

December 1, 2017

RE-INITIATING REPORT
GMM Pfaudler Limited

VOL-3, NO-24

BUY

CMP: Rs.628

TARGET PRICE: Rs.800

TIME : 12 months

REINITIATION REPORT

We had initiated coverage on GMM Pfaudler Limited on July 7, 2016 (Vol-2 No-11) at the price of Rs332 and target of Rs500. Post our coverage, the stock has breached our initial target price to hit a new high of Rs675. With the recent developments in the company, the conviction in the recommendation stands stronger. We thereby re-initiate a BUY call on the stock at CMP of Rs628 and target of Rs800 over a horizon of 12 months.

About the Company:

GMM Pfaudler Limited (GMM) is a leading supplier of engineered equipment and systems which have critical applications in the pharmaceutical and chemical market. The company pioneers in manufacturing glass-lined steel equipment's which have applications in pharmaceutical, chemical, petrochemical, pesticide and food industries. The company is also involved in designing, manufacturing and marketing of glass-lined reactor vessels, storage tanks, valves and pipe & fittings. GMM is an ISO 9001:2008 company. The company has also been approved by Special Equipment Licensing Office (SELO) for the supply of pressure vessels to the Peoples Republic of China. GMM has its manufacturing plant located at Karamsad in Gujarat.

INVESTMENT RATIONALE

(A) Strong foundations:

GMM is a market leader in India and enjoys a market share of more than 50% in Glass lined equipment. The company has been constantly diversifying its product portfolio. The basket of products offered include mixing systems, filtration & drying equipments, engineered systems and other tailor made process equipments. Moreover, the company also offers a complete annual maintenance contract (AMCs) which ensures trouble free working of the equipments. The company also has a dedicated Spares & Service network and a dedicated team which ensures smooth working of the equipments.

GMM enjoys a very sturdy and stable customer base with relationship of more than 15 years with most of them. These customers are spread across various industry segments like Agrochem, Pharma and Specialty Chemicals & Dyes etc to mention a few. Some of the customers are stalwarts like Bayer, Rallis, GSFC, UPL, Excel and many more in the Agrochem sector; Cipla, Lupin, Sun Pharma, Ranbaxy, Glenmark, IPCA etc. in the pharmaceuticals segment and customers like CRODA, Ion Exchange, Thermax, Clariant, Auchel, Heubach etc. from the world of specialty chemicals and dyes. The company exports glass lined products & parts to various developed countries like USA, Germany, Netherlands, Australia, Japan etc, as well as to some leading companies in Israel, China, Malaysia, Indonesia and Thailand. Since these products are accepted by major multinational companies across the globe, it clearly indicates the high standards and quality of products manufactured by the company.

(1) Indian Triggers:

During the last two to three years, Pharma Industry was the main driver for the revenues of the company; however, the scenario has changed and drifted towards Agrochem and fertilizers companies. However, the management is optimistic about the revival of growth in Pharma. The strict compliance via USFDA will benefit players like GMMP and other organized players (though GMMP is the reputed market leader). The company has a healthy order back log, which the management has indicated is better than the previous year. The company is looking to explore opportunities in other countries around the Indian sub continent. The company will gradually change focus from GL (Glass Lined) to NGL (Non Glass Lined), which is currently 70:30. The expenses of the company had increased (one-off expense) for the last two quarters in FY17-18, which is due to change in product mix, increase in cost of energy (as they are using electricity instead of the regular gas furnace) and the company has hired a consultant to help them achieve higher operational efficiencies. All these efforts will benefit the company in times to come. The company will be installing the new gas furnace by the end of the year and the long-term benefits of the same will be seen from the second half of this financial year.

SNAPSHOT				
52 week H / L	Mcap (INR mn)			
675 / 482	9,180			
Face value: 2				
BSE Code	NSE CODE			
505255	-			
Annual Performance				
(Rs mn)	FY15	FY16	FY17	FY18E
Sales (Net)	2,240	2,296	2,663	2,991
EBITDA	314	320	410	449
EBITDA (%)	14.0	13.9	15.4	15.0
Other Income	34	32	78	80
Interest	5	7	9	10
Depreciation	81	67	74	79
PBT	261	278	405	440
PAT	172	184	282	308
Equity	29	29	29	29
EPS (INR)	12	13	19	21
Quarterly Performance				
Parameters (Rs mn)	Dec-16	Mar-17	Jun-17	Sept-17
Sales (Net)	666	795	689	764
EBITDA	106	108	79	116
EBITDA (%)	16	14	11	15
Other Income	6	59	29	13
Interest	2	3	4	1
Depreciation	19	19	20	20
PAT	58	110	56	70
Equity (Rs mn)	29	29	29	29
Ratio Analysis				
Parameters (Rs mn)	FY15	FY16	FY17	FY18E
EV/EBITDA (x)	28.3	27.9	22.3	20.4
EV/Net Sales (x)	4.0	3.9	3.4	3.1
M Cap/Sales (x)	4.1	4.0	3.4	3.1
M Cap/EBITDA (x)	29.3	28.7	22.4	20.5
Debt/Equity (x)	0.0	0.0	0.0	0.0
ROCE (%)	21	21	27	25
Price/Book Value (x)	7.2	6.5	5.5	4.9
P/E (x)	53.4	50.0	32.5	30.2
Share Holding Pattern as on 30th September 2017				
Parameters	No of Shares	%		
Promoters	1,09,63,125	75.00		
Institutions	60,865	0.42		
Public	35,93,510	24.58		
TOTAL	1,46,17,500	100.00		

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INVESTMENT RATIONALE (contd.)

