



3R MATRIX

| | + | = | - |
|----------------------|---|---|---|
| Right Sector (RS) | ✓ | ✗ | ✗ |
| Right Quality (RQ) | ✓ | ✗ | ✗ |
| Right Valuation (RV) | ✓ | ✗ | ✗ |

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

| | Old | | New |
|----|-----|---|-----|
| RS | ✓ | ↔ | ✓ |
| RQ | ✓ | ↔ | ✓ |
| RV | ✓ | ↔ | ✓ |

Company details

| | |
|-------------------------------|--------------|
| Market cap: | Rs. 3,827 cr |
| 52-week high/low: | Rs. 295/191 |
| NSE volume: (No of shares) | 8.7 lakh |
| BSE code: | 500730 |
| NSE code: | NOCIL |
| Free float: (No of shares) | 11.0 cr |

Shareholding (%)

| | |
|-----------|------|
| Promoters | 33.8 |
| FII | 4.5 |
| DII | 5.1 |
| Others | 56.6 |

Price chart



Price performance

| (%) | 1m | 3m | 6m | 12m |
|--------------------|-------|-------|-------|-------|
| Absolute | -12.4 | -14.5 | -2.2 | -11.5 |
| Relative to Sensex | -17.7 | -18.3 | -14.4 | -12.6 |

Sharekhan Research, Bloomberg

NOCIL Ltd

Weak show; demand concerns temporary

Specialty Chemicals

Sharekhan code: NOCIL

Reco/View: Buy



Upgrade



Maintain

CMP: Rs. 230

Price Target: Rs. 305



Downgrade

Summary

- Q2FY23 performance was subdued with a miss of 19%/37%/45% in revenue/operating profit/PAT at Rs. 389 crore/Rs. 62 crore/Rs. 36 crore, down 24%/40%/46% q-o-q. The large miss was due to sharply lower-than-expected volume (down 23% q-o-q) and higher per unit opex on lower utilisation and elevated energy cost.
- Steep volume decline of 13%/23% y-o-y/q-o-q to 11,817 tonnes was on the account of lower export volumes given a recessionary trend in key markets while domestic volume witnessed some improvement. Despite beat in per unit gross margin, EBITDA margin of Rs. 52/kg (down 22% q-o-q) missed our estimate as beat in realisation was more than offset by higher per unit opex on volume decline.
- Management expects near-term export demand to remain under pressure given recessionary trend and its difficult to guide on timeline to achieve optimum utilisation. Having said that, NOCIL is confident on long-term growth, aspires to improve market share and sees growth from Europe plus one opportunity. We have lowered our FY23-24 earnings estimate to factor lower volume/margin assumption.
- We maintain a Buy on NOCIL but lower the PT to Rs. 305 to reflect earnings cut. Our expectation of earnings recovery over FY24E-25E, potential gain in global market share (benefit of China/Europe plus One strategy) makes valuation attractive at 16.5x/14.3x FY24E/FY25E EPS.

Q2FY23 results were weak with a sharp miss on all fronts primarily due to lower-than-expected sales volume and EBITDA margin. Consolidated revenue of Rs. 389 crore (up 3.8% y-o-y; down 23.5% q-o-q) was 19% below our estimates of Rs. 486 crore due to a sharp miss of 27% in sales volumes at 11,817 tonnes (down 13%/23% y-o-y/q-o-q) partially offset by better-than-expected blended realisation at Rs. 329/kg (down only 1% q-o-q and versus estimate of Rs. 300/kg). EBITDA margin of Rs. 52/kg (up 42% y-o-y; down 22% q-o-q) was significantly below our estimate of Rs. 62/kg primarily on the account of sharply higher-than-expected per unit opex (up 17% q-o-q) as steep volume de-growth impacted operating leverage. On the positive side, gross margin remained resilient at Rs. 155/kg (flat q-o-q) and was 9% above our estimate of Rs. 142/kg. Consequently, operating profit/PAT of Rs. 62 crore/Rs. 36 crore, down 40%/46% q-o-q and 37%/45% below our estimate due to weak volume, pressure in per unit opex and higher tax rate of 26.4% (versus assumption of 25%).

Key positives

- Gross margin remained resilient at Rs. 155/kg, flat q-o-q.
- Domestic market has seen volume growth in Q2FY23.

Key negatives

- Sharply lower-than-expected sales volume of 11,817 tonnes; down 23% q-o-q due to steep decline in export volume.
- Miss of 15% in EBITDA margin at Rs. 52/kg, down 22% q-o-q.
- Muted demand outlook in near term due to recessionary environment.

