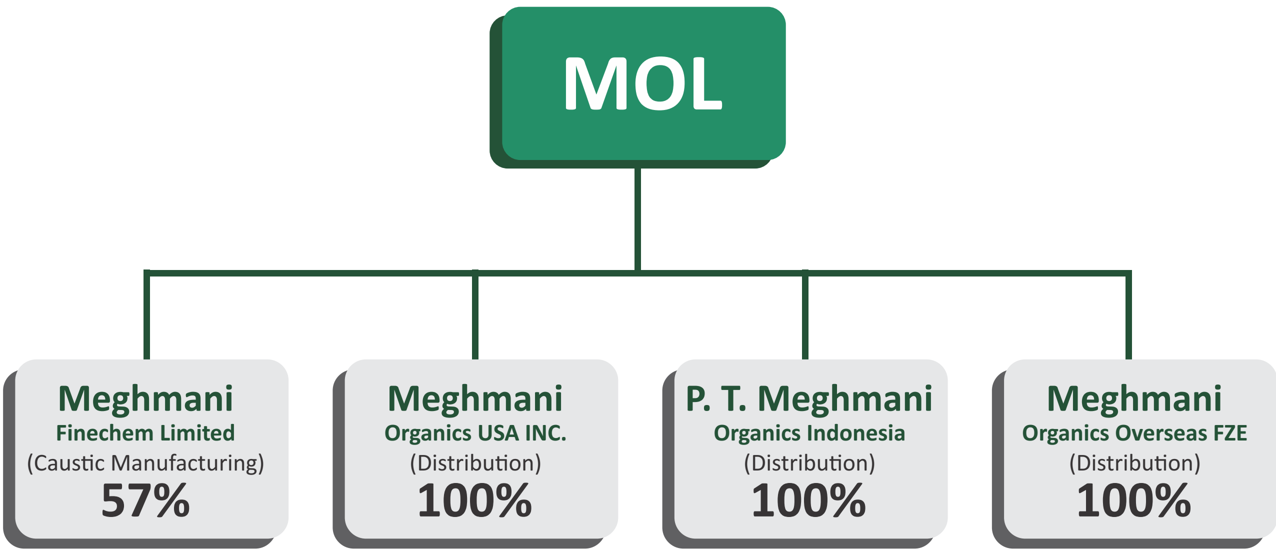
Source: Company Data

Company Evolution



Source: Company Data, SMIFS Research

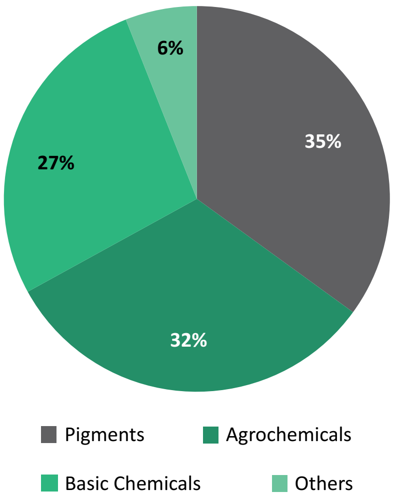
MOL and its subsidiaries



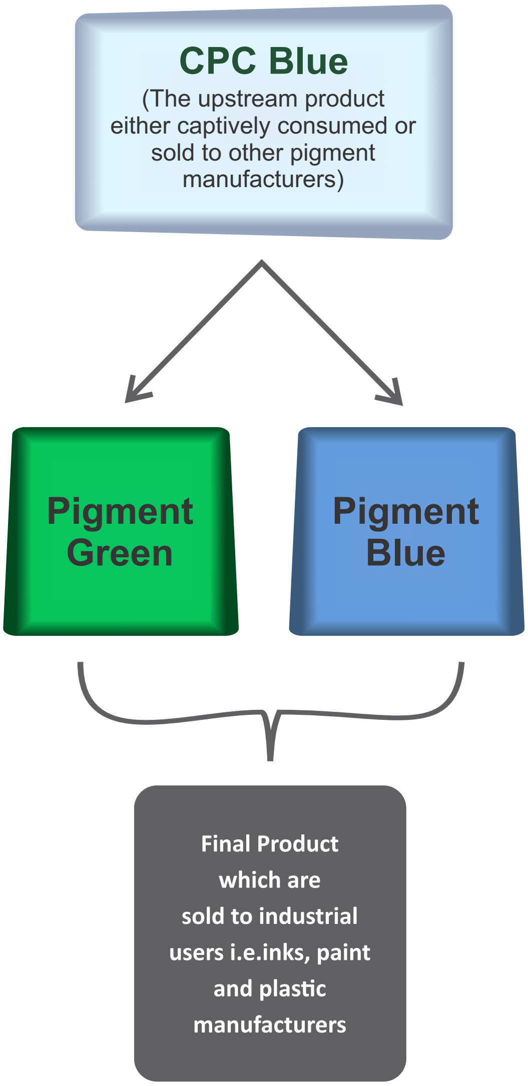
Source: Company Data, SMIFS Research

Business Overview

Revenue Mix (FY17)



Source: Company Data, SMIFS Research



Source: Company Data, SMIFS Research

The company is mainly engaged in the manufacture and sale of Pigments and Agrochemicals. Its subsidiary Meghmani Finechem also produces basic chemicals like caustic soda, caustic potash.

