AXIS CAPITAL

GMM Pfaudler

Global powerhouse in glass lined equipment

Midcaps | Initiating Coverage | October 19, 2022

BUY

Current Price (Rs)	: 1,830
Target Price (Rs)	: 2,548
Potential Upside	: 39%

Market Data

No. of shares	: 44 mn
Free Float	: 44%
Market Cap (USD)	: 967 mn
52-week High/ Low (Rs)	: 2,110/ 1,251
Avg. Daily Volume (6M)	: 0.18 mn
Avg. Daily Value (6M;USD)	: 3.71 mn
Bloomberg Code	: GMM IB
Promoters Holding	: 56%
FII / DII	: 12% / 4%

Price Performance

(%)	1M	3M	12M
Absolute	(1.1)	27.1	10.7
Relative	(1.1)	19.2	14.9

Source: Bloomberg

GMM Pfaudler is a play on the manufacturing shift of chemicals and pharmaceuticals from China/ developed markets to India – a strong theme for the next decade. Interestingly, a similar theme is playing out in the company's own operations. In the international companies that GMM Pfaudler acquires, product manufacturing is moved to India, finishing/assembly is done in developed markets, and a top-quality product is delivered to clients at a developed market pricing. We initiate coverage on GMM Pfaudler with a **BUY** rating and target price of Rs 2,548, which is set using target P/E of 36x Sep'24E (in line with the company's average P/E multiple over the last 5 years).

Manufacturing shift to India

Shift in manufacturing from China, Europe, and the USA to India is the key growth driver for chemical and pharmaceutical sectors over the next decade. Covid-19, Russia–Ukraine war, higher labor costs in China and developed world, stricter pollution norms in China and the Indian government's support to chemicals and pharmaceutical industries through the PLI scheme and Pharma city are the key facilitators of this trend.

Dominant global and India market leader in glass lined equipment (GLE)

GMM Pfaudler is the global (40% market share) and the India market leader (60% market share) in GLE due to the company's superior product quality, technology leadership and strong client credentials. Absence of product substitutes and increasing size of equipment presents a strong moat to the business.

Ramping up non-GLE business aggressively

The company is also ramping up its non-GLE business through acquisitions, expansion of product offerings using Pfaudler Inc's portfolio, expanding in heavy engineering business, and tapping export opportunities through Pfaudler's global network.

59% EPS CAGR over FY22-25

We expect GMM Pfaudler to post revenue CAGR of 16% over FY22-25 with EBITDA margin expanding from 11.2% to 16.3% (bulk of the delta coming from improvement in Pfaudler Inc). This should lead to PAT and EPS CAGR of 60% and 59% respectively over FY22-25E with average RoE of ~25%.

Key downside risks

Slowdown in capex by pharma and chemical industries; commodity price inflation, rising input costs, geopolitical events, environmental and regulatory risks.

Financial summary (Consolidated)

Y/E March	FY21	FY22	FY23E	FY24E	FY25E
Sales (Rs mn)	10,011	25,406	30,000	34,800	39,324
EBITDA (Rs mn)	1,386	2,839	4,133	5,443	6,410
Adj. PAT (Rs mn)	1,068	850	1,661	2,863	3,502
Con. EPS* (Rs)	-	-	41.5	56.6	77.0
EPS (Rs)	24.4	19.4	36.9	63.7	77.9
Change YoY (%)	50	(20)	90	72	22
Previous EPS (Rs)	-	-	-	-	-
RoE (%)	29.0	18.2	24.1	29.1	27.3
RoCE (%)	10.9	9.6	17.5	22.0	24.6
P/E (x)	75.1	94.4	49.6	28.7	23.5
EV/E (x)	60.7	29.6	20.0	15.0	12.4

Source: *Consensus broker estimates, Company, Axis Capital

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Exhibit 1: GMM Pfaudler – Financials, valuations, and key ratios

Year End Mar31 (Rs mn)	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E	FY25E
P&L Statement									
Net Revenues	3,530	4,057	5,026	5,911	10,011	25,406	30,000	34,800	39,324
YoY	*21%*	*15%*	*24%*	*18%*	*69%*	*154%*	*18%*	*16%*	*12%*
EBITDA	477	621	770	1,111	1,386	2,839	4,133	5,443	6,410
EBITDA margin	13.5%	15.3%	15.3%	18.8%	13.8%	11.2%	13.8%	15.6%	16.3%
EBIT	395	523	660	900	881	1,512	2,970	4,134	4,934
EBIT margin%	11.2%	12.9%	13.1%	15.2%	8.8%	6.0%	9.9%	11.9%	12.5%
PAT to Shareholders	333	427	506	711	733	850	1,661	2,863	3,502
PAT Margins	9.4%	10.5%	10.1%	12.0%	7.3%	3.3%	5.5%	8.2%	8.9%
YoY	*65%*	*28%*	*19%*	*41%*	*3%*	*16%*	*95%*	*72%*	*22%*
Balance Sheet									
Net Fixed Assets	517	655	703	1,073	8,385	7,832	8,407	9,077	9,805
Other non-CA	155	150	192	324	2,480	2,557	4,004	3,765	3,527
Total CA	2,519	3,083	3,449	3,899	13,310	16,887	18,544	20,552	22,421
Total Assets	**3,191**	**3,889**	**4,344**	**5,296**	**24,175**	**27,276**	**30,956**	**33,394**	**35,753**
Networth	1,948	2,277	2,689	3,290	4,071	5,271	8,501	11,184	14,461
Minority Interests	-	-	-	-	1,233	1,413	-	-	-
Long-term Borrowings	-	-	-	-	4,428	4,496	4,296	3,396	896
Other non-CL	111	173	208	361	6,418	5,388	5,388	5,388	5,388
Total CL	1,132	1,438	1,447	1,645	8,024	10,708	12,771	13,426	15,008
Total Liabilities & Net worth	**3,191**	**3,889**	**4,344**	**5,296**	**24,175**	**27,276**	**30,956**	**33,394**	**35,753**
Cash Flow Statement									
Net Profit	333	427	506	711	733	850	1,661	2,863	3,502
Change in WC	(225)	150	(292)	(815)	(1,046)	360	(316)	(295)	(256)
Others	68	120	110	216	626	1,542	1,164	1,309	1,476
Operational CF	**176**	**697**	**323**	**112**	**313**	**2,752**	**2,508**	**3,877**	**4,721**
Capex	(137)	(242)	(159)	(737)	(9,560)	(1,067)	(3,186)	(1,740)	(1,966)
Others	(206)	(6)	20	111	4,769	(2,232)	-	-	-
Investing CF	**(343)**	**(248)**	**(139)**	**(626)**	**(4,791)**	**(3,299)**	**(3,186)**	**(1,740)**	**(1,966)**
Change in Debt	-	-	-	344	5,641	372	247	(1,900)	(2,500)
Change in Equity	(53)	(97)	(94)	(110)	1,281	529	156	(180)	(225)
Financing CF	**(53)**	**(97)**	**(94)**	**234**	**6,923**	**901**	**403**	**(2,080)**	**(2,725)**
Valuations & Key Ratios									
EPS	7.6	9.7	11.5	16.2	16.7	19.4	36.9	63.7	77.9
YoY	*65%*	*28%*	*19%*	*41%*	*3%*	*16%*	*90%*	*72%*	*22%*
BV	44.4	51.9	61.3	75.0	92.8	120.2	189.1	248.8	321.7
DPS	1.3	1.3	1.5	1.7	1.7	2.0	3.0	4.0	5.0
P/E	241.0	187.9	158.5	112.7	109.4	94.3	49.5	28.7	23.5
P/BV	41.1	35.2	29.8	24.4	19.7	15.2	9.7	7.3	5.7
EV/EBITDA	166.3	127.3	102.6	71.7	60.0	29.3	20.8	15.4	12.7
Yield %	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.2%	0.2%	0.3%
Dividend Payout Ratio (%)	18%	14%	13%	10%	10%	10%	8%	6%	6%
Net D/E	-0.39	-0.51	-0.46	-0.15	0.58	0.46	0.42	0.15	-0.06
RoE	18.4%	20.2%	20.4%	23.8%	19.9%	18.2%	24.1%	29.1%	27.3%
PAT/EBIT	84.2%	81.6%	76.6%	79.0%	83.2%	56.2%	55.9%	69.2%	71.0%
EBIT/Sales	11.2%	12.9%	13.1%	15.2%	8.8%	6.0%	9.9%	11.9%	12.5%
Sales/Assets	122.8%	114.6%	122.1%	122.6%	67.9%	98.8%	103.0%	108.2%	113.7%
Assets/Net worth	158.9%	167.5%	165.8%	161.2%	400.3%	550.7%	422.8%	326.9%	269.6%
RoCE (post Tax)	18.0%	19.4%	19.9%	26.2%	13.4%	9.8%	17.1%	20.5%	22.7%

Source: Company, Axis Capital

Investment thesis and valuations

Investment thesis

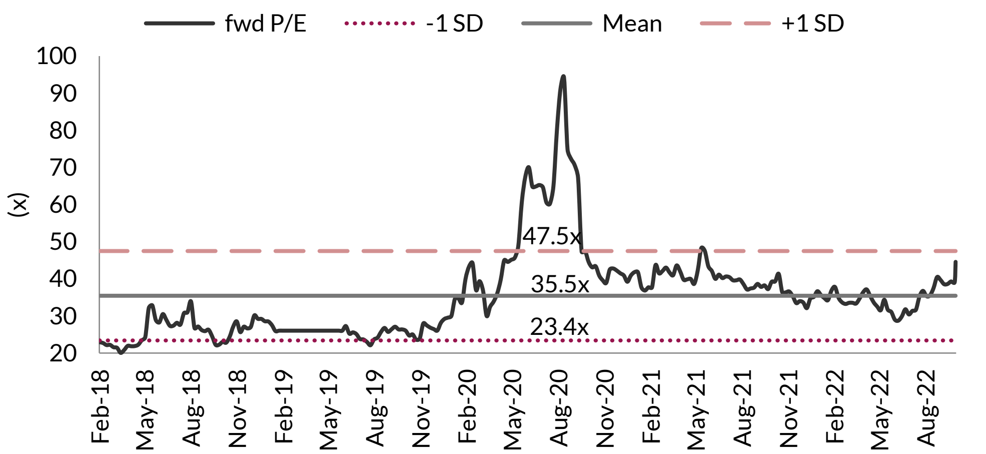
We initiate coverage on GMM Pfaudler with a **BUY** rating and target price of Rs 2,548:

- Shift in manufacturing from China, Europe, and the USA to India is the key growth driver for chemical and pharmaceutical sectors over the next decade. Covid-19, Russia–Ukraine war, higher labour costs in China and developed world, stricter pollution norms in China and the Indian government support to chemicals and pharmaceutical industries through the PLI scheme and Pharma city are the key facilitators of this trend.
- GMM Pfaudler is the global (40% market share) and India market leader (60% market share) in GLE due to the company's superior product quality, technology leadership and strong client credentials. Absence of product substitutes and increasing size of equipment present a strong moat to the business.
- The company is also ramping up its non-GLE business acquisitions, expansion of product offerings using Pfaudler Inc's portfolio, expanding in heavy engineering business, and tapping export opportunities through Pfaudler's global network.
- We expect GMM Pfaudler to post revenue CAGR of 16% over FY22-25 with EBITDA margin expanding from 11.2% to 16.3% (bulk of the delta coming from improvement in Pfaudler Inc). This should lead to PAT and EPS CAGR of 60% and 59% respectively over FY22-25E with average RoE of ~25%.
- In August 2022, GMM Pfaudler acquired the balance 46% stake (26% from the Patel Family and 20% from DBAG Fund VI) in Pfaudler Inc, which has cleaned up the holding structure and would be viewed positively by investors.

