

June 18, 2018

Fine Organics Industries Ltd

Price band ₹ 780-783

Long-term portfolio bet in speciality space ...

Fine Organics Industries Ltd (FOIL) is a speciality chemicals company operating in the high-end oleo chemicals space that is primarily used as additives in the polymer and consumer space (food, cosmetics etc). Prakash Kamat & late Ramesh Shah established FOIL in 1970's. It provides oleo chemicals to the polymer industry (Slip additive; reduces friction, packaging segment) and food industry (performance additives, processed food segment). It realises 73% of its sales from plastic additives segment and 27% of sales from food & other additives. Sales & PAT at FOIL has grown at a CAGR of 13.2% & 21.4% respectively over FY15-17 (on consolidated basis). In FY17, its net sales stood at ₹ 778 crore, EBITDA at ₹ 145 crore (EBITDA margins at 18.7%) and PAT at ₹ 78 crore. FOIL is a capital efficient player with high asset turns at ~3-3.5x (Gross block), healthy ~18-20% margin profile coupled with controlled working capital cycle with consequent RoE & RoCE in excess of 25%

Investment Rationale

In-house R&D, niche chemistry with limited competition!

One of the key USP at FOIL is its R&D capability and technical prowess in plant designing and consequent capacity addition. FOIL claims to have increased its capacity at 1/8th cost of best available technology. Therefore, such high capital costs of imported technology coupled with long gestation period of customer approvals deter a new entrant and provide a strong entry barrier for the industry. FOIL is the largest manufacturer of oleo-chemicals based additives in India and one of the only few in the world thereby operating in the limited competition landscape.

Impressive Expansion underway; capacity to nearly double by FY20E

Present installed capacity at FOIL stands at 64,300 tonne (FY18). FOIL has plans to nearly double the installed base by incremental capacity addition of ~67,000 tonne over 2-year period (FY18-20E) which will eventually result in growth to sustain at FOIL going forward. With healthy demand prospects in place, growth visibility is robust at FOIL going forward.

Risk Factors

- High reliance on Exports (~56%); foreign exchange risk
- Extreme weather conditions impacting raw material supply
- Raw material supply skewed in favour of few suppliers
- Inability to innovate, to limit growth prospects

Available at 3.0x MCap/sales & 30x P/E (FY18E); recommend SUBSCRIBE

At the upper price band of ₹ 783, FOIL is available at MCap/sales of ~3.0x and P/E of ~30x on FY18 numbers (annualised given 9MFY18 numbers). FOIL possess healthy balance sheet with Net Debt: Equity at 0.1x, average NWC days ~70 days and robust return ratios profile (FY17 RoE at 25%). We advise **SUBSCRIBE** on FOIL for **long-term perspective**.

Exhibit 1: Key Financials

₹ crore	FY14	FY15	FY16	FY17	9MFY18
Net Sales	567.2	606.8	652.5	778.2	581.0
EBITDA	107.8	110.9	145.2	145.4	104.3
EBITDA Margins (%)	19.0	18.3	22.3	18.7	17.9
Depreciation	10.6	22.6	29.6	23.7	14.6
Interest	9.7	7.7	8.3	4.6	3.0
PAT	61.7	53.2	76.5	78.4	61.0
PAT Margins (%)	10.9	8.8	11.7	10.1	10.5
EPS (₹)	20.1	17.3	24.9	25.5	19.9

Source: RHP, ICICI Direct Research

Rating matrix

Rating : **Subscribe**

Issue Details

Issue Opens	20-Jun-17
Issue Closes	22-Jun-18
Issue Size (₹ Crore)	₹ 598 - 600 crore
Price Band (₹)	₹ 780 - 783
No of Shares on Offer (lakh)	77
QIB (%)	50
Non-Institutional (%)	15
Retail (%)	35
Minimum lot size	19 shares and in multiples of thereof

Objects of the Issue (₹ Crore)

It is purely an Offer For Sale (OFS) by the promoter group (~₹ 600 crore). No proceeds from the IPO will be ploughed into the company

