

INDUSTRY	CHEMICALS		
<b>CMP (as on 2 May 2014)</b>	<b>Rs 136</b>		
<b>Target Price</b>	<b>Rs 212</b>		
Nifty	6,695		
Sensex	22,404		
<b>KEY STOCK DATA</b>			
Bloomberg	ADFI IN/ADIF.BO		
No. of Shares (mn)	13		
MCap (Rs bn) / (\$ mn)	1.7/27.9		
6m avg traded value (Rs mn)	2		
<b>STOCK PERFORMANCE (%)</b>			
<b>52 Week high / low</b>	<b>Rs 150/39</b>		
	3M	6M	12M
Absolute (%)	97.2	133.4	168.4
Relative (%)	88.0	127.7	153.5
<b>SHAREHOLDING PATTERN (%)</b>			
Promoters	62.87		
FIs & Local MFs	0.72		
FIIIs	0.40		
Public & Others	36.01		
Source : BSE			

## Niche product play

*Adi Finechem (AFL) is a small cap specialty chemical maker, manufacturing a variety of chemicals that fall into two categories: Nutraceutical Intermediates and Oleo Chemicals. We think that with doubling of capacity to 45,000 TPA over FY14-16E, no competition for 50% of revenues and stability in RM prices will lead to Revenue/PAT CAGR of 39/51% over FY14-16E. We see value in AFL due to its premium priced products, advantage of low cost RM, better technology, ROEs>30% and initiate coverage with a BUY. Our TP is Rs 212, valuing the company at 7x FY16E EPS of Rs 30.22/sh.*

- **Niche products :** AFL manufactures high grades of Fatty Acids viz. Linoleic, Distilled, Dimer and Monomer Fatty Acids from by-products or waste product streams generated during processing of soft vegetable oils Viz. Soya, Sunflower, Corn and Cotton (SSCC). It also manufactures Nutraceuticals like Tocopherol, which is a natural source of vitamin E. We believe that there is further scope of realization improvement for Dimer Acid (11% CAGR over FY10-13, sole producer in the country) and Mixed Tocopherol (37% CAGR over FY10-

13) which is in high demand in the developed export markets.

