JOINDRE CAPITAL SERVICES LTD.

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RESEARCH REPORT

20th Sept 2017

KESAR PETROPRODUCTS LIMITED

NSE : KESARPE **Sector:** PIGMENTS & COLOURS **BSE: 524174**

View - BUY

CMP : Rs. 54

Target Price: Rs 80 (In next 12 to 18 mths)

BUSINESS BACKGROUND

Kesar Petrorodučts Limited (KPL) was established in 2010 (incorporating the business of Shreyas Intermediates Limited) and was promoted by Mr. Dinesh Sharma. KPL is among the leading Indian manufacturers of Phthalocyanine Blue Crude and downstream products. KPL is presently a leading manufacturer of Phthalocyanine Blue Crude and its downstream products in India and contribute upto 15% of the entire Copper Phthalocyanine market of India enjoying a global presence in 15 countries. Within the Pignmebts product basket KP has a product Capacity (MTA) of CPC Blue Crude of 18,000 tpa, Alpha Blue 2,400 tpa & Beta Blue 3,600 tpa. In Dye intermediates it makes K - Acid 840, Gamma Acid 360, Vinyl Sulphone 1,200 and Sulpho VS 600. KPL has its plant located at Lote Parshuram in Maharashtra.

INVESTMENT HIGHLIGHTS

Strong Financials for KPL as on Q1 FY18 –

KPL reported a strong set of Q1FY18 numbers with net sales totaling Rs 42.60 crs with EBIDTA placed at Rs 9.90 crs from Rs 7.30 crs in Q1 last year. The PAT in Q10 FY18 grew by 46% YoY to Rs 8 crs as compared to Rs 5.50 crs in Q1 last year.

For FY17 the company has recorded net sales of Rs 173 crs, a EBIDTA of Rs 25.90 crs and a PAT of Rs 20.10 crs from Rs 12.1 crs last year.

KPL enjoys strong customers relationships and caters to diverse end user segments –

KPL's clientele comprises established players like Sudarshan Chemicals, Heubach Colours,Sun Chemicals, Unilex Colours & Chemicals, Jaysynth, Kolourjet Chemicals, Mallack, Hind Prakash and Alliance Organics LLP. In FY17 Pigments accounted for 93% of revenues while the rest came from Dye intermediates.

KPL caters to electronics, automotive, food packaging, textiles, Inks, Plastics, Rubber, Paints and various other industries.KPL presently accounts for 8% of the global CPC Blue Crude (and downstream products) market due to a high quality commitment from the management. Also KPL has strategically decided to focus more on value added pigments rather than dye intermediates where margins are better and opportunity is huge.

Exports is also another focus area for KPL and currently account for 8% of revenues having started since 2014 onwards. The KPL management is targeting 10% share via export revenues in the next fiscal year.

KEY DATA

FACE VALUE Rs	1.00
DIVD YIELD %	NA
52 WK HI/LOW	56/30
NSE CODE	KESARPE
BSE CODE	KESARPE
MARKET CAP	RS 522 CRS

SHAREHOLDING PATTERN

PROMOTERS	-	31%
BANKS, MFs & DIIs	-	%
FIIs	-	%
PUBLIC	-	69%

KEY FUNDAMENTALS

YE	FY18	FY19	FY20
Rev Gr%	22	23	25
EBIDTA Gr%	47	23	28
PAT Gr%	65	36	27
EPS Gr%	65	36	27
EPS (Rs)	3.4	4.65	5.90
ROE %	31	32	29
ROCE %	26	25	25
P/E(x)	15	12	9

KPL has recently gone in for a debottlenecking at its existing facility –

KPL recently went in for a de-bottlenecking of its existing facility where in it commissioned a new 300 TPM beta facility in January 2017. KPL expects that this expanded plant will strengthen its business sustainability: as this facility represents a value addition over its established CPC manufacturing capacity where this plant was commissioned in eight months as against a prevailing benchmark of 18 months

This expanded plant was funded completely from accruals, which is the cheapest form of capital for any business and with this capacity getting commissioned KPL's product portfolio will make it manufacture additional value added products, mitigating an excessive dependence on CPC, its core building block.

KPL has also debottlenecked its existing alpha blue capacity – from 80 TPM to 125 TPM (operational from June 2017). The increase in capacity was undertaken with a number of objectives in mind mainly to increase the revenue proportion of this value-added product, capture a larger share of the customer's wallet. .

