

INDUSTRY	CHEMICALS		
CMP (as on 25 Jun 2014)	Rs 177		
Target Price	Rs 206		
Nifty	7,569		
Sensex	25,314		
KEY STOCK DATA			
Bloomberg	ADFI IN/ADIF.BO		
No. of Shares (mn)	13		
MCap (Rs bn) / (\$ mn)	2/37		
6m avg traded value (Rs mn)	3		
STOCK PERFORMANCE (%)			
52 Week high / low	Rs 184/39		
	3M	6M	12M
Absolute (%)	22.7	216.5	204.6
Relative (%)	7.9	196.2	168.8
SHAREHOLDING PATTERN (%)			
Promoters	62.87		
FIs & Local MFs	0.72		
FIIIs	0.40		
Public & Others	36.01		
<i>Source : BSE</i>			

Margin sustenance is key

Adi Finechem (AFL) delivered EBITDA margin expansion of 780 bps in FY14, led by strong revenue growth in two key products – Dimer Acid and Tocopherol. Revenues grew 23% YoY on account of higher volumes and slightly aided by the weak rupee. PAT came in at Rs 187mn vs 84mn.

With doubling of capacity to 45,000 TPA (currently at 25,000 TPA) over FY15-16E, virtually no competition for half its revenues and stability in RM prices, AFL can deliver Revenue/PAT CAGR of 31/41% over FY14-16E. With high return ratios, clean cash flows and a reasonably large addressable opportunity AFL looks like a classic compounder to us. At 6x FY16E EPS, it looks attractive despite the recent runup. Margin sustenance will drive rerating. Maintain BUY with a TP of Rs 206/sh, valuing the company at 7x FY16E EPS of Rs 29.5.

- **FY14 Highlights :** Revenue growth for two of its main products viz. Dimer acid and Mixed Tocopherol was 30%+. EBITDA at Rs 331mn (+92% growth YoY) was aided by gross margin expansion of 900 bps. The company has expanded capacity from 18k TPA to 25k TPA. Working capital cycle has increased to 105 days (vs 81 days) as inventory has risen in line with the capacity addition. The co has recommended dividend of Rs 1.50 per equity share and also issued Bonus Shares in the ratio of 1:10.
- **The road ahead :** With increase in demand for oleochemicals from the paint and FMCG sectors, AFL is

expanding capacity from 25,000 TPA to 45,000 TPA by FY16E at a cost of Rs ~230 mn (Rs 120 mn expended in FY14, funded via debt + internal accruals). AFL has indicated that the global Tocopherol business will face challenges over the next two years. Hence volume growth in this business may ease a bit. We have factored this in addition to a stronger rupee (vs FY14). We have also assumed a slight deterioration in WC cycle on account of higher capacity.

- **Outlook and valuations :** We believe that AFL is well positioned for a period of high intensity growth on doubling of capacity over FY14-16E. Sustaining margins at current levels of 20%+ (vs 14% in FY14) and clarity on plans post FY16 (capacity expansion or foray into other value added products) will lead to re-rating of the stock.
- We value AFL conservatively at 7x FY16E EPS of Rs 29.5. Maintain BUY with a TP of Rs 206/sh.

FINANCIAL SUMMARY

(Rs mn)	FY12	FY13	FY14	FY15E	FY16E
Net Sales	1,231.0	1,518.0	1,942.7	2,614.0	573.6
EBITDA	146.3	172.6	331.1	428.6	610.0
PAT	73.7	83.9	186.6	247.5	369.8
Diluted EPS (Rs)	7.76	7.36	14.88	19.74	29.49
P/E (x)	22.9	24.2	12.0	9.0	6.0
EV / EBITDA (x)	12.9	12.7	7.6	5.7	3.7
RoE (%)	35.8	30.7	47.8	42.3	42.4

Source: Company, HDFC Sec Inst Research

KEY ASSUMPTIONS

Year ending March	FY12	FY13	FY14	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%	90%	83%	81%
Average price of Raw Materials / Ton	45,558	50,903	46,039	48,341	50,758
Average sale price / Ton	67,783	73,780	74,284	76,884	79,575
Contribution (Delta)	22,226	22,877	28,245	28,543	28,817