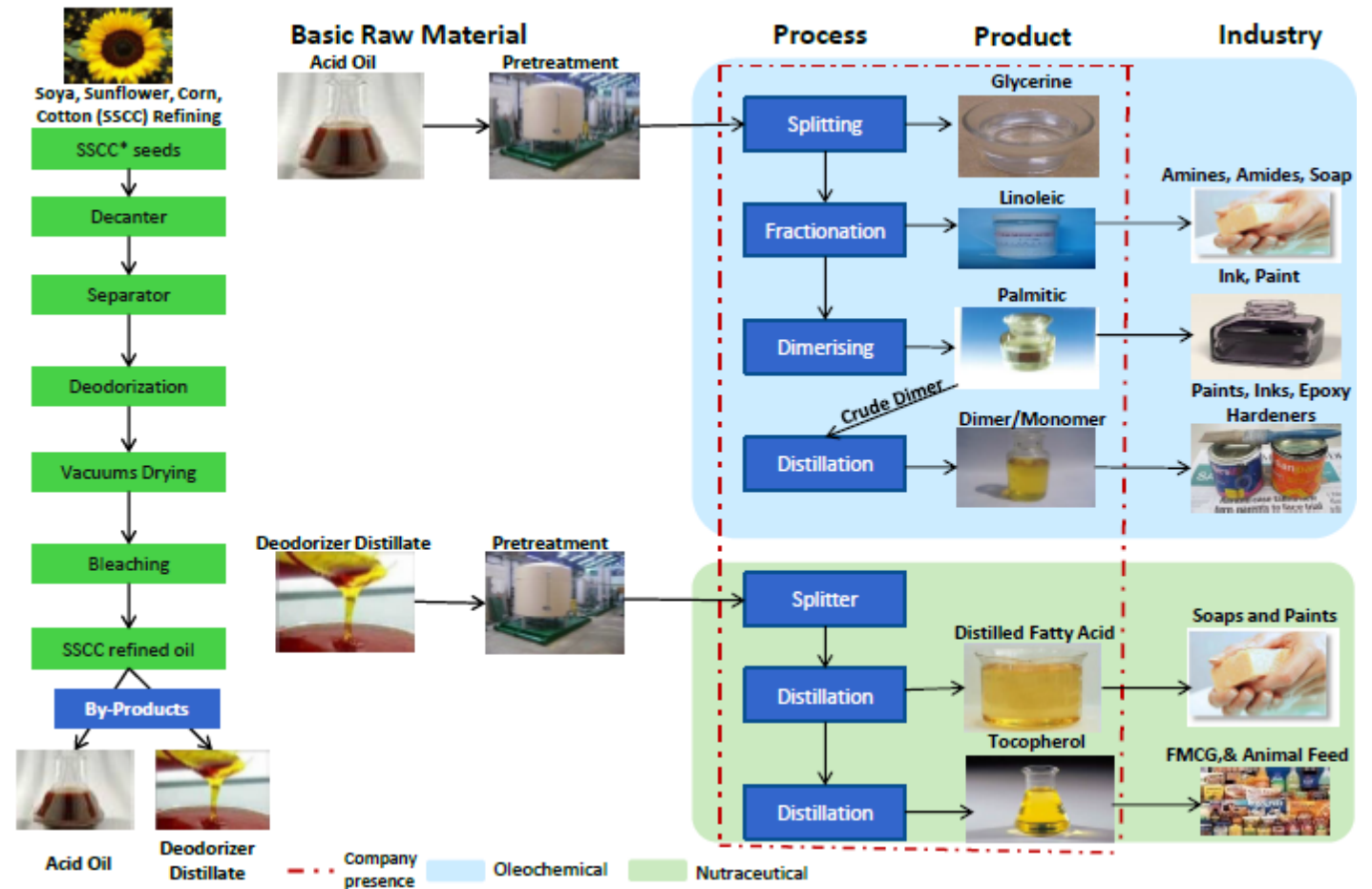
- **Competitive position :** AFL is the sole player in the oleo chemical market using renewable resources in India. Company uses by-products of vegetable oil processing giving it cost advantage. The company is in a position to pass on the hikes of RM prices (prices have increased by ~17% CAGR over FY09-FY13). Adi's customers include the highly respected Asian Paints, Hindustan Inks in the domestic market and Riken Vitamin, BASF, Tama Biochem, Archer Daniels Midland (ADM) overseas
- **Outlook and valuations :** We believe that AFL is well poised for a period of high intensity growth on doubling of capacity over FY14-16E. We expect margins to sustain at 20%+ levels in FY15 (currently at 14%) on better realizations of premium products and cost reduction on account of stable RM prices and better technology.
- We value AFL conservatively at 7X FY16E EPS of Rs 30.22 and recommend BUY with a TP of Rs 212.

### FINANCIAL SUMMARY

Year Ending March (Rs mn)	FY10	FY11	FY12	FY13	FY14E	FY15E	FY16E
Net Sales	383.9	573.6	971.6	1,231.0	1,468.2	2,048.9	2,802.3
EBITDA	25.2	103.7	146.3	172.6	302.3	445.8	619.8
PAT	-5.6	50.8	73.7	83.9	166.6	261.6	379
Diluted EPS (Rs)	(0.59)	5.35	7.76	7.36	13.29	20.86	30.22
P/E (x)	(232.4)	25.4	17.5	18.5	10.2	6.5	4.5
EV / EBITDA (x)	56.4	13.8	10.2	10.0	6.4	4.2	2.7
RoE (%)	(8.2)	32.8	35.8	30.7	43.4	44.8	42.6

Source: Company, HDFC Sec Inst Research

**Manufacturing Process**



Source : Company

## Company background

- 1985-1995 : The company was incorporated to process Rice Bran Oil and commenced project in late 1993. The Company was listed on the BSE in 1995
- 1996-2010 : AFL shifted its focus to producing Fatty Acids and was the first and only company to manufacture Mixed Tocopherol Concentrate in India and supply to Henkel Corp subsequently taken over by Congnis. The company increased its manufacturing capacity to 8,000 MT p.a.
- 2011-2012 : Main focus was on reduction of manufacturing cost per ton Complete Re- Engineering of its Energy Consumption System and Installation of new balancing equipment. Increase in manufacturing Capacity to 18,000 MT p.a.
- 2013 – Onwards : The company has also started production and supply of Sterol Concentrate for Nutraceutical Industry. AFL plans to increase capacity to 36,000 MT pa by FY15 and subsequently to 45,000 MT pa.