Management Commentary

- Management hinted that near term export demand to remain muted given global recessionary environment and destocking but do not see any structural change in long growth outlook. Europe accounts for 10-15% of global rubber production and current challenges environment provides growth opportunity.
- Raw material price remained flat q-o-q but continues to remain volatile and demand slowdown in China could result in dumping of rubber chemical and this could affect rubber chemical prices for the next 1-2 quarters.
- Q2FY23 utilisation at 65-70% versus 70% in Q1FY23 and management indicated that the current uncertain demand environment makes it difficult to predict timeline of optimum plant utilisation (in the past quarter management guided for 3-6 months delay from original guidance of Sep'23 to reach optimum plant utilisation on expanded capacity of 110,000 tonnes).
- Debottlenecking is on track to be completed in next 12 months and would be sufficient meet demand for next 1-2 years. New capex plan under evaluation and would take decision at an appropriate time.
- Other updates – 1) Europe accounts for 20% of total export volumes, 2) maintained market share at last year level, 3) domestic realisations are 10% higher than export realisation.

Revision in estimates – We have lower our FY23 and FY24 earnings estimate to factor volume and margin assumption. We have also introduced our FY25 earnings estimate in this report.

Our Call

Valuation – Maintain Buy with revised PT of Rs. 305: Although FY23 volume growth outlook is subdued but long-term structural growth outlook remains intact supported by growth in tyre industry and Europe plus one opportunity. A potential volume recovery and resilient margin would drive earnings recovery. We believe that NOCIL is a play on import substitution and China/Europe Plus One strategy by global customers and the same would drive market share gains going forward. Valuation of 16.5x/14.3x FY24E/FY25E EPS is attractive considering our expectation of sharp PAT recovery (post subdued FY23) over FY24E-25E and improvement in RoE to 14-15% (versus 12.9% in FY22). Hence, we maintain a Buy on NOCIL with a revised PT of Rs. 305 (lowered to reflect cut in earnings estimate).

Key Risks

Slowdown in auto/tyre industry and delay in ramp-up of new capacity could impact volume growth. Competition from Chinese players could affect pricing and margins.

Valuation (Consolidated)

| | Rs cr | | | |
|--------------------|-------|-------|-------|-------|
| Particulars | FY22 | FY23E | FY24E | FY25E |
| Revenue | 1,571 | 1,841 | 2,181 | 2,475 |
| OPM (%) | 18.2 | 16.0 | 16.5 | 16.5 |
| Adjusted PAT | 176 | 182 | 232 | 268 |
| % YoY growth | 99.2 | 3.4 | 27.2 | 15.6 |
| Adjusted EPS (Rs.) | 10.6 | 10.9 | 13.9 | 16.1 |
| P/E (x) | 21.7 | 21.0 | 16.5 | 14.3 |
| EV/EBITDA (x) | 13.3 | 12.5 | 10.4 | 9.0 |
| RoNW (%) | 12.9 | 12.1 | 14.2 | 15.0 |
| RoCE (%) | 16.0 | 14.3 | 16.5 | 17.5 |

Source: Company; Sharekhan estimates

Big miss in Q2FY23 earnings as volume/margin disappoints

Q2FY23 consolidated revenue of Rs. 389 crore (up 3.8% y-o-y; down 23.5% q-o-q) was 19% below our estimates of Rs. 486 crore due to a sharp miss of 27% in sales volume at 11,817 tonnes (down 13%/23% y-o-y/q-o-q) partially offset by better-than-expected blended realisation at Rs. 329/kg (down only 1% q-o-q and versus an estimate of Rs. 300/kg). EBITDA margins of Rs. 52/kg (up 42% y-o-y; down 22% q-o-q) was significantly below our estimate of Rs. 62/kg primarily led by sharply higher-than-expected per unit opex (up 17% q-o-q) as steep volume de-growth impacted operating leverage. On the positive side, gross margins remained resilient at Rs. 155/kg (flat q-o-q) and was 9% above our estimate of Rs. 142/kg. Consequently, operating profit/PAT of Rs. 62 crore/Rs. 36 crore, down 40%/46% q-o-q was and 37%/45% below our estimate due to weak volume, pressure in per unit opex and higher tax rate of 26.4% (versus assumption of 25%).