Pigments: Meghmani Organics is the largest manufacturer of Pthalocyanine based pigments. It is among the top 3 players in the world in Blue pigment and has a global market share of 8% in terms of volumes. In FY17, pigment division contributed 35% to the total revenue.

The pigment division manufactures and distributes Phthalocynine Green 7, Copper Phthalocynine Blue (CPC), Alpha Blue and Beta Blue. CPC Blue is an upstream product which is either used for captive consumption for manufacturing of Pigment Blue and Pigment Green or is sold to other pigment manufacturers. The pigment green and blue are sold and used in multiple applications, including printing inks, plastics, rubber, paints (for exterior and interior surfaces), textiles, leather and paper.

The pigment business enjoys strong global presence as export accounts for almost 68% of net sales in this segment. The company's customers mainly comprises of MNCs like Sun-DIC, Flint Group, Akzo Nobel, DuPont, and PPG Industries. The customers have enough confidence on the company and 90% of the business comes from repeat customers.

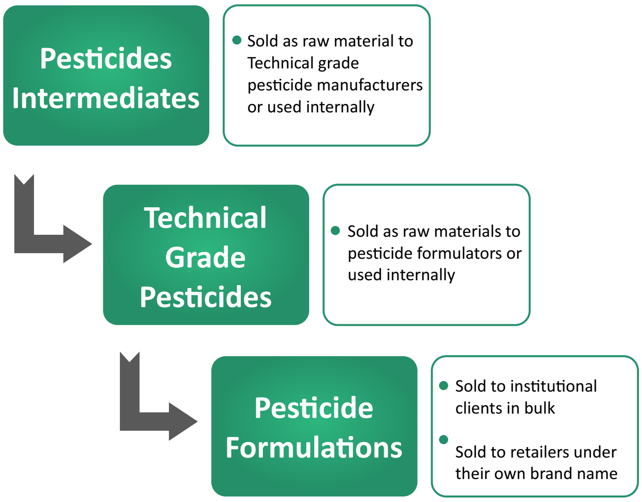
It has a global distribution network of 70 overseas distributers. It also has subsidiaries in the US, Europe, Indonesia and Dubai which helps it to work closely with the customers.

Pigments Manufacturing Facilities

Plants	Capacity	Products
GIDC Vatva, Ahmedabad	2,940 MTPA	Pigment Green
GIDC Panoli, near Ankleshwar	17,400 MTPA	CPC Blue, Alfa and Beta Blue, Pigment Blue
Dahej SEZ Ltd	11550 MTPA	CPC Blue, Alfa and Beta Blue

Source: Company Data

Formulated Agro Products



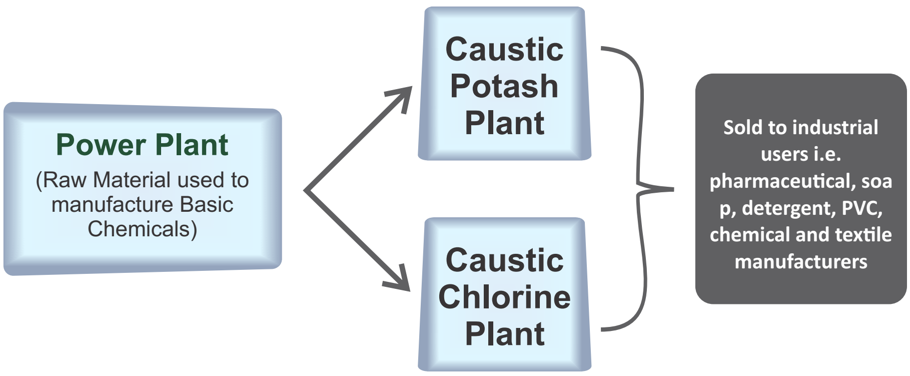
Source: Company Data, SMIFS Research

- **Agrochemicals:** The company manufactures pesticides used for basic crop protection and public health. It manufactures and distributes entire value chain of agrochemicals which includes technical, intermediates as well as formulations. The formulations are produced using technical grade pesticides manufactured in-house as well as purchased from external suppliers. The pesticide formulations is either sold to institutional customers or sold as formulations under their own brand name to their retail customers through our agents and distributors. Their pesticides are used on a broad range of crops and insects, and are used on fruits, vegetables and common crops such as cotton, rice, groundnuts and chillies. The Major products include 2, 4-D, Cypermethrin, Permethrin, Metaphenoxy, Benzaldehyde, Chlorpyrifos and Profenophos. Its Key markets include US, Brazil, Argentina and China.

