Stock Recommendation – Shree Pushkar Chemicals and Fertilisers

(BSE - 539334/ NSE - SHREEPUSHK)

Current Market rate – Rs.125

Date of recommendation - 20th September 2016

Target – 210 within 2017 end

Good Buy - Below Rs.130

Maximum Portfolio Allocation – 8%

Short note on investment rationale -

- **China Factor -** During the recommendation of Bodal Chemical (16th April 2016), we had mentioned that the ongoing environmental issues in China resulted in the price increase of various dye intermediate products like H-acid, Vinyl Sulphone etc. The issue is still hurting the China with the shutdown of few manufacturing facilities. Around 20-25 years ago European countries were the global manufacturing hub of dye and dye intermediate products, then around 10-12 years ago it shifted to China. Now China is gradually losing the attractiveness and a chunk of business is coming towards India. Within the next few years, India might become the global manufacturing hub of dye and dye intermediate products. So, there is a sectorial tailwind and companies in this sector have better days ahead.
- **Capacity Expansion without debt -** Shree Pushkar Chemicals and Fertilisers is expanding its existing H-acid plant capacity by 750MTA, Vinyl Sulphone capacity by 1000 MTA and reactive dyes capacity by 3000 MTA. Additional capacity will contribute from H2FY17 onwards. Moreover, expanding fertiliser portfolio (NPK - 20,000MTA, SOP -10,000MTA) will contribute in the top line from Q2FY17 onwards. The interesting part is that the company is not raising any debt for the ongoing capacity expansion. The fund is coming from the IPO proceeds and internal accruals. Thus operating leverage will come into the play from H2FY17. Click here to read the detailed capacity expansion plan from the management concall.

- **Strong and Improving financials -** In spite of huge capacity expansion over the last 3-4 years, the company is maintaining positive operating cash flow, minimal debt and strong balance sheet. Average ROCE over the last 3 years is close to 20%. Debt to equity ratio is below 1. Over the next 2 years, EBITDA margin is going to improve further to 18%-19% once value added "Dye products" contribute to the bottom line. It will also improve the free cash flow, return ratios and the balance sheet strength.
- **Reasonable Valuation -** Since April 2016 almost all stocks in the "Dyes and dye intermediates" segment like Kiri Industries, Bodal Chemical, Sudarshan Chemical, Ultramarine Pigments, Akshar Chemical etc rallied a lot. However, Shree Pushkar Chemicals and Fertilisers didn't participate in the rally mainly because the improved financials (due to increased capacity) will reflect from H2FY17 onwards. The stock is giving us the excellent entry opportunity considering the sectorial tailwinds and the internal development. H2FY17 numbers should reflect the expanded capacity and FY18 should witness margin expansion due to operating leverage.We are expecting FY18 EPS around 15-16 with the top line of 350-400 crores and 18-19% EBITDA margin. Assigning the fair P.E multiple of 14-15, the target price is coming around Rs. 210 within 2017 end.

Detailed Note

About the industry

Dye & Dye Intermediate Industry - Dye Intermediates (DI) in an organic compound used in synthesizing dyes and pigments. If we talk about the manufacturing process, then it's root can be traced back to petroleum based products. Naphtha & natural gas are used to manufacture benzene and toluene, which is then used to produce nitro- aromatics. Finally, this nitro-aromatics is employed in the production of dye intermediates. Some examples of DI are Gamma Acid, Vinyl Sulphone, H-Acid, J-Acid. Dye Industries has got wide usage in the leading industries like textile, paint, plastics, paper etc. DI also serves as raw materials for Acid, Direct and Reactive Dyes. Coming to Dyes, as we all know it is a coloured organic compound or mixture used to permanently colour materials like cloth, leather, paper etc.

In the last few years, this industry has witnessed a drastic geographical shift. Earlier, European countries were the manufacturing hub which then shifted to Asian countries, controlled mostly by China. But lately, due to stringent environmental norms in China, India is being seen as the biggest manufacturer. Due to this shift, various chemical companies like Bodal Chemical, Kiri Industries would benefit.