Shareholding Pattern

	Pre-Issue	Post-Issue
Promoter & promoter group	100.0%	75.0%
Public & Others	0.0%	25.0%

Valuation Summary (at ₹ 783; upper price band)

	FY15	FY16	FY17	9MFY18
P/E*	45.2	31.4	30.7	29.6
EV/EBITDA*	22.5	16.9	16.7	17.3
P/B*	11.6	9.6	7.3	6.3
ROCE	31.1	35.8	34.1	23.6
ROE	29.0	33.4	27.0	17.6

*Valuations ratios use annualized FY18 numbers

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The company has an extensive distribution network catering to over 5000 end users in 69 countries. It sells in total 387 products. It has 631 direct customers, 127 distributors with no customer forming more than 3% of its sales.

Zeelandia International is part of the Royal Zeelandia Group, a Dutch family-owned group of companies that was founded in 1900. They manufacture baking ingredients for the global bread and confectionary trade. The group has more than 2,900 employees, 20 production facilities and their products are sold in more than 100 countries.

Company Background

FOIL is one of the largest producers of oleo-chemicals in India and one of the renowned names globally. It was started as a partnership firm in the field of oleo chemicals in 1970 by Late Mr. Ramesh Shah involved in the business of chemical trading and Mr. Prakash Kamat, a chemical engineer and researcher in the field of edible oil chemistry (food emulsifier).

Oleo chemicals are essentially the chemicals derived from natural oils and fats of plant origins. FOIL commissioned its first plant in Dombivli in 1973 which received a tremendous response owing to import substitution nature of the product profile being offered. Thereafter in 1988 they set up their second fully automated state of the art manufacturing capacity at Ambernath in 1988. In 2005 the company set up its R&D centre in Navi Mumbai. Thereafter over a period of years it expanded at its Ambernath facility in the area of polymer and food additives. Over a period of time the company has merged with itself all the other partnership firms that promoter held in their personal capacity with total consolidated installed capacity of 64,300 tonne per annum.

The company counts all petrochemical players in India as well as globally as its key clients for the plastics additive division. While its customers in the food additives segment include all food confectionary players including bakery and biscuit/cookies manufacturers. FOIL has a Technocrat promoter group and management team with rich experience in chemical industry. Its Board of directors includes 5 member's from the promoter family and 5 independent directors. Going forward the company plans to more than double its existing manufacturing capacity to 131,000 tonne per annum over next 2 years.

Product Basket

FOIL product basket can be briefly bifurcated into two main heads i.e. Polymer additives & food additives and others. In the polymer additive segment its product are primarily used to reduce friction in the packaging segment, improving flow and mould release agents in the lubricants segment, anti-fogging applications for plastic films among others. In the food additives segment its products find application as Emulsifiers, preservatives, additives for elastomers to reduce dampening among others. FOIL product basket's other applications include rubber additives for elastomers to reduce dampening, Anti-settling and anti-sagging agents in the paints and coating segment among others.

The company has also ventured into 2 JV's with noted international firms:

1) Fine Zeelandia International Ltd, Patalganga (India)

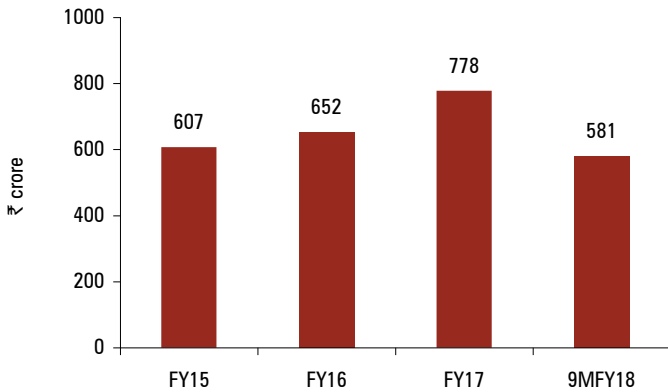
In 2014, the company entered in a JV (50% equity) with Netherland based Zeelandia International for setting up a food additives capacity of 10,000 tonne per annum at Patalganga (India), primarily targeted at premixes for bakery and confectionary products. Management commentary suggests commissioning of the said plant in Q1FY19. The total investment envisaged in this venture is ₹ 60 crore with equity contribution at ₹ 22.6 crore (FOIL share at ₹ 11.3 crore).