Agrochemical Manufacturing Facilities

Plants	Capacity
GIDC Ankleshwar	6420 MTPA
GIDC Panoli	7200 MTPA
GIDC Dahej	13440 MTPA

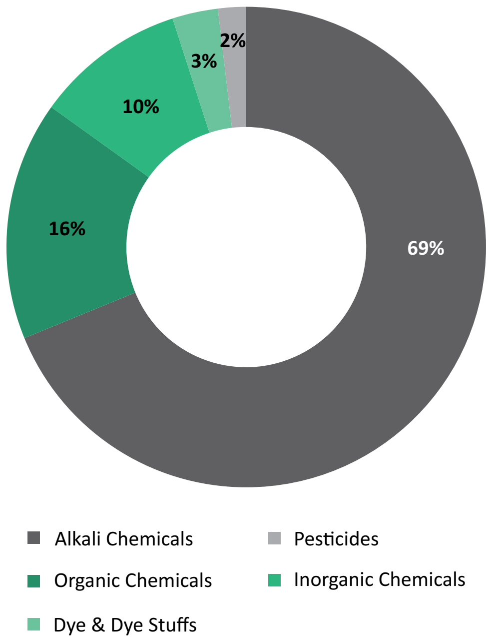
- **Basic Chemicals:** The company forayed into Basic Chemicals in 2009 with a capacity of 119,000 MTPA at Dahej. Currently it has the fourth largest caustic chlorine capacity in India. The company is planning to increase caustic soda capacity to 2,50,000 MTPA by June FY19. It has also set up 21000 MTPA capacity for caustic potash and will start producing chlorine derivative products soon. The company has an integrated captive power plant of 60MW which would be upgraded to 90MW soon. Since power cost accounts for almost 60% of total raw material cost, captive power plant incurs in lower cost and results in higher margins.



Source: Company Data, SMIFS Research

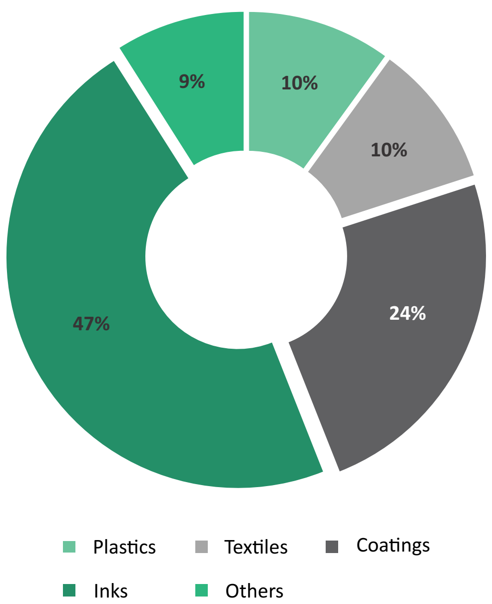
Industry Overview

Production Share in FY16



Source: IBEF

Pigment Industry by end use



Source: Company Data, SMIFS Research

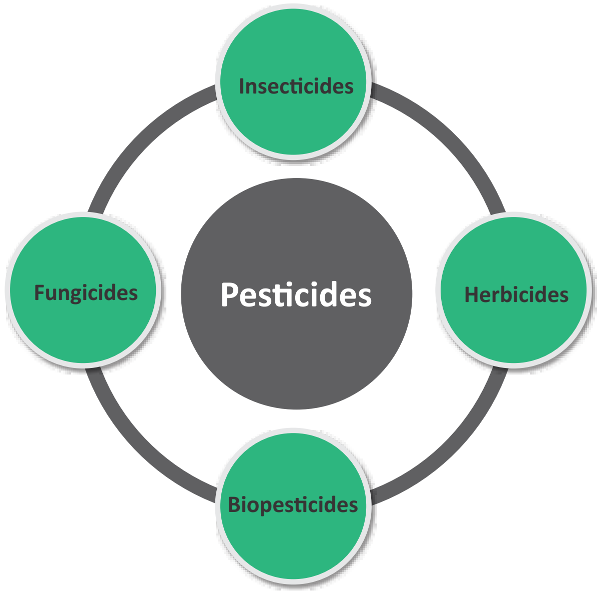
The Chemical Industry has diversified manufacturing base and contributes to almost every manufactured product. The chemical industry in India is a key constituent of Indian economy, accounting for about 2.11% of the GDP. The Government of India has launched the Draft National Chemical Policy, which aims to further increase the share of chemical sector in the country's GDP. The Draft Chemical Policy focuses on meeting the rising demand for chemicals and will reduce imports. However, supply cut due to pollution issues in China and possibility of crude price increase may increase the raw material prices and may impact margins of these companies. Product-wise the chemical sector in India is classified into alkali chemicals, Inorganic chemicals, Organic chemicals, Agrochemicals and Dyes & dyestuff.

