

Adi Finechem

7 May 2015

Reuters: ADIF.BO; Bloomberg: ADFI IN

Improvement In Receivable Days Despite Weak Revenue

With a 30.3% decline in blended realisation, Adi Finechem's (AFL) net revenue for 4QFY15 fell 16.6% to Rs370mn, 13.2% below our estimate. Price of tocopherol, which accounts for 35% of revenue, declined by ~30% in FY15. With a high base, downturn in tocopherol and weak demand, operating margin declined 1,074bps to 14.7%, below our estimate of 16.2%. As a result, net profit fell 52.9% to Rs30mn, below our estimate of Rs37mn. Despite weak demand, AFL reduced receivable days from 50 in FY14 to 37 in FY15. With the decline in realisation and delay in expansion, we have cut our FY16E/FY17E PAT by 40.1%/18.6% respectively. Downturn in tocopherol started in 1QFY14, but now its price has stabilised. Assuming ~18-month cycle, operating margin is likely to improve from 2HFY16. Expanded capacity of 80% is expected to touch full utilisation by 4QFY16 and it is likely to reduce overheads, improve margins and increase net profit by 82.7% in FY17E. AFL has declared dividend of Rs1.5 per share. Healthy 82.7% net profit growth likely in FY17E coupled with better operating cash flow of Rs367mn, an 839bps RoCE improvement to 27.5%, and decline in the D/E ratio from 0.51x to 0.39x likely over FY15-FY17E will drive AFL's valuation. We have retained Buy rating on AFL with a revised target price of Rs369 (Rs453 earlier) based on 16.5x FY17E P/E and 10.1x EV/EBITDA, respectively.

Weak demand and lower realisation hurts profitability: With the delay in capacity expansion, volume grew by a mere 10.6% to 6,149tn, while because of the downturn in tocopherol (35% of revenue), blended realisation declined 30.3% in 4QFY15. As a result, net sales declined 16.6% to Rs370mn against our estimate of Rs426mn. With the depreciation of the Indian rupee (benefiting exports - 35% of revenue) and a better product mix, operating margin increased 1,292bps to 25.4% in 4QFY14. Tocopherol is undergoing a downturn and therefore operating margin declined 1,074bps to 14.7%, 149bps below our estimate of 16.2%. With a higher base, lower sales growth and a fall in EBITDA margin, EBITDA declined 51.8% to Rs54mn compared to our estimate of Rs69mn.

Improvement in operational efficiency: Gross margin/tn declined by Rs9,016 to Rs21,805 in FY15. However, because of efficiency in the manufacturing process, total other costs/tn declined 16.1% to Rs11,324 from Rs13,500. As a result, operating profit/tn fell to Rs6,840 from Rs10,481. There is enough scope to reduce manufacturing costs from the current level, which is expected to moderate the pain of downturn in tocopherol.

Healthy 82.7% growth in FY17E net profit likely: On account of the delay in 80% capacity expansion, revenue/profit will get impacted in FY16 but it will provide healthy volume growth of 80.3% over FY15-FY17E. Healthy volume growth along with upturn in the tocopherol cycle is expected to result in a 82.7% growth in net profit to Rs308mn in FY17E, thereby leading to a strong re-rating in the long run although the valuation may remain capped in the near term because of the delay in expansion and pressure on profitability.

BUY
Sector: Specialty Chemicals

CMP: Rs290

Target Price: Rs369

Upside: 27%

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Key Data

Current Shares O/S (mn)	13.8
Mkt Cap (Rsb/US\$m)	4.0/63.0
52 Wk H / L (Rs)	395/125
Daily Vol. (3M NSE Avg.)	12,325

Price Performance (%)