2) FineAdd, Germany

In 2018, the company entered in a JV (50% equity) with Germany based Adcotec group for setting up a food additives & Speciality food emulsifiers capacity of 10,000 tonne per annum in Germany (Leipzig) with likely commissioning in Q3FY20. The total investment envisaged in this venture is EUR 18 Million (~₹ 125 crore) with equity contribution at 30% of project cost (FOIL share at 15% of project costs).

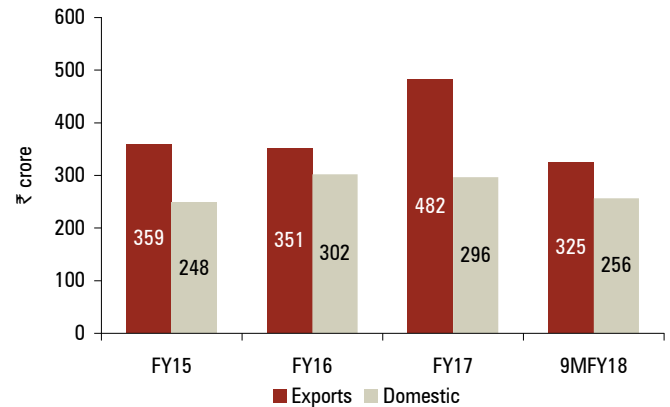
Key financials: Story in charts

Exhibit 2: Revenues grew at 13.2% CAGR in FY15-17



Source: RHP, ICICI Direct Research

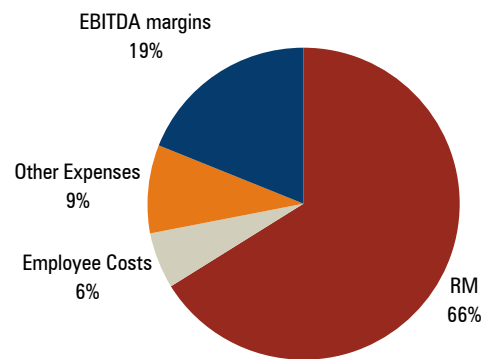
Exhibit 3: Domestic vs. export revenue trend



Source: RHP, ICICI Direct Research

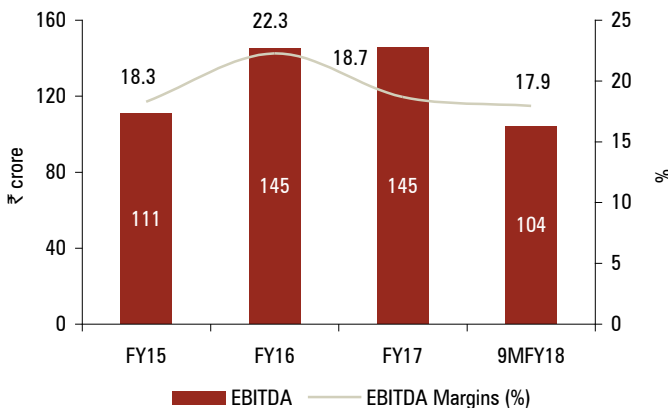
The technological expertise in niche chemistry, long customer approval process and specialised product offering allow FOIL to command healthy EBITDA margins to the tune of 18-22%. As of 9MFY18, raw material costs constituted bulk of the expenses at 66% while employee costs and other expenses stood at 6% and 9% respectively.