Acid Complex - Sulphuric Acid - Sulphuric acid is one of the most important compounds used in chemical industry. It is used as a raw material to manufacture many compounds, largely phosphoric acid which is then used to make phosphate fertilizers. It is also used to make various other industrial substances.

Cattle Feed - It is a mixture of different feed ingredients in given proportion used to promote rapid growth in animals like enhancing reproduction capability, embryo protect rate, hybridization rate, survival rate of domestic animals. Currently, cattle feed industry is growing at a modest rate of 8%. Growth rate is expected to pace up considering the growth requirement of dairy, poultry products.

Indian Fertilizer Industry - It is one of the critical industries in India as agriculture sector largely depends on it. Fertilizer industry is divided into two main segments - urea and non-urea fertilizers. Out of which, urea fertilizer segment accounts for nearly 50% of the total fertilizer consumption. 80% of the requirement is met by domestic manufacturers. On the other hand, India is still largely dependent on imports for the potassium and phosphatic fertilizers. The future of fertilizer industry is closely linked to the agriculture sector. Lately, we have seen various initiatives taken by the government to uplift the agriculture sector and in future also, we can expect many more progressive steps. This will in return directly benefit the fertilizer sector.

About the company

Founded in 1994, Shree Pushkar Chemicals and Fertilizer (SPCFL) is now an established player in dye & dye intermediate segment. Last year, it came up with an IPO and got listed on the bourses. It has its manufacturing facility located at Lote Parshuram, Maharashtra.

The company is present into four business verticals - Dye Intermediates, acid complex, cattle feed, fertilizers (SSP & soil conditioner). Currently, dye intermediates segment contributes 70% of the total revenue, while fertilizers contribute 20%. Remaining is contributed by cattle feed and acids. Due to its unique model, the company boasts of having a zero-waste status.

% of FY16 Revenue	Business Verticals	Details	Products	Industries
71%	Dye Intermediates	Products manufactured from organic chemicals and are further processed to obtain dyestuff	Gamma Acid, K- Acid, R-Salt, Vinyl Sulphone, Meta Ureido Aniline and H- Acid	Manufacturers of Synthetic Dyes
7%	Acid Complex	A compound capable of neutralizing alkalis & containing hydrogen that can be replaced by a me tal to form a salt	Sulphuric Acid, Oleum and Chloro Sulphonic Acid (CSA)	An acid reagent typically used for Sulphonation reaction
2%	Cattle Feed Supplement	Mainly used as a dietary supplement in animal feed products	Di- Calcium Phosphate (DCP)	Used by Cattle & Poultry Feed manufacturers
20%	Fertilisers	Phosphatic fertiliser & a fertiliser used to the improve the soils quality and for improving / Building soil	Single Super Phosphate (SSP) Soil Conditioner, Nitrogen Phosphorus Potassium (NPK), Sulphate Of Potash (SOP)	Agriculture
	Dyestuff	Commenced commercial production in May 2016	Reactive Black, Reactive Red, Reactive Yellow	Used for Dying of Textile / Yarns commonly cellulosic material

Investment rationale

- **China Factor -** During the recommendation of Bodal Chemical (16th April 2016), we had mentioned that the ongoing environmental issues in China resulted in the price increase of various dye intermediate products like H-acid, Vinyl Sulphone etc. The issue is still hurting the China with the shutdown of few manufacturing facilities. Around 20-25 years ago European countries were the global manufacturing hub of dye and dye intermediate products, then around 10-12 years ago it shifted to China. Now China is gradually losing the attractiveness and a chunk of business is coming towards India. Within the next few years, India might become the global manufacturing hub of dye and dye intermediate products. So, there is a sectorial tailwind and companies in this sector have better days ahead.
- **Capacity Expansion without debt -** Shree Pushkar Chemicals and Fertilisers is expanding its existing H-acid plant capacity by 750MTA, Vinyl Sulphone capacity by 1000 MTA and reactive dyes capacity by 3000 MTA. Additional capacity will contribute from H2FY17 onwards. Moreover, expanding fertilizer portfolio (NPK - 20,000MTA, SOP -10,000MTA) will contribute in the top line from Q2FY17 onwards. Apart from this, the company has lined up various expansion plans in FY18 which includes - doubling the capacity of dye plant (to 6000 MTA), doubling of the Sulphate of Potash (SOP) plant, introduction of specialty textile dyes and specialty textile chemical which will make the company a complete textile solution company and launch of new products. The best part is that the company is not raising any debt for the ongoing capacity expansion. The fund is coming