	1 M	6 M	1 Yr
Adi Finechem	(12.1)	3.6	105.6
Nifty Index	(6.5)	(2.9)	21.7

Source: Bloomberg

Y/E March (Rsmn)	4QFY14	3QFY15	4QFY15	YoY (%)	QoQ (%)	FY14	FY15	YoY (%)
Net sales	443	372	370	(16.6)	(0.6)	1,518	1,506	(0.8)
Net RM costs & purchases of finished goods	260	246	245	(5.8)	(0.3)	941	989	5.1
% of sales	58.8	66.2	66.4	-	-	62.0	65.7	-
Employee costs	14	19	20	37.5	5.1	56	74	33.1
% of sales	3.2	5.0	5.3	-	-	3.7	4.9	-
Other expenses	56	48	50	(9.6)	4.3	191	194	2.0
% of sales	12.6	13.0	13.6	-	-	12.6	12.9	-
Total expenditure	330	313	315	(4.6)	0.7	1,187	1,258	5.9
Operating profit	113	59	54	(51.8)	(7.5)	331	249	(25.0)
OPM (%)	25.4	15.8	14.7	-	-	21.8	16.5	-
Interest costs	7	8	8	8.2	(6.2)	26	27	3.4
Depreciation	6.8	6.3	6.4	(6.2)	1.0	26	22	(16.3)
Other income	0.7	0.7	1.7	140.4	162.0	6	7	10.3
PBT	99	45	42	(57.9)	(6.4)	284	206	(27.7)
Provision for tax	35	15	12	(67.1)	(24.1)	97	69	(29.3)
Effective tax rate (%)	35.3	34.0	27.6	-	-	34.2	33.4	-
Reported PAT	64	30	30	(52.9)	2.7	187	137	(26.8)
EPS (Rs)	5.1	2.1	2.2	(57.2)	2.7	15.2	10.3	(32.0)

Source: Company, Nirmal Bang Institutional Equities Research

Please refer to the disclaimer towards the end of the document.

Exhibit 1: Financial summary

Y/E March (Rsmn)	FY12	FY13	FY14	FY15	FY16E	FY17E
Revenue	972	1,231	1,518	1,506	1,975	2,820
YoY (%)	69.4	26.7	23.3	(0.8)	31.1	42.8
EBITDA	147	171	333	249	329	541
EBITDA margin (%)	15.2	13.9	21.9	16.5	16.7	19.2
Adj. PAT	74	84	187	137	169	308
EPS (Rs)	5.9	6.7	14.9	9.9	12.2	22.4
YoY (%)	46.2	13.6	122.0	(33.4)	23.3	82.7
RoE (%)	35.9	30.9	47.9	26.3	26.7	37.1
RoCE (%)	23.2	21.6	32.8	19.2	20.0	27.5
RoIC (%)	21.1	19.7	30.4	17.6	18.6	26.0
P/E (x)	49.1	43.2	19.5	29.2	23.7	13.0
P/BV (x)	15.3	11.8	7.7	7.0	5.7	4.1
EV/ EBITDA (x)	26.1	22.3	11.8	17.3	13.3	8.1

Source: Company, Nirmal Bang Institutional Equities Research

Strong improvement in working capital cycle

AFL was able to improve its receivable days from 50 in FY14 to 37 in FY15 even in a challenging environment, which is likely to be sustainable. However, the management expects a decline in raw material prices, hence they reduced the raw material stock and lead to a reduction in inventory days from 61 in FY14 to 48 in FY15E. Post stabilisation of raw material prices, inventory is expected to increase to the normal level.

Strong cash flow generation

With better working capital cycle management, AFL generated a healthy cash flow of Rs318mn in FY15 as against Rs99mn in FY14. Despite high inventory days, we expect Rs367mn of cash flow generation over FY15-FY17E, which is expected to reduce its D/E ratio from 0.51x in FY15 to 0.39x in FY17E. Healthy cash flow and lower D/E ratio will support future capex plan, once it is finalised.

Margin in tocopherol likely to improve in 2HFY16

Tocopherol witnessed an uptrend from 1QFY12 to 4QFY13 where its price increased from ~Rs155/kg to ~Rs572/kg. Downturn started from 1QFY14, with its price declining from Rs572/kg in 4QFY13 to ~Rs250/kg currently. In FY15 alone, tocopherol price declined by ~30%. Tocopherol price has stabilised at a lower level and we expect the downturn to get over by the next two quarters and also the margins to improve from 2HFY16.

Healthy 82.7% growth in FY17E net profit likely

AFL is expected to commission 80% expanded capacity by June 2015. It was earlier scheduled for commissioning in September 2014 but got delayed to June 2015 because two critical components were delayed by suppliers. The components have arrived in the first week of May 2015. On account of the delay in expansion, revenue/profit will get impacted in FY16. However, it will provide healthy volume growth in FY17. Management expects the plant to operate at 80% of its capacity in 2QFY16 and touch the optimum level in 4QFY16. As AFL is the only producer in India of dimer acid/tocopherol, (accounting for 53.2% of FY14 revenue) and a low-cost producer of other items, it is in a sweet spot to replace Chinese/local competitors.