Pigments: The size of the global Pigments market in 2016 was $24 Billion and is expected to rise to $32 Billion by 2023, growing at a CAGR of 3.8%. Asia Pacific is expected to make up the lion's share of the global geographical market with approximately 47% share in 2023. The global pigments industry is broadly classified as organic, inorganic, and specialty pigments.

Organic pigments contain carbon atoms, are non-toxic in nature, or have low level of toxicity, thus are environmentally safe. Organic pigments offer high color strength with durability and are available in wider range of bright colors, such as blue, green, yellow, red, and orange. The global organic pigments market is expected to grow at a CAGR of more than 3% between 2017 and 2021. They are usually less opaque and are chemically inert. There are various types of organic pigments, such as azo, phthalocyanine, quinacridone, and others.

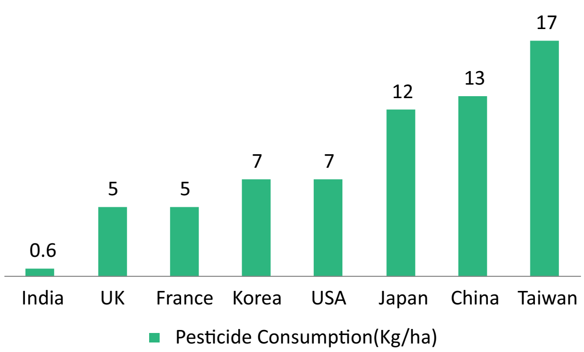
Inorganic pigments are coloring materials obtained from metal oxides by the process of high-temperature calcinations. They possess high light fastness, high hiding power, non-migratory, non-wrapping, and non-bleeding properties. Inorganic pigments are capable of withstanding extreme weather conditions and high temperatures as compared to organic pigments. They are widely used in paints & coatings, plastics, construction materials, printing ink, etc. Types of inorganic pigments include titanium dioxide pigment, iron oxide pigment, cadmium pigment, carbon black pigment, chromium oxide pigment, complex inorganic pigments, and others.

Specialty pigments produce a range of vibrant colors with brilliant luster and have superior hiding power and light fastness, which makes them ideal for high-performance paints & coatings, plastics, and cosmetics. These pigments are usually used to enhance the appearance, value, and performance of the product.



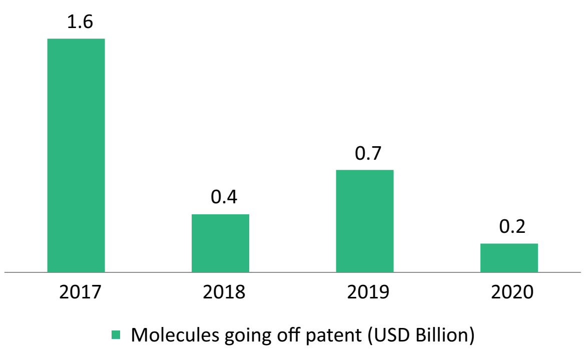
Source: Company Data, SMIFS Research

Pesticide Consumption(Kg/ha) across countries



Source: FICCI

Agrochemicals going off patent in the next two years



Source: FICCI

These include classic organic pigments, metallic pigments, high-performance pigments, light interference pigments, fluorescent pigments, and luminescent pigments, and thermo-chromic pigments.

Agrochemicals: Indian agriculture sector is the backbone of the nation's economy accounting for about 15% of the country's Gross Domestic Product. However, it is highly monsoon driven and out of 142 million hectares of net sown area only 64 million hectares have access to irrigation facilities. Apart from dependency in rainfall, another issue which makes the situation more critical is the loss of 15-20% of the total crop produced due to pests, weeds and diseases. Due to this the importance of pesticides has been increasing over the last few decades

Currently, India is the fourth largest global producer of pesticides with an estimated market size of around $4.9 billion in FY17 after United States, Japan and China. In India, the pesticides are broadly divided into four types, Insecticides, Fungicides, Herbicides and Bio-pesticides. Bio-pesticides are an emerging category and are currently a small proportion of the market but have a huge growth potential considering its non-toxic nature.

