DCW Ltd.

Quick small/midcap Funda Momentum Picks

Medium to High risk

Key points:

- These picks are based on fundamentals and issued when momentum is seen in them. These stocks may not have enough liquidity and depth and may go from circuit to circuit (either up or down). In the interest of timeliness, detailed financial projections are not prepared.
- Small allocation of investible surplus may be put in such stocks and spread your surplus among several such stocks.
- Once the risk appetite in the market reduces, such stocks could face the pressure of selling irrespective of fundamentals or valuations.
- Entry and exit into these stocks have to be carefully timed.
- These stocks have inherent value in them and their expected rate of growth could be faster than their peers. Their current valuations may not reflect these and hence considering the current market conditions, a buy report has been issued.
- It is possible that the street may take time to recognize these or there may be adverse developments in the interim. Hence proper exit strategies have to be worked out in advance (that may include stoploss or trailing stoploss).

15-Sept-2021

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Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Red flag level*	Time Horizon
Chemicals	Rs.39.2	Buy in Rs. 38-41 band & add more on dips to Rs 33	Rs. 44	Rs. 48	Rs.30	2 quarters

*Investor may sell 60-65% of their holding on first target being achieved and later keep a stop loss of first target for balance holding, in case the second target takes time to be achieved. Investor may also maintain Rs.30 as red flag level below which investment position needs to be reviewed, including the possibility to exit

HDFC Scrip Code	DCWLTDEQNR
BSE Code	500117
NSE Code	DCW
Bloomberg	DCW:IN
CMP Sept 14, 2021	39.2
Equity Capital (Rs cr)	52
Face Value (Rs)	2
Equity Share O/S (cr)	26
Market Cap (Rs cr)	1022
Book Value (Rs)	26
Avg. 52 Wk Volumes	24,04,370
52 Week High	44.9
52 Week Low	13.9

Share holding Pattern % (June, 2021)	
Promoters	46.76
Institutions	6.10
Non Institutions	47.14
Total	100.0

Retail Research Risk Rating:

		Red*

*** Refer at the end for explanation on Risk Ratings**

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Our Take:

Dhrangadhra Chemical Works Ltd (DCW) is one of the pioneers in chloro-alkali industry in India and is a leading multi-product chemical company with presence across Caustic Soda, Soda Ash, PVC, CPVC and SIOP (Synthetic Iron Oxide Pigments). On the specialty chemical side, in 2016, the company had commenced operations of SIOP in its Sahupuram facility with technological help from Huntsman pigments while in 2017, it entered into a niche, margin accretive CPVC business with technical license from Arkema and became the first and only manufacturer of CPVC in India. Apart from this, the company has self-sufficiency with respect to major raw materials (Salt, Liquid Chlorine, Hydrogen, Hydrochloric Acid, Leach Liquor etc) which are sourced in-house and it has a cogen power plant with an installed capacity of 58MW with 12 MW DG sets for backup at its Sahupuram facility.

The SIOP division had taken quite a long time to stabilize; also this being in the specialty chemical segment its validation process was slow and tedious. Post commencement of operations this division got finally stabilized by 2019 which resulted in continuous low utilization levels resulting in stress in companies operating performance. In order to ensure smooth functioning of its operations, the company in Mar 2019 had issued 1.58Cr convertible warrants at Rs. 19/share to promoter group and its associates aggregating Rs. 30Cr. Also in Q4FY21, DCW was able to manage a fund raise from Kotak Special Securities Fund(KSSL) of Rs. 410cr via NCDs of Rs. 350Cr and OCDs of Rs. 60Cr (optionally convertible into 3.33Cr @ RS. 18/share before Dec 2022 – resulting in ~11% stake in the company). Through these transactions, the company extended its debt stack maturities and added additional liquidity to the balance sheet. Going forward, we believe, the recent fund raise will address the company's liquidity related issues and will reduce overall finance cost post conversion of warrants. The chemical industry upswing will benefit DCW.

DCW could benefit out of upswing in the prices of PVC, Caustic Soda and Soda Ash in Q2FY22 and the entire FY22 while its utilization in CPVC and SIOP could rise leading to higher revenues and margins.

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Valuations & Recommendation:

We expect, with the required capital infusion, the company's operations are likely to stabilize and there will be an end to the turbulent phase which it had experienced since last 2-3 years. DCW is one of the oldest company in the commodity chemical space and scale-up in its margin accretive speciality chemical side along with constant de-leveraging and no large capex lined up for next 2 years will result in strong cash flow generation and improvement in its return ratios which would the key drivers for the stock to get re-rated. We think DCW can post a revenue/EBITDA and PAT growth of CAGR 16/22/480% over FY21-FY23E. We believe the base case fair value of the stock is Rs.44 (4.4x FY23E EV/EBITDA) and the bull case fair value is Rs.48 (4.7x FY23E EV/EBITDA). Investors can buy the stock in the band of Rs. 38-41 and further accumulate on dips at Rs.33.