On account of capacity expansion, volume is expected to increase 80.3% over FY15-FY17E. As a result, we expect a 82.7% growth in net profit to Rs308mn in FY16E, thereby leading to a strong re-rating in the long run. In the near term, valuation may remain capped because of the delay in expansion and pressure on profitability.

Expansion plan

AFL is doing research and development (R&D) for future expansion, which is expected to support its growth beyond FY17. The new product can be either vertical integration of its existing product (i.e. value addition) or altogether a new oleochemical. If it is a new oleochemical, then both its suppliers and the manufacturing process will remain unchanged and only the product will be different. As there is no land available at its existing plant, the new project will be at a new location and at a higher capex, unlike the current capex which is low because of being brownfield in nature. AFL plans to purchase land for Rs150mn and apply for environment clearance and other regulatory clearances in FY16, which will take at least a year. In the mean time, AFL will finalise the capacity and other details and place an order for equipment. It will take 12-18 months for the plant to get operational once details are finalised. However, as the market is not conducive, AFL has delayed its expansion plan.

Exhibit 2: Working capital analysis

(Rsmn) consolidated	FY14	1HFY15	FY15	YoY (%)	FY15 over 1HFY15 (%)
Revenue	1,518	765	1,506	(0.8)	(1.5)
Inventory	157	167	133	(15.7)	(20.3)
Inventory days	61	48	48	-	-
Sundry debtors	213	129	156	(26.8)	20.9
Sundry debtor days	50	30	37	-	-
Sundry creditors	28	33	48	70.7	46.7
Sundry creditor days	11	9	18	-	-
Net working capital	342	262	240	(29.8)	(8.5)
Net working capital days	101	69	68	-	-
Ex-cash current assets	432	383	339	(21.4)	(11.4)
As % of annualised sales	28.4	25.1	22.5	-	-
Current liabilities	73	65	132	79.7	101.5
As % of annualised sales	4.8	4.3	8.7	-	-
Ex-cash net current assets	358	318	208	(42.0)	(34.6)
As % of annualised sales	23.6	20.8	13.8	-	-

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Our estimates versus actual performance

(Rsmn)	4QFY14	3QFY15	4QFY15	YoY (%)	QoQ (%)	4QFY15E	Devi. (%)
Revenue	443	372	370	(16.6)	(0.6)	426	(13.2)
EBITDA	113	59	54	(51.8)	(7.5)	69	(21.2)
EBITDA (%)	25.4	15.8	14.7	(1,074)bps	(109)bps	16.2	(149)bps
Adjusted PAT	64	30	30	(52.9)	2.7	37	(18.1)

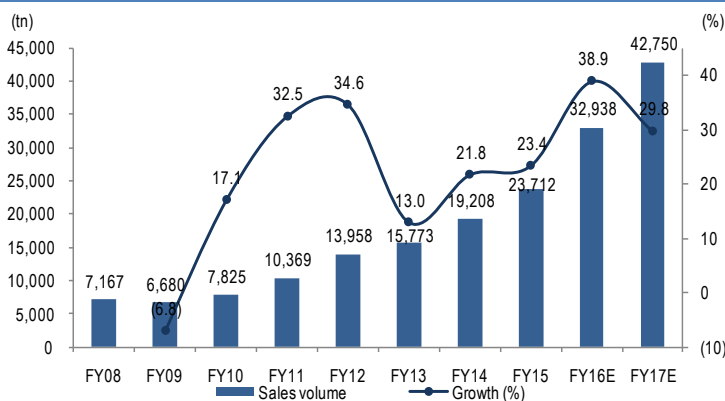
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Change in our estimates

Y/E March (Rsmn)	Earlier estimates		Revised estimates		Change (%)	
	FY16E	FY17E	FY16E	FY17E	FY16E	FY17E
Sales	2,647	3,300	1,975	2,820	(25.4)	(14.6)
EBITDA	487	644	329	541	(32.4)	(15.9)
EBITDA (%)	18.4	19.5	16.7	19.2	(173)bps	(32)bps
APAT	282	379	169	308	(40.1)	(18.6)

