Fineotex Chemical Ltd.

BUY

March 31, 2021

Fineotex Chemical Ltd. (FCL) is one of the leading specialty chemical manufacturer in India. Its products are widely used in textile sector, water treatment, leather, construction and paint sector. The company has manufacturing facilities in India and Malaysia with a combined production capacity of 43,000 tonnes per annum and with over 450 products in the portfolio. FCL's products find application across the entire textile value chain spanning from pre-treatment, dyeing, printing and finishing. It has long track record in chemical industry with a presence in key international textile hubs like Bangladesh, Indonesia, Malaysia, Thailand, Vietnam, Singapore, Brazil, USA and Germany. As on FY20, around 94% of the revenue is derived from textile chemicals. On consolidated basis, it's overseas business accounted to 52% to the total revenue.

Investment rationale:

Leading player in textile chemical market with rich client base

- Through its subsidiary i.e. Biotex Malayasia's (Biotex) high-end product expertise and strategic positioning among the global customers, FCL has maintained a strong client relationship in domestic as well as in international markets. With a four decade long business expertise, the company has maintained faith among its customers for its customized quality products that specializes in entire range of textile processing.
- Textile chemical accounts only a small portion of the total textile production cost thus, FCL's clients are price insensitive and sticky due to its product expertise. Currently, it is doing business with around 85 textile corporate like Welspun, Vardhaman, Raymonds , Birla, Himatsingka, etc.
- In terms of government support, there is a policy tailwinds for the textile sector from key flagship programs like Make-in-India, Atmanirbhar Bharat, investment in textile parks, etc.
- Textile chemical sector has large presence of unorganized players. FCL aims to gain market share with its customized value added products that primarily focuses on saving costs (power, water consumption and treatments cost).
- As a result, the company is likely to witness strong growth in textile chemical in next five years and benefit from India's emergence as a global supply alternate to China.

Strong growth trajectory ahead with upcoming Ambernath plant

- FCL is undertaking a brownfield expansion at its Ambernath facility, with an estimated capex of Rs. 27cr. The plant is expected to be operational by Q1FY22. The capacity of plant will increase on a staggering basis to reach the guided capacity of 36,000 tonnes per annum. Post expansion, the company will have total capacity of 79,000 tonnes per annum.
- This expanded facility will be utilized to cater demand for textile chemicals, cleaning & hygiene and drilling specialty chemicals.

Diversification into new high growth areas

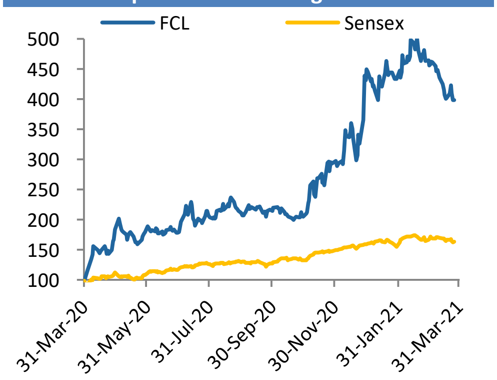
- To diversify the business presence, FCL has made an entry in new high growth areas like home care, hygiene and oil & drilling chemical. In home care/hygiene segment, the company is targeting to cater leading branded detergent manufacturers for their requirements for polymers.

Rating matrix	
Face value	Rs. 2
CMP	Rs. 61.5
Rating	BUY
Target price	Rs. 105
Holding period	24 months
Upside potential	70.7%
52 Week H/L	76.4/12.5
MCAP	Rs. 681cr
Enterprise value	Rs. 653cr
Sector	Specialty Chemicals

Shareholding pattern

Particulars	Mar'20	Jun'20	Sep'20	Dec'21
Promoters	71.4%	71.4%	71.8%	64.7%
FPIs	0.0%	0.0%	0.0%	0.0%
DIIs	0.1%	0.2%	0.0%	6.0%
Non. Inst.	28.5%	28.4%	28.2%	29.3%

Relative capital market strength



Consolidated financial snapshot (Rs. cr)