Exhibit 4: Contribution of various overheads in sales 9MFY18



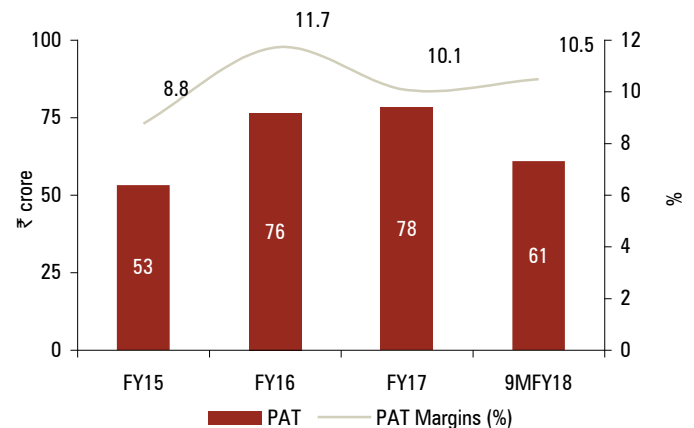
Source: RHP, ICICI Direct Research

Exhibit 5: EBITDA & EBITDA margins trend



Source: RHP, ICICI Direct Research

Exhibit 6: PAT & PAT margins trend



Source: RHP, ICICI Direct Research

FOIL realizes healthy EBITDA margins of ~18-22% & ~9-11% as PAT margins given advanced technology & specialized product offering.

Investment Rationale

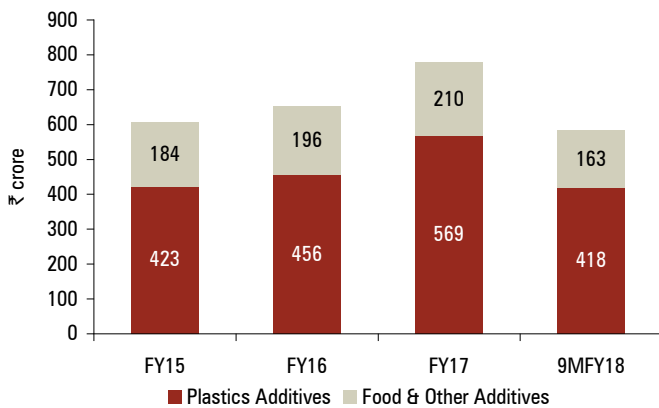
In-house R&D, niche chemistry with limited competition!

One of the key USP at FOIL is its R&D capability not only in the edible oil chemistry and corresponding product development but also in technical prowess in plant designing and consequent capacity addition. FOIL claims to have increased its capacity at 1/8th cost of best available technology. Therefore, such high capital costs of imported technology coupled with long gestation period of customer approvals (minimum 2-3 years) deter a new entrant in the industry and acts as a strong entry barrier. On the product R&D front, FOIL has developed and launched 46 new products since April 2014. FOIL is also the largest manufacturer of oleo-chemicals based additives in India and one of the only few in the world thereby operating in the limited competition landscape and realising healthy EBITDA margin profile (18%-22%).

Exposure to high growth: Packaging & processed food segments!

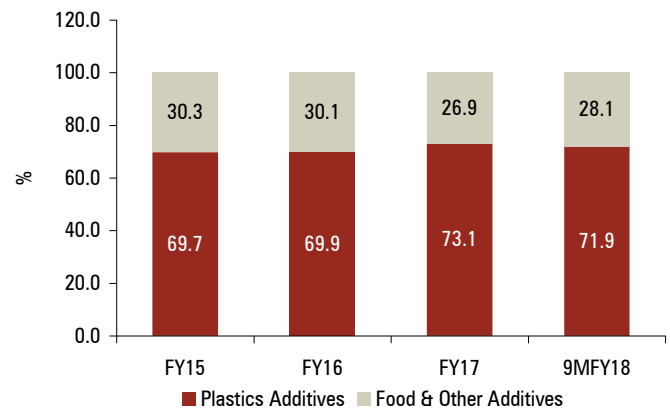
Oleo chemicals additives can be broadly divided into two buckets depending upon the end usage namely Polymers/Plastics & Food and others. FOIL realizes ~73% of its sales from the polymer segment wherein primarily it is the market leader in the SLIP additives, which is used to reduce friction in the high growth packaging products segment. FOIL realizes ~27% of its sales from the food additives and others wherein they are primarily used as performance agents to improve the properties and textures of the end-product especially high growth processed food segment. As per industry sources, global oleo-chemicals market is expected to grow at a CAGR of 5-6% over CY16-20E with domestic market expected to grow at a CAGR of 10-15% over the aforesaid period. Total product basket size at FOIL stands at 387 products