Valuations

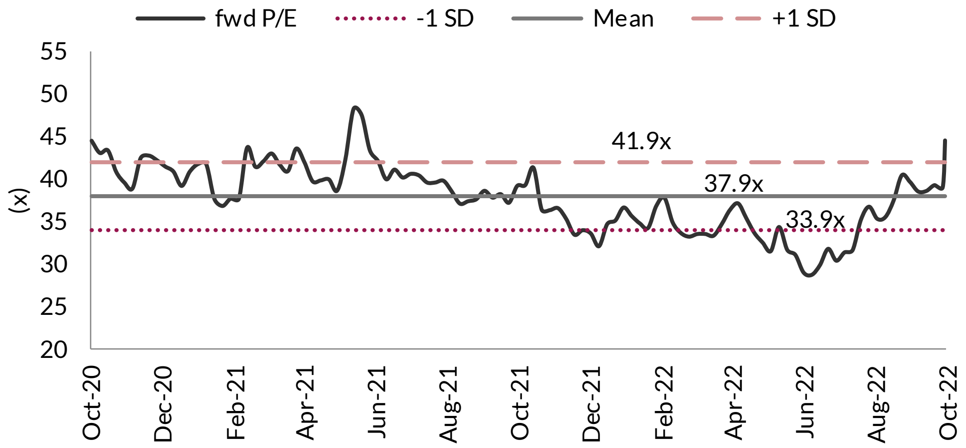
We value GMM Pfaudler at 36x Sep'24 P/E, which is in line with the historical mean over the last 5 years. This is justified by the 59% EPS CAGR over FY22-25 with average RoE of ~25%. From the comparables, we clearly see that majority of global capital equipment companies (with access to technology) listed in India trade at high valuations. We believe GMM Pfaudler ticks the same boxes and should be accorded valuations in the same range as this pack of companies.

Exhibit 2: GMM Pfaudler 1-year forward consolidated P/E (last 5 years)



Source: Bloomberg, Company, Axis Capital

Exhibit 3: GMM Pfaudler 1-year forward consolidated P/E (last 2 years)



Source: Bloomberg, Company, Axis Capital

Exhibit 4: India Capital Equipment comparables

	Price	MCap	P/E			P/BV			EV/EBITDA			RoE		
Company	**(Rs)**	**(USD mn)**	**FY22**	**FY23E**	**FY24E**	**FY22**	**FY23E**	**FY24E**	**FY22**	**FY23E**	**FY24E**	**FY22**	**FY23E**	**FY24E**
GMM Pfaudler	1,828	975	94.3	44.0	32.3	15.2	10.5	8.1	29.4	20.0	16.0	18.2%	27.9%	29.0%
HLE Glascoat	3,550	591	75.5	NA	NA	17.3	NA	NA	NA	NA	NA	27.9%	NA	NA
ABB	3,197	8,229	108.7	101.7	77.4	16.7	14.6	12.7	116.9	75.1	57.6	13.6%	15.1%	17.3%
Siemens	2,726	11,793	73.0	55.2	46.1	8.6	7.7	6.9	49.8	38.9	32.1	12.3%	14.2%	15.5%
Honeywell	38,673	4,134	100.8	68.3	53.3	12.1	10.5	9.1	66.7	51.1	39.4	12.5%	16.5%	18.3%
Cummins	1,192	4,015	43.8	34.4	28.7	6.8	6.3	5.8	35.5	30.4	25.4	19.2%	18.5%	20.2%
Thermax	2,099	3,040	84.6	54.0	40.0	7.2	6.3	5.7	56.2	39.8	28.8	9.3%	11.9%	15.0%
Schaeffler	3,292	6,250	81.8	58.7	36.5	14.1	12.1	10.5	NA	37.9	31.6	18.5%	21.3%	22.7%
Grindwell Norton	1,999	2,687	74.9	61.1	51.6	14.1	12.3	10.7	53.6	43.5	36.5	20.2%	21.4%	22.0%

Source: Bloomberg, Company, Axis Capital

Business analysis

GLE in chemical processes and why stainless steel is not the solution

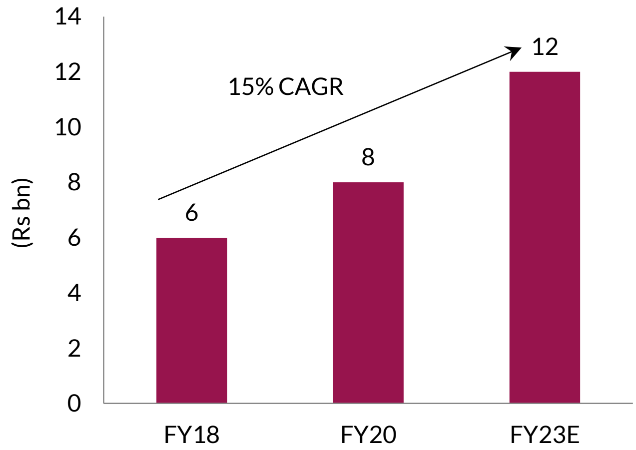
Glass lined equipment (GLE) provides an ideal technical solution for chemical and pharma processing applications for the safe containment of corrosive contents, maintaining the vessel pressure and ensuring the optimum production quality. A glass coating or porcelain enamel is sprayed, then thermally infused onto the surface of the underlying material, typically steel. This ensures that the underlying metal is not exposed directly to harsh chemicals and mitigates corrosion. The greatest advantage of GLE is its extremely high corrosion resistance against chemicals and varying concentrations and temperatures. GLE surfaces are also contamination resistant and ensures purity of the contents in the equipment. Lastly, these surfaces are highly polished, making it easier to clean.

Stainless steel, although considered resistant to corrosion, cannot be the solution for these industries since it does not have sufficient properties to overcome a chemical or corrosive attack. Ultimately, with time, stainless steel will corrode as electrochemical potentials arise, leading to oxidation of iron. Stainless steel can be treated chemically to be made less reactive, but this is a time consuming, expensive process and most importantly can only be considered a temporary solution.

Leader with 60% market share in the India GLE industry

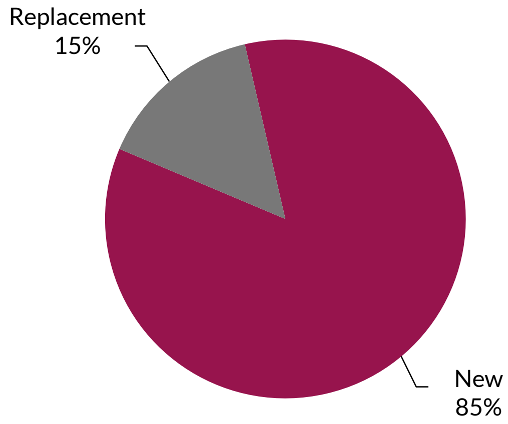
GMM Pfaudler is the market leader with 60% share in India's GLE industry. The industry has been registering 15% CAGR driven by growth in pharmaceuticals, specialty chemicals and agrochemicals. GLE forms 8-12% of overall process equipment capex for pharmaceutical and chemical sectors. 85% of demand is new while 15% of demand is replacement. GLE has a finite life of 7-10 years which helps generate replacement demand.

Exhibit 5: India GLE industry



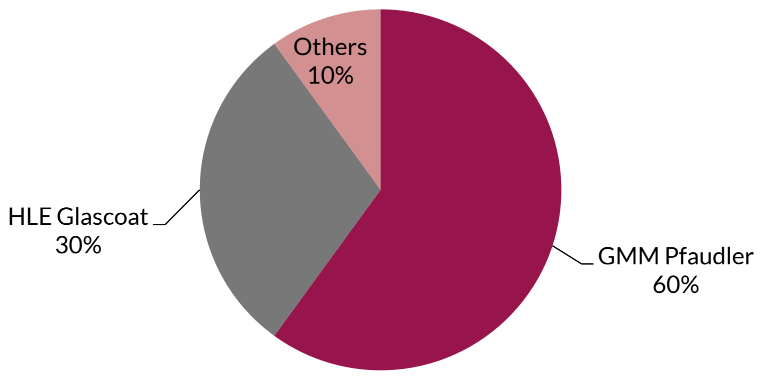
Source: Company, Axis Capital

Exhibit 6: GLE industry – New vs. replacement demand



Source: Company, Axis Capital

Exhibit 7: India GLE industry market share



Source: Company, Axis Capital

Leader with 40% market share in global GLE industry

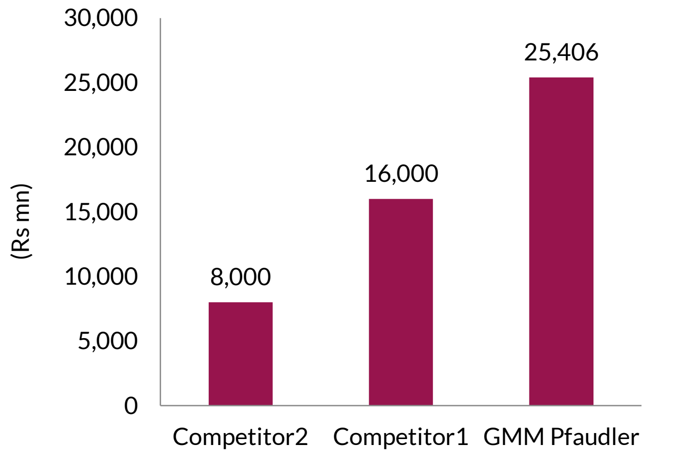
Global GLE market is ~US$ 1 bn, of which GMM Pfaudler believes its total addressable market (TAM) is US$ 750 mn. This industry is growing at 6-7% CAGR globally. GMM Pfaudler is a global leader with 40% market share. The company primarily caters to its customer base in the chemical and pharmaceutical industries – being a preferred choice for marquee players, constantly building on its strengths of global leadership, execution credibility, management expertise and integration capabilities. The company has operations spread globally, across 100+ countries in the Americas, Europe and Asia and services its clients through 15 manufacturing facilities, 7 complementary brands and 1,800+ employees.

Domestic and global competition

Domestically, HLE Glascoat is GMM Pfaudler's key competitor. HLE Glascoat is the market leader in the filtration and drying segment (with 60% market share), where GMM Pfaudler is relatively weaker. HLE Glascoat recently acquired German manufacturer of specialized process equipment/ reactors Thaletec to further strengthen global presence and competitiveness. Operating through 7 manufacturing facilities globally, HLE derives 51% and 48% revenue from glass-lined equipment and filtration and drying equipment respectively. Globally, major competitors include:

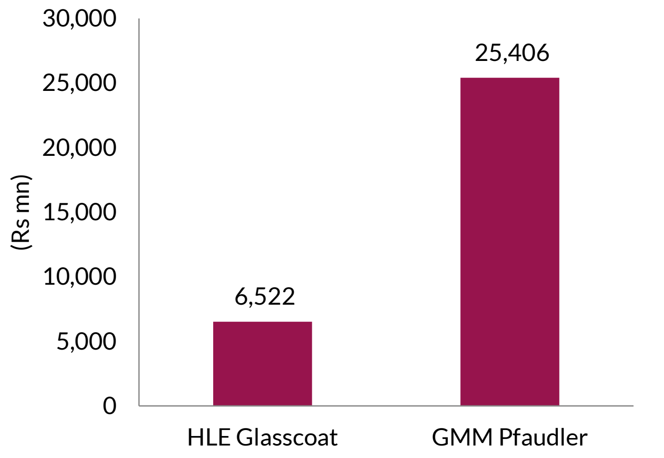
- Zibo Taiji Industrial Enamel Company, the largest glass lined equipment manufacturer in the Chinese market and operates in >50 countries.
- France-based De Dietrich Process Systems which produces corrosion resistant borosilicate glass equipment, GLE and plants for thermal separation processes.