Particulars	FY20	FY21E	FY22E	FY23E
Net Sales	196.3	206.6	266.4	336.5
EBITDA	34.2	40.8	53.1	69.3
EBITDA margin	17.4%	19.8%	19.9%	20.6%
Adjusted PAT	13.1	43.9	40.3	52.8
PAT margin	6.7%	21.3%	15.1%	15.7%
EPS (Rs)	1.2	4.0	3.6	4.8
RoE	7.7%	20.6%	15.9%	17.2%
P/E (x)	52.1	15.5	16.9	12.9
P/BV (x)	4.0	3.2	2.7	2.2
EV/Sales (x)	3.4	3.2	2.5	2.0
EV/EBITDA (x)	19.5	16.3	12.7	9.8
P/S(x)	3.5	3.3	2.6	2.0

**FY21 PAT margin higher due to other income (refer page no. 2)*

Source: Choice Equity Broking

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Quarterly analysis

Particulars (Rs. cr)	Q3 FY21	Q3 FY20	Y-o-Y %	Q2 FY21	Q-o-Q %
Net Sales	58.35	52.06	12.1%	54.75	6.6%
EBITDA	13.62	8.02	69.8%	9.96	36.7%
EBITDA %	23.3%	15.4%	794bps	18.2%	515bps
PAT	13.08	7.65	71.0%	10.49	24.7%
PAT %	22.4%	14.7%	772bps	19.2%	326bps

Source: Choice Equity Broking

Performance analysis:

- During Q3FY21, consolidated revenue came in at Rs. 58.4cr, up 12.1% Y-o-Y and up 6.6% a sequential basis. Strong top-line performance was primarily driven by incremental order book.
- Consolidated EBITDA increased 69.8% Y-o-Y to Rs. 13.6cr, mainly due to lower operational expenses. As a result margin stood at 23.3%, up 794bps Y-o-Y.
- Consolidated PAT increased in-line to EBITDA and stood at Rs 13.1cr, up 71% Y-o-Y. PAT margin stood at 22.4%, up 772bps Y-o-Y.
- Q3FY21 PAT included mark-to-market gain on investments of Rs. 4.5cr and 9MFY21 other income stood at Rs. 14.6cr. Higher PAT margins of 21.9% during 9MFY21 is primarily on the account of higher other income. FCL booked a notional loss on financial assets in FY20 which kept the PAT margin under pressure. Thus, higher other income on account of reversal is expected to improve FY21e PAT margin by 1,460bps.

Key earning call highlights:

- Current capacity utilization is at 50-55%.
- Revenue is dependent on the product-mix, which in turn is dependent on the order-mix.
- Production commencement from Ambernath plant is targeted from Q1FY22 (before June, 2021). The plant will cater demand of textile, cleaning & hygiene and drilling specialty chemicals.
- FCL expects significant opportunities in home care & hygiene segment. It intends to provide polymer to various leading branded detergent manufacturers.
- In Oil & drilling specialties, it expects to meet chemical requirement of leading oil & gas companies.
- Capex will be funded through internal accruals. In the long run, the company targets to maintain a net debt neutral capital structure.
- The company is ready for any inorganic acquisitions, which are in same line of business and can provide synergy benefits. According to the management, various proposals are on the table for consideration.
- If there is any acquisition, it will be mainly funded through internal accruals. With global bond yields at favourable levels, this can be considered as a viable option.
- As on 31st Dec. 2020, cash balance was Rs. 50 crs.

Business overview: FCL operates in specialty chemicals area with specialization in textile processing. Its products play an important role in textile manufacturing processes. Increasing usage of chemicals in the textile industry is a strong demand driver for textile chemical companies due to expectations of quality and fashionable textile products. FCL is nearly a zero debt company with strong balance sheet and has a strong track record of maintaining steady margins. It holds cash of Rs. 50cr (in Q3 FY21) and in past have used conservative capital allocation approach for expansion (i.e. acquisition and expansion through internal accruals).

Its step-down subsidiary, BioTex is a world-class specialty chemical and sustainable solutions producer. BioTex innovates and specializes in high end specialty finishing textile chemicals like water & oil repellents, antimicrobials, etc. for textiles and also has great presence in few segments for paint sector. With "Blue Sign" and other sustainable certifications, BioTex is tapping the global markets with its innovative products.