Source : Company, HDFC sec Inst Research

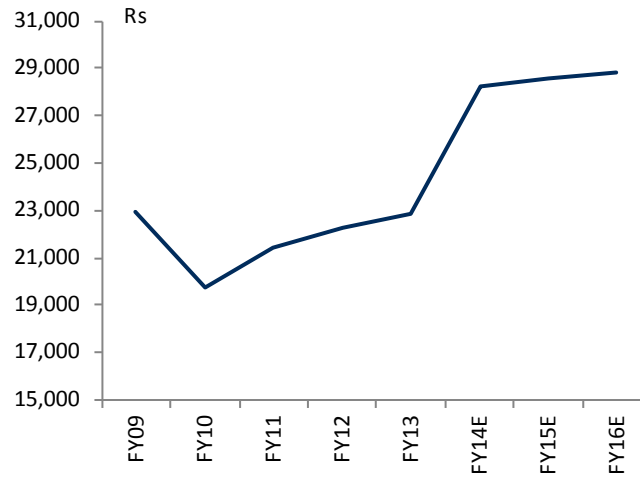
Our assumptions

- **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 utilisation is assumed to be 83% and 81% for the next 2 years respectively.
- **Avg RM prices** : RM prices have been very volatile for this company going as high as 45% hike in FY12. 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 contribution (Avg Sales price – Avg RM cost). The company in most cases has been able to pass on the increase in RM cost. Contribution trend has grown from FY11-14. 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 FY15-16E on account of large volume push.

Outlook

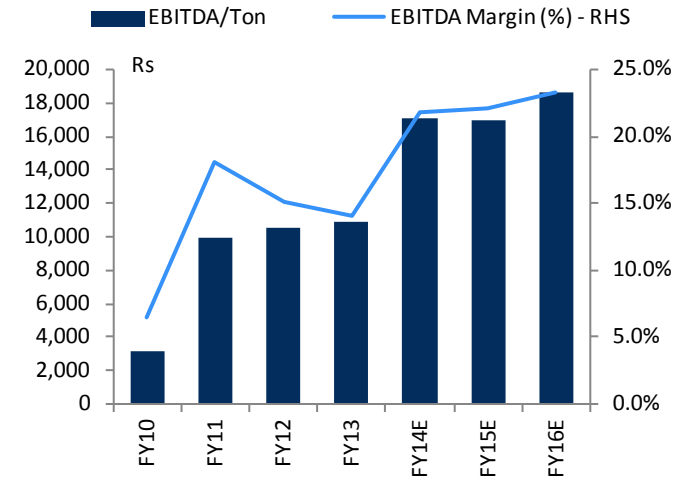
- **Oleochemicals** : The global Oleochemicals market was estimated at 13.5 million tonnes in the 2013 financial year and it is expected to grow at 6% per year over the next five years to reach 18 million tones. Asia accounts for 2/3rd of this market and is expected to grow at 8% pa over next 5 years. The Indian Paint Association (IPA) expects the paint industry to double to up to Rs 50,000 crore in the next three years which will be mainly driven by rising urbanisation and revival of the economy which augurs well for AFL. With revival in the economy, consumption of edible oil will increase which will be beneficial for AFL as raw material supply streams will expand.
- **Nutraceuticals** : The natural Tocopherol (Vitamin E) market has been characterized by a significant imbalance in demand and supply due to a spike in prices for the product. One of the key factors lying behind the price hikes is the shortage of the primary feedstock (deodorized Distillates). High price of natural Tocopherol may lead to customers shifting to synthetic Tocopherol which is cheaper and might lead to a price correction. The global volume of natural source Vitamin E consumption is expected to grow from 11,000 Tonnes in 2013 to about 18,000 Tonnes by 2020, posting a CAGR of 7.3% through 2020.

