July 20, 2017 RE-INITIATING REPORT VOL-3, NO-12

Excel Industries Limited

BUY

CMP: Rs.426 TARGET PRICE: Rs.650 TIME : 12 months

REINITIATION REPORT

We had initiated coverage on the Excel Industries Limited on January 16, 2017 (Vol-3 No-1) at the price of Rs380 and target of Rs550. Post our coverage, the stock has hit a high of Rs450. With the recent Annual Report FY17 hitting the inbox of investors, the conviction in the recommendation stands strong post analysis. We thereby re-initiate a fresh BUY call on the stock at CMP of Rs426 and target of Rs650 over a 12 months horizon.

About the Company:

Excel Industries Limited (Excel) is involved in the business of chemical manufacturing as well as sale of industrial agrochemicals & pesticides intermediates and specialty chemicals. The company is a pioneer in the domain of phosphorus, its derivatives and related chemistry. It is the largest producer of Phosphorous based compounds like Phosphorous Trichloride (PCl_3), Phosphorous Pentasulphide (P_2S_5) and Diethyl Thiophosphoryl Chloride (DETC) in India.

Broadly speaking, the company can be organized into two business segments namely:

(a) Chemicals: comprising of industrial and specialty chemicals and pesticides intermediates.

(b) Environment: comprising of soil-enrichers, bio-pesticides and other bio-products.

The products basket can be divided into chemicals, polymer units, API and intermediates, veterinary APIs and environ biotech.

Excel has been a consistent performer and has been showing long-term business sustainability. All the above could be achieved since it has many catalyst to growth like innovation, environmental-friendly processes, in-house R&D, a very rich product portfolio, cost-efficiency, high quality of products etc.

Positives for the company from a Macro Point of view:

(a) The Indian Agrochemicals Industry is heavily dependent on China for intermediates and other raw materials. In a twist to tighten the pollution control norms, the Chinese Government has become very strict where non-compliant factories are levied with heavy penalties and many are asked to shut down. Thus, the unavailability of some key intermediates opens the door for Indian producers of intermediates. The current unfavourable situation in China related to the segment of speciality chemicals and agrochemical intermediates, blends in well for increased demand for reliable Indian suppliers of intermediates. Under this scenario, many Multinational companies are looking towards Indian companies for contract manufacturing of speciality intermediates. Thus, Excel appears to be in a sweet spot to take advantage of these opportunities.

(b) The US Government has imposed an anti-dumping duty on the import of one of the large volume Organophosphonates. Excel has recognised this opportunity and has complied with the norms to take advantage of this situation and increase its exports to US. Recently, India has emerged as a hub for the production of generic agrochemicals. After USA, China and Japan; India is the fourth largest producer of agrochemicals. The size of the Indian agrochemical Industry is estimated at USD5 bn.

(c) Under the umbrella of the 'Make in India' initiative, the Government of India (GOI) has taken some major steps to encourage indigenous production of agrochemical actives. There is no doubt; this will give a major boost to the Indian manufacturing companies. The GOI has issued certain regulations which favours domestic production of agrochemicals which is expected to provide an impetus to the agrochemical manufacturing in India and in turn will be beneficial to suppliers of intermediates.

(d) Monsoon is expected be normal this year (as per advance forecasts available). There is an uptick in demand from the Latin American market (which is a major export market for Agrochemicals manufactured in India), which justifies the possibilities of increased demand of agrochemicals and the intermediates for the financial year 2017-18.

SNAPSHOT

52 week H / L	Mcap (INR mn)
496 / 285	5358
Face value: 5	
BSE Code	NSE CODE
500650	EXCELINDUS

Annual Performance

(Rs mn)	FY15	FY16	FY17	FY18E
Sales (Net)	4,816	4,481	4,450	4,928
EBITDA	719	617	417	641
EBITDA (%)	14.9	13.8	9.4	13.0
Other Income	70	29	81	85
Interest	139	125	114	92
Depreciation	147	154	139	166
PBT	502	366	245	468
PAT	405	252	*450	316
Equity	60	65	63	63
EPS (INR)	34.0	19.6	35.8	25.1