Results (Consolidated)

| Particulars | Q2FY23 | Q2FY22 | YoY (%) | Q1FY23 | QoQ (%) |
|-------------------------|------------|------------|-------------|------------|--------------|
| Revenue | 389 | 375 | 3.8 | 509 | -23.5 |
| Total Expenditure | 327 | 325 | 0.7 | 406 | -19.5 |
| Operating profit | 62 | 50 | 23.3 | 103 | -39.6 |
| Other Income | 1 | 1 | -37.2 | 1 | -18.1 |
| Interest | 0 | 0 | 21.7 | 0 | 0.0 |
| Depreciation | 14 | 11 | 30.6 | 14 | 1.9 |
| Reported PBT | 49 | 41 | 19.4 | 90 | -45.8 |
| Tax | 13 | 11 | 19.0 | 23 | -44.7 |
| Reported PAT | 36 | 30 | 19.5 | 66 | -46.2 |
| Equity Cap (cr) | 17 | 17 | | 17 | |
| Reported EPS (Rs.) | 2.1 | 1.8 | 19.2 | 4.0 | -46.2 |
| Margins (%) | | | BPS | | BPS |
| OPM | 15.9 | 13.4 | 252.7 | 20.2 | -423.2 |
| NPM | 9.2 | 8.0 | 121.2 | 13.1 | -386.8 |
| Tax rate | 26.4 | 26.5 | -8.2 | 25.9 | 53.4 |

Source: Company; Sharekhan Research

Key operating metrics

| Particulars | Q2FY23 | Q2FY22 | YoY (%) | Q1FY23 | QoQ (%) |
|-------------------------|--------|--------|---------|--------|---------|
| Volume (tonnes) | 11,817 | 13,635 | -13.3% | 15,251 | -22.5% |
| Realisation (Rs. /kg) | 329 | 275 | 19.7% | 334 | -1.3% |
| RM cost (Rs. /kg) | 174 | 164 | 6.4% | 179 | -2.6% |
| Gross margin (Rs. /kg) | 155 | 112 | 39.3% | 155 | 0.2% |
| EBITDA margin (Rs. /kg) | 52 | 37 | 42.3% | 67 | -22.0% |

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Import substitution and export opportunities bode well for domestic rubber chemical players

Global rubber consumption stands at ~30 million tonnes annually and of this, rubber chemical has a ~3.5% share and is dominated by China, which accounts for ~75% of global rubber chemical production. Global customers are shifting sourcing of rubber chemicals from China to India and the same provides strong export growth opportunities for domestic players like NOCIL. Additionally, domestic demand for rubber chemicals is also set to stay strong, supported by restriction on tyre imports, improvement tyre demand from both OEM and replacement market and capex by tyre companies to expand capacity. Moreover, a potential anti-dumping duty on major rubber chemicals would result in import substitution and drive-up domestic players' volumes.

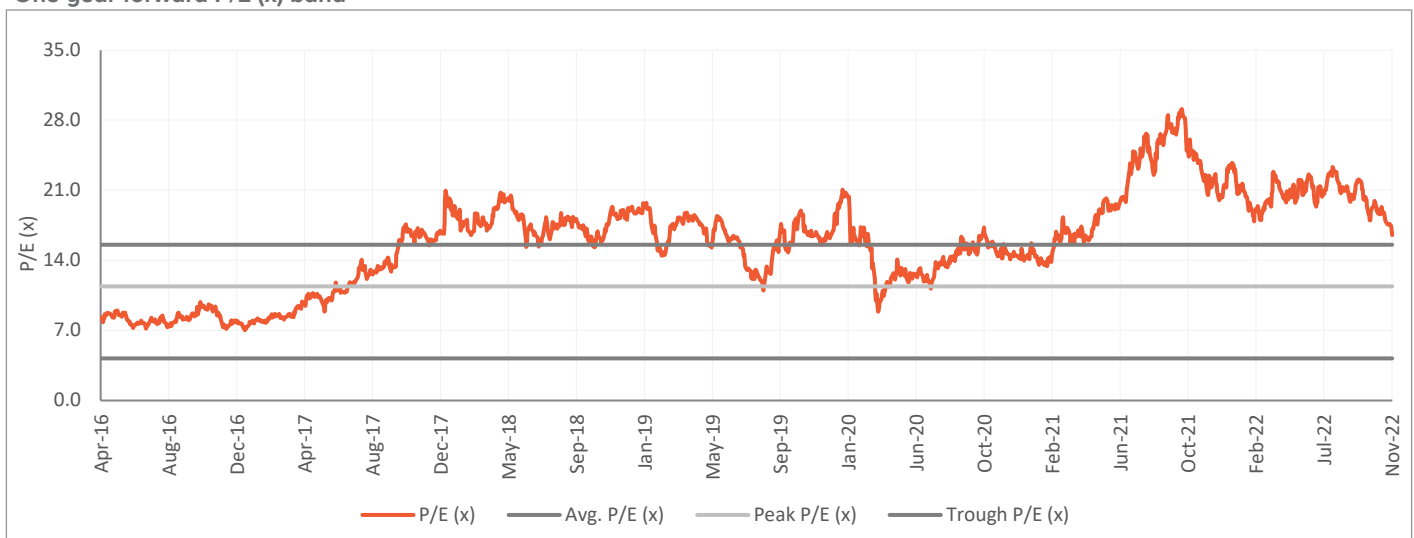
■ Company Outlook – Near volume to remain subdued, structural growth drivers intact