Exhibit 8: GMM Pfaudler vs. global competition



Source: Company, Axis Capital
Note: GMM FY22 revenue. Competitors' information are FY22 estimates

Exhibit 9: GMM Pfaudler vs. HLE Glascoat FY22 revenue



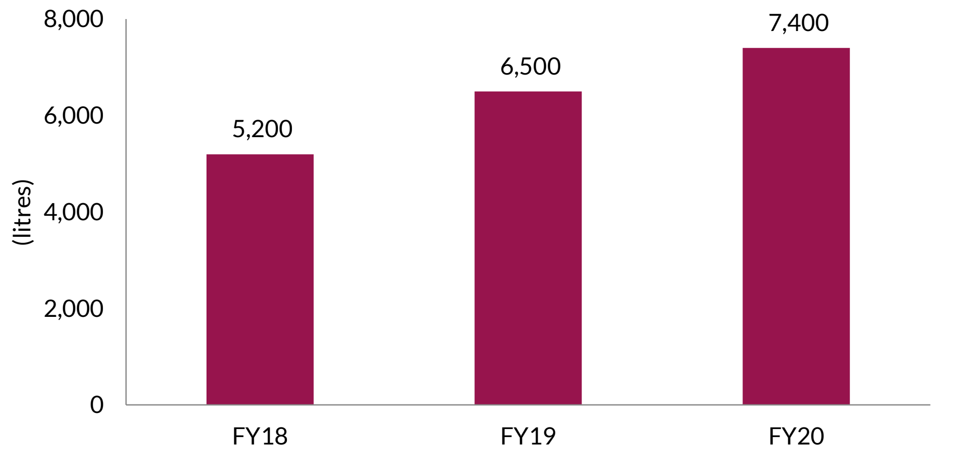
Source: Company, Axis Capital

Preferred choice in larger reactors

GLE vary in sizes from 50 litres all the way to 63,000 litres. The higher the capacity, the higher the chances of product failure. The chemicals segment uses larger reactors >16,000 litres in size while the pharmaceutical sector uses reactors in the 3,000-4,000 litres range.

Currently, 35% of the INR 8 bn GLE industry is >16,000 litres, which is key advantage for GMM Pfaudler as customers prefer the company to prevent product failures. This allows the company to share a premium for larger sized reactors. Over the last 5 years, the company's average size of product delivered has moved from 3,000 litres to 7,000-8,000 litres.

Exhibit 10: GMM Pfaudler – Average size of GLE reactor delivered



Source: Company, Axis Capital

15 manufacturing facilities across Asia, Europe, and Americas

Asian facilities
In Asia, GMM Pfaudler has manufacturing facilities/ sales offices in India, China, Singapore, and Korea. In India, it operates through 3 manufacturing facilities:

- **Karamsad –** Glass lined equipment
- **Hyderabad –** Acquired from De Dietrich Process Systems India (DDPSI), which earlier manufactured glass lined equipment in this facility.
- **Vatva –** Heavy Engineering, acquired from HDO Technologies.
- In China, GMM Pfaudler has one manufacturing facility in Li Yang City in Jiang Su province.

European facilities
Europe includes presence France, Netherlands, Germany, Switzerland, Italy, and UK, of which it has manufacturing facilities in Germany, Switzerland, and Italy. In Germany, manufacturing facilities are in:

- **Waghäusel -** Belongs to Pfaudler GmbH
- **Ilmenau –** Lab & process glass products under the Normag brand are manufactured
- **Hofheim-Wallau -** Sealing technology under the Interseal brand

In the UK, it has manufacturing facilities in Leven and Bolton, and another one in Italy, all belonging to the Pfaudler International business. Lastly, in Switzerland, the facility manufactures filtration & drying equipment under the Mavag brand.

American facilities
Of the 4 manufacturing facilities in the Americas, 3 are in the United States and 1 in Brazil. Of the 3 in the USA:

- **Rochester –** GMM Pfaudler US, Inc
- **Avondale, Pennsylvania –** Fluoropolymers under the Edlon brand.
- **Americus –** JDS manufacturing glass lined Equipment.

Exhibit 11: GMM Pfaudler – Manufacturing facilities

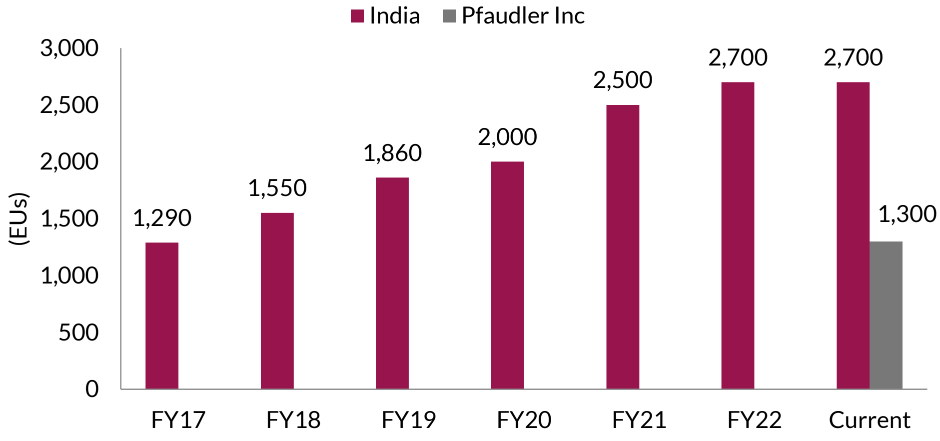
Source: Company, Axis Capital

A customer order generally takes 4-6 months to complete depending on the dimensions of the reactor. A larger product may take longer. Generally, 4-5 layers of glass-lining are sprayed and can increase to 6-8 layers for more corrosive chemicals.

Expanded GLE capacity to fulfil demand in the past

GMM has more than doubled its capacity from 1,290 EUs/ year in FY17 to 2,700 EUs/ year in FY22. Of this, 400 EUs is from acquisition of De Dietrich Process Systems India (DDPSI) facility is south India. Pfaudler Inc acquisition has increased global capacity to 4,000 EUs/ year.

Exhibit 12: GMM Pfaudler – GLE capacity ramp up



Source: Company, Axis Capital

Trying to aggressively expand non-GLE business

GMM Pfaudler is pursuing an aggressive strategy to increase its non-GLE business. This will open opportunities in various sectors and eventually allow the company to be less dependent on the GLE business.

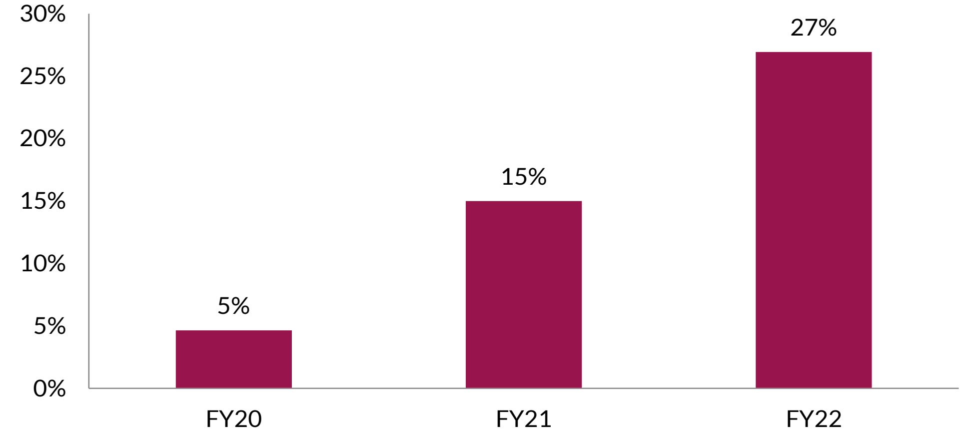
- **Mixing systems:** This segment provides a wide range of agitators and mixers for solid-liquid, gas mixing. GMM Pfaudler acquired the Industrial Mixing solutions division of Sudarshan Chemical Industries to focus on the industrials mixing business and venture into newer industries such as minerals, metals, sugar, and food.
- **Filtration and drying:** GMM Pfaudler provides funda filters, spherical dryers, and vacuum paddle dryers, among others. It works closely with clients to make tailor-made products based on the type of output. It aims to reduce overall down-time and batch time.
- **Engineered systems:** This segment focuses on engineered systems such as systems for evaporation, heating, cooling, and acid recovery, among others. GMM works closely with small manufacturers to provide them with complete solutions.
- **Heavy engineering:** GMM Pfaudler is a differentiated player in the heavy engineering segment focusing only on specific product categories such as reactors, heat exchangers, pressure vessels and columns. It does not aim to compete with the large players such as L&T, Toyo Engineering and ISGEC, who are its clients. Exports contribute 15-20% of revenue for this segment and offers a large opportunity going forward. GMM has delivered products to EU, USA and countries in South-east Asia and aims to leverage the Pfaudler network to win strong orders. Export orders are highly margin accretive. Management is focused on taking orders only above certain margin threshold of 12-14%.

Fulfilling client requirements through technologies, systems, and services

- **Technologies:** includes the glass-lined business, where the company enjoys the leadership position and non-glass lined businesses, where it attempts to cross sell to existing and adjacent industries.
- **Systems:** Through the systems vertical, the company attempts to combine technologies and services to develop fully integrated systems, which includes the designs of all unit operations surrounding and supporting the core technologies. They supply turnkey systems for all chemical processes for customers ranging from labs through full scale industrial plants. System layouts are custom designed specifically for all clients' processes.
- **Services:** This vertical enables the company to provide parts and maintenance services for the technologies supplied by it throughout the plants of its customers.

Services have much higher EBITDA margin compared to technologies and systems and is driven by 50,000+ of global GLE installed base. Pre-acquisition of Pfaudler Inc, services revenues was only 5% of revenue in FY20, while post acquisition this has gone up to 27% of consolidated entity in FY22.

Exhibit 13: GMM Pfaudler – After sales service as a percentage of revenue



Source: Company, Axis Capital

Strong client relationships

GMM Pfaudler has strong long-term relationships with both Indian and international clients, given its strong reputation in the industry. Given the regulatory hurdles for approvals in the end-user industry and criticality of reactor, clients don't mind paying a premium for quality.