Already KPL has de-bottlenecked its alpha blue capacity resulting in a production increase by more than 50% during the first quarter of the current financial year, it also intends to launch two new products that will serve as raw materials for dyes with an aggregate capacity of 250 TPM where the annual revenue potential of Rs 100 cr is expected from incremental revenues.

The KPL management believes that by 2019-20, it will be in a position to fully-utilise all capacities and should be in a position to generate peak revenues of nearly Rs 700 crs at margins higher than the prevailing levels, translating into enhanced value for the company going ahead.

KPL believes 3 key macro trends in its overall business model to be drive its business in a significant way, these include –

Strong Secular Demand for eco friendly colour pigments –

Firstly there is a strong secular colour-driven demand trend witnessed as the world gets younger in some of the more populated geographies, there is a fundamental movement towards colour-vibrancy, which, in turn, is related to the need for feel-good; besides, printing technologies have become increasingly versatile, making it possible to reproduce virtually any colour on demand through a stronger interplay of information technology.

Focus on Greener material –

There is a growing recognition that in the world of colours, there will be a larger role for modern-day pigments over conventional dyes on the grounds of environmental integrity, cleaner technology-driven textile processing and richer tonal impact.

The traction is reflected in the numbers: even as the market for pigments is growing annually at the rate of population growth, the considerably larger dyes market is de-growing. What makes pigment prospects compelling is that it accounts for a mere 2% of the overall colours market, indicating a vast operating leverage that can keep the sector growing sustainably for years to come.

Make in India Initiative to help Indian Players –

KPL management has stated that it is witnessing a weakening in China's CPC competitiveness which in turn is creating an attractive window of opportunity for robust Indian pigment manufacturers especially in the pigments sector coupled with a sharp increase in wages, has affected China's global CPC market share.

Nimble footed Indian pigment manufacturers like KPL have capitalised and their competitiveness is reflected in the fact that some have even begun to export to China.

The KPL management believes that it has a significant market-leading role to play in this transformation and with a near-9% share of the global CPC market makes it one of the largest global players in this space; across the foreseeable future, wherein its expects to enhance its capacity utilisation and offer higher value addition with the objective to unlock value and emerge as one of the best known CPC players in the world coupled with a growing non-CPC play that enhances value for all the company's stakeholders.

India is now gaining significant share in the Global Pigments & Dyestuffs markets –

The Indian dyestuffs and pigments industry has transformed from being import dependent to an export driven industry. Given the stringent measures in majority of the developed economies, companies are sourcing the dyes intermediates and pigments from cost-effective markets (developing economies). Exports from India have grown at double digit over the last few years.

Large manufacturers of dye intermediates in China were asked to shut their operations due to non-compliance of environmental norms. It is now mandatory for chemical companies in China to first focus on effluent treatment mechanisms before starting business (production activity), which has substantially increased the manufacturing cost over there.

Considering the strict norms and margin erosion of chemical companies globally, and a sharp rise in labour costs as well as declining state support has also led to diminishing cost advantage of Chinese players thereby benefiting Indian players at large.

Also with plant shutdowns in China, global customers are looking at diversifying their procurement base and increasingly targeting India as the next alternate source thereby benefiting Indian dye intermediates and dye stuff industry at large.

The global market for pigment is expected to grow at an estimated CAGR of 4.5% between 2013 and 2020 ($14.7 billion by 2018). There is a growing traction in buying from organised players following downstream customers demanding higher product quality and environment integrity.

KPL is attractively placed as it is one of the global leaders in the phthalocyanine segment, with its products having a wide product range (printing, paints, plastics, automobile coatings and textiles).

GST Implementation is likely to be a big game changer for the domestic Pigments & Colours market –

KPL expects GST Implementation to be a big game changer for the domestic pigments & colours industry as almost 50 to 55% of the local pigments and Colours industry is yet in the unorganized sector. Thus going ahead we expect a reasonable pricing gain for a player like KPL which is quality wise better and thus when pricing diffrencial will not exist this will enable KPL to capture significant domestic market share gain at the cost of the unorganized sector players.