(A) Indian Triggers:

The company will grab opportunities for tailor made products if any via the heavy engineering segment. The strategy of S3 i.e. Service, Spares and Support still is intact. The company has two service centers in Vizag and Ankleshwar; and intends to explore opportunities in Roha district. Keeping Mission2020 which aimed at increasing the profitability of the company in mind, the management intends to and mentioned about accelerating growth. The government of India is focusing on providing incentives to companies and manufacturers who are net exporters. GMMP can avail this benefit via exports to its subsidiary.

(2) Overseas Triggers:

The company is anticipating more orders via the parent in the next year. The company is seeing traction for the heavy engineering business via Pfadler's network. Last year (FY16-17) there was a slowdown in the European market, however, there appears to be a slow revival in these market places. Initially, GMMP did not have access to the US market; however, with the working of Mavag picking up, the company is in a position to pitch to the US market. If any requirement for spare parts of glass lined equipment or non glass lined equipments arises in the European zone, Pfadler via GMMP will be the one stop solution provider, as the manufacturing of spare parts is an expensive affair in Europe. Thus, the reliance and reliability on GMMP will be higher. Moreover, if Mavag has to grow, it will have to source from GMMP, thus Mavag is the gateway to Europe. The chemical sector will be dominated by nations in Asia Pacific. India will be benefitted due to the strict implementation of environmental norms and safety standards against Chinese firms and providing an opportunity to Indian companies to explore the possibilities of capturing a part of Chinese market share. The chemical sector worldwide is expected to grow in the coming years and India in particular may grow faster than the world averages. We expect this to bring in a growth in capacity creation for the sector. GMM Pfadler, a debt free company is fully geared to capitalize on this situation in the coming years. The company has ordered for a new gas furnace which is expected to be delivered by the end of FY18. Given the strong growth visibility and better operating margins one can expect the company to become attractive on future projections.

(B) Pharma Vision:

The government of Telangana is contemplating setting up of a Pharma City in Rangareddy and Mahbubnagar districts of the state. The approximate area of this land parcel is 14,000 acres. The vision is to make Telangana, a one stop shop for Pharma, biotech and life sciences companies. The proposed park will be catering to activities related to antibiotics, vaccines, formulation of drugs, fermentation products, synthetic drugs, chemical intermediaries, cosmetics, specialty chemicals, nutraceuticals, herbal medicinal products etc. In order to achieve this, the same will require an influx of R&D centers, testing facilities related to clinical trials, contract research etc. All these activities and their further requirements provide a clear sense of the upcoming demand for reactors and glass lined equipments used in Pharma and Specialty Chemical segments. Moreover, in order to avoid the issues related to USFDA and other regulatory norms, the focus would be to install equipments which match international standards at the inception itself. Thus, GMM Pfadler which is one stop solution for all chemical engineered equipments can be one of the biggest beneficiaries, which is subject to as and when the project kick starts. The state of Telangana is a land of huge opportunities; the company is waiting for environmental clearances. Moreover, the Government of India (GOI) has unveiled the project called Pharma Vision 2020 to boost the Indian Pharma industry. The main goal of this project is to make India a global leader in manufacture of drugs.

Financials:

The company has been successfully maintaining its operating margins in the range of 14-15%. The average ROCE for the company over the last 5 years has been in the range 21-22%. The company is cash rich and is waiting for the perfect match for a potential buy-out or product addition which will be in-sync with their product profile or a value addition to their offerings. GMM Pfadler is a debt free consistently dividend paying company (on a quarterly basis). The company as well as the subsidiary (Mavag) has a strong order book. The management is focusing at further improving their operational efficiencies which will have long term benefits for the company. The gas furnace which will arrive in December 2017 and its installation in the early months of the new-year will boost the operational efficiencies of the company. The company has added certain capacities recently to increase the number of equipments manufactured by them and does not require Capex for atleast next 2 years. The company is fully geared to capitalize on the opportunities in the coming years. The impending growth will be very much apparent from the H2FY18.

Risks and concerns:

The company is involved in exports to many countries, slowing down of the global economy and industrial output can adversely affect the company. Moreover, the company is exposed to forex fluctuations. The major raw material for the company is steel, is subject to price fluctuations. Rising cost of power and electricity affects the company. The stock is slightly illiquid in nature (promoters hold 75% of equity, giving little room for retail investors), any good or bad news / sentiments can lead to wild swings in the stock price.

Outlook and valuations:

The company stands lucrative to benefit from the growth expected across fertilisers, agrochemical and Pharma sectors going forward. The chemical sector particularly in India is expected to grow faster than the world averages. The Pharma sector is currently under stress due to compliance issues; to resolve some of the issues, some of the companies will have to upgrade to the best equipment manufacturers. The impending growth will be very much apparent from the second half of FY18 for GMMP. At CMP of Rs628, the valuations appear to be a little expensive but given the strong growth visibility and better operating margins one can expect the company to become attractive on future projections. Consistent trajectory growth of the company is immense and we continue to maintain a BUY on the stock with a target of Rs800 with a 12 month's perspective.

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