Exhibit 14: GMM Pfaudler – List of clients

Pharmaceuticals	Specialty Chem & Dyes	Agrochem & Fertilizers	Oil & Gas
Glenmark Pharmaceuticals	Asian Paints	G.N.F.C	Engineers India
Jubilant Lifesciences	LyondellBasell	Deccan Fine Chemicals	ONGC
Aurobindo Pharma	DyStar	GSFC	Indian Oil
Ranbaxy Laboratories	Halliburton	PDIL	Bharat Petroleum
Cipla	Perstorp AB	IFFCO	Air Liquide
Sun Pharmaceuticals	Heubach GmbH	KRIBHCO	ADNOC
Lupin	BASF	Excel Industries	Qatargas
Dr. Reddy's	Croda Chemicals	Coromandel	CPCL
Divis Labs	Bayer	Rallis India	Maire Tecnimont
Ipca Laboratories	3M	Sumitomo Corporation	Larsen & Toubro
USV	LANXESS	Bayer	Fluor Corporation
Teva Pharmaceuticals	Convestro AG	Gharda Chemicals	Bechtel
Ampac Fine Chemicals	Kukdo Chemicals	United Phosphorus	
AbbVie	Clariant Specialty Chemicals	RCF	
Sandoz (Novartis)	SACHEM		
Apotex			
MOEHS Fine Chemicals			
Fabbrica Italiana Sintetici			

Source: Company, Axis Capital

Acquisition of Mavag in 2008

GMM Pfaudler acquired Mavag AG, Switzerland in 2008 to get a foothold in Europe and bring Mavag's technology to India. Mavag supplies non-GL/ highly engineered equipment for critical filtration, drying and mixing applications to the pharmaceutical and biotech industries. In the past (till FY16), its profitability was low due to high manufacturing costs, employee expenses (> 40% of revenue) and slowdown in Europe. In order to improve the profitability, GMM Pfaudler increased sourcing from India plant. A hybrid model was adopted in which the product is primarily made in India while it is finished/assembled in Switzerland, ensuring top-quality for clients. Further, stringent cost control measures were implemented.

Break-even for Mavag was brought down to revenue of CHF 10 mn, which led to higher profitability. For FY22, Mavag delivered CHF 22.3 mn of revenue with double digit EBITDA and PAT margins.

Acquisition of Pfaudler Inc – a strategic move

GMM Pfaudler's acquisition of Pfaudler Inc established it as the global leader in the attractive anti-corrosion technologies market. The merger paves the way for a co-ordinated approach to combine Pfaudler Inc's strong innovation tradition with GMM's successful expansion into adjacent categories. It will solidify GMM Pfaudler's leadership position in GLE market and create opportunities to enter adjacent markets (cathode sheets, water probes etc). The two companies are a strong fit in terms of products, customers and markets, cross pollination of which would result in significant gains for the entire group. GMM Pfaudler will work on realizing synergies via: (a) value sourcing; (b) operational excellence across plants; and (c) cross-selling.

Sourcing of components from cost-efficient manufacturing locations like India and Brazil would form a key strategy for GMM Pfaudler for margin enhancement. The company will develop European/ American grade raw materials/components in India at lower costs, which it will ship to international facilities, where the finishing touches would be put to deliver to European/ American clients at European/ American level of order pricing.

GMM Pfaudler was a natural buyer for Pfaudler Inc since it is a niche industry and there aren't too many suitors in the industry. Talks began just pre Covid-19 in February 2020, post which it took 6-7 months of paperwork. It was complex transaction given multiple jurisdictions. Business has turned around now with the international business doing exceedingly well. Germany and China, which were loss making factories, have turned profitable and the synergies are coming much faster than expected.

Smaller bolt-on acquisitions

Over the last few years, besides the acquisition of Pfaudler's international business, GMM has made several other bolt-on acquisitions, most of them targeted to bring in new technology which GMM can grow and cross sell, or for expanding their manufacturing reach.

- In 2017, GMM Pfaudler acquired Interseal, a supplier of sealing technology. Since the time Interseal has become part of the GMM family, revenue is up 4x and target is to double it from current levels.
- In 2020, GMM Pfaudler acquired the Hyderabad unit of De Dietrich Process Systems India for € 6.25 mn, with an objective of strengthening its GLE manufacturing footprint in that region. This also enabled GMM Pfaudler to be able to leverage opportunities arising from the expected investments in the upcoming Pharma City in Hyderabad.
- In 2021, GMM Pfaudler acquired HDO Technologies Ltd, which was under liquidation under the IBC, 2016. This gave it access to a state-of-the-art manufacturing facility in Vatva spread across 11.9 acres.

- In August 2022, GMM Pfaudler acquired Hydro Air Research Italia, which has primarily been acquired for technology process know-how and engineering capability, enabling the company to extend its product portfolio and enter new markets. Consideration paid was € 4.96 mn and revenue of the company for CY21 was € 7.9 mn. Hydro Air Research is a small company, with 15 employees, having expertise in membrane technology, complementary to the acid recovery business that GMM already has. It also provides customers with green technologies in plant base proteins and is doing some work in the EV side as well. Management believes doubling or tripling this business over the next 3-5 years should not be very difficult.

Exhibit 15: GMM Pfaudler – Bolt-on acquisitions

Year	Company	Technology
2017	Interseal	Sealing technology
2018	Normag	Lab & Process glass
2019	Industrial Mixing Solutions Division	Mixing Technology
2020	De Dietrich Process Systems India	Glass-Lined Equipment
2021	HDO Technologies	Alloy Process Equipment
2022	Hydro Air Research Italia	Membrane Technologies
2022	JDS Manufacturing	Glass-Lined Equipment

Source: Company, Axis Capital

Insight into the M&A process

- The company is now trying to structure the process. Earlier, it was relatively unstructured where the top management would drive discussions and negotiations.
- The board will look for specific opportunities for growth and will not acquire market share if it comes at the cost of margin. The focus is on acquiring technologies or capacities. Having only one core manufactured product (GLE) is a risky prospect, and it is essential to enhance the portfolio through complementary products which go into end industries.
- The company has a couple of more acquisitions lined up which will enhance and change size and scale of the company going forward.
- The company also believes it is better to purchase assets and start manufacturing rather than spending a two-year window to develop one and lose a cyclical opportunity. It did that in case of Vatva and Hyderabad facilities. For the Hyderabad and Vatva deal, the company got the capacities up and running in 2-3 months vs. the expected 9 months. In the second month of operations in Hyderabad, the company crossed the capacity that the earlier owner (De Dietrich) had reached in a span of 8 years. Revenues have doubled from the Hyderabad facilities within a year of operations.
- In price-conscious markets where Pfaudler Inc doesn't have a presence, products made in India, China, Brazil help. Low-cost manufacturing in India and local representatives in foreign countries handling sales is a great strategy. In a recent case of a latex plant in USA, the product was required in 6-8 months, but USA plant booked out. The product was shipped from India through help of local representatives and deal worked well. Similarly in China, it pushed Indian manufactured products, through local salesforce. The products were 20-25% cheaper than European competitors.
- The Pfaudler brand name is already working wonders to get new orders.

Integrating employees during acquisitions

GMM Pfaudler hasn't lost a single employee since taking over Pfaudler Inc. Indian and international teams remain the same having own CEO and CFO, ensuring stability. However, the company is looking at better management setup and a more institutionalized culture.

For small acquisitions that GMM undertakes (companies with 15-20 employees), it does not face major integration problems. It is important to give international employees job security and ensure them that all capacities will not be shifted to India. Giving incentive programs to align global executives directly to the company's performance through ESOPs also helps.

FY25 revenue and EBITDA targets

For FY25, the management has a revenue, EBITDA and RoCE guidance of Rs 37 bn, Rs 6.3 bn and 25% respectively implying 13% revenue CAGR and 24% EBITDA CAGR over FY22-25. Management had earlier guided for Rs 28 bn of revenue by FY24, but with Rs 14 bn of revenue in the last 2 quarters, the company is on track to achieve its previous guidance before FY24.

Exhibit 16: GMM Pfaudler FY25 guidance

	FY22	FY25
Revenue	25,410	37,000
EBITDA	#3,300	6,300
EBITDA margin	13.0%	17.0%
RoCE	22%	25%
Capex		3% of revenues
Leverage	1.2x	<1x

Source: Company, Axis Capital; #Note: Reported FY22 EBITDA was lower at Rs 2,839 mn due to PPA and acquisition related adjustments

Path to achieve FY25 guidance

- **Stock and sale:** Intends to make monthly exports to Germany/ other international locations at a rate of 20-25 units/ month. These units will be stored abroad and supplied to clients as demand arises and allow the company to be fast in responding to client needs. The company will benefit from low-cost India manufacturing with premium European/ American pricing and another premium for speedy delivery.
- **Operational excellence in GLE business:** Strategy involves efficiently using existing capacities to drive growth and current 4,000 EUs in GLE is sufficient to achieve its growth targets. For example, the newer China and Germany facilities has already achieved 60% of budgeted throughput, much earlier than targeted deadlines.
- **Scaling up services business:** Currently, the company has an installed base of 50,000+ EUs in GLE business. Covid-19 was a major hindrance since the company's engineers could not visit plants to provide after sales services. With Covid-19 behind us, this business should scale up and be a major contributor to growth with higher EBITDA margin.
- **Non-GLE growth:** The company is attempting to grow the non-GLE business by cross selling products to GLE customers. Recent example of the same was a Belgian API, who along with GLE also purchased filtration, drying and mixing solutions.
- **New technologies:** Working on introducing new technologies to cater to various client needs. Some of the examples are: **(1) smart glass**: cobalt free which promotes faster reactions and a lesser exchange of heat **(2) fermentation technology:** existed earlier but is being commercialized now. For example, collaboration with companies which are setting up penicillin capacities **(3) membrane separation technology**: used for mock-meat, biofuel, vegetable-based proteins and **(4) Ace 5000:** sealing technology alerts when seal fails (helps avoid machine down time) and ensures no contamination in reaction.

Financial analysis

Q1FY23 performance

- Revenue at Rs 7.4 bn was up 34% YoY (standalone +45% YoY and Mavag + PFI up 29% YoY). EBITDA margin at 13.2% more than doubled from 6.5% in Q1FY22 and was also up sequentially from 10.3% in Q4FY22. Standalone EBITDA margin was 16.3% while Mavag + PFI delivered 11.7% EBITDA margin. The company delivered profits of Rs 445 mn vs. Rs 26 mn in Q1FY22 and Rs 160 mn in Q4FY22.
- Other income spiked to Rs 285 mn in Q1FY23 due to Rs 220 mn MTM forex revaluation gain on loans in Europe.

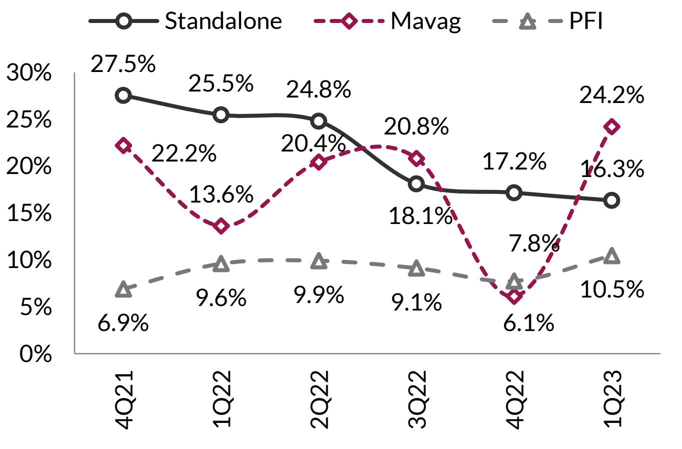
Drivers of higher EBITDA margin going forward

- Pfaudler's German and China plants are ramping up with value sourcing from India which should drive margin expansion going forward. Value sourcing was +24% YoY to Rs 10 bn.
- Standalone gross margin in Q1FY23 at 50.1% was the lowest in the past 13 quarters due to higher steel prices, which have now started going down which should aid H2FY23 margin. The company is trying to improve heavy engineering margin by cost control and operational efficiencies and more higher margin exports.