Quarterly Performance

Parameters (Rs mn)	Jun-16	Sep-16	Dec-16	Mar-17
Sales (Net)	1,233	1,240	958	1,151
EBITDA	173	150	23	80
EBITDA (%)	14.1	12.1	2.4	6.9
Other Income	62	9	3	9
Interest	33	31	22	27
Depreciation	34	36	37	36
PAT	123	69	*212	51
Equity (Rs mn)	63	63	63	63

Ratio Analysis

Parameters (Rs mn)	FY15	FY16	FY17	FY18E
EV/EBITDA (x)	8.5	9.9	14.2	9.1
EV/Net Sales (x)	1.3	1.4	1.3	1.2
M Cap/Sales (x)	1.1	1.2	1.2	1.1
M Cap/EBITDA (x)	7.5	8.7	12.9	8.4
Debt/Equity (x)	0.5	0.5	0.3	0.3
ROCE (%)	30	21	14	19
Price/Book Value (x)	2.8	2.7	2.2	2.0
P/E (x)	14.9	21.8	43.7	17.0

Share Holding Pattern as on 30th June 2017

Parameters	No of Shares	%
Promoters	65,85,030	52.38
Institutions	9,72,451	7.74
Public	50,13,211	39.88
TOTAL	1,25,70,692	100.00

Note: All the data is calculated as per Market Price on 19th July 2017.
** Includes an exceptional item of Rs267mn*

Please Turn Over

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INVESTMENT RATIONALE

(A) Speciality Chemicals and Agrochem Intermediates: The Backbone

Excel has an experience of more than 7 decades in process and product development catering to different agrochemical intermediates. The segment for chemicals which engages specialty chemicals & intermediates produced for various industries like agricultural chemicals, polymer, manufacturing & processing, soap & detergents, dyes & intermediates, water treatment and Pharma have been contributing nearly 96% to the total revenue of the company. The annual turnover of the Chemicals Business for the financial year 2016-17 was Rs4,160mn. The company has a well-established presence in production of phosphorus intermediates which are used further for production of Organphosphorus (OP) insecticides. China which has a strong presence in OP market is currently under stress due to increased cost of production and implementation of strict environmental laws by Chinese government, which serves as an opportunity for the company. The turnover from the agrochemical intermediates business is bound to increase in the current financial year as well due to the optimistic sentiments related to rainfall via agricultural activities.

Many multinational companies look at India as a cost-effective manufacturing hub for sourcing specialty chemicals and intermediates. Excel is currently focusing on development of intermediates for major molecules which are expected to go off patent. The specialty chemicals business of the company consists of product categories like Organophosphonates, Acetyl Chloride, Biocides and Floatation reagents i.e. Styrene Phosphonic Acid (SPA).

(B) Solid Remedy for Solid Organic Waste:

The ever-increasing population, economic growth and the shift towards urban cites invites problems associated to tackling tonnes of waste. Excel was the first Indian company to innovate Solid and Liquid Waste Management technologies and still continues to be the front runner in this philosophy with innovative products like OWC, Bioneer, Bioculum and Sanitreat. Realizing the importance of decentralizing waste management system, Excel has improvised to create Organic Waste Converter (OWC).

Bioneer is another such compact and automated machine which can convert organic waste into compost in 24 hours. The patented OWC System and Bioneer can see a huge demand in housing societies, corporations, large kitchens, municipalities and many other places where manageable organic waste is produced within few days.
Under the Swachh Bharat Mission and Smart cities project, such products are bound to have a huge potential; provided strict protocols are followed by the local Municipal corporations in handling Solid Waste. The Municipal Solid Waste (MSW) Management industry as a whole has a number of triggers, provided they are channelled in the correct direction.

Discontinuing operation of Environment and Bio-tech Division

Recently in March 2017, the company announced to discontinue the Environment and Bio-tech (E & BT) Division, (which is also a separate segment as per AS 17 segment reporting). This is in line with the company's long-term strategy to focus its activities in the areas of solid waste management and related services, and to divest unrelated activities. On 31st March 2017, the company signed a business transfer agreement to sell the Biotech Division to Excel Bio Resources Limited for Rs97.5mn.