## Product Portfolio

- AFL manufactures a variety of chemicals that fall into two categories : Nutraceutical Intermediates and Oleo Chemicals. The company produces Oleo Chemicals like Linoleic, Dimer, Monomer and distilled fatty acids used in paints, inks and soap industry.
- These chemicals are used as import substitutes by the paint and FMCG industries. Sales realization for all products have grown by 100%+ over FY09-13. With Nutraceuticals like Mixed Tocopherol concentrate and Concentrated sterols, the management has found lucrative intermediates in high demand in advanced countries such as Japan and the United States.

- Other speciality chemicals are also mostly manufactured exclusively by Adi Finechem or have a handful of suppliers in India.

## Raw Material Sourcing

- Availability and access to the raw material is a key challenge in the Oleo Chemical industry. AFL manufactures all of these chemicals via processing of low value by-products (deodoriser distillate and acid oil) of edible oil refineries. What this means is that refineries are only too happy to supply raw materials to Adi Finechem, who then converts them to difficult to synthesise value added chemicals.
- The prices of RM are directly dependent on vegetable oil prices like soya, sunflower, cotton and corn. India is one of the largest consumers of Soya & Sunflower in the world, hence giving good access to raw materials required by AFL. AFL has largely been able to adjust its raw material cost to market forces and pass through the price increases. Large part of its Raw Material comes from Kutch whereas the plant is located at Ahemdabad giving it a strategic advantage.

## Expansion plans

- The current capacity is of 25,000 MT pa which the company plans to expand to 36,000 MT pa by FY15 and 45,000 MT pa by FY16. The capex for the expansion is ~ Rs 210mn wherein the company will take a term loan of ~Rs 60mn and the balance ~ Rs 150mn will be funded by internal accruals.
- The company maintains a capacity utilization of ~85-88% and we expect it to operate at the same level going ahead. The company has been able to sell whatever it produces and is confident to sell its entire produce from the expanded capacity.

**KEY ASSUMPTIONS**

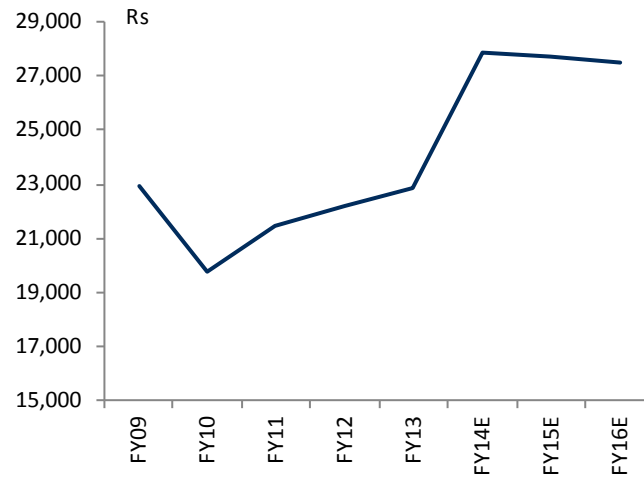
Year ending March	FY12	FY13	FY14E	FY15E	FY16E
Capacity (MT)	16,000	18,000	25,000	36,000	45,000
Avg Capacity available for production	16,000	18,000	21,500	30,500	40,500
Capacity Utilisation	87%	88%	88%	85%	85%
Average price of Raw Materials / Ton	45,558	50,903	48,867	51,310	53,876
Average sale price / Ton	67,783	73,780	76,731	79,033	81,404
Contribution (Delta)	22,226	22,877	27,864	27,723	27,528