All-time high order backlog and prospect pipeline

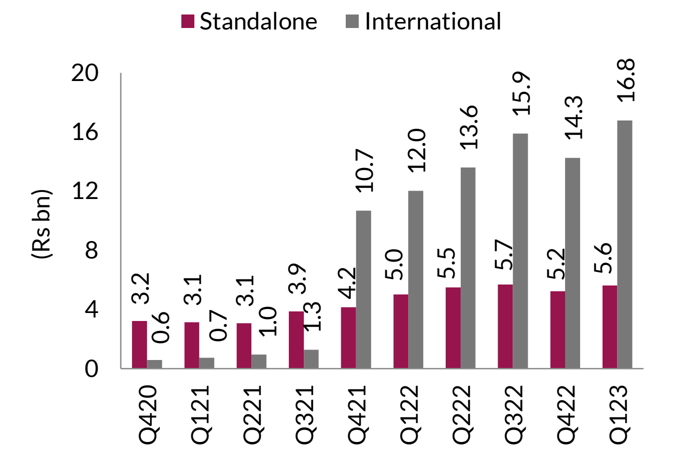
- Inflows at Rs 9.98 bn were up +24% YoY. Management believes it would continue to see quarterly inflows of Rs 3 bn in standalone business. Strong order intake was seen in GLE business in India, Europe, and China. Q2FY23 order intake would be good.
- GMM Pfaudler ended Q1FY23 with an all-time high backlog of Rs 21.8 bn, +27% YoY and its prospect pipeline across geographies is robust. Mavag's order backlog is at a healthy CHF 43 mn (vs CHF 18-20mn previously), providing good visibility for 16-18 months.
- Significant investments have been made in the chemicals sector in India. The acid recovery opportunity is healthy, with the company working on a breakthrough large project.
- China+1 demand continues to increase. Segments such as fermentation, paints, bioplastics, green technology, and plant-based proteins are showing strong demand.

Exhibit 17: GMM Pfaudler – Quarterly EBITDA margin



Source: Company, Axis Capital

Exhibit 18: GMM Pfaudler – Quarterly order backlog



Source: Company, Axis Capital

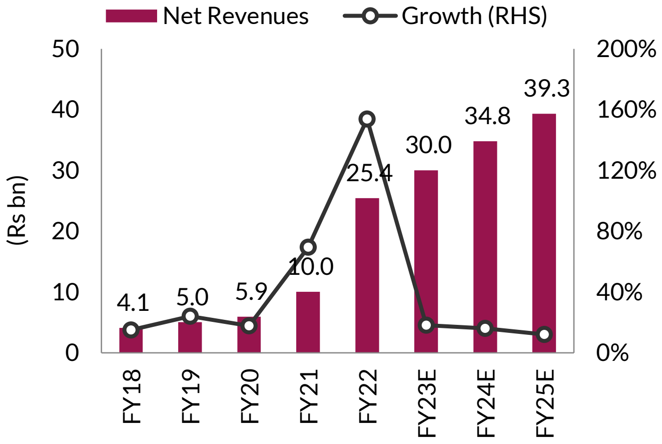
Management guidance for FY23 and FY25

- For FY23, the management expects 15-16% revenue growth and margin expansion due to steel prices falling. The effect of the same will be pronounced in H2FY23 as manufacturing done at that time will involve usage of lower priced steel.
- For FY25, management has guided for revenue (13% CAGR), EBITDA (24% CAGR) and RoCE of Rs 37 bn, Rs 6.3 bn and 25% respectively.

Expect 60% PAT CAGR over FY22-25

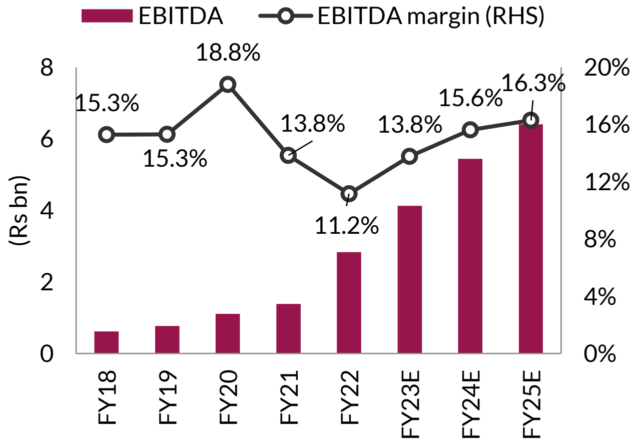
We expect GMM Pfaudler to grow revenue at a CAGR of 16% over FY22-25 with EBITDA margin expanding from 11.2% to 16.3% (bulk of the delta coming from improvement in Pfaudler Inc). This should lead to PAT and EPS CAGR of 60% and 59% respectively over FY22-25E with average RoE of ~25%.

Exhibit 19: GMM Pfaudler – Consolidated revenue and growth



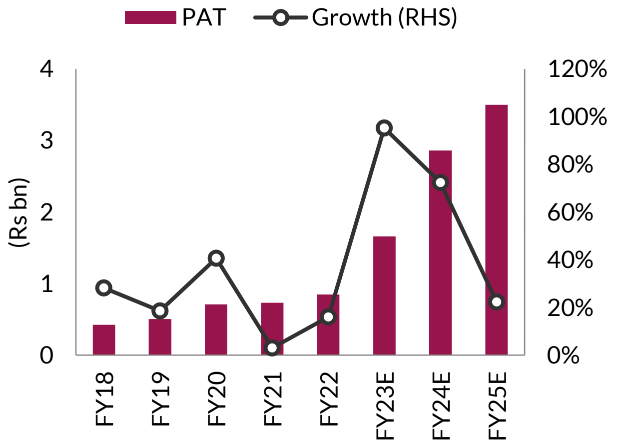
Source: Company, Axis Capital

Exhibit 20: GMM Pfaudler – Consolidated EBITDA and margin



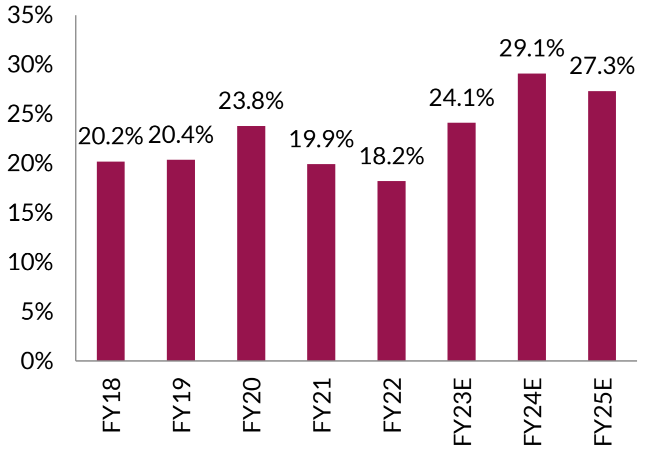
Source: Company, Axis Capital

Exhibit 21: GMM Pfaudler – Consolidated PAT and growth



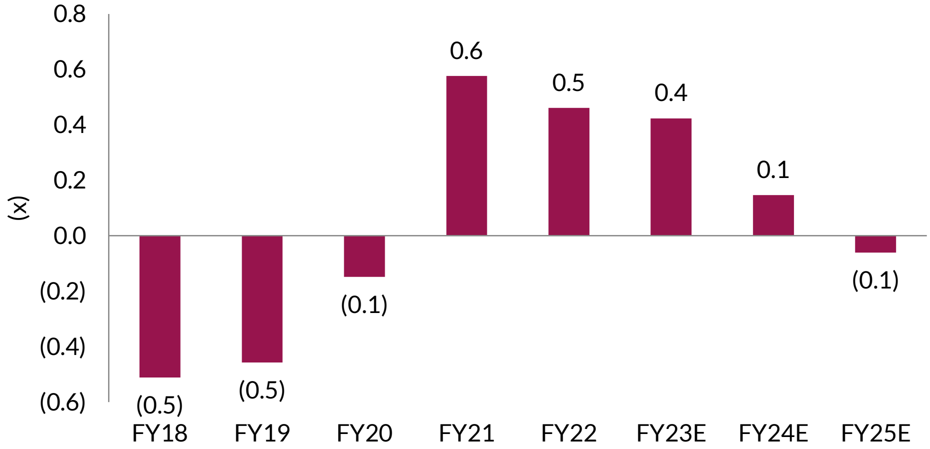
Source: Company, Axis Capital

Exhibit 22: GMM Pfaudler – Consolidated RoE



Source: Company, Axis Capital

Exhibit 23: GMM Pfaudler – Consolidated Net Debt/ Equity



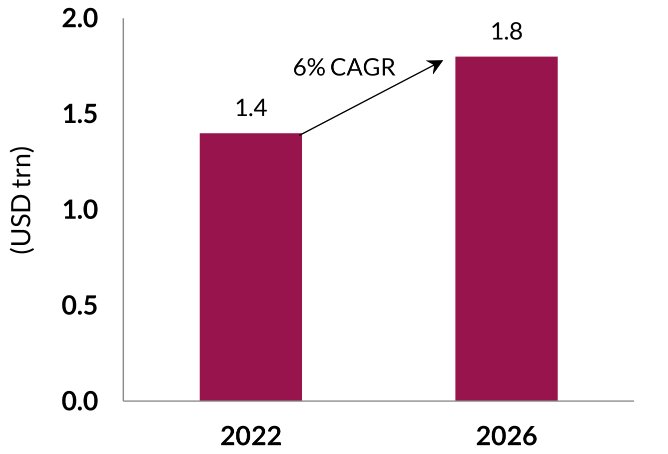
Source: Company, Axis Capital

Industry analysis

Pharmaceutical

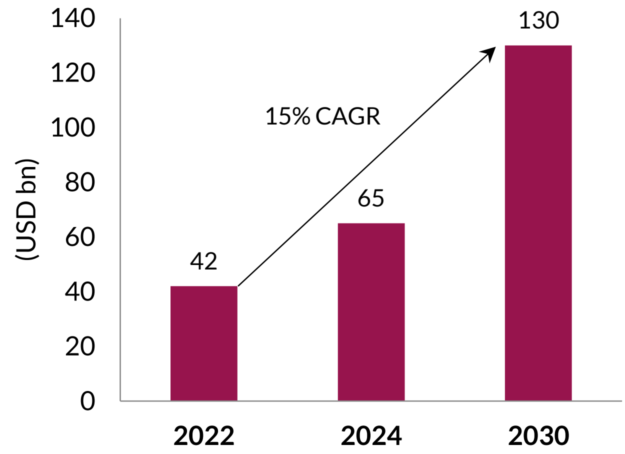
The global pharmaceutical industry is currently valued at US$ 1.4 trillion and is further expected to see CAGR of 6% and expand to US$ 1.8 trillion by 2026. The Indian pharmaceutical industry is presently valued at US$ 42 bn and expected to grow to US $65bn by 2024 and US$ 120-130 bn by 2030.