Business overview (Contd…)

FCL has a diversified revenue mix across its clients, products and geographies. Its top-10 clients contributed about one third of the revenue, while top-10 products accounted for 18% of the revenue in FY20. Recently, the company entered into the home care & hygiene chemicals and drilling specialty chemicals to drive future growth and leverage core technical expertise.

Manufacturing facilities: At present, FCL has two manufacturing facilities with a combined capacity of 43,000 tonnes per annum.

1) Biotex, Malaysia (textile chemical and R&D centre)

- This plant produces specialty chemical for different application and through its R&D centre, it offers customized application research based specialty chemicals to its clients globally.
- Biotex's R&D centre assists FCL through its innovative products & customized solutions, which further enhances FCL's ability in expanding market presence.
- This facility has a production capacity of 6,500 tonnes and produces niche products (50+ categories) and also provides sustainable and effective textile solutions for high end speciality textile chemical applications. One of its unique product "Mosquito life cycle controller" is likely to benefit FCL is the future.

2) Mahape, Navi Mumbai (textile chemical)

- This facility has a production capacity of 36,500 tonnes and manufactures chemicals that are mainly used in textile value chain i.e. pre-treatment, dyeing, printing and finishing process. Other key segment products are home care, oil drilling and other specialty chemicals.
- Biotex's R&D helps this plant in providing tailor made solution to its rich client base.

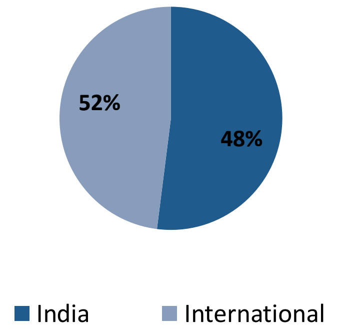
3) Upcoming plant in Ambernath

- Ambernath plant is situated on four acres of land. This facility will be fully automated and is developed as per the schedule of commencing production by Q1 FY22.
- The guided capital expenditure towards this facility is Rs. 27cr, funded through internal accruals. This plant will cater to customer demands in the existing textile specialties, homecare & hygiene and drilling specialties business.

	India	Malaysia
Product count	Over 400 categories	Over 50 categories
Application	Textile	Textile and R&D Centre
Capacity	36,500 MT	6,500 MT
Production volume	20,440 MT	4,550 MT
Utilisation rate	56%	70%
Peak utilization rate	75%	75%
Location	Navi Mumbai	Selangor
Location advantage	• Near to Port, logistical advantage & easy access to textile hubs (India)	• Easy access to raw material • FTA with important regions like Vietnam, China and India provides cost benefits

Source: Choice Equity Broking

FY20 Consolidated Geographical Revenue-Mix



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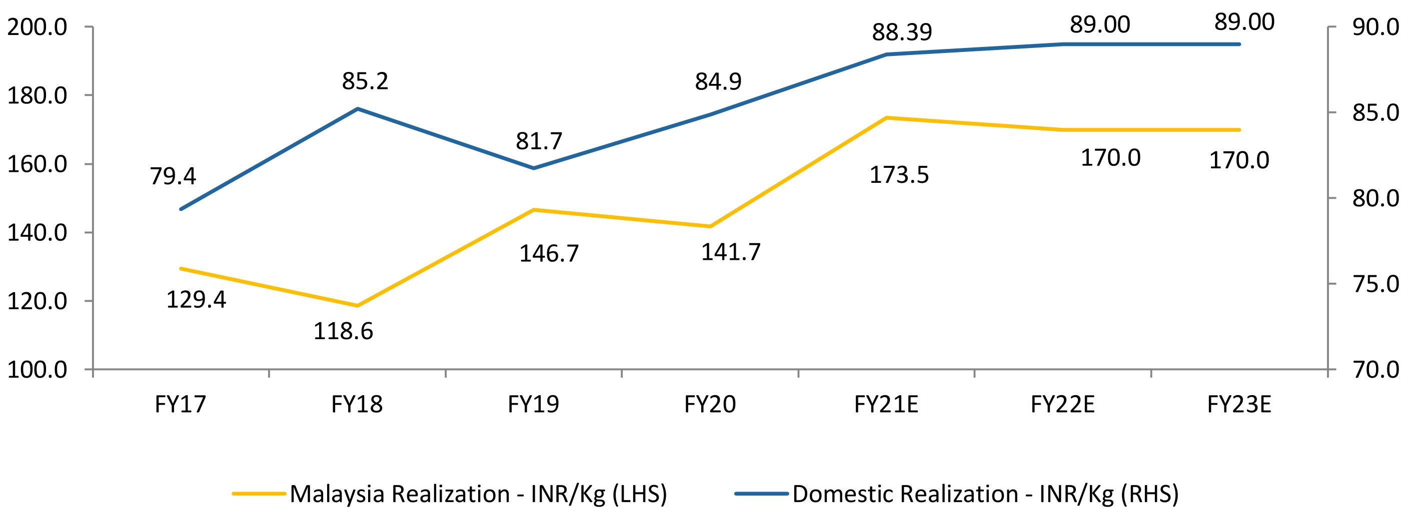
Business overview (Contd…)