Financial Summary

Particulars (Rs cr)	Q1FY22	Q1FY21	YoY-%	Q4FY21	QoQ-%	FY19	FY20	FY21
Total Operating Income	520.5	284.6	82.9	455.7	14.2	1,352.8	1,277.3	1,464.3
EBITDA	57.4	32.6	76.2	69.8	-17.8	161.9	146.4	209.5
Depreciation	30.9	27.7	11.4	36.2	-14.7	83.4	87.2	87.0
Other Income	16.1	0.8	1868.3	7.3	121.7	3.6	8.6	11.0
Interest Cost	30.9	27.7	11.4	36.2	-14.7	104.0	107.5	120.0
Tax	7.3	-6.1	-219.4	12.3	-40.2	-17.6	-12.9	10.0
PAT	13.4	-9.8	-235.9	6.5	106.6	-4.3	-26.7	3.5
Diluted EPS (Rs)	0.5	-0.4	-227.5	0.3	104.0	-0.2	-1.0	0.2
RoE						-1%	-4%	1%
P/E (x)						NA	NA	226.7
EV/EBITDA						8.7	9.3	6.5

(Source: Company, HDFC sec)
Fig in Cr

Q1FY22 Review

Revenue for the quarter stood at Rs. 520Cr which grew by 83/14% on a YoY/QoQ basis. Segment-wise the commodity/ speciality segment registered a growth of 66/86% on a YoY basis and on a sequential basis commodity chemicals grew by 18% while speciality segment declined by 9%. Higher growth in commodity segment was driven by caustic soda and PVC which grew by 103% on QoQ basis.

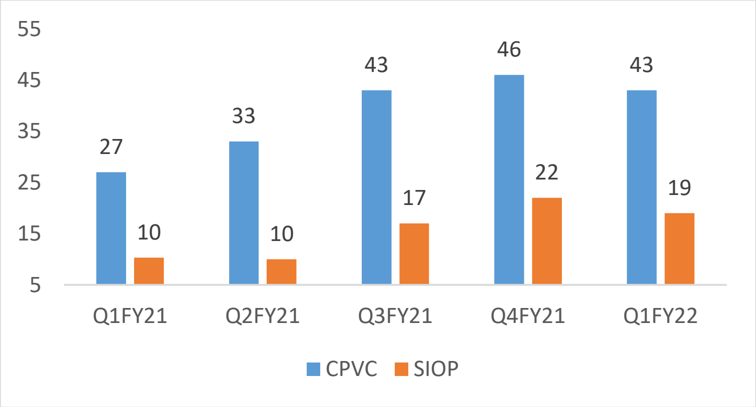
EBITDA for the quarter stood at Rs. 57.4Cr which grew by 76% on a YoY basis, however on a sequential basis it declined by 17.8%. Segment-wise commodity/specialty chemical EBITDA grew by 75/97% on YoY basis while sequentially it declined by 34/17%. Consequently PAT for the quarter stood at Rs. 13.4Cr v/s a loss of Rs. 9.8Cr in Q1FY21.

Long Term Triggers

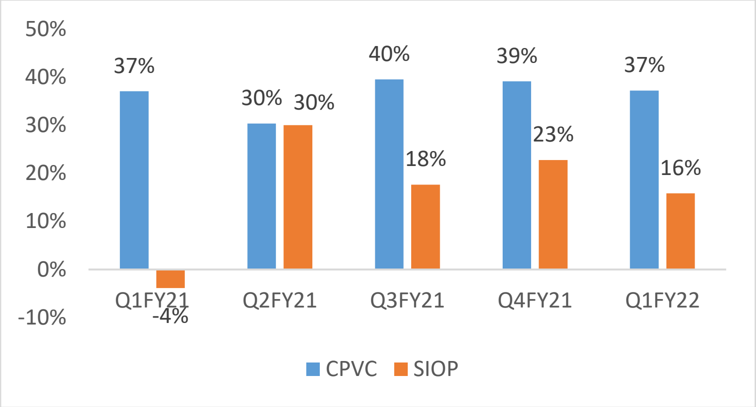
Ramp-up of Specialty Chemicals to be margin accretive for the company