Exhibit 7: Break up of sales in key segments (FY15-9MFY18)



Source: RHP, ICICI Direct Research

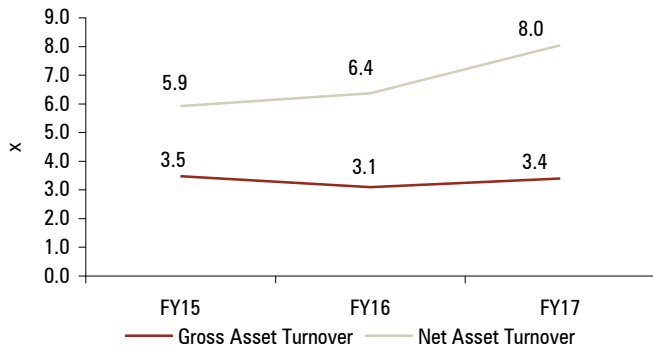
Exhibit 8: Segmental share in sales (end user industry, FY15-9MFY18)



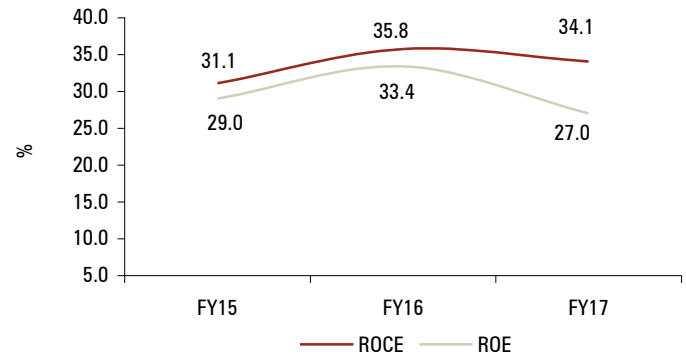
Source: RHP, ICICI Direct Research

High asset turns; Capital efficient business model

Gross block asset turnover ratio for FOIL has been in excess of 3x thereby ensuring healthy sales on the invested capital. This coupled with healthy EBITDA margin profile of ~18-22% and controlled working capital cycle at ~60-70 days ensures high double-digit return ratios at FOIL. Consequent average RoE & ROCE in FY15-17 stood at 29.8% & 33.6% respectively. With incremental capex to yield similar asset turns we expect the core return matrix at FOIL to comfortably remain in excess of 20% going forward. FOIL also generates healthy cash flows with average CFO over FY15-17 at ₹ 68 crore with corresponding cash flow yield at ~3%.

Exhibit 9: Gross and Net Asset turnover trend


Source: Company, ICICI Direct Research

Exhibit 10: RoCE & RoE trend


Source: RHP, ICICI Direct Research

Impressive Expansion underway; capacity to nearly double by FY20E

Present installed capacity at FOIL stands at 64,300 tonne (FY18E). FOIL has plans to almost double the installed base by incremental capacity addition of ~67,000 tonne over 2-year period (FY18-20E). It involves a mix of standalone capacity of 47,000 tonne and JV capacity of 20,000 tonne. Such impressive capacity additions has the potential to eventually double the Sales & PAT over a 5-year period FY18-23E. With healthy demand prospects in place and scheduled capacity coming on stream, growth visibility is robust at FOIL. This makes it an ideal portfolio bet.