Source : Company, HDFC sec Inst Research

**Our assumptions**

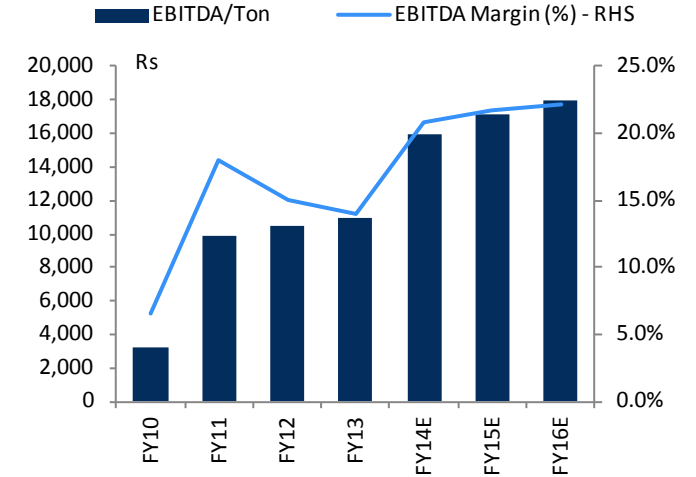
- **Available Capacity for the year** : The company has mentioned that the expanded capacity in each year will be commissioned by 2Q end. Hence we are assuming the capacity available to be the arithmetical average in each year. Capacity utilization is assumed to be 85% for the next 2 years.
- **Avg RM prices** : RM prices have been very volatile for this company going as high as 45% hike in FY12. Although there is no specified quote for RM (Acid oil, deodorizer distillate) in any commodity exchanges, the trend follows the path of vegetable oil prices. Hence we have taken price of MCX Refined Soy Oil as a benchmark indicator for RM prices. The Refined Soy Oil prices have corrected 4% in FY14. We have taken a conservative 5% price hike of RM prices in the next 2 years.
- **Avg sales price** : High volatility in RM prices has led to volatility in sales price/Ton. The company in most cases has been able to pass on the increase in RM cost. Contribution i.e. Avg Sales Price – Avg RM price, has grown from FY11-13. We believe that this trend is likely to continue in the future on account of premium and value added products. We have factored in a conservative 3-4% increase in avg sales price over FY14-16E on account of large volume push.

**Contribution (Delta) = Avg sales price - Avg price of RM**



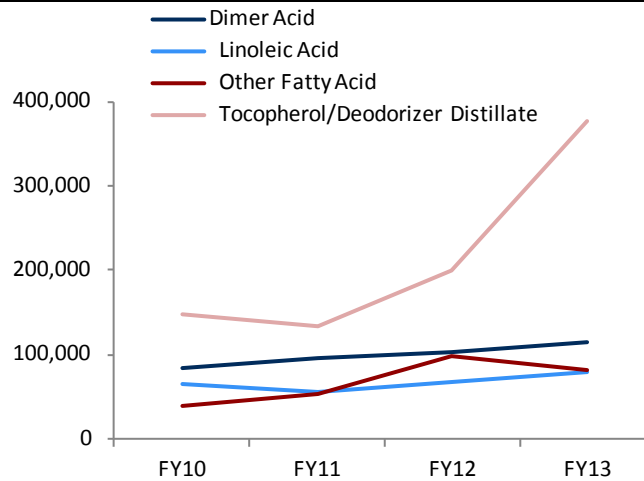
Source : Company, HDFC sec Inst Research

**EBITDA margin & EBITDA/Tn**



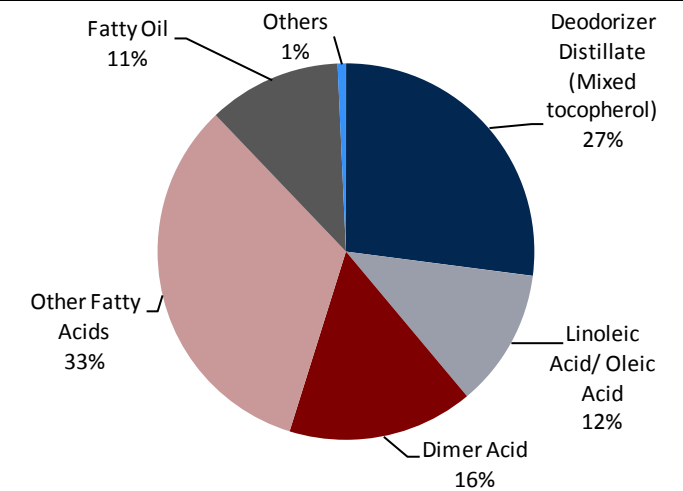
Source : Company, HDFC sec Inst Research