from the IPO proceeds and internal accruals. Click here to read the detailed capacity expansion plan from the management concall.

- **Healthy earning growth visibility -** Currently, the capacity utilization of dye intermediate segment is 66%. After expansion, the capacity would be around 9586 MTA with an expected utilization of 68%. We are expecting Rs. 215 Crores of revenue from this segment in FY18. While capacity addition in the reactive dye would be 6000 MTA (3000 MTA commissioned during Jan-2016 while another 3000 MTA will get completed by end of FY17) and with expected capacity utilization of 70%, 100 Crores of revenue is expected. Revenue from fertilizer, acid complex and cattle feed in FY18 is expected to be 67, 19 and 6 Crores respectively. Collectively, the expected revenues comes around Rs. 407 Crores. Expected FY18 PAT is 40-44 Crore which translates into FY18E EPS to be in the range of 15-17.
- **Strong backward and forward integrated operation - Backbone of the company -** Over the years, the company has developed a strong backward and forward integrated model. Many of its intermediate products are used in manufacturing other value-added products which reduce the external dependencies and also aids the margin. The company has a strong distribution and marketing network to take care of the distribution of its wide product portfolio amongst the diversified client base. You can get a sense of its diversified client base by the fact that it has a poor farmer as a client along with multinational companies. Having a strong a dedicated sales team is a huge positive. Needless to say, this is the reason why in the past, the company has seen many repeat buy orders and also new buyers coming in. Other than its own network, they have a marketing tie up with big names. Like arrangement with Huntsman for sales of dyestuff, then arrangement with DCM Shriram for distribution of products in the region of Maharashtra and Karnataka. The company can leverage the huge reach and expertise of such reputed names. It has many more tie-ups with the established marketing players across the country and is looking to strengthen it further.
- **A Zero Waste manufacturer - Converting waste into wealth -** The company has established itself as a zero waste company. Thanks to its unique model where the waste generated is used in utilizing into value added products. During the manufacturing, various effluents are released which are then processed and used to manufacture another final product. This is a huge positive as it not only improves the margin but also because we have an assurance that the company is taking necessary steps to avoid any environmental issues. Due to this unique model, the waste which would have led to the expense incurred during waste treatment is now the reason for revenue contribution.
- **Strong and Improving financials -** In spite of huge capacity expansion over the last 3-4 years, the company is maintaining positive operating cash flow, minimal debt and strong balance sheet. Average ROCE over the last 3 years is close to 20%. Debt to equity ratio is

below 1. Over the next 2 years, EBITDA margin is going to improve further to 18%-19% once value added "Dye products" contribute to the topline. It will also improve the free cash flow, return ratios and the balance sheet strength.

- **Shareholding pattern and management -** The company's management includes high qualified personal having rich experience in the operating sectors and other required segments. Mr. Puneet Makharia is the Chairman and MD of the company and has an experience of more than two decades in the chemical sector. As per the previously given guidance by the management, most of them have been done in time. They have also well utilized the IPO proceeds which increases the trust factor. Promoters hold 60% stake in the company without pledging a single share. We find the management honest and highly ambitious who are willing to take the company to new heights. They also distribute a part of the profit as dividend to its shareholders. Dividend yield stands at 0.77%.
- **Reasonable Valuation -** Since April 2016 almost all stocks in the "Dyes and dye intermediates" segment like Kiri Industries, Bodal Chemical, Sudarshan Chemical, Ultramarine Pigments, Akshar Chemical etc rallied a lot. However, Shree Pushkar Chemicals and Fertilisers didn't participate in the rally mainly because the improved financials (due to increased capacity) will reflect from H2FY17 onwards. The stock is giving us the excellent entry opportunity considering the sectorial tailwinds and the internal development. H2FY17 numbers should reflect the expanded capacity and FY18 should witness margin expansion due to operating leverage.We are expecting FY18 EPS around 15-16 with the top line of 350-400 crores and 18-19% EBITDA margin. Assigning the fair P.E multiple of 14-15, the target price is coming around Rs. 210 within 2017 end.