NOCIL has recently doubled its production capacity to 110,000 tonnes in time for a rubber chemical demand recovery cycle both in domestic and export markets. However, a recessionary environment in its key export market makes us cautious on H2FY23 volume growth. We have therefore lowered our volume growth estimate and now expect volume to witness 15% CAGR over FY22-25E. Resilient margin of >Rs. 50/kg and likely volume recovery would drive 15% PAT over FY22-25E.

■ Valuation – Maintain Buy on NOCIL with a revised PT of Rs. 305

Although FY23 volume growth outlook is subdued but long-term structural growth outlook remains intact supported by growth in tyre industry and Europe plus one opportunity. A potential volume recovery and resilient margin would drive earnings recovery. We believe that NOCIL is a play on import substitution and China/Europe Plus One strategy by global customers and the same would drive market share gains going forward. Valuation of 16.5x/14.3x FY24E/FY25E EPS is attractive considering our expectation of sharp PAT recovery (post subdued FY23) over FY24E-25E and improvement in RoE to 14-15% (versus 12.9% in FY22). Hence, we maintain a Buy on NOCIL with a revised PT of Rs. 305 (lowered to reflect cut in earnings estimate).

One-year forward P/E (x) band



Source: Sharekhan Research

About company

NOCIL, incorporated in 1975, is part of Arvind Mafatlal Group and is the largest rubber chemical manufacturer in India with production capacity of 110 ktpa and market share of ~42%/5% in domestic/global markets. The company has presence in over 40 countries with exports accounting for 36% of FY2022 revenues. The business segments include Accelerator, Anti-oxidant, Pre/Post vulcanization inhibitor/stabilizer and Zinc based applications.

Investment theme

NOCIL is the key beneficiary of China plus one strategy and import substitution in niche market of rubber chemicals. Recent doubling of capacity has made in third largest rubber chemical manufacturers in term of capacity and ramp-up of utilisation would drive sustainable double digit volume growth and help expand global market share to ~8% over next 2-3 years as compared to 5% currently. Volume growth coupled with margin expansion would drive strong earnings growth and consistent FCF generation. Balance sheet remains strong with net cash position.

Key Risks

- ♦ Slowdown in auto/tyre industry and delay in ramp-up of new capacity could impact volume growth.
- ♦ Competition from Chinese players could impact pricing and margin.

Additional Data

Key management personnel

| | |
|--------------------------------|-------------------------|
| Mr. Hrishikesh Arvind Mafatlal | Chairman |
| Mr. S.R. Deo | Managing Director |
| P Srinivasan | Chief Financial Officer |

Source: Company Website

Top 10 shareholders

| Sr. No. | Holder Name | Holding (%) |
|---------|---------------------------------------|-------------|
| 1 | Tejas Trivedi | 1.75 |
| 2 | Trivedi Shivani Tejas | 1.63 |
| 3 | Canara Robeco Asset Management Co Ltd | 1.52 |
| 4 | Aagam Agencies Pvt Ltd | 1.16 |
| 5 | HN Safal Infra Space Pvt Ltd | 1.10 |
| 6 | IDFC Mutual Fund | 1.04 |
| 7 | Trivedi Minaxi Balchandra | 0.99 |
| 8 | Trivedi Khushi Tejas | 0.99 |
| 9 | Dimensional Fund Advisors LP | 0.89 |
| 10 | Deo Sudhir Ramchandra | 0.48 |

Source: Bloomberg (Old data)

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Understanding the Sharekhan 3R Matrix

| Right Sector | |
|-----------------|--|
| Positive | Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies |
| Neutral | Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies |
| Negative | Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability. |
| Right Quality | |
| Positive | Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance. |
| Neutral | Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable |
| Negative | Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and deteriorating balance sheet |
| Right Valuation | |
| Positive | Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment. |
| Neutral | Trading at par to historical valuations and having limited scope of expansion in valuation multiples. |
| Negative | Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple. |

Source: Sharekhan Research

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