Margin accretive products in the planned expansion

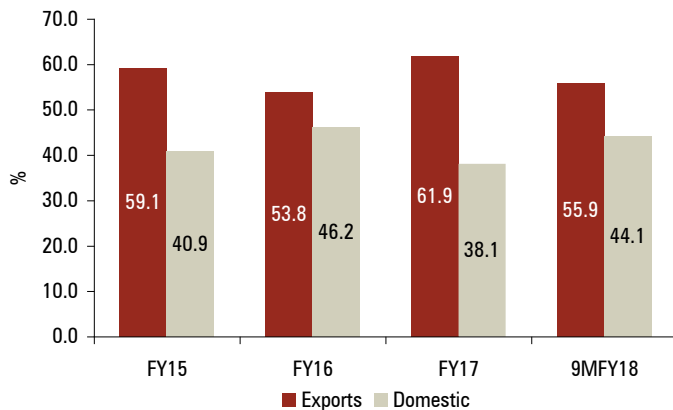
At its new facility in Ambarnath amount to 32,000 tonne (Capex outlay at ₹ 130 crore) among other products, FOIL intends to manufacture additive for animal feed segment (feed nutrition) which is intended at increasing the milk yield in cattle (cows & buffaloes). Apart from this, the company also intends to manufacture additives for cosmetic industry. As per the management commentary, both the segments will fetch higher margins than the existing product basket and will contribute incrementally to the profitability. Therefore, FOIL possesses the requisite DNA to develop higher margin value added products and move up the value chain.

Key risks and concerns

High reliance on Exports (~56%); foreign exchange risk

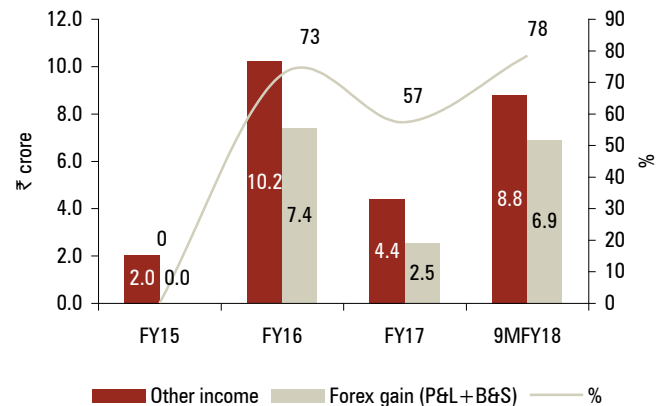
On account of specialized nature of product basket, exports form a large share of revenues at FOIL thereby marking it susceptible to foreign exchange risk. The company also imports ~25% of its raw material requirement from overseas. On net basis FOIL is a net exporter wherein company stands to gain in case of depreciation of domestic currency and vice versa. FOIL also realizes significant portion of other income from Forex exchange gains which are uncertain with any adverse currency movement beyond the hedged limits leading to decline in profitability.

Exhibit 11: Exports vs. Domestic Share in Sales (%)



Source: RHP, ICICI Direct Research

Exhibit 12: Forex Gains as a % of Other income



Source: RHP, ICICI Direct Research

As a mitigation factor, FOIL opts for back to back procurement of raw material wherein raw material price is locked the moment the sales contract is executed with its key customers. The intent is not to play on the commodity price fluctuation but rather focus on niche chemistry and product application

Extreme weather conditions impacting raw material supply

FOIL's major raw materials are derivatives of vegetable oils (rapeseed, palm, palm kernel, sunflower, castor, soybean, rice bran). It forms a significant 60-65% of its sales value and hence is susceptible to risk due to their adverse supply dynamic as well as price fluctuations. The company also stands to lose in case of loss of oilseeds crop domestically (procurement share at ~75%) in case of very adverse weather conditions including drought like situation. One notable point there is, FOIL mostly uses vegetable oil derivatives are its key raw materials, the prices of which do not increase in tandem with edible oil prices or gets impacted by governments move to increase the import duty on edible oils.

Skewed raw material procurement

Top two suppliers share in total raw procurement at FOIL remains high at ~40% thereby making it susceptible to any supply side disruptions. Their share however is in the declining trend with company developing other alternate sources of supply to mitigate this risk. In FY15, FY16, FY17 and 9MFY18 their share stood at 46.2%, 47.2%, 51.6% & 39.4% respectively.