Thus the next 2 years are likely to see a big shakeout in the domestic dyestuff industry which wil largely benefit the listed organized sector players like KPL in the domestic market arena and other larger organized sector players

KPL enjoys a strong balance sheet and both Topline and Bottomline growth is likely to remain steady going ahead –

KPL enjoys a strong balance sheet with a virtually debt free position of Rs 4 crs on the balance sheet as on FY17 as compared to a tangible networth of Rs 88.30 crs as on March 2017.

More Importantly both key operating parameters like ROCE, ROE are placed around 25% and 32% respectively which we believe look attractive but which are likely to remain stable despite the higher volume base as volume growth improves further.

We expect that going ahead overall bottomline growth in the next 2 years starting FY17 onwards should easily touch 35-40% and with no debt and healthy cash flows being generated and no large capex expected in the next 2 years, we expect KPL to generate healthy internal accruals making the capital structure healthy. Our expectation is that ROCE and ROE by FY19 should touch 25% and 31% respectively

What is KPL's key USP and strong competitive edge vis a vis other players

Firstly KPL is a large player in CPC Blue enjoying a 9% global market share. .

Secondly this is reflected from the fact that top 5 customers account for 70% of its revenues.

Thirdly these customers have being doing business with KPL since the last 10-15 years indicating strong product quality acceptance from them

KPL is a global leader in the phthalocyanine segment, accounting for 9% of the world's organic pigment market

KPL enjoys a debt free balance sheet with very high ROE and ROCE operating ratios which would get better over the next 2 years

Business Outlook & Stock Valuation –

On a rough cut basis, in FY18, Revenue is expected to touch Rs 211 crs.

On the bottomline level we expect the company to record a PAT of Rs 33 crs in FY18E. Thus on a conservative basis, KPL should record a EPS of Rs 3.5 for FY18E. For FY19E and FY20E our expectation is that earnings traction for KPL will be strong and remain attractive wherein we expect a EPS of Rs 4.65 and Rs 5.90 respectively.

KPL's clientele comprises established players like Sudarshan Chemicals, Heubach Colours,Sun Chemicals, Unilex Colours & Chemicals, Jaysynth, Kolourjet Chemicals, Mallack, Hind Prakash and Alliance Organics LLP. In FY17 Pigments accounted for 93% of revenues while the rest came from Dye intermediates.

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KPL has also debottlenecked its existing alpha blue capacity – from 80 TPM to 125 TPM (operational from June 2017). The increase in capacity was undertaken with a number of objectives in mind mainly to increase the revenue proportion of this value-added product, capture a larger share of the customer's wallet.

More importantly KPL has strategically focussed on value added chemicals apart from CPC whuich has resulted in EBIDTA margins improving to around 15% in FY17 from 1.5% in FY14. Similarly KPL's net margins have also improved significantly to 11.6% in FY17 from 1.1% in FY14. .

Hence looking at KPL's strong market position, strong management bandwidth and excellent R & D skillsets coupled with a healthy balance sheet make us confident that the stock will soon get re rated looking at its future prospects.

The KPL stock trades at a P/E of 11x and 9x based on FY19E and FY20E, which looks attractive considering its strong execution capability, consistent financial track record, and expected operating leverage benefits in the next two years going ahead.

Hence we believe that the KPL stock should be purchased at the current price for a price target of around Rs 80 over the next 12 to 18 months.

FINANCIALS

For the Year Ended March RsCrs	FY17A	FY18E	FY19E	FY19E
Net Sales	173.00	211.06	259.60	324.50
EBIDTA	25.9	37.99	46.73	60.03
EBIDTA %	14.97	18.00	18.00	18.50
Interest	0.6	0.5	0.4	0.0
Depreciation	1.3	1.5	1.65	1.75
Non Operational Other Income	1.3	1.5	1.6	1.6
Profit Before Tax	25.4	37.49	46.28	59.88
Profit After Tax	20.1	33.1	45.1	57.1
Diluted EPS (Rs)	2.07	3.41	4.65	5.89
Equity Capital	9.7	9.7	9.7	9.7
Reserves	78.6	111.7	156.8	213.9
Borrowings	4.6	2.6	0.0	0.0
GrossBlock	39.5	41.5	43.5	47.5
Investments	1.00	1.00	1.00	1.00

Source Company our Estimates

KEY CONCERNS

Loss of Major Customers

Major downturn in user segments can also impact profitability negatively for KPL

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