Exhibit 24: Global pharma industry – 2022 to 2026



Source: Company, Axis Capital

Exhibit 25: Indian pharma industry – 2022 to 2030



Source: Company, Axis Capital

Key growth drivers

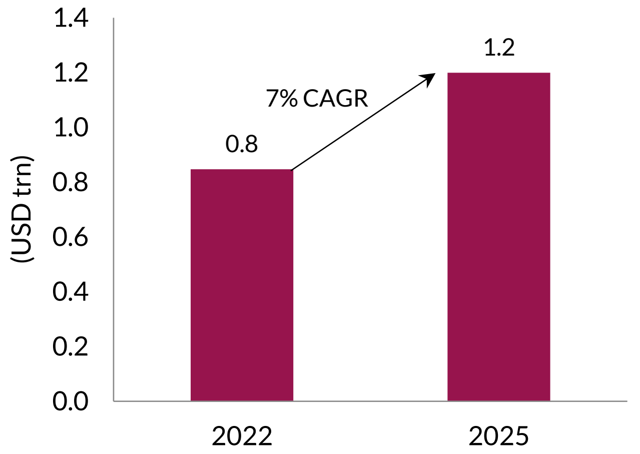
- **Cost-effectiveness:** Pharmaceutical companies in India can produce high-quality products at an economical rate vs. peers. This enables them to be competitive on a global scale and participate in the US$ 5-6 bn opportunity that may emerge on patent expiry across the globe in next 4-5 years.
- **Policy support:** The PLI scheme can potentially reduce India's import dependency and promote exports. This involves setting up of bulk drug parks for APIs and formulations. Currently, the PLI scheme has an outlay on Rs 150 bn for pharmaceuticals manufacturing and Rs 65 bn for bulk drugs. As of March 2022, the government has approved 19 applications in committed investment, aggregating to Rs 46 bn.
- **Foreign investment:** FDI in the Indian pharmaceutical industry has increased exponentially over the past two years, primarily to combat the increased demand of vaccines and therapeutics due to the Covid-19 pandemic.
- **Pharma City in Hyderabad:** The government is planning 'Pharma City' in Hyderabad and around 19,000 acres of land is to be allocated for the same. The Telangana State Industrial Infrastructure Corporation (TSIIC) has already acquired about 8,500 acres for the 1st phase of the Pharma City project. The Pharma City is expected to attract investments up to Rs 650 bn from pharma, biotech, and related industries. Over 350 firms will set up projects, including about 120 big players. To speed up the project, the government has formed a SPV 'Hyderabad Pharma City Ltd '. Currently, land has been acquired and roads are being constructed.

Specialty chemicals

Global specialty chemical industry is valued at US$ 847 bn and expected to grow to US$ 1.2 trillion by 2025, at a 7% CAGR. Over the years, there has been a shift towards Asia owing to flexible government regulations and low cost of labor from leaders such as North America and Europe. China too is showing signs of slowing down, leading to establishment of the China+1 strategy. Leveraging this, India is becoming larger is the global specialty chemicals value chain.

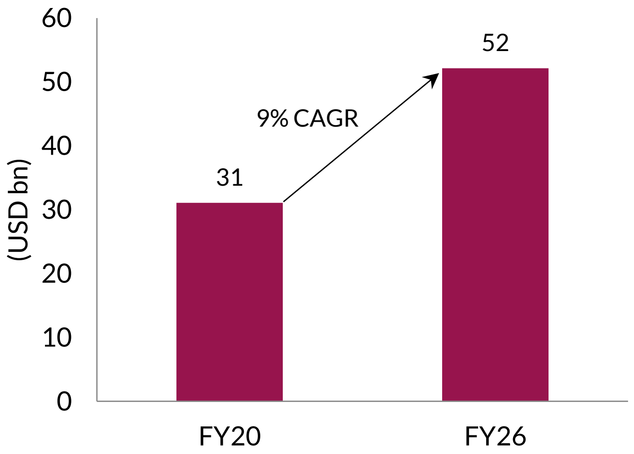
In FY20, the specialty chemicals market in India was valued at US$ 31.1 bn and is set to grow at a CAGR of 9% between FY20-26.

Exhibit 26: Global specialty chemicals industry – 2022 to 2025



Source: Company, Axis Capital

Exhibit 27: Indian specialty chemicals industry – FY20 to FY26



Source: Company, Axis Capital

Key growth drivers:

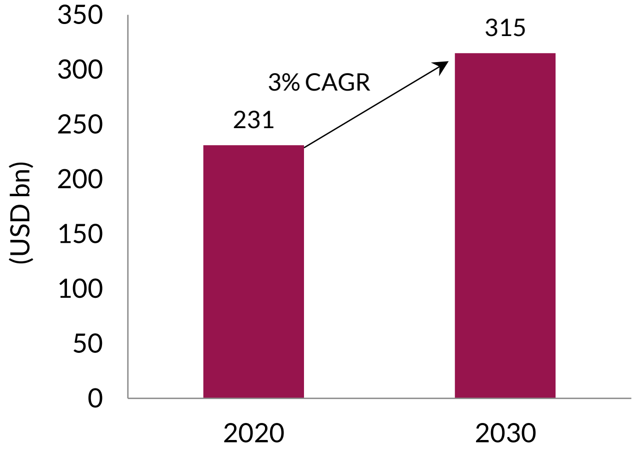
- **Production Capabilities:** With the advent of concepts such as 'green chemicals' and 'sustainable energy', India is progressing towards more sustainable manufacturing methods. India also possesses the infrastructural facilities and capabilities to expedite specialty chemicals production. This is supported by IP protection rights, improved compliance, an evolving R&D culture, contract manufacturing opportunity and strategies adopted by nations to find the next best alternative to China.
- **Accessibility:** The geographic advantage of having access to ports has made the distribution of specialty chemical products and raw materials very convenient.

Agrochemicals

The global agrochemical market in 2020 was valued at US$ 231 bn and is expected to grow at a CAGR of 3% till 2030 and reach a market size of US$ 315 bn.

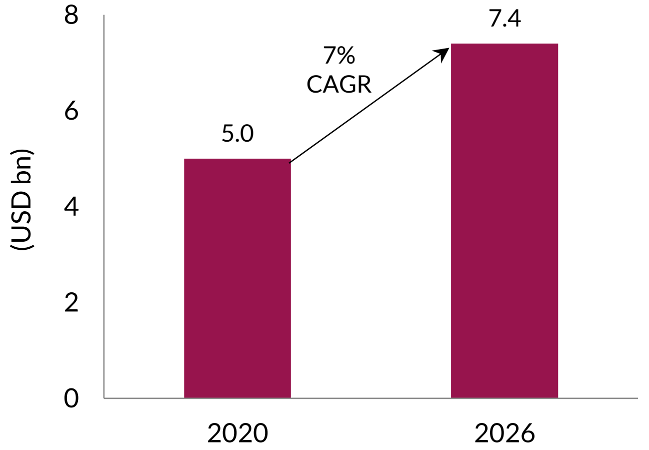
With an increasing global population, the demand for crop protection agents too is rising to increase crop yields. Given the trending practices of organic consumption, this industry has been incentivized due to its environmentally friendly appeal. Although the fertilizers segment is the dominant segment in the agrochemical market, pesticides is projected to grow faster over the next decade. India, China & Australia are expected to lead the growth further in the Asia-Pacific region due to the increasing number end-users in these countries. The Indian agrochemical industry was valued at US$ 5.0 bn in 2020 and is expected to grow at a CAGR of 8.6% to $7.4 bn in 2026. India is currently the fourth-largest producer of agrochemicals globally.

Exhibit 28: Global agrochemicals industry – 2020 to 2030



Source: Company, Axis Capital

Exhibit 29: Indian agrochemicals industry – 2020 to 2026



Source: Company, Axis Capital

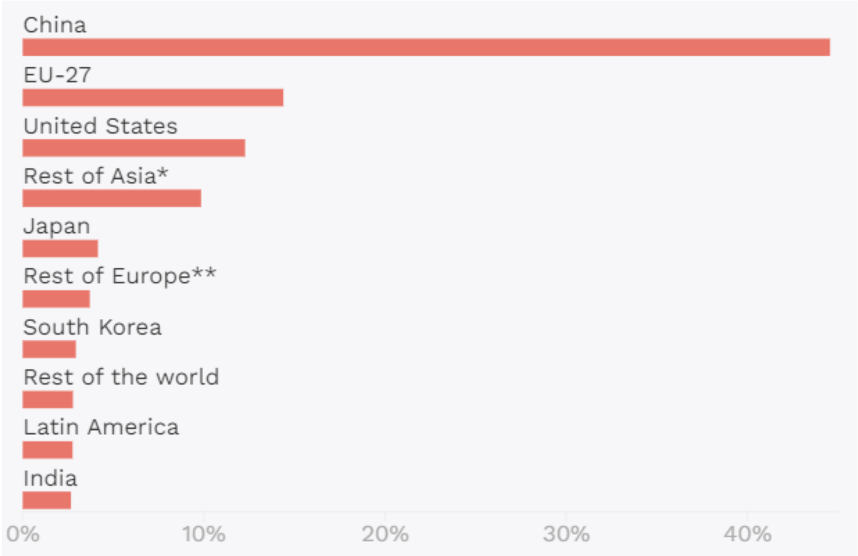
Key growth drivers:

As per ICRA, India's agrochemical exports have significantly increased over the past few years, displaying a positive and improved outlook. India's biggest advantage here too is that it manages to export agrochemical products on a competitive pricing basis due to lower manufacturing costs, cheap skilled manpower and sufficient infrastructural capacity to meet demand.

'China +1' phenomenon

Last 30 years have seen China emerge as the dominant player in the US$ 4 trillion global chemicals industry with a 45% market share. In 2020, chemicals worth US$ 1.77 trillion were consumed in China. These chemicals are widely used in making medicines, pesticides, fertilizers, plastics, textiles, building supplies, laundry detergents and cosmetics. This success was driven by lower labor costs, high subsidies, and relaxed environmental norms. However, some of the success factors seem to be reversing progressively.

Exhibit 30: China is the world's largest chemical producer (2020)



Source: Cefic, Statista, Axis Capital

Stringent environmental norms

The Chinese government started implementing stricter environmental protection norms from January 2015. In 2017, an estimated 40% of the chemical manufacturing capacity in China was temporarily shut down for safety inspections, with over 80,000 manufacturing units charged and fined for breaching emission limits. China's Ministry of Environmental Protection enforced strict penalties on polluting industries, including chemicals.

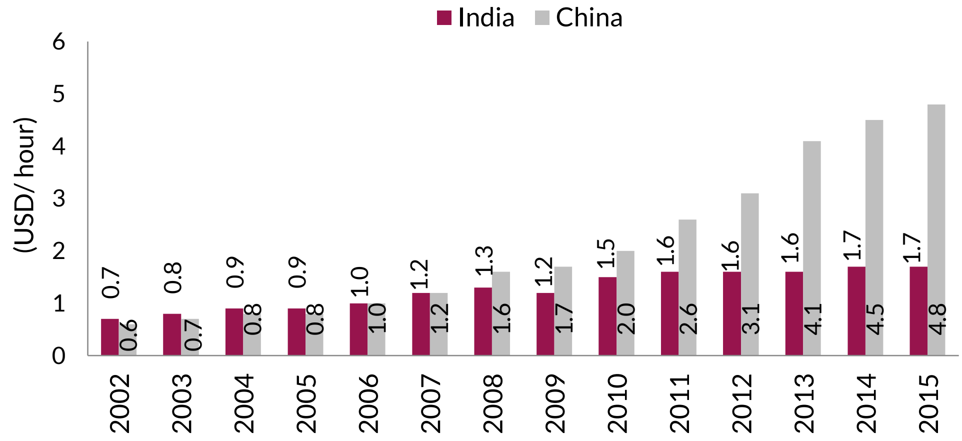
In 2016, the government of Jiangsu, China issued a development plan for the Yangtze River Delta Economic Belt. Pollution in the river had reached dangerous levels with several chemical manufacturers located near the river. As per the plan, the government set a goal of shutting down or relocating nearly 1,000 chemical plants by 2020.