Inability to innovate in a cost effective manner will limit growth

The key USP at FOIL is its ability to innovate and develop new products as well as manufacturing processes in a cost effective way. Company has an established R&D lab in Navi Mumbai with infrastructure set up spread over 5000 sq. mts. Therefore, inability to innovate along with changing industry dynamics will limit growth prospects at FOIL going forward.

Amalgamation of partnership firms in the past

FOIL in the past has operated through many partnership firms which were eventually amalgamated with the proposed to be listed entity i.e. FOIL. However, there still exists some entities which are still owned by promoter group and yet to be merged with the company. The financial activity albeit is quiet limited in these entities.

Valuations

Fine Organics Industries Ltd (FOIL) is a niche player present in the speciality chemicals domain. FOIL is the domestic leader in the high end/value added oleo-chemicals space and is amongst the renowned industry names globally. FOIL has a product basket of 387 products, which find application as additives in the polymer (packaging) and FMCG space (processed food, cosmetics, paints etc). FOIL is a technology driven enterprise with focus on product as well as process development. It follows a capital efficient model with high asset turns at ~3-3.5x (Gross block), healthy ~18-20% margin profile coupled with controlled working capital cycle (~70 days) with consequent RoE & RoCE in excess of 25%. It has also nearly nil debt on its books as on Decemebrr'18. Sales & PAT at FOIL has grown at a CAGR pf 13.2% & 21.4% respectively over FY15-17 (on consolidated basis). In FY17, its net sales stood at ₹ 778 crore, EBITDA at ₹ 145 crore (EBITDA margins at 18.7%) and PAT at ₹ 78 crore.

On the valuation front, there is no direct peer of FOIL in the listed space domestically. However, given the unique chemistry it is in, it is available at somewhat similar valuation multiples as commanded by other speciality chemical companies domestically. At the upper price band of ₹ 783, FOIL is available at MCap/sales of ~3.0x and P/E of ~30x on FY18 numbers (annualised). Given impressive capex underway and robust product demand, we expect growth to sustain at FOIL going forward. Recommend **SUBSCRIBE** from **long-term perspective**.

Financial summary

Profit and loss statement		₹ Crore			
(Year-end March)	FY15	FY16	FY17	9MFY18	
Revenue	606.8	652.5	778.2	581.0	
Growth (%)	7.0	7.5	19.3	NM	
Total Raw Material Costs	382.4	387.6	497.8	384.4	
Employee Cost	44.3	54.5	64.3	37.9	
Other Operating Expense	69.1	65.1	70.7	54.4	
Total Expenditure	495.9	507.3	632.8	476.7	
EBITDA	110.9	145.2	145.4	104.3	
Growth (%)	2.8	31.0	0.1	NM	
Depreciation	22.6	29.6	23.7	14.6	
EBIT	88.3	115.7	121.7	89.6	
Interest	7.7	8.3	4.6	3.0	
Other Income	2.0	10.2	4.4	8.8	
Exceptional Items	0.0	0.0	0.0	0.0	
PBT	82.7	117.6	121.6	95.4	
Tax	29.5	41.1	43.2	34.5	
PAT	53.2	76.5	78.4	61.0	

Source: RHP, ICICI Direct Research

Cash flow statement		₹ Crore			
(Year-end March)	FY15	FY16	FY17	9MFY18	
Profit Before Tax	82.7	117.6	121.6	95.4	
Add: Depreciation	22.6	29.6	23.7	14.6	
Cash Profit	105.2	147.1	145.3	110.0	
other changes	-25.5	-41.4	-49.4	-38.6	
Increase/(Decrease) in CL	-10.3	7.8	6.4	6.8	
(Increase)/Decrease in CA	-19.7	-4.4	-56.0	-3.8	
CF from Operating Activities	49.7	109.1	46.3	74.4	
Purchase of Fixed Assets	-46.1	-24.3	-15.3	-14.1	
Others	3.6	-3.5	-1.2	-14.4	
CF from Investing Activities	-42.5	-27.9	-16.4	-28.5	
Inc/(Dec) in Loan Funds	-3.4	-7.8	-53.9	-11.7	
Others	-7.1	-45.2	-1.4	-22.8	
CF from financing activities	-10.4	-53.0	-55.3	-34.5	
Net cash/cashflow	-3.2	28.3	-25.4	11.4	
Cl. Cash and cash Eq.	3.0	39.4	14.0	26.1	