**Product wise Realisation in Rs/tn**



Source : Company, HDFC sec Inst Research

**FY13 Product wise revenue breakup**



Source : Company, HDFC sec Inst Research

## Indian Industry

- Indian Oleo Chemical players are well positioned with abundant raw material supply, lower manpower cost and improving infrastructure which should be the key market drivers for the industry at large. About 1.25% of Acid oil and 0.25% of Deodorizer Distillate is extracted when soft crude vegetable oil is processed.
- India consumed ~15.8 MnT of Vegetable oil in 2012 which translates into a possible extraction of 0.237 MnT of raw material oil. The consumption of edible oil is expected to increase with growth in economy which augurs well for AFL as RM supply streams will expand

### APPLICATION OF PRODUCTS

Oils	By-product	Fatty Acids	Application
SSCC, Groundnuts, Rice Bran & Rapeseeds	Acid Oils	Palmitic, Linoleic, Dimer, Monomer	Inks & Paints, Export hardeners
SSCC, Groundnuts, Rice Bran & Rapeseeds	Deodorizer Distillate	Mixed Tocopherol, Distilled Fatty Acids	Natural Vitamin E
Palm, Palm Kernel & Coconut	Deodorizer Distillate	Stearic, Lauric, Distilled Fatty Acids	Soap Noodles, Rubber Tyre, Cosmetic

Source : Company, HDFC sec Inst Research

## Global Industry

- The global market for Oleo Chemicals was estimated to be over 13 million tons in 2010 which is expected to reach 15 million tons by 2018, growing at a CAGR of around 6.0% from 2013 to 2018. Asia Pacific is the fastest growing market for Oleo Chemicals, growing at a CAGR of 8.2% from 2013 to 2018.
- The Oleo Chemicals industry is expected to grow on account of demand for new applications, innovative and sustainable products. The prospects of the industry are further enhanced by the hike in demand from a

growing consumer market and wider availability of raw materials. These products primarily find end-use applications in Surfactants, Soap and Detergents, Cosmetics, Food Emulsifiers, Paints and Inks, and Lubricants.

- The global nutraceutical product market reached \$142.1 billion in 2011 and is expected to reach \$204.8 billion by 2017, growing at a CAGR of 6.3% from 2012 to 2017. Asia Pacific (including Japan) is expected to have the second largest market share after North America by 2017. North America has the highest market share for nutraceutical product market, which is primarily supported by the U.S. health conscious consumers segment.

### Return ratios are in the high thirties, cash flows are clean

- Return ratios are currently in the high thirties which we expect to go 40%+ over FY14E-FY16E due to volume push and stability in RM prices. Net Debt to equity in FY13 is very healthy at 0.6. We expect Cash flow generation from the expanded capacity will be used to lower debt and to fund further expansion. Reinvestment of cash flow for further capacity expansion or foray into Value added product will lead to re-rating of the stock in our opinion

### What are the Positives for Adi Finechem

- No Indian competitor for 50% of its revenue.
- Plant location in Ahemdabad which will help in procuring RM from the strong edible oil producing western states.
- Realisation for premiumised Mixed Tocopherol (Natural Vitamin E) has almost doubled over FY10-FY13 which is slightly aided by Rupee depreciation.
- Expanded capacity (25000 T to 45000 T) will be almost funded via internal accruals

- Company uses by-products of vegetable oil processing giving it price advantage.
- Near monopolistic position in the industry due to barriers to entry. Any new entrant would require 2.5 yrs to set up a plant from scratch, and it would take many years to develop the technology know-how and build up close relationship with raw material suppliers.
- Ability to pass increase of RM cost to its customers.
- Return ratios are currently in the mid 30% which we expect to go to 40%+ over FY14-16.