Realization trend



Standalone segment-wise volume break-up

Standalone volume break-up	FY17	FY18	FY19	FY20	YTD FY21
Textile	96.5%	95.5%	94.4%	94.6%	95.0%
Home Care	0.0%	0.0%	0.0%	0.0%	1.2%
Drilling chemicals	0.0%	0.0%	0.0%	0.5%	0.6%
Others	3.5%	4.5%	5.6%	4.9%	3.2%

Source: Choice Equity Broking

Peer comparison (TTM)

Companies	CMP (Rs)	ROE (%)	12MR (%)	M. Cap (Rs. Mn)	EPS (Rs)	BVPS (Rs)	EBIDTA (%)	NPM (%)
Fineotex Chemical Ltd.	**61.5**	**13.3%**	**334.7%**	**681**	**2.3**	**17.0**	**18.8%**	**13.4%**
Rossari Biotech	1,043.7	20.9%	40.0%	5,420	14.6	70.0	18.1%	11.6%
Galaxy Surfactants	2,446.2	24.0%	115.5%	8,673	80.7	336.7	16.3%	10.8%
Kiri Industries	416.8	12.7%	52.5%	1,401	73.8	582.0	7.2%	27.8%
Atul Ltd	7,053.1	17.5%	77.3%	20,868	210.2	1,199.0	23.8%	17.4%
Average		**16.9%**	**124.0%**				**16.8%**	**16.2%**

Companies	P/E (x)	P/Bv (x)	P/Sales (x)	EV/EBIDTA (x)	D/E	PAT (Rs Crs)	EBIDTA (Rs Crs)	Sales (Rs. Crs)
Fineotex Chemical Ltd.	**27.2**	**3.6**	**3.6**	**18.5**	**0.0**	**25**	**35**	**187**
Rossari Biotech	71.3	14.9	8.3	45.1	0.0	76	118	654
Galaxy Surfactants	30.3	7.3	3.3	20.3	0.2	286	434	2,657
Kiri Industries	5.6	0.7	1.6	23.8	0.1	248	64	892
Atul Ltd	33.6	5.9	5.8	24.3	0.0	622	851	3,581
Average	**33.6**	**6.5**	**4.5**	**26.4**	**0.1**			

Source: Choice Equity Broking

Valuation: We are forecasting a 59.2% CAGR growth in the earnings on a 19.7% CAGR rise in top-line over FY20-23E. Earning growth would be aided by the expansion in the operating margin and the reversal of booked notional loss on investments, which has kept the FY20 earning at depressed levels.

At CMP of Rs. 61.5, FCL is trading at TTM PE of 27.2x against its peer average of 33.6x. We have a positive outlook on the stock considering the synergies of R&D expertise coupled with its leading position in textile speciality chemicals market, capacity expansion and positive industry outlook. We assign a P/E multiple of 22x to its FY23E EPS to arrive at a target price of Rs. 105 per share. Thus we assign a **"BUY"** rating to the stock.