Source: RHP, ICICI Direct Research

Balance sheet		₹ Crore			
(Year-end March)	FY15	FY16	FY17	9MFY18	
Source of Funds					
Equity Capital	4.8	4.8	4.8	15.3	
Reserves & Surplus	202.4	246.3	324.3	346.9	
Shareholder's Fund	207.2	251.1	329.1	362.2	
Long Term Borrowing	29.1	21.3	0.0	0.0	
Short Term Borrowing	65.6	72.9	40.3	28.6	
Deferred Tax Liabilities	0.0	0.0	0.0	0.0	
Current Liabilities	69.4	69.9	76.3	83.1	
Trade Payables	53.3	53.3	64.3	77.1	
Other current liabilities	16.0	16.2	11.9	6.0	
Short term provisions	0.2	0.3	0.0	0.0	
Source of Funds	371.3	415.1	445.7	473.8	
Application of Funds					
Net Block (Incl Intangibles)	102.4	102.6	97.0	92.5	
Capital WIP	8.1	5.7	2.8	6.7	
Total Fixed Assets	110.5	108.3	99.8	99.2	
Long Term loans & advances	52.8	58.5	60.4	74.3	
Deferred Tax Assets	1.2	0.9	7.4	6.3	
Current Assets	206.8	247.5	278.1	294.0	
Inventories	64.4	76.0	92.0	86.6	
Trade Receivables	86.3	86.8	111.4	117.2	
Cash & Bank Balances	3.0	39.4	14.0	26.1	
Current Investments	0.3	2.9	4.1	0.3	
Short Term Loans & Advances	52.1	41.6	55.9	63.1	
Other Current Assets	0.6	0.8	0.7	0.7	
Application of Funds	371.3	415.1	445.7	473.8	

Source: RHP, ICICI Direct Research

Key ratios					
(Year-end March)	FY15	FY16	FY17	9MFY18	
Per share data (₹)					
Book Value	67.5	81.8	107.2	118.0	
Cash per share	1.1	13.8	5.9	8.6	
EPS	17.3	24.9	25.5	19.9	
Cash EPS	24.7	34.5	33.2	24.6	
Profitability & Operating Ratios					
EBITDA Margin (%)	18.3	22.3	18.7	17.9	
PAT Margin (%)	8.8	11.7	10.1	10.5	
Inventory Turnover (Days)	38.8	42.5	43.1	54.4	
Debtor (Days)	51.9	48.5	52.3	73.6	
Creditor (Days)	41.7	38.9	35.8	52.2	
Net Working Capital Cycle (Days)	49.0	52.2	59.6	75.9	
Return Ratios (%)					
RoE	29.0	33.4	27.0	17.6	
RoCE	31.1	35.8	34.1	23.6	
Valuation Ratios (x) @ ₹ 783 (post dilution)					
PE	45.2	31.4	30.7	29.6	
Price to Book Value	11.6	9.6	7.3	6.3	
EV/EBITDA	22.5	16.9	16.7	17.5	
EV/Sales	4.1	3.8	3.1	3.1	
Leverage & Solvency Ratios					
Debt to equity (x)	0.5	0.4	0.1	0.1	
Interest Coverage (x)	11.5	13.9	26.6	29.7	
Debt to EBITDA (x)	0.9	0.6	0.3	0.3	
Current Ratio	3.0	3.5	3.6	3.5	

Source: RHP, ICICI Direct Research

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Strong Buy: > 15%/20% for large caps/midcaps, respectively, with high conviction;

Buy: > 10%/15% for large caps/midcaps, respectively;

Hold: Up to +/-10%;

Sell: -10% or more;



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