The Chinese government also mandated the construction of effluent treatment plants and imposed a 'green tax' on the chemical industry to combat pollution.

Rising labor costs

Comparing labor cost on an hourly cost of compensation basis, China was lower than India till 2007. However, over 2005-2015, the average labor cost in China increased nearly ~20% CAGR, against 6% CAGR in India.

Exhibit 31: Hourly cost of compensation India vs. China



Source: Cefic, CRISIL, Axis Capital

All the above measures have increased the cost burden on manufacturers, both in terms of capital expenditure to meet statutory needs and operational and compliance costs. This is expected to significantly hamper the profitability of Chinese manufacturers, and moreover, discourage new entrants. This situation has led the world to move away from China, establishing what is commonly known as the 'China+1' strategy.

India – a major beneficiary

India seems to be emerging as a structural beneficiary of the 'China +1' phenomenon. Apart from lower labor costs, the other key drivers are abundant availability of technically qualified manpower, strict adherence to global manufacturing standards and laws providing strong protection of intellectual property (IP) rights.

India has in the past proven its capabilities in the pharmaceutical industry as the 'generic pharma capital of the world'. As reported by IBEF in March 2022, India is the 3rd largest pharmaceutical producer globally in terms of volume and ranks 14th in terms of value.

Indian chemical manufacturers too seem to be well poised to emerge as a credible alternative, and, in some cases, cater to global firms as primary suppliers. India's chemical industry has grown by 12% over the last 5 years. Even a 1-2% incremental market share gain from China can result into high-teens growth rates for the Indian chemical industry.

Within the overall chemicals industry, specialty chemicals are estimated to disproportionately benefit, primarily due to high entry barriers and differentiated offerings. Many Indian companies have been investing in R&D, enabling them to move up the value chain and create multiple growth opportunities.

Company background

GMM Pfaudler is the leading provider of critical technologies, systems, and services catering predominantly to the chemical, pharmaceutical, food and energy industries globally. Its offerings include glass-lined technology, filtration and drying, lab and process glass, sealing technology, mixing technology, alloy processing equipment and fluoropolymers.

The company has a dominating 40% market share in glass-line equipment segment globally, significantly higher than competition driven primarily by higher quality products, customer relationships and local presence, and a commendable execution track record.

The company operates in 100+ countries, serviced through 15 manufacturing facilities globally with a strength of 1,800+ employees and 7 complementary brands, which include:

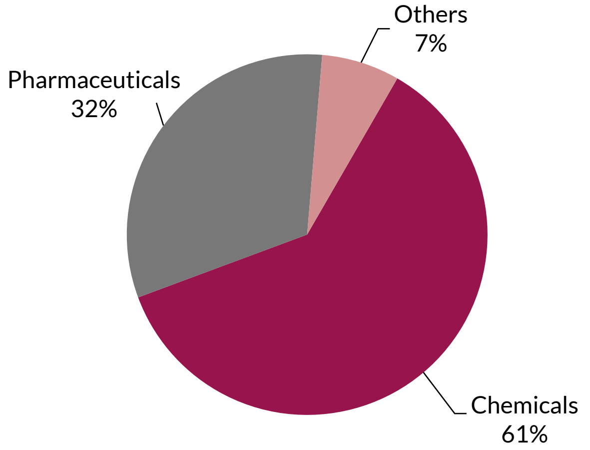
Exhibit 32: GMM Pfaudler's brands and products

Brand	Products
Pfaudler	Glass-Lined Technology
Normag	Lab & Process Glass
Mavag	Filtration & Drying
Mixion	Mixing Technology
Interseal	Sealing Technology
Equilloy	Alloy Process Equipment
Edlon	Fluoropolymers

Source: Company, Axis Capital

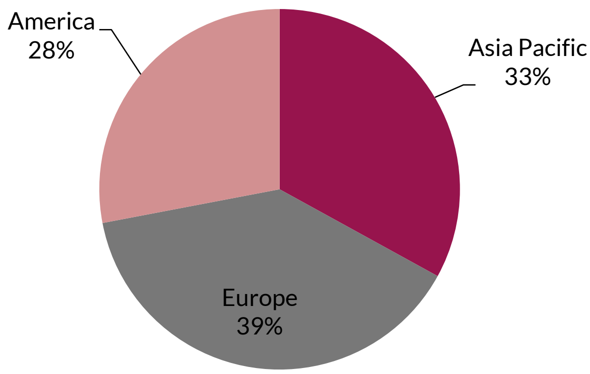
In FY22, chemicals contributed 61% of revenue, pharmaceuticals contributed 32% of revenue and others like metals & mining, oil & gas contributed 7% of revenue.

Exhibit 33: GMM Pfaudler – FY22 revenue by end markets



Source: Company, Axis Capital

Exhibit 34: GMM Pfaudler – FY22 revenue by geography



Source: Company, Axis Capital

Origins of the company

Gujarat Machinery Manufacturers Ltd (GMM) was set up in 1962 and started manufacturing Glass Line Equipment (GLE) with the help of technology acquired from a Hungarian company Lampart. GMM entered in a financial and technical tie-up with the world leader in that field – Pfaudler, Inc. USA – in 1988. Subsequently, Pfaudler, Inc. acquired a 40% stake in GMM which it increased to 51% in 1999. The company was renamed as GMM Pfaudler.

Pfaudler, Inc. known for the invention and commercialization of GLE technology (known as Pfaudler Glasteel) was started in 1884 in the USA. Pfaudler is the world leader for corrosion-resistant technologies, systems and related services in an oligopolistic market primarily catering to chemical and pharmaceuticals industries. Private equity fund DBAG acquired Pfaudler.

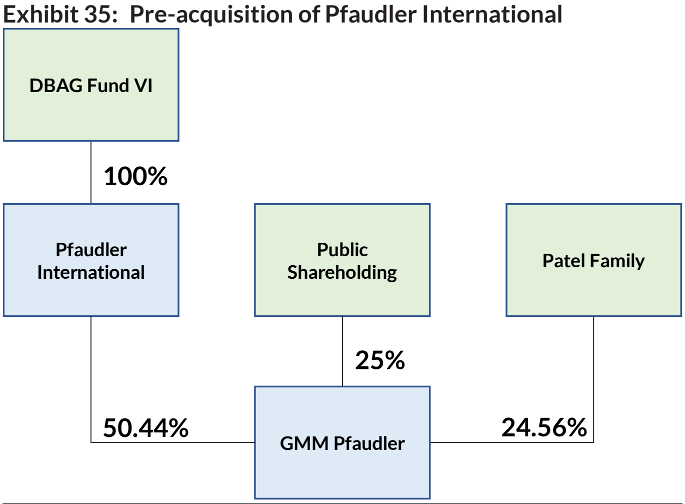
Pfaudler, Inc – from 51% owner to 100% subsidiary

In August 2020, GMM Pfaudler along with its promoter (Patel family) acquired its parent Pfaudler's international business from DBAG (private equity) making its parent a subsidiary. GMM Pfaudler (along with its wholly owned subsidiary Mavag) acquired 54% stake for US$ 27.4 mn. The Patel family acquired 26% stake to re-enforce their commitment to the business and avoid higher leverage in GMM Pfaudler. The balance 20% stake remained with DBAG. This transaction was completed in February 2021.

This was immediately followed by an offer for sale (OFS) by the promoters – Patel Family and DBAG in GMM Pfaudler. While the Patel family looked to raise cash to fund their purchase in Pfaudler International, DBAG wanted to cash-in on some part of investment.

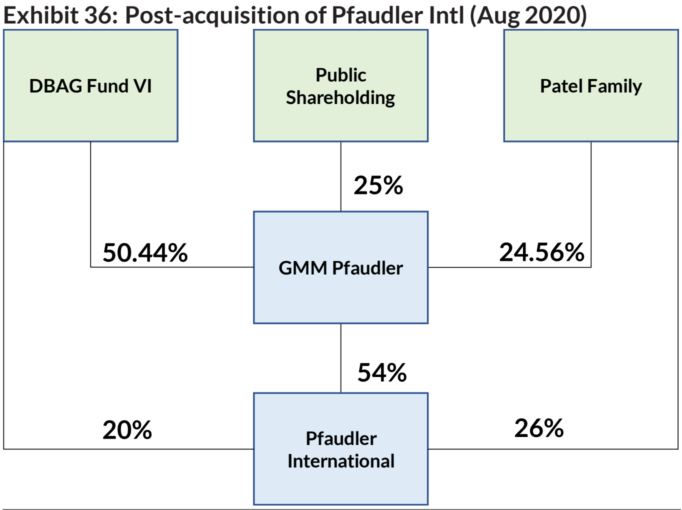
In August 2022, GMM announced the acquisition of the balance 46% stake (26% held by Millars Concrete Technologies Pvt. Ltd. (Patel Family) and 20% held by DBAG Fund VI). This decision was backed by the solid performance of the international business and the business turning around earlier than expected. The company plans to fund the cash portion of consideration by debt. This transaction also increases the stake of the Patel family in GMM Pfaudler, reiterating their long-term commitment to the company.

Exhibit 35: Pre-acquisition of Pfaudler International



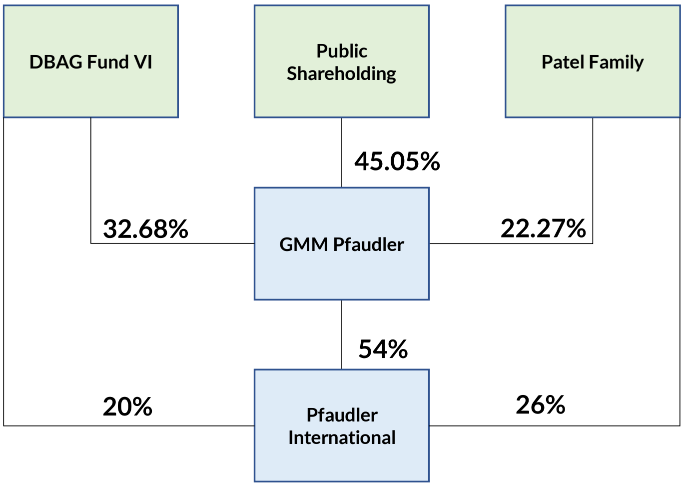
Source: Company, Axis Capital

Exhibit 36: Post-acquisition of Pfaudler Intl (Aug 2020)



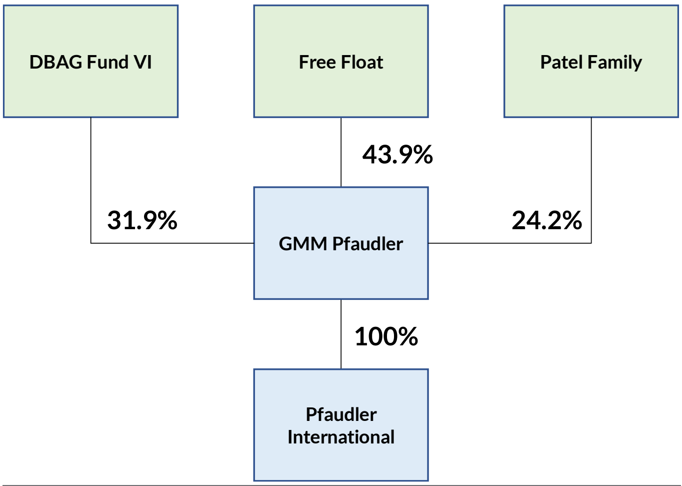
Source: Company, Axis Capital

Exhibit 37: Post OFS of 20% stake in GMM Pfaudler



Source: Company, Axis Capital

Exhibit 38: GMM Pfaudler owns 100% of Pfaudler International

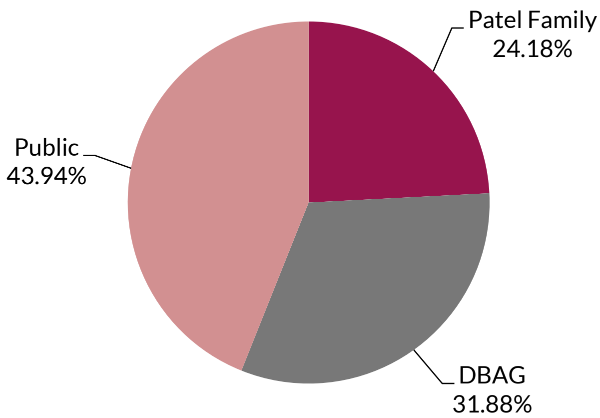


Source: Company, Axis Capital

Shareholding pattern

As of 30th September 2022, the promoters own 56.06% of GMM Pfaudler, of which the Patel Family owns 24.18% and DBAG Fund VI owns 31.88%. DBAG Fund VI stake is locked in till ~ August 2023. Post this, in case DBAG chooses to sell, the Patel family may increase their stake provided adequate finances are in place. This stake could also be sold in the market or be taken over by some other private equity investor.