### Risks

- **Sourcing of Raw Material:** Key risk for the company is availability of raw materials. Firstly, the output of by products is very less (Acid oil ~1.25% and Deodorizer Distillate ~ 0.25%). Hence AFL has to source the material from many suppliers (highest is 30% from one

supplier), which in turn affects the quality of end products.

- **Deterioration of WC Cycle:** Adi has to make advance payment to ensure constant supply of raw materials. With almost doubling of capacity, we believe that the company will be required to keep a higher number of RM inventory days. Debtor days are in sync with the peer companies.
- **Quality of raw materials:** As the company is sourcing from various manufacturers, the quality of raw material differs drastically.
- **Illiquid stock:** Currently, the stock is very illiquid with listing only on the BSE. Adi Finechem is not yet listed on NSE. However the company has initiated the listing process on NSE and expects it to happen soon.

**INCOME STATEMENT**

(Rs mn)	FY12	FY13	FY14E	FY15E	FY16E
<b>Net Sales</b>	<b>972</b>	<b>1,231</b>	<b>1,452</b>	<b>2,049</b>	<b>2,802</b>
<b>Growth (%)</b>	<b>69.4</b>	<b>26.7</b>	<b>17.9</b>	<b>41.1</b>	<b>36.8</b>
Material Expenses	672	874	925	1,330	1,855
Employee Expenses	34	42	54	65	78
Other Operating Expenses	119	143	171	208	250
<b>EBIDTA</b>	<b>146</b>	<b>173</b>	<b>302</b>	<b>446</b>	<b>619.76</b>
<b>EBIDTA (%)</b>	<b>15.1</b>	<b>14.0</b>	<b>20.8</b>	<b>21.8</b>	<b>22.1</b>
<b>EBIDTA Growth (%)</b>	<b>41.1</b>	<b>18.0</b>	<b>75.1</b>	<b>47.5</b>	<b>39.0</b>
Other Income	3	4	5	3	3
Depreciation	20	23	26	32	36
EBIT	129	154	281	417	587
Interest	21	25	32	26	21
Exceptional items	-	3	-	-	-
<b>PBT</b>	<b>108</b>	<b>126</b>	<b>249</b>	<b>390</b>	<b>566</b>
Tax	34	42	82	129	187
<b>PAT</b>	<b>74</b>	<b>84</b>	<b>167</b>	<b>262</b>	<b>379.01</b>
EPS	7.8	7.4	13.3	20.9	30.2

Source: Company, HDFC Sec Inst Research

**BALANCE SHEET**

(Rs mn)	FY12	FY13	FY14E	FY15E	FY16E
Share Capital	95	114	125	125	125
Reserves	143	194	335	582	946
<b>Total shareholders' Fund</b>	<b>238</b>	<b>308</b>	<b>460</b>	<b>707</b>	<b>1,072</b>
Long Term Debt	62	54	84	114	104
Short Term Debt	140	117	137	67	42
<b>Total Debt</b>	<b>203</b>	<b>171</b>	<b>221</b>	<b>181</b>	<b>146</b>
Deferred taxes	34	36	36	36	36
Long Term Provisions & others	1	1	1	1	1
<b>Total Sources of Funds</b>	<b>475</b>	<b>516</b>	<b>718</b>	<b>925</b>	<b>1,254</b>
<b>Application of Funds</b>					
Net Block	257	271	368	445	454
CWIP	15	13	20	10	5
Investments, LT Loans & Adv.	14	8	10	11	12
Inventories	95	99	152	219	305
Debtors	141	154	199	281	384
Cash & Equivalent	1	1	6	6	154
ST loans & Advances, others	20	50	63	63	63
<b>Total current assets</b>	<b>257</b>	<b>304</b>	<b>420</b>	<b>568</b>	<b>905</b>
Creditors	54	63	81	91	103
Other Current Liabilities & Prov	15	18	19	19	20
<b>Total Current Liabilities</b>	<b>69</b>	<b>80</b>	<b>99</b>	<b>110</b>	<b>123</b>
<b>Net Current Assets</b>	<b>188</b>	<b>224</b>	<b>320</b>	<b>458</b>	<b>783</b>
<b>Total Application of Funds</b>	<b>475</b>	<b>516</b>	<b>718</b>	<b>925</b>	<b>1,254</b>