Specialty chemical portfolio of the company currently includes CPVC and SIOP. CPVC is a rigid thermoplastic material that is used for hot and cold potable water applications in residential construction. In the CPVC space, anti-dumping duty imposition on imports from China and Korea are creating opportunity for domestic Market. India’s total requirement for CPVC is ~127k MTPA and its demand is growing at 13%. DCW is currently the sole manufacturer in India and has an installed capacity of 10,000 MTPA. The company is currently operating at optimal utilization levels resulting in consistent delivery of best-in-class operating performance for the last 5 quarters. It has been clocking a healthy 30%+ EBITDA Margin which are likely to sustain. Apart from DCW, companies like Lubrizol, Sekisui and Kaneka are top global players with strong presence in Indian markets.

Recent revenue growth trend- Specialty Chemicals



Segmental EBITDA Margin Trend



(Source: Company, HDFC sec)
Fig in Cr

In the SIOP segment, DCW is one of the largest and leading manufacturer of synthetic iron-oxide pigments with patented chlorine based technology transferred from Rockwood Pigments. Its total current capacity is 27k MTPA with 50k MTPA of calcium chloride. These pigments are resistant to UV rays, salty weather and all different kind of atmospheric conditions. They are used in a wide variety of applications, mainly in coatings and construction. India contributes ~45-50% of the overall revenues for SIOP while rest are from exports. BASF, Huntsman are its top customers. Going forward, post the recent capital infusion, we expect this segment utilizations to improve substantially over next couple of years (from 46% in Q1FY22) resulting in strong uptick in margins on the back of operating leverage benefits. Red and yellow pigments are manufactured from an EoU and 40-50% of the production is sold in India and the rest exported.

Commodity chemicals consistently showing signs of improvement

Commodity chemical segment comprises of Caustic Soda, Soda Ash & PVC which is DCW's legacy business which it has been running for decades. In the caustic soda space, the company has presence in Southern India and operates through its Sahupuram, Tamil Nadu facility. In the domestic market almost 50% of capacity is installed in western India while 25% is in southern India. DCW plant location is in the close

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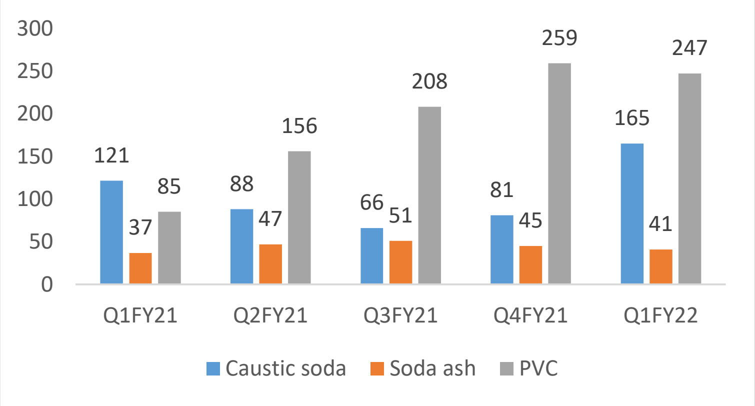
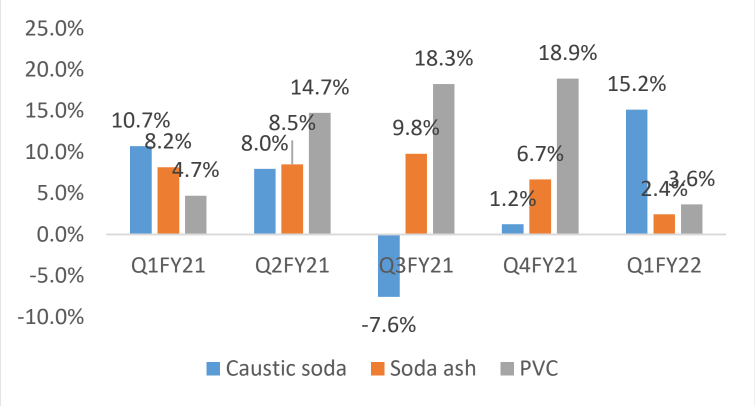
proximity of salt deposits which makes raw material availability easier. The company has a 96k MTPA capacity and competes to players like Chemplast Sanmar and Andhra Sugar in the southern markets. The company caters to bulk sales to NALCO which is mainly present in southern markets. Caustic soda as on FY21 contributed 25% of DCW overall revenue.