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



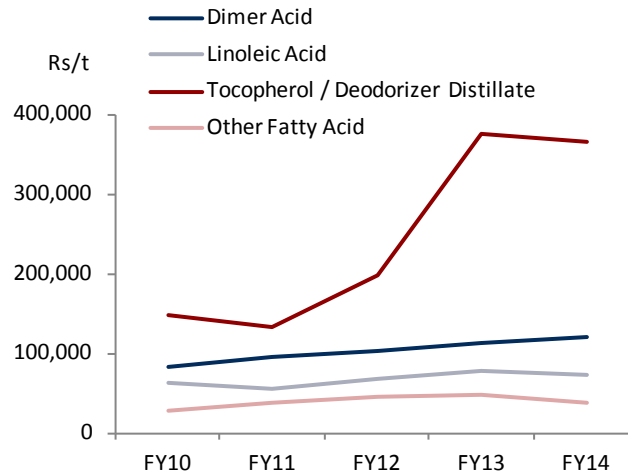
Source : Company, HDFC sec Inst Research

EBITDA margin & EBITDA/Tn



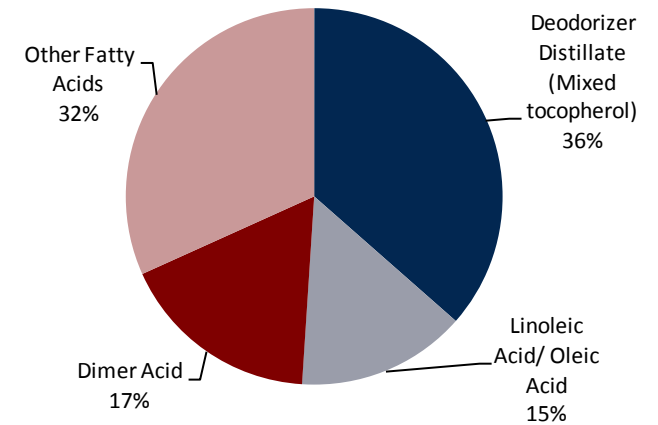
Source : Company, HDFC sec Inst Research

Product wise Realisation in Rs/tn



Source : Company, HDFC sec Inst Research

FY14 Product wise revenue breakup



Source : Company, HDFC sec Inst Research

INCOME STATEMENT

(Rs mn)	FY12	FY13	FY14	FY15E	FY16E
Net Sales	972	1,231	1,518	1,943	2,614
Growth (%)	69.4	26.7	23.3	28.0	34.6
Material Expenses	672	874	941	1,222	1,667
Employee Expenses	34	42	56	67	80
Other Operating Expenses	119	143	190	226	257
EBIDTA	146	173	331	429	610.04
EBIDTA (%)	15.1	14.0	21.8	22.1	23.3
EBIDTA Growth (%)	41.1	18.0	91.8	29.4	42.3
Other Income	3	4	6	8	10
Depreciation	20	23	26	33	39
EBIT	129	154	310	404	581
Interest	21	25	27	35	30
Exceptional items	-	3	-	-	-
PBT	108	126	284	369	552
Tax	34	42	97	122	182
PAT	74	84	187	248	370
EPS	7.8	7.4	14.9	19.7	29.5

Source: Company, HDFC Sec Inst Research

BALANCE SHEET

(Rs mn)	FY12	FY13	FY14	FY15E	FY16E
Share Capital	95	114	125	125	125
Reserves	143	194	347	573	921
Total shareholders' Fund	238	308	473	698	1,046
Long Term Debt	62	54	70	100	90
Short Term Debt	140	117	208	138	113
Total Debt	203	171	278	238	203
Deferred taxes	34	36	40	40	40
Long Term Provisions & others	1	1	1	1	1
Total Sources of Funds	475	516	792	978	1,290
Application of Funds					
Net Block	257	271	328	502	508
CWIP	15	13	116	10	5
Investments, LT Loans & Advs.	14	8	5	6	7
Inventories	95	99	157	211	288
Debtors	141	154	213	293	394
Cash & Equivalent	1	1	1	20	167
ST loans & Advances, others	20	50	57	63	63
Total current assets	257	304	428	587	912
Creditors	54	63	50	94	107
Other Current Liabilities & Prov	15	18	34	33	34
Total Current Liabilities	69	80	84	127	141
Net Current Assets	188	224	343	460	771
Total Application of Funds	475	516	792	978	1,290