Source: Company, HDFC Sec Inst Research



**CASH FLOW**

(Rs mn)	FY12	FY13	FY14E	FY15E	FY16E
Reported PAT	74	84	167	262	379
Non-operating & EO items	0	0	0	0	0
PAT from Operations	74	84	167	262	379
Interest expenses	21	25	32	26	21
Depreciation	20	23	26	32	36
Working Capital Change	(79)	(22)	(92)	(138)	(177)
<b>OPERATING CASH FLOW ( a )</b>	<b>35</b>	<b>109</b>	<b>134</b>	<b>182</b>	<b>260</b>
Capex	(70)	(51)	(130)	(100)	(40)
Free cash flow (FCF)	(34)	58	4	82	220
Investments	0	0	0	0	0
<b>INVESTING CASH FLOW ( b )</b>	<b>(70)</b>	<b>(51)</b>	<b>(130)</b>	<b>(100)</b>	<b>(40)</b>
Share capital Issuance	-	-	-	-	-
Debt Issuance	70	(34)	50	(40)	(35)
Interest expenses	(21)	(25)	(32)	(26)	(21)
Dividend	(11)	(11)	(15)	(15)	(15)
<b>FINANCING CASH FLOW ( c )</b>	<b>38</b>	<b>(70)</b>	<b>3</b>	<b>(81)</b>	<b>(71)</b>
<b>NET CASH FLOW (a+b+c)</b>	<b>3</b>	<b>(11)</b>	<b>7</b>	<b>1</b>	<b>149</b>
Non-operating and EO items	(6)	11	(2)	(1)	(1)
Closing Cash & Equivalents	1	1	6	6	154

Source: Company, HDFC Sec Inst Research

**KEY RATIOS**

	FY12	FY13	FY14E	FY15E	FY16E
<b>PROFITABILITY (%)</b>					
GPM	30.9	29.0	36.3	35.1	33.8
EBITDA Margin	15.1	14.0	20.8	21.8	22.1
EBIT Margin	13.3	12.5	19.3	20.3	20.9
APAT Margin	7.6	6.8	11.5	12.8	13.5
RoE	35.8	30.7	43.4	44.8	42.6
ROIC	32.2	31.8	46.4	51.7	58.8
RoCE	31.5	31.0	45.5	50.7	53.9
<b>EFFICIENCY</b>					
Tax Rate (%)	31.7	33.6	33.0	33.0	33.0
Asset Turnover (x)	2.1	2.4	2.1	2.2	2.3
Inventory (days)	52	41	60	60	60
Debtors (days)	53	46	50	50	50
Payables (days)	6	6	6	6	6
Cash Conversion Cycle (days)	98	81	104	104	104
Debt/EBITDA (x)	1.4	1.0	0.7	0.4	0.2
Net D/E	0.8	0.6	0.5	0.2	(0.0)
Interest Coverage	6.1	6.2	8.8	15.9	27.7
<b>PER SHARE DATA</b>					
EPS (Rs/sh)	7.8	7.4	13.3	20.9	30.2
CEPS (Rs/sh)	9.8	9.3	15.4	23.4	33.1
DPS (Rs/sh)	1.16	0.97	1.16	1.16	1.16
BV (Rs/sh)	25.0	27.0	36.7	56.4	85.5
<b>VALUATION</b>					
P/E	17.5	18.5	10.2	6.5	4.5
P/BV	5.4	5.0	3.7	2.4	1.6
EV/EBITDA	10.2	10.0	6.4	4.2	2.7
OCF/EV (%)	2.4	6.4	7.0	9.7	15.3
FCF/EV (%)	(2.3)	3.4	0.2	4.4	12.9
FCFE/Mcap (%)	1.1	0.0	1.3	0.9	9.6
Dividend Yield (%)	0.9	0.7	0.9	0.9	0.9

Source: Company, HDFC Sec Inst Research

## Rating Definitions

- BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period
- NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
- SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

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