Key risk to investment:

- Higher raw material prices
- Increasing competition from domestic and Chinese manufacturers
- Prolonged slowdown in global economy; weak demand and higher inventory levels
- Delay in commencement of Ambernath plant and weak growth in new segments

Financial statements

Consolidated profit & loss statement (Rs. cr)	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
Net Sales	108.7	134.4	142.9	182.3	196.3	206.6	266.4	336.5
EBITDA	26.5	29.5	30.0	34.7	34.2	40.8	53.1	69.3
EBITDA (%)	24.4%	21.9%	21.0%	19.0%	17.4%	19.8%	19.9%	20.6%
(+) Other Income	3.3	9.8	5.2	0.8	2.2	19.4	4.3	4.3
(-) Interest	0.4	0.4	0.6	1.0	0.6	0.6	0.4	0.4
(-) Depreciation	0.6	0.6	0.7	1.0	1.2	1.4	1.3	1.3
(+) Exceptional items	0.0	0.0	0.0	0.2	-12.6	0.0	0.0	0.0
Profit Before Tax	28.9	38.2	33.9	33.6	22.0	58.2	55.8	71.9
(-) Taxes	9.1	9.1	10.0	9.3	7.7	12.4	13.4	16.9
(-) Minority Interest	2.7	3.3	1.3	1.8	1.2	1.9	2.1	2.2
PAT	17.0	25.8	22.7	22.5	13.1	43.9	40.3	52.8
PAT Margins (%)	15.7%	19.2%	15.9%	12.4%	6.7%	21.3%	15.1%	15.7%

Consolidated balance sheet (Rs. cr)	FY16	FY17	FY18	FY19	FY20
Share capital	22.5	22.3	22.3	22.3	22.3
Total reserves	68.8	90.2	113.5	136.5	147.4
Minority interest	4.8	7.2	6.2	5.7	6.3
Deferred tax assets liabilities	-0.5	-0.4	-0.2	0.2	-0.5
Other long term liabilities	0	0.2	0.4	0.5	0.5
Long term provisions	0	0.1	0	0	0.1
Trade payables	13.0	15.5	10.9	20.9	23.4
Other current liabilities	0.5	3.4	3	6.3	4.9
Short term borrowings	3.0	1.1	4.4	2	2.8
Short term provisions	1.5	0.1	0.2	0.3	0.2
Total liabilities	**113.7**	**139.7**	**160.9**	**194.7**	**207.3**
Net block	19.3	23.4	25.4	32.2	36.8
Capital WIP	0	0	0.1	0.1	0.6
Non current investments	39	50.8	57	47	47.8
Long term loans & advances	6	6.8	6.2	7	6.6
Other non current assets	0	0	0.1	0.1	0.1
Currents investments			1.6	4.9	8.5
Inventories	11.5	13.1	21.1	25.1	21.1
Sundry debtors	25.4	29.2	27.9	49.1	53.8
Cash and bank balance	9.5	13.1	8	14.7	17.9
Other current assets	0.1	0.8	9.9	12.5	12.5
Short term loans and advances	3.1	2.4	3.7	1.9	1.5
Total assets	**113.7**	**139.7**	**160.9**	**194.7**	**207.3**

Consolidated cash flow statement (Rs. cr)	FY16	FY17	FY18	FY19	FY20
Cash from operating activities	13.6	19.1	6.3	12.0	28.4
Cash flow from investing activities	-9.8	-10.9	-9.4	4.2	-19.0
Cash flow from financing activities	-1.5	-5.8	-3.6	-3.4	-3.9
Net cash flow	2.4	2.4	-6.7	12.8	5.5
Opening cash balance	9.2	8.5	6.6	3.6	17.2
Closing cash balance	8.5	7.7	3.6	17.2	23.0

Source: Choice Equity Broking

Choice's Rating Rationale

The price target for a large cap stock represents the value the analyst expects the stock to reach over next 12 months. For a stock to be classified as Outperform (Buy), the expected return must exceed the local risk free return by at least 5% over the next 12 months. For a stock to be classified as Underperform (Reduce, Sell), the stock return must be below the local risk free return by at least 5% over the next 12 months. Stocks between these bands are classified as Neutral (Hold).

BUY	Absolute Return >15%
Hold	Absolute Return Between 0-15%
Reduce	Absolute Return 0 To Negative 10%
Sell	Absolute Return > Negative 10%

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