Associated Risk

Increase in crude oil price - Crude oil is used as the raw material in the production process. Any significant increase or volatility in the crude oil price will hurt the margins. But we don't foresee major concern by the time the crude price is below 60$. Above this level, there might be some pressure on the numbers.

Financials

Quarterly Result (Figures in Crores)

Particulars	Sep-15	Dec-15	Mar-16	Jun-16
Sales	60.46	49.61	78.38	63.68
Sales Growth(y-o-y)	-21.78%	-14.54%	10.83%	5.71%
Operating Profit	7.69	6.44	8.87	10.2
Op Profit growth	2.81%	-23.52%	9.64%	9.09%
OPM	12.72%	12.98%	11.32%	16.02%
Net Profit	5.04	5.96	5.71	6.03
Profit Growth	26.95%	2.94%	8.56%	7.87%
NPM	8.34%	12.01%	7.29%	9.47%

Annual (Figures in Crores)

Particulars	Mar-15	Mar-16
Sales	266.52	248.7
Sales Growth	-10.30%	-6.69%
Operating Profit	31.55	32.37
Operating Profit Growth	-55.10%	2.60%
OPM	11.84%	13.02%
Net profit	18.65	22.29
Net Profit Growth	-12.24%	19.52%
NPM	7.00%	8.96%
EPS	9.01	7.38
EPS Growth	-53.62%	-18.10%
Asset Turnover	190.63%	112.06%
Financial Leverage	1.59	1.36
Return on Equity	21.15%	13.66%
ROCE	22.86%	12.79%
Debt to equity ratio	0.29	0.11
Interest Coverage	3.21	13.79
Tax rate	18.20%	23.48%
Receivables	28.96	43.92
Receivables Growth	597.83%	51.66%
Cash Flow from operation	51.19	27.42

- As the company came up with an IPO last year, so we are considering the performance after FY15.

- Revenue growth in the last fiscal was subdued due to the volatility in the price of end product resulting in the reduction of orders. However, due to better capacity utilization, operating margins saw an improvement.
- Despite the aggressive expansion, debt is very low.

Conclusion

Shree Pushkar is a company which has huge ongoing and upcoming expansion plans which offer healthy earning growth visibility that too without stressing the balance sheet. Has well-integrated operations to take care of its margins and volume growth. Above all, the most intriguing factor is the tailwind in the sector which can open new doors of opportunity for the company. Valuation is also in the comfortable zone and from hereon, there is a huge room for re-rating. You can invest anywhere below 130 for a target of 210 within 2017 end.

Research Analyst - Prasenjit Paul (SEBI Registration Number - INH300003157)

Disclosures as per SEBI Research Analyst regulation:

At the time of recommendation, the analyst hold the position in the stock covered in this report.

The analyst did not trade in the mentioned stock during last 30 days period from the publication of this report.

The analyst does not own more than 1% equity in the said Company.

The analyst has not served as an officer, director or employee of the subject Company.

The analyst has not received any compensation from the subject Company in the past twelve months.

The analyst or its associates have not managed, or co-managed public offering of the securities has not received any compensation for investment banking or merchant banking or brokerage services nor received any third party compensation. The subject Company was not a client during twelve months preceding the date of distribution of the research report.

The analyst has not been engaged in market making activity for the subject Company.

The analyst or research entity or its associates or relatives does not have actual/beneficial ownership of one percent or more in the securities of the subject Company, at the end of the month immediately preceding the date of publication of the research report or date of the public appearance.