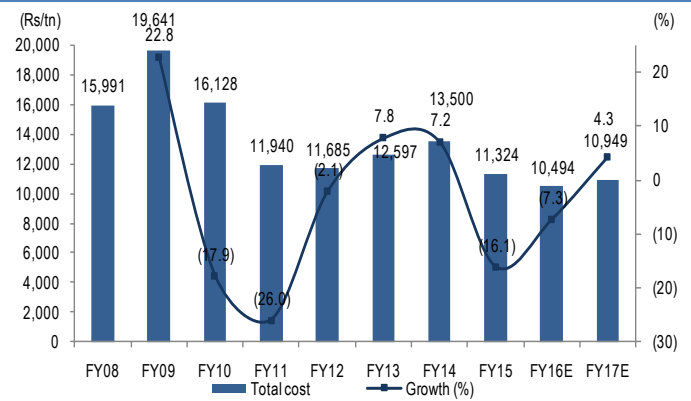
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Volume growth



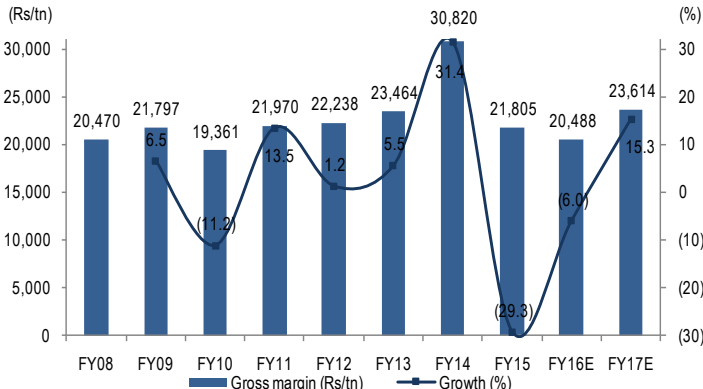
Source: Nirmal Bang Institutional Equities Research

Exhibit 6: Reduction in cost/tn



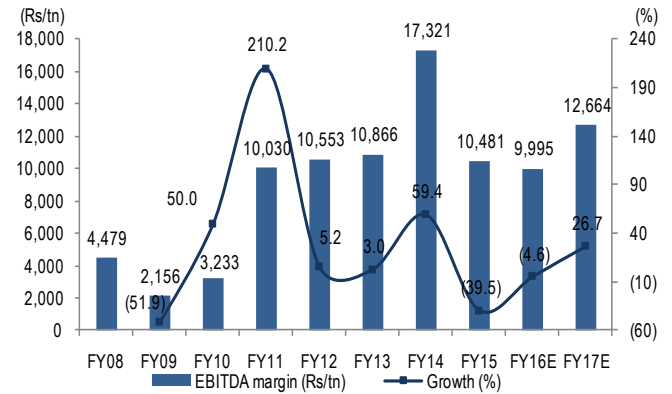
Source: Nirmal Bang Institutional Equities Research

Exhibit 7: Trend in gross margin



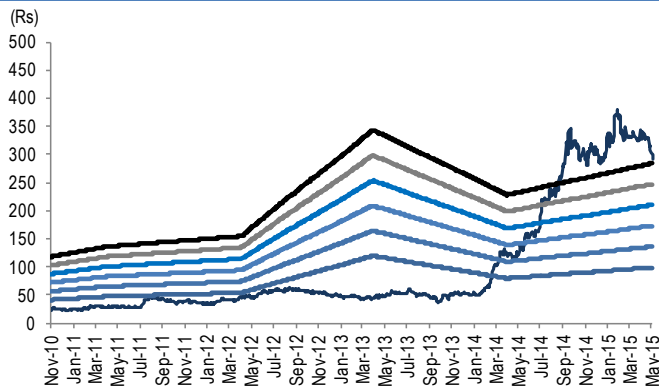
Source: Nirmal Bang Institutional Equities Research

Exhibit 8: Trend in EBITDA



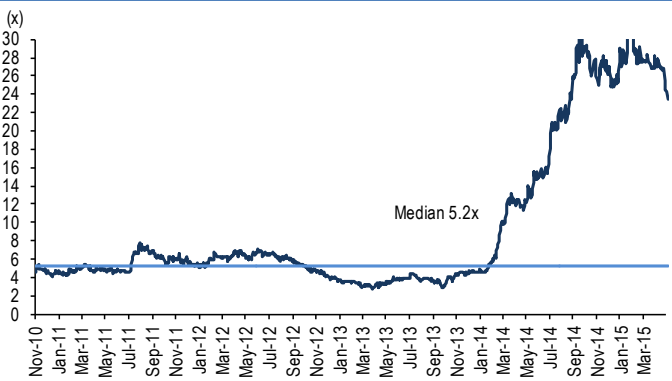
Source: Nirmal Bang Institutional Equities Research