(C) API: Pharma and Veterinary intermediates:

Many molecules are expected to go off patent by 2020 providing an opportunity of nearly USD155bn, of which more than 40 molecules of renowned drugs will open the doors for Indian API manufacturers. It is quite evident that India is one of the most preferred destination for APIs due to many factors such as cost advantage, advanced technology, better infrastructure etc. Excel has focused on backward integration and intends to employ the opportunity by launch of new intermediates required by the industry. The Company has a dedicated plant for manufacturing of APIs at Lote and has acquired GMP certification which will pave way for exports market. The API plant operates independently from Excel's dedicated veterinary facility at Roha. The veterinary division which produces API that helps farmers improves the yields per animal whereas the other division of API segment is focusing on anti-retroviral drug used for the treatment of HIV and also advanced stage intermediates for the treatment of Gout. The segment for Pharma intermediates and API business had recorded sales of Rs240mn for the fiscal year 2016-17. Moreover, the company has increased its focus on exports and R&D of introducing new molecules. The company has been constantly upgrading its product portfolio in the segments of Pharma intermediaries.

(D) The Polymer Input Division:

It is quite evident that the use of polymers in industries like automobiles, electronics, construction industry, power equipment, aerospace etc. is ever increasing due to shift in lifestyle across the world. This clearly provides a good vision for increase in demand for Polymer Inputs and Additives segment as well.

By adopting the concept of Alliance Manufacturing, Excel has partnered and supported global polymer players, wherein they synergise with the customers and develop processes and products for them. Both the manufacturing plants at Roha and Lote are powered to develop products that match global standards. Excel has established itself as one of the leaders in the range of polymer inputs which they produce, while the company has also been able to establish a leadership position for the Polycarbonate Branching Agent produced by it.

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INVESTMENT RATIONALE (contd.)

(E) Expansion plans going forward:

The Company intends to increase its production capacity of Organophosphonates and Acetyl Chloride during the current year. Moreover, the company is also in the process of constructing a facility for production of an Organophosphorus (OP) Insecticide on campaign basis at the Roha Plant. The company is anticipating commercial launch of new APIs and expanding the range of API products provided by them. Thus, this can lead to addition of API production facility for the plant which is located at Lote. As per the recent Annual Report, the company has progressed well with the construction of our Multipurpose (MPP) plant in Roha. The first phase of the plant is expected to be commissioned in Q2 of 2017-18. Moreover, the company has also enhanced Pharma intermediate plant capacity by adding balance equipment and started commercial production of new agro intermediate (which is an import substitute).

Financials:

With the sale of the holding (along with its subsidiaries) in Excel Crop Care (2.23% holding) the total consideration was around Rs300mn. The debt reduction stood at around Rs180mn as of March 2017. This is in tandem to the indications in the previous report. Also, the company has given final dividend of Rs6/- per share which is in the gradual increasing trend. We believe the company should have the room to expand with operational efficiencies with the triggers remaining intact.

Risks and concerns:

Besides the intense rivalry amongst the chemical industries, the threat of International players dumping chemicals at low price has increased due to 100% FDI. China has been one of the biggest concerns. Crop protection and seed business in India is directly dependent on timely and adequate rainfall requirements. Thus, a sub-normal monsoon can lead to an adverse impact on the demand of agrochemical and its intermediates. Ban or restriction on any of the products related to OP insecticides, (which is constantly under Governments scrutiny) can lead to an adverse impact on the performance of segment for agrochemical intermediates. The basic raw material i.e. yellow phosphorus is subject to volatile price movements.

Outlook and valuations:

We have been very bullish on the company with regards to the Pharma intermediates and EnviroBiotech Business as well as the gradual ramp up in the Speciality Chemicals Segment. There is a lot of positivity in the management indicated through the recent Annual report. Clarity of focus and growth strategies seem to be in place for the company. On the same lines, we thereby re-initiate coverage on the stock at Rs426 for a target of Rs650 over a 12 months horizon.

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