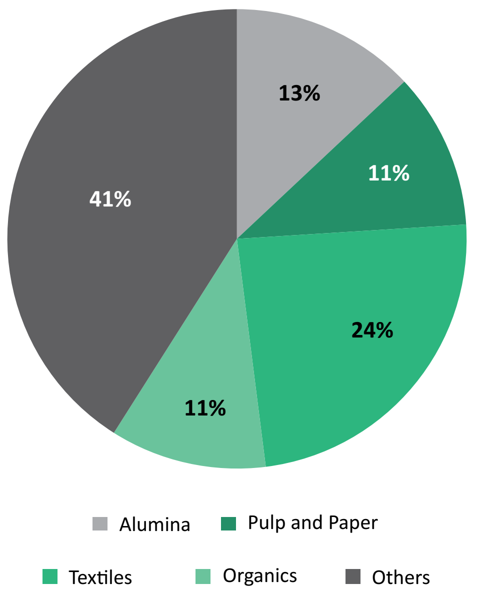
Indian companies are now building strategic partnerships with global pesticides companies from the USA, Europe, Japan and China. In return, Indian companies provide strong distribution network and sales infrastructure. An intense competition among the industry players has led to mergers & acquisitions in the pesticides market with only six players including Syngenta AG (Switzerland), Bayer Crop Sciences (Germany), BASF (Germany), The Dow Chemical Company (U.S.), Monsanto (U.S.), and DuPont (U.S.) controlling more than 80% of the global pesticide product sales.

India's share in global pesticide market is around 10% in FY17. However, India's pesticides consumption is one of the lowest in the world with per hectare consumption of just 0.6 Kg compared to US (5-7 Kg/ha) and Japan (11-12 Kg/ha).

Nevertheless this industry is faced with challenges such as low spending of R&D by Indian Players compared to the foreign players, seasonal demand as 70% of the pesticide consumption is skewed in favor of kharif crop, low brand awareness resulting in non-genuine products, inefficiencies in the supply chain and requirement of higher working capital investment due to elongated Inventory and credit periods.

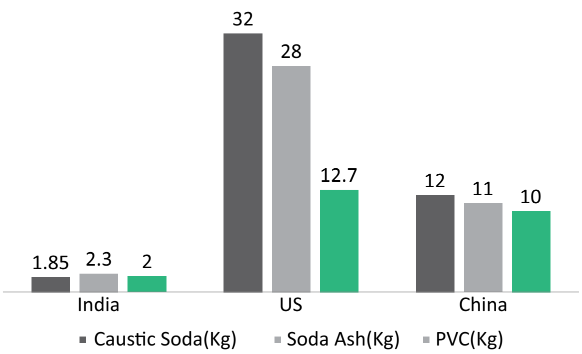
Even so the domestic pesticide market is expected to grow steadily as the farmers have learnt modern techniques of farming which has led to increased dependence on pesticides to enhance crop production and this has a substantial opportunity to explore

Sector-wise caustic soda consumption



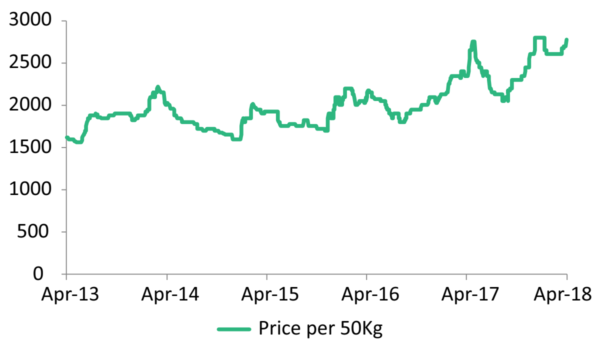
Source: Company Data

Per Capita Consumption of Chlor-Alkali



Source: Alkali Manufactures Association of India

Caustic Soda Price per 50Kg in India



Source: Bloomberg

the molecules going off-patent during CY2017-2020 and strategic partnerships with global giants.

Chlor-alkali Industry: The chlor-alkali industry consists of caustic Soda, chlorine and soda ash. Caustic soda and chlorine are produced simultaneously while soda ash is produced during a different process. Caustic soda finds major application in diverse industries, such as soap & detergents, pulp & paper and textile processing among others. Chlorine is produced as a by-product during caustic soda production and is widely used during PVC manufacturing, drinking water disinfection and pharmaceutical production. Soda Ash is used mainly during glass, soap & detergent and silicate production. With strong growth anticipated in all these end use industries, the market for chlor alkali in India is forecasted to grow considerably in the next five years. The global chlor-alkali market is projected to grow at a CAGR of between 5.0% and 5.5% from 2016 to 2022.

For chlor-alkali producers, electricity is the primary raw-material and accounts for about 60% of the manufacturing cash cost to produce chlorine and caustic soda. The electrochemical process for production of caustic soda leads to the generation of a fixed ratio of 1 tonne chlorine, 1.1tonne caustic soda (sodium hydroxide) and 0.03 tonne hydrogen. This product combination is called an Electrochemical Unit (ECU).