Quarterly segment-wise revenue trend



Quarterly segment-wise margin trend



(Source: Company, HDFC sec)
Fig in Cr

Synthetic Rutile (titanium oxide) is a part of the Caustic Soda business and is made using Chlorine generated from caustic soda manufacture and buying ilmenite ore. This is used by paint and polymer manufacturers. The waste from this process is used to manufacture SIOP.

In the Soda Ash segment, DCW produces the light grade soda ash which is used in soap and detergents, pulp and paper, iron and steel, aluminum cleaning compounds, water softening and dyeing. The total domestic capacity stands at 4Mn MTPA while almost 23% of Indian demand is still met through imports. A large part of Soda Ash capacities in India are concentrated in Western part due to availability of required raw material i.e. Salt, Lime Stone and Coal/Lignite. DCW produces Soda Ash at its Dhrangandra facility in Gujarat. Soda Ash total current capacity is 104k MTPA while its utilizations for last 5 years has been consistently 90%+. As on FY21 it contributed 12% of DCW overall revenue.

The 3rd product in the commodity chemical side is PVC where DCW is a leading player in South India with a capacity of 90k MT. PVC is used in variety of items, such as Pipes and Fittings, Wires and Cables, Calendared Sheets, Blow Molded Bottles, Profiles, Footwear, Roofing, Automotive Parts, Table Clothes, Shower Curtains and Furniture. In India the per capita consumption of PVC is significantly less as compared with developed countries. DCW produces PVC at its Sahupuram, Tamil Nadu facility and competes with the likes of Chemplast Sanmar in this region. The total domestic demand for PVC is almost twice of domestic production, as a result India is highly dependent on PVC imports. Also over last 15 years there has been no major incremental capacity expansion in India as PVC expansion is highly capital intensive in nature. DCW uses chlorine generated in caustic soda manufacture in its PVC manufacture, leading to cost optimisation.

Post the pandemic led lockdown PVC prices in Apr ’20 had crashed to almost $600/MT which by Apr ’21 shot to almost $1600/MT while the prices currently have come down to ~$1200/MT. Going forward, on the back of supply side issues mainly from US (due to its own rising consumption to feed its infra spend), the prices of PVC are likely to stay firm for the foreseeable future.

Concerns

- The soda ash and its consuming industries has shown signs of recovery but still hasn’t reached pre-covid levels. Any recurrence of covid cases and further lockdowns can impact demand in the short to medium term.
- Extreme volatility in commodity chemical prices and contraction in spreads of PVC/VCM can impact future earnings growth outlook.
- High energy prices, increase in freight cost along with any supply chain disruptions can be potential risk for the medium term growth outlook of the company.
- Inability to scale up and have a sustainable profitable growth in the specialty chemical business especially SIOP can have an adverse impact on companies growth outlook.
- Due to the high debt on books due to its capex in the past, its interest liability remains high. It has to generate large cashflows over the next two years to repay a large portion of its debt. Any delay in this could be detrimental to its leverage ratios. This may also result in Kotak Special Situations fund not opting to convert the high cost OCDs.

DCW Ltd

Financial

Income Statement

(Rs Cr)	FY18	FY19	FY20	FY21
Net Revenues	**1187**	**1353**	**1277**	**1464**
Growth (%)	1%	14%	-6%	15%
Operating Expenses	1062	1191	1131	1255
EBITDA	**126**	**162**	**146**	**210**
Growth (%)	**29%**	**-10%**	**43%**	**30%**
EBITDA Margin (%)	**11**	**12**	**11**	**14**
Depreciation	88	83	87	87
EBIT	**38**	**79**	**59**	**123**
Other Income	6	4	9	11
Interest expenses	93	104	107	120
PBT	**-49**	**-22**	**-40**	**14**
Tax	-29	-18	-13	10
RPAT	**-20**	**-4**	**-27**	**4**
APAT	**-20**	**-4**	**-27**	**4**
Growth (%)	-197%	-79%	523%	-113%
EPS	-0.9	-0.2	-1.0	0.2

Balance Sheet

As at March	FY18	FY19	FY20	FY21
SOURCE OF FUNDS				
Share Capital	44	44	52	52
Reserves	591	587	626	635
Shareholders' Funds	**635**	**632**	**678**	**687**
Long Term Debt	689	537	531	588
Net Deferred Taxes	84	66	54	62
Other Liabilities	38	27	21	47
Minority Interest				
Total Source of Funds	**1446**	**1262**	**1283**	**1384**
APPLICATION OF FUNDS				
Net Block & Goodwill	1471	1534	1467	1407
CWIP	124	7	12	4
Other Non-Current Assets	13	28	16	53
Total Non Current Assets	**1608**	**1569**	**1496**	**1464**
Current Investments	0	0	0	0
Inventories	157	122	177	169
Trade Receivables	86	74	73	95
Cash & Equivalents	4	17	50	122
Other Current Assets	49	23	38	24
Total Current Assets	**297**	**236**	**338**	**411**
Trade Payables	173	278	323	298
Other Current Liab & Prov	285	264	227	193
Total Current Liabilities	**458**	**542**	**550**	**491**
Net Current Assets	-161	-306	-212	-80
Total Application of Funds	**1446**	**1262**	**1283**	**1384**