Exhibit 9: One-year forward P/E band



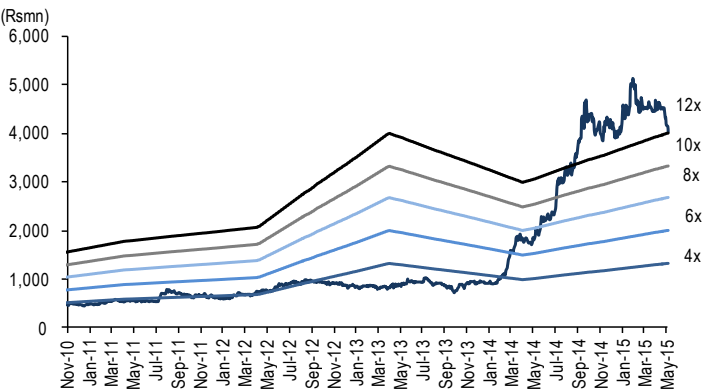
Source: Nirmal Bang Institutional Equities Research

Exhibit 10: P/E median band



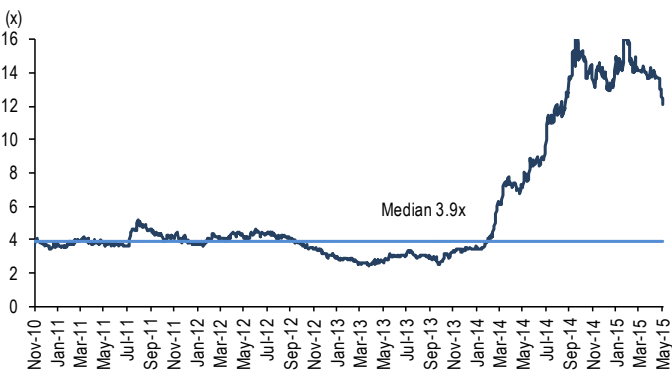
Source: Nirmal Bang Institutional Equities Research

Exhibit 11: One-year forward EV/EBITDA band



Source: Nirmal Bang Institutional Equities Research

Exhibit 12: EV/EBITDA median band



Source: Nirmal Bang Institutional Equities Research

Financials

Exhibit 13: Income statement

Y/E March (Rsmn)	FY12	FY13	FY14	FY15	FY16E	FY17E
Net sales	972	1,231	1,518	1,506	1,975	2,820
Growth (%)	69.4	26.7	23.3	(0.8)	31.1	42.8
Raw material costs	661	861	926	989	1,300	1,810
Power & fuel costs	76	90	106	116	154	214
Staff costs	34	42	56	74	89	113
Other costs	53	67	98	78	103	141
Total expenditure	824	1,060	1,186	1,258	1,646	2,278
EBITDA	147	171	333	249	329	541
Growth (%)	41.6	16.4	94.1	(25.3)	32.5	64.5
EBITDA margin (%)	15.2	13.9	21.9	16.5	16.7	19.2
Other income	3	4	6	7	6	9
Interest costs	22	26	28	27	37	38
Gross profit	128	149	310	228	298	512
Growth (%)	32.6	16.6	108.5	(26.7)	31.0	71.6
Depreciation	20	23	26	22	45	50
Profit before tax	108	126	284	205	253	462
Growth (%)	36.6	17.1	124.9	(27.6)	23.2	82.7
Tax	34	42	97	69	84	154
Effective tax rate (%)	31.7	33.6	34.2	33.4	33.3	33.3
Net profit	74	84	187	137	169	308
Growth (%)	45.7	13.8	122.8	(26.8)	23.3	82.7
Extraordinary items	-	-	-	-	-	-
Adjusted PAT	74	84	187	137	169	308
Growth (%)	46.2	13.6	122.0	(26.8)	23.3	82.7

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 15: Balance sheet

Y/E March (Rsmn)	FY12	FY13	FY14	FY15	FY16E	FY17E
Equity	95	114	125	138	138	138
Reserves	143	194	348	430	559	827
Net worth	238	308	473	568	697	965
Short-term loans	149	127	220	149	149	142
Long-term loans	62	54	70	139	236	236
Total loans	211	180	291	288	385	378
Deferred tax liability	34	36	40	61	46	53
Liabilities	482	524	804	916	1,128	1,395
Gross block	451	485	568	956	1,006	1,106
Depreciation	193	214	240	262	307	357
Net block	258	271	328	694	699	749
Capital work-in-progress	15	13	116	-	125	225
Long-term Investments	-	-	-	-	-	-
Inventories	95	99	157	133	192	266
Debtors	141	154	213	156	203	290
Cash	1	1	1	2	1	3
Other current assets	34	59	61	51	60	71
Total current assets	271	312	432	341	456	630
Creditors	17	19	28	48	64	82
Other current liabilities	44	53	45	70	89	127
Total current liabilities	62	72	73	119	153	209
Net current assets	210	240	359	222	303	421
Total assets	482	524	804	916	1,128	1,395