Prices of caustic soda have risen by nearly 30% over the last four months due to healthy demand growth and lower supplies following closure of manufacturing plants in Europe and China. The Indian alkali industry is regarded by global peers as among the most efficient, eco-friendly and progressive industries and has adopted the latest energy-efficient and eco-friendly membrane cell technology for producing caustic soda. The entire Indian alkali industry has phased out mercury cell process and adopted the latest membrane-cell technology for manufacturing caustic soda, the second country after Japan to do so.

However, India has low per capita consumption of Alkalis and PVC as compared to US and China but the 'Make in India' programme of the Indian government can provide a fillip to domestic manufacturing and add some value provided the right ecosystem is put in place to bring in investments and augment domestic manufacturing capacity. Moreover, the Chlorine, co-produced with caustic soda, has limited use and cannot be stored or transported in large quantities. The chlorine derivatives industry in India is still developing and not large enough to drive demand. This, in turn, retards the production of caustic soda.

Outlook

For Pigments, focusing on high margin paints and plastic markets

- The company is now on a sound footing. The Beta Blue plant has fully ramped up and utilization levels are also increasing. Going forward, the company is also going to focus on high-margin paints and plastic market by developing Speciality pigments for International markets.

In Agrochemicals, focusing of strengthening distribution network

- The Agrochemicals sector will do well on the back of normal monsoon predicted by India Meteorological Department (IMD) and increasing govt thrust over the sector. IMD has projected total rainfall in 2018 to be 97 per cent of the long-period average (LPA) of 89 cm. This will bear a positive effect on all the industries dependent on agriculture. This has already started factoring in as agrochemical business already reported higher revenue last year on the back of robust volume growth. The Company is also putting efforts in strengthening its distribution network which was earlier not being practiced due to subdued market conditions.

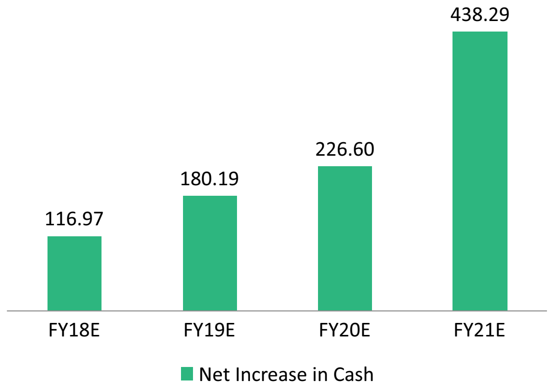
Expansion of caustic potash to drive growth in Basic Chemicals

- The Basic chemicals segment has already reported good margins and with the capacity expansion in this segment and upgradation of its caustic plant to the zero gap technology margins are likely to expand further.MOL views MFL as the vehicle for the future investments and growth. Subsequently, MFL would also enter into the production of chlorine derivatives or downstream products such as PVC, ECH, Mono-chloro Acetic acid, Cyanuric chloride, aluminum chloride, calcium chloride, methyl chloride, hydrogen peroxide and others. It is already setting up Chloromethane and Hydrogen Peroxide plant which are expected to be commissioned soon. This will further boost the revenue generation and would yield higher margins.

- Overall the export markets is reviving and Meghmani Organics is witnessing increasing demand for its higher-value products which will result in higher realisations and better margins.

Valuation

Cash Flow (INR Cr.)



Source: SMIFS Research

- We have valued the company on the basis of weighted average of DCF, EV/EBITDA and P/E multiple
- Post its major Capex the company is expected to generate huge cash flow, based on discounted cash flow we arrive at a price of INR167 (considering the WACC to be 18% and terminal growth rate of 2.50%).
- On the basis of P/E, we assigned a multiple of 8.5 times to its FY20 EPS and arrive at a price of INR127
- On the basis of EV/EBITDA, we assigned a multiple of 5.5 times to its FY20 EBITDA and arrive at a price of INR144

Finally on the basis of weighted average, of the three methods we arrive at a price target of INR140.

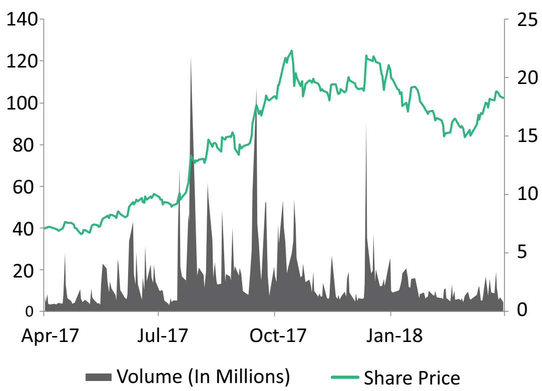
Aggressive Capex to generate huge cash flow