Source: Company, HDFC Sec Inst Research

CASH FLOW

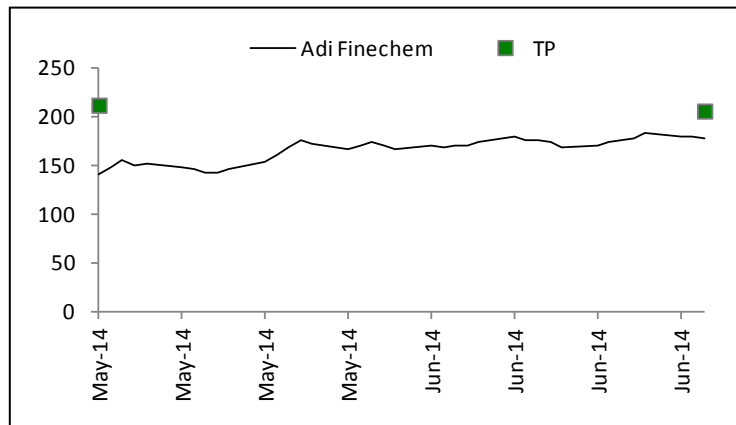
(Rs mn)	FY12	FY13	FY14	FY15E	FY16E
Reported PAT	74	84	187	248	370
Non-operating & EO items	0	0	0	0	0
PAT from Operations	74	84	187	248	370
Interest expenses	21	25	27	35	30
Depreciation	20	23	26	33	39
Working Capital Change	(79)	(22)	(138)	(97)	(164)
OPERATING CASH FLOW (a)	35	109	102	217	274
Capex	(70)	(51)	(191)	(100)	(40)
Free cash flow (FCF)	(34)	58	(89)	117	234
Investments	0	0	0	0	0
INVESTING CASH FLOW (b)	(70)	(51)	(191)	(100)	(40)
Share capital Issuance	-	-	-	-	-
Debt Issuance	70	(34)	108	(40)	(35)
Interest expenses	(21)	(25)	(27)	(35)	(30)
Dividend	(11)	(11)	(13)	(22)	(22)
FINANCING CASH FLOW (c)	38	(70)	68	(97)	(87)
NET CASH FLOW (a+b+c)	3	(11)	(21)	21	147
Non-operating and EO items	(6)	11	21	(1)	(1)
Closing Cash & Equivalents	1	1	1	20	167

Source: Company, HDFC Sec Inst Research

KEY RATIOS

	FY12	FY13	FY14	FY15E	FY16E
PROFITABILITY (%)					
GPM	30.9	29.0	38.0	37.1	36.2
EBITDA Margin	15.1	14.0	21.8	22.1	23.3
EBIT Margin	13.3	12.5	20.4	20.8	22.2
APAT Margin	7.6	6.8	12.3	12.7	14.1
RoE	35.8	30.7	47.8	42.3	42.4
ROIC	32.2	31.8	48.0	46.5	56.2
RoCE	31.5	31.0	47.4	45.7	51.3
EFFICIENCY					
Tax Rate (%)	31.7	33.6	34.2	33.0	33.0
Asset Turnover (x)	2.1	2.4	1.9	2.0	2.0
Inventory (days)	52	41	61	63	63
Debtors (days)	53	46	51	55	55
Payables (days)	6	6	7	7	7
Cash Conversion Cycle (days)	98	81	105	111	111
Debt/EBITDA (x)	1.4	1.0	0.8	0.6	0.3
Net D/E	0.8	0.6	0.6	0.3	0.0
Interest Coverage	6.1	6.2	11.7	11.7	19.7
PER SHARE DATA					
EPS (Rs/sh)	7.8	7.4	14.9	19.7	29.5
CEPS (Rs/sh)	9.8	9.3	17.0	22.3	32.6
DPS (Rs/sh)	1.16	0.97	1.06	1.76	1.76
BV (Rs/sh)	25.0	27.0	37.7	55.7	83.4
VALUATION					
P/E	22.7	24.0	11.9	8.9	6.0
P/BV	7.1	6.5	4.7	3.2	2.1
EV/EBITDA	12.8	12.6	7.5	5.7	3.7
OCF/EV (%)	1.9	5.0	4.1	8.9	12.2
FCF/EV (%)	(1.8)	2.7	(3.6)	4.8	10.4
FCFE/Mcap (%)	0.9	0.0	-0.3	1.9	7.6
Dividend Yield (%)	0.7	0.5	0.6	1.0	1.0

Source: Company, HDFC Sec Inst Research

RECOMMENDATION HISTORY


Date	CMP	Reco	Target
02-May-14	136	BUY	212
25-Jun-14	177	BUY	206

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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