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 14: Cash flow

Y/E March (Rsmn)	FY12	FY13	FY14	FY15	FY16E	FY17E
EBIT	128	149	306	226	284	492
(Inc./dec. in working capital)	(87)	(31)	(119)	138	(81)	(116)
Cash flow from operations	40	117	188	364	203	376
Other income	3	4	6	7	6	9
Depreciation	20	23	26	22	45	50
Deferred liabilities	4	2	4	21	(14)	6
Interest paid (-)	(22)	(26)	(28)	(27)	(37)	(38)
Tax paid (-)	(34)	(42)	(97)	(69)	(84)	(154)
Dividend paid (-)	(11)	(13)	(22)	(40)	(40)	(40)
Minority interest (P&L)	-	-	-	-	-	-
Net cash from operations	(1)	64	77	277	78	209
Capital expenditure (-)	(71)	(34)	(187)	(272)	(175)	(200)
Net cash after capex	(72)	30	(110)	5	(97)	9
Inc./(dec.) in short-term borrowing	9	(22)	94	(72)	-	(7)
Inc./(dec.) in long-term borrowing	60	(8)	17	69	97	-
Inc./(dec.) in preference capital	-	-	-	-	-	-
Inc./(dec.) in borrowings	70	(31)	110	(3)	97	(7)
(Inc./dec.) in investments	-	-	-	-	-	-
Equity issue/(buyback)	-	18	11	-	-	-
Cash from financial activities	70	(13)	122	(3)	97	(7)
Others	-	(18)	(11)	(2)	-	-
Opening cash balance	3	1	1	1	2	1
Closing cash balance	1	1	1	2	1	3
Change in cash balance	(2)	(1)	-	1	-	2

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 16: Key ratios

Y/E March	FY12	FY13	FY14	FY15	FY16E	FY17E
Per share (Rs)						
EPS	5.9	6.7	14.9	9.9	12.2	22.4
Book value	18.9	24.6	37.7	41.2	50.5	69.9
Valuation (x)						
P/E	49.1	43.2	19.5	29.2	23.7	13.0
P/sales	3.7	3.0	2.4	2.7	2.0	1.4
P/BV	15.3	11.8	7.7	7.0	5.7	4.1
EV/EBITDA	26.1	22.3	11.8	17.3	13.3	8.1
EV/sales	4.0	3.1	2.6	2.8	2.2	1.6
Return ratios (%)						
RoIC	21.1	19.7	30.4	17.6	18.6	26.0
RoCE	23.2	21.6	32.8	19.2	20.0	27.5
RoE	35.9	30.9	47.9	26.3	26.7	37.1
Margins (%)						
EBITDA margin	15.2	13.9	21.9	16.5	16.7	19.2
PBIT margin	13.1	12.1	20.2	15.0	14.4	17.4
PBT margin	11.1	10.3	18.7	13.6	12.8	16.4
PAT margin	7.6	6.8	12.3	9.1	8.5	10.9
Turnover ratio						
Asset turnover ratio (x)	2.0	2.3	1.9	1.6	1.8	2.0
Avg. inventory period (days)	52	41	61	48	53	53
Avg. collection period (days)	52	45	50	37	37	37
Avg. payment period (days)	9	8	11	18	18	16
Solvency ratios (x)						
Debt-equity	0.9	0.6	0.6	0.5	0.6	0.4
Interest coverage	5.7	5.7	11.0	8.3	7.7	12.9
Debt/EBITDA	1.4	1.1	0.9	1.2	1.2	0.7
Growth (%)						
Sales	69.4	26.7	23.3	(0.8)	31.1	42.8
EBITDA	41.6	16.4	94.1	(25.3)	32.5	64.5
PAT	46.2	13.6	122.0	(26.8)	23.3	82.7

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
4 September 2014	Buy	280	417
10 October 2014	Buy	308	417
11 November 2014	Buy	304	460
6 January 2015	Buy	328	460
13 February 2015	Buy	339	453
13 April 2015	Buy	328	453
7 May 2015	Buy	290	369

Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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