Valuation Matrix

Method	Price(INR)	Weight(%)	Weighted Price (INR)
P.E	127	50%	63.38
EV/EBITDA	144	30%	43.22
DCF	167	20%	33.35
Total			**140**

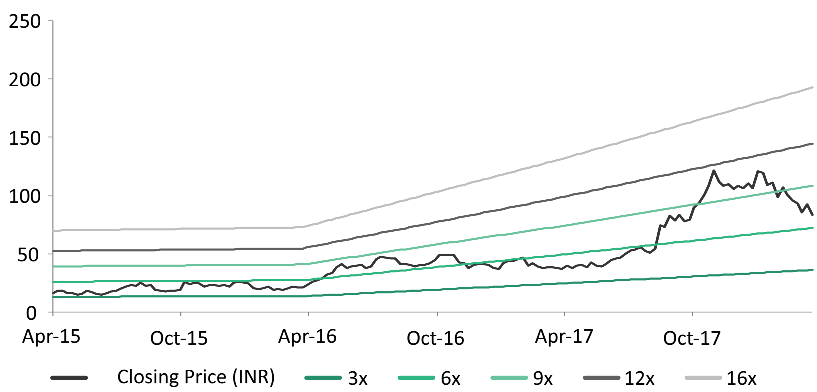
Source: SMIFS Research

Price Vol. Chart



Source: Company Data, SMIFS Research

P/E Band



Source: Company Data, SMIFS Research

Key Risks

- **Raw Material Risk**: Raw materials are mainly crude derivative so their prices are unstable. Moreover because of their hazardous nature the regulatory norms are becoming increasingly stringent. This is a critical challenge faced by this Industry.

- **Foreign Currency Risk**: In FY17, exports contributed 51% to the net sales of the company. Since significant portion of the business is dependent on exports so the risk of exchange rate functions affects the companies realisations.

- **Low consumption and awareness of agrochemicals in India**: Erratic rains typically impact sowing and make farmers miss the application of pesticides. Moreover, this Industry faces challenges in terms of low awareness levels among farmers about agrochemical products and their usage. Likewise rising sale of spurious pesticides and spiked bio pesticides pose major threats to industry growth.

- **The Indian Alkali sector faces steep power costs:** The chlor-alkali industry is power-intensive and the industry has invested substantially in setting up captive power plants due to undependable and expensive grid power. Power costs constitute nearly 60% of the overall cost of production. Instead of supporting the industry on this, state governments have imposed electricity duty and cess on captive power generation. With power costs in India relatively high, the domestic industry is at a disadvantage when compared to many countries from which imports come in, especially the Gulf. This result in dumping of caustic from neighbouring countries which might impact realisations of the Electrochemical Unit (ECU).

- **Limited use of chlorine in Basic chemicals segment:** Chlorine, co-produced with caustic soda, has limited use and cannot be stored or transported in large quantities. The chlorine derivatives industry in India is still developing and not large enough to drive demand. This, in turn, retards the production of caustic soda. Average chlorine realization is INR1 to minus INR1.5. However in the December quarter this fiscal year it has corrected and come up to zero level.

- **Stringent Pollution norms faced by Indian Chemical industry**: Environmental governance in India pushes chemical industry to face stricter pollution norms. In the last five years the output of the chemical industry has stagnated due to host of rules laid by pollution control board. The domestic chemical industry is simply unable to manufacture the required amount due to this policy bottlenecks.

Financial Details

Income Statement (Consolidated) — INR Cr.

Particulars (Y/E March)	FY16A	FY17A	FY18E	FY19E	FY20E	FY21E
Net Revenues	**1,332**	**1,423**	**1,819**	**2,139**	**2,517**	**2,986**
Cost of Material Consumed	707	794	905	1,043	1,220	1,469
Employee Cost	58	65	84	96	101	128
Other Expenses	306	275	381	438	515	538
Total Expenditure	**1,071**	**1,134**	**1,369**	**1,577**	**1,836**	**2,135**
EBITDA	**261**	**289**	**450**	**562**	**681**	**851**
[+] Other Income	25	12	12	12	12	12
[-]Depreciation	77	91	104	120	126	132
[-] Finance Cost	63	51	52	50	39	33
[+]Exceptional Items	-	(4)	-	-	-	-
[-]Tax Expense	35	40	87	114	149	196
PAT	**111**	**116**	**219**	**290**	**379**	**501**

Balance sheet (Consolidated) — INR Cr.