Exhibit 39: GMM Pfaudler – Shareholding pattern



Source: Company, Axis Capital

Management team

Exhibit 40: GMM Pfaudler – Management team

Name	Designation	Education	Past Experience
Mr. Tarak Patel	Managing Director	1) BA in Economics - University of Rochester, USA 2) MBA jointly conferred by Columbia Business School, London Business School & University of Hong Kong Business School	Universal Consulting
Mr. Thomas Kehl	CEO - International Business	Degree in Marketing and General Management - The University for Applied Sciences Mainz.	1) Coperion Group - President & CEO 2) Rieter Automatic, Switzerland - MD 3) Rieter AG, Switzerland - Senior VP 4) Freudenberg Nonwovens - CEO 5) Hoechst Group 6) Pfaudler Group (pre acquisition) - CEO
Mr. Aseem Joshi	CEO - India Business	1) MBA - INSEAD, France 2) MS in Industrial and Systems Engineering from the Virginia Tech University, USA 3) BE in Mechanical Engineering from the University of Pune	20 years' experience in technology, consulting, strategy, sales and manufacturing. 1) IBM, USA 2) McKinsey, USA 3) Eaton Fluid Power, India 4) Honeywell, India
Mr. Alexander Pömpner	CFO - International Business	1) MBA - University in Cologne, Germany 2) Chartered Financial Analyst (CFA) qualification	15 years of experience in various Finance / M&A roles in Private Equity portfolio companies. 1) Vision Ophthalmology Group - CFO 2) BBI Group - CFO 3) Azelis 4) Mauser
Mr. Manish Poddar	CFO - India Business	1) Chartered Accountant 2) B.Com - Delhi University 3) Executive MBA in IFRS, Treasury, Forex Management and Systems Audit	22 years of rich experience across B2B and B2C space with Global and Indian MNCs. 1) Diversey India - portfolio company of Bain Capital 2) Sun Pharma (Ranbaxy) 3) Louis Dreyfus, India

Source: Company, Axis Capital

Exhibit 41: GMM Pfaudler – Management team

Source: Company, Axis Capital

Key risks

Slowdown in capex by pharma and chemical industries

GMM Pfaudler's business is highly dependent on the performance of the end user industries of pharma and chemical. Poor business outlook in these end industries and a consequent cut in capex might impact business prospects.

Commodity price inflation

Raw materials include carbon steel, stainless steel, caustic soda, quartz, sand etc and any significant uptick in the prices of these commodities can potentially impact margins. Raw material inflation in end user industries, as witnessed post Covid or during the Russia–Ukraine war, can adversely impact the business of clients leading to a deferment of capex which impacts the company's order booking. Raw material price increases are usually passed on with a lag of a quarter and normally the company has raw material inventory of 3- 4 months.

Potential dent to profitability due to rising input costs

Rise in gas prices, fuel costs, freight charges, pose as a risk to the profitability of the company's existing order backlog. However, to mitigate the same, the company is undertaking cost reduction measures. Further, its leadership position in this business and the focus on quality, opens opportunities to pass on price increases to customers.

Geopolitical events may impact business

As of Q1FY23, 71% of the revenue was from outside India. Any geopolitical tension can impact cross border trade.

Environmental and regulatory risks

End user industries of pharma and chemicals do get disrupted due to environmental and regulatory risks which in turn can affect the company. In India, the chemical industry has faced regulatory challenges, like the following:

(1) **Red Triangle Ban:** Owing to pollution concerns, chemical companies are subject to supervision by the Pollution Control Board of India. The Indian government, proposed to ban 27 pesticide products, labelling them as toxic with risk to human beings and animals.

(2) **Withdrawal of incentive schemes –** The MEIS schemes were created for the benefit of exports and exporters, which helped involved companies avail significant financial benefits. The incentives under the schemes were calculated as a percentage, which is 2%, 3% or 5% of the realised FOB (free-on-board) value of exports. This scheme stood withdrawn with effect from 01 January 2021.

Financial summary (Consolidated)

Profit & Loss (Rs mn)

Y/E March	FY21	FY22	FY23E	FY24E	FY25E
Net sales	10,011	25,406	30,000	34,800	39,324
Other operating income	-	-	-	-	-
Total operating income	**10,011**	**25,406**	**30,000**	**34,800**	**39,324**
Cost of goods sold	(4,477)	(10,139)	(12,090)	(14,024)	(15,848)
Gross profit	5,534	15,267	17,910	20,776	23,476
Gross margin (%)	55	60	60	60	60
Total operating expenses	(4,148)	(12,428)	(13,777)	(15,332)	(17,066)
EBITDA	**1,386**	**2,839**	**4,133**	**5,443**	**6,410**
EBITDA margin (%)	14	11	14	16	16
Depreciation	(233)	(514)	(925)	(1,071)	(1,237)
EBIT	**881**	**1,512**	**2,970**	**4,134**	**4,934**
Net interest	(67)	(244)	(256)	(223)	(136)
Other income	200	65	65	65	65
Profit before tax	**1,014**	**1,334**	**2,779**	**3,976**	**4,863**
Total taxation	(45)	(580)	(778)	(1,113)	(1,362)
Tax rate (%)	4	44	28	28	28
Profit after tax	969	754	2,001	2,863	3,502
Minorities	99	97	(340)	-	-
Profit/ Loss associate co(s)	-	-	-	-	-
Adjusted net profit	1,068	850	1,661	2,863	3,502
Adj. PAT margin (%)	11	3	6	8	9
Net non-recurring items	(335)	-	-	-	-

Balance Sheet (Rs mn)

Y/E March	FY21	FY22	FY23E	FY24E	FY25E
Paid-up capital	29	29	90	90	90
Reserves & surplus	4,042	5,242	8,411	11,094	14,371
Net worth	4,071	5,271	8,501	11,184	14,461
Borrowing	5,643	5,590	5,390	4,490	1,990
Other non-current liabilities	5,203	4,294	4,294	4,294	4,294
Total liabilities	**16,151**	**16,568**	**18,185**	**19,968**	**20,745**
Gross fixed assets	9,149	9,527	11,027	12,767	14,733
Less: Depreciation	(808)	(1,824)	(2,749)	(3,820)	(5,057)
Net fixed assets	8,341	7,703	8,278	8,947	9,676
Add: Capital WIP	44	130	130	130	130
Total fixed assets	8,385	7,832	8,407	9,077	9,805
Total Investment	0	0	0	0	0
Inventory	5,849	6,695	7,984	9,261	10,465
Debtors	3,096	3,562	4,207	4,880	5,514
Cash & bank	2,923	3,277	3,003	3,060	3,090
Loans & advances	-	-	-	-	-
Current liabilities	8,024	10,708	12,771	13,426	15,008
Net current assets	5,285	6,179	5,774	7,126	7,413
Other non-current assets	2,480	2,557	4,004	3,765	3,527
Total assets	**16,151**	**16,568**	**18,185**	**19,968**	**20,745**

Source: Company, Axis Capital

Cash Flow (Rs mn)

Y/E March	FY21	FY22	FY23E	FY24E	FY25E
Profit before tax	778	1,431	2,439	3,976	4,863
Depreciation & Amortisation	506	1,326	1,164	1,309	1,476
Chg in working capital	(1,046)	360	(316)	(295)	(256)
Cash flow from operations	**193**	**2,536**	**2,508**	**3,877**	**4,721**
Capital expenditure	(9,560)	(1,067)	(3,186)	(1,740)	(1,966)
Cash flow from investing	**(4,791)**	**(3,299)**	**(3,186)**	**(1,740)**	**(1,966)**
Equity raised/ (repaid)	121	437	1,704	-	-
Debt raised/ (repaid)	5,641	372	247	(1,900)	(2,500)
Dividend paid	(73)	(88)	(135)	(180)	(225)
Cash flow from financing	**6,923**	**901**	**403**	**(2,080)**	**(2,725)**
Net chg in cash	2,324	139	(275)	57	30

Key Ratios

Y/E March	FY21	FY22	FY23E	FY24E	FY25E
OPERATIONAL					
FDEPS (Rs)	24.4	19.4	36.9	63.7	77.9
CEPS (Rs)	28.2	49.6	62.8	92.8	110.7
DPS (Rs)	1.7	2.0	3.0	4.0	5.0
Dividend payout ratio (%)	10.0	10.3	8.1	6.3	6.4
GROWTH					
Net sales (%)	69.4	153.8	18.1	16.0	13.0
EBITDA (%)	24.7	104.8	45.6	31.7	17.8
Adj net profit (%)	50.2	(20.4)	95.3	72.4	22.3
FDEPS (%)	50.2	(20.4)	90.5	72.4	22.3
PERFORMANCE					
RoE (%)	29.0	18.2	24.1	29.1	27.3
RoCE (%)	10.9	9.6	17.5	22.0	24.6
EFFICIENCY					
Asset turnover (x)	1.9	2.7	2.9	2.9	2.9
Sales/ total assets (x)	0.7	1.0	1.0	1.1	1.1
Working capital/ sales (x)	0.2	0.1	0.1	0.1	0.1
Receivable days	112.9	51.2	51.2	51.2	51.2
Inventory days	247.5	108.3	112.7	115.1	116.1
Payable days	125.2	63.3	65.8	67.3	67.8
FINANCIAL STABILITY					
Total debt/ equity (x)	1.3	0.9	0.7	0.5	0.2
Net debt/ equity (x)	0.6	0.4	0.3	0.1	(0.1)
Current ratio (x)	1.7	1.6	1.5	1.5	1.5
Interest cover (x)	13.1	6.2	11.6	18.5	36.4
VALUATION					
PE (x)	75.1	94.4	49.6	28.7	23.5
EV/ EBITDA (x)	60.7	29.6	20.0	15.0	12.4
EV/ Net sales (x)	8.4	3.3	2.8	2.3	2.0
PB (x)	19.7	15.2	9.7	7.4	5.7
Dividend yield (%)	0.1	0.1	0.2	0.2	0.3
Free cash flow yield (%)	(11.7)	1.8	(0.8)	2.7	3.4

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