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Cash Flow Statement

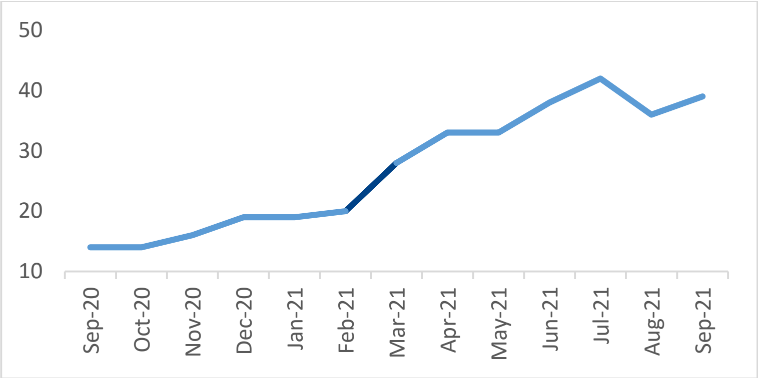
(Rs Cr)	FY18	FY19	FY20	FY21
Reported PBT	-49.0	-22.0	-40.0	14.0
Non-operating & EO items	0.0	0.0	0.0	0.0
Interest Expenses	88.0	83.0	87.0	87.0
Depreciation	92.0	103.0	105.0	116.0
Working Capital Change	-81.6	121.0	19.0	5.0
Tax Paid	1.2	5.0	-13.0	0.0
OPERATING CASH FLOW (a)	**50.6**	**290.0**	**158.0**	**222.0**
Capex	-21.0	-31.0	-16.0	-18.0
Free Cash Flow	29.6	259.0	142.0	204.0
Investments	0.2	0.0	0.0	0.0
Non-operating income	6.8	-14.0	-32.0	-66.0
INVESTING CASH FLOW (b)	**-14.0**	**-45.0**	**-48.0**	**-84.0**
Debt Issuance / (Repaid)	42.0	-127.0	-85.0	34.0
Interest Expenses	-88.0	-113.0	-106.0	-132.0
FCFE	-16.4	19.0	-49.0	106.0
Share Capital Issuance	2.3	0.0	72.0	0.0
Others	0.0	0.0	0.0	0.0
FINANCING CASH FLOW (c)	**-43.8**	**-240.0**	**-119.0**	**-98.0**
NET CASH FLOW (a+b+c)	**-7.1**	**5.0**	**-9.0**	**40.0**

Key Ratios

(Rs Cr)	FY18	FY19	FY20	FY21
EBITDA Margin	10.6%	12.0%	11.5%	14.3%
EBIT Margin	3.2%	5.8%	4.6%	8.4%
APAT Margin	-1.7%	-0.3%	-2.1%	0.2%
RoE	-3%	-1%	-4%	1%
RoCE	3%	6%	5%	9%
Solvency Ratio				
Net Debt/EBITDA (x)	5.4	3.3	3.6	2.6
Net D/E	1.1	0.8	0.7	0.7
PER SHARE DATA				
EPS	-0.9	-0.2	-1.0	0.2
CEPS	3.1	3.6	2.3	3.5
Dividend	0.0	0.0	0.0	0.0
BVPS	28.7	28.6	26.0	26.3
Turnover Ratios (days)				
Debtor days	25.6	21.6	20.9	26.5
Inventory days	45	38	43	44
Creditors days	39	61	86	46
VALUATION				
P/E	NA	NA	NA	227
P/BV	1.2	1.2	1.3	1.3
EV/EBITDA	12.5	8.7	9.3	6.5
EV / Revenues	1.3	1.0	1.1	0.9
Dividend Yield (%)	0.0	0.0	0.0	0.0
Dividend Payout	0.0	0.0	0.0	0.0

(Source: Company, HDFC sec)

One Year Price Chart



(Source: Company, HDFC sec)

HDFCSec Retail Research Rating description

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This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Blue Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

Disclosure:

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