Particulars (Y/E March)	FY16A	FY17A	FY18E	FY19E	FY20E	FY21E
Share Capital	**25**	**25**	**25**	**25**	**25**	**25**
Reserves & Surplus	606	693	844	1048	1317	1675
Total Net Worth	**631**	**718**	**869**	**1073**	**1342**	**1700**
Non-Controlling Interests	**126**	**155**	**196**	**250**	**321**	**415**
Long term loans	217	122	100	150	100	92
Long Term Provisions	4	4	4	4	4	4
Other non-current Liabilities	28	29	32	32	32	32
Total Non-Current Liabilities	**248**	**155**	**136**	**186**	**136**	**128**
Short Term Borrowings	268	250	279	223	178	142
Trade Payables	178	163	216	249	281	332
Other Current Liabilities	142	138	160	175	190	215
Total Current Liabilities	**588**	**551**	**656**	**648**	**649**	**689**
Total Equities and Liabilities	**1595**	**1579**	**1857**	**2166**	**2493**	**3018**
Net Block	**736**	**779**	**815**	**854**	**838**	**764**
Capital Work in Progress	92	19	69	89	79	69
Other Non-Current Assets	20	16	11	11	11	11
Total Non-Current Assets	**849**	**815**	**895**	**954**	**928**	**844**
Inventories	313	242	344	387	456	539
Trade Receivables	327	331	387	434	496	589
Cash and bank balances	11	10	127	303	524	958
Other Current Assets	95	182	88	88	88	88
Total Current Assets	**746**	**765**	**946**	**1212**	**1565**	**2173**
Total Assets	**1595**	**1579**	**1858**	**2166**	**2493**	**3018**

Cashflow Statement (Consolidated)

INR Cr.

Particulars (Y/E March)	FY16A	FY17A	FY18E	FY19E	FY20E	FY21E
PBT	**146**	**155**	**306**	**404**	**528**	**697**
[+]Adjustments	140	149	159	173	168	168
Operating Profit Before Working Capital Changes	**286**	**304**	**465**	**577**	**696**	**866**
Changes in Working Capital	(51)	(7)	(17)	(47)	(85)	(99)
Tax Paid	(34)	(34)	(86)	(113)	(148)	(195)
Cash From Operating Activities	**201**	**263**	**362**	**417**	**463**	**571**
Cash From Investing Activities	**(73)**	**(95)**	**(187)**	**(167)**	**(87)**	**(37)**
Cash from Financing Activities	**(134)**	**(164)**	**(58)**	**(70)**	**(149)**	**(96)**
Net Cash inflow/Outflow	(6)	4	117	180	227	438
Opening Cash & Cash Equivalents	**7**	**3**	**1**	**118**	**295**	**516**
Closing Cash & Cash Equivalent	**2**	**7**	**118**	**299**	**521**	**954**
[+]Adjustments	**(1)**	**5**	**-**	**4**	**5**	**5**
Total Cash Balance as per Balance Sheet	**3**	**1**	**118**	**295**	**516**	**949**

Source: Company Data, SMIFS Research

Key Ratios

Particulars (Y/E March)	FY16	FY17	FY18E	FY19E	FY20E	FY21E
Revenue Mix						
Pigments	30.6%	33.9%	30.8%	29.7%	28.6%	27.8%
Agrochemicals	32.9%	33.5%	32.8%	32.0%	29.3%	26.5%
Basic Chemicals	29.0%	27.3%	32.0%	34.4%	38.8%	42.9%
Profit Margins						
Gross Margin	44.7%	48.7%	49.6%	50.6%	49.8%	50.0%
EBITDA Margin	19.6%	20.3%	24.7%	26.3%	27.1%	28.5%
EBT Margin	11.0%	10.9%	16.8%	18.9%	21.0%	23.4%
Net Income Margin	8.3%	8.1%	12.0%	13.5%	15.1%	16.8%
Liquidity Ratios						
Current Ratio (x)	1.27	1.39	1.44	1.87	2.41	3.15
Quick Ratio (x)	1.26	1.39	1.26	1.42	1.62	1.78
Return Ratios						
ROAE	18.8%	17.2%	27.6%	29.8%	31.4%	32.9%
ROACE	24.7%	25.0%	36.9%	37.1%	39.3%	40.8%
Solvency Ratios						
Long term Debt/ Equity (x)	0.34	0.17	0.11	0.14	0.07	0.05
Debt/Asset (x)	0.14	0.08	0.05	0.07	0.04	0.03
Interest Coverage Ratio (x)	3.32	4.13	6.84	9.11	14.49	21.86
Valuation Ratios						
P/E (x)	22.5	21.6	11.4	8.6	6.6	5.0
P/B (x)	4.0	3.5	2.9	2.3	1.9	1.5
EV/EBITDA (x)	12.0	10.8	7.2	5.3	4.5	4.1

Source: Company Data, SMIFS Research

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Stock Recommendation	Expected absolute returns (%) over 12 months
Strong Buy	>20%
Buy	between 12% and 20%
Accumulate	between 6% and 12%
Hold	between 0% and 6%
Sell	0 to <10%
Neutral	No Rating

Bloomberg Ticker for Stewart & Mackertich Research: SMIF<Enter>

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