

July 31, 2017

PICK OF THE MONTH

VOL-3, NO-13

Sadhana NitroChem Limited

BUY

CMP: Rs.67

TARGET PRICE: Rs.100

TIME : 12 months

OVERVIEW: Industry:

Global Chemical industry:

The global chemical industry, estimated at USD2.4trn, is one of the fastest growing sectors of the manufacturing industry. Despite the challenges of escalating crude oil prices and demanding international environmental protection standards now adopted globally, chemicals industry has still grown at a rate higher than the overall manufacturing segment. As per industry reports, the pharmaceutical segment contributes approximately 26% of total industry output, while 35-40% is dominated by the petrochemical segment. Commodity chemicals is the largest segment in the chemicals market with an approximate size of USD750bn while the speciality and fine chemicals segment accounts for USD500bn. Some of the major markets for chemicals are North America, Western Europe, Japan and emerging economies in Asia and Latin America. US consumes approximately one-fifth of the global chemical consumption whereas Europe is the largest consumer with approximately half the consumption. US markets are the largest consumer of commodity chemicals whereas Asia Pacific is the largest consumer of agrochemicals and fertilizers.

Indian chemical industry:

The Chemical industry is one of the oldest industries in India, contributing significantly towards industrial and economic growth of the nation. Over the last decade, it has evolved from being a basic chemical producer to becoming an innovative industry. With investments in R&D, the industry is registering significant growth in the knowledge sector comprising of speciality chemicals, fine chemicals and pharmaceuticals. The Indian Chemical Industry, being one of the important constituents of the Indian economy, is estimated at around USD35bn equivalent to about 3% of India's GDP. It accounts for 13-14% of total exports and 8-9% of total imports of the country. In terms of volume, it is 12th largest in the world and 3rd largest in Asia. There has been a shift in emphasis seen towards product innovation, brand building and environmental friendliness; moving the industry towards greater customer orientation. The Industry is putting in efforts to build upon technical services and marketing capabilities to face global competition and increase its share of exports. India also produces a large number of fine and speciality chemicals, which have very specific uses and are essential for increasing industrial production. The Industry offers a range of products that find wide usage and provides building blocks for downstream industries like food additives and pigments, polymer additives, anti-oxidants in the rubber industry, etc. to mention a few. *(data as per market reports)*

About the Nitrobenzene market:

Nitrobenzene is a kind of organic compound which is used in the manufacturing of aniline and acts as a predecessor for the production of chemicals and numerous derivatives in cosmetics, agriculture, pharmaceuticals and other types of industrial applications. It is also used as a chemical to manufacture pesticides, synthetic rubber and lubrication oil. The nitrobenzene market has been segmented on the basis of application and end-user. On the basis of application, it is segregated into use for:

- Pesticides
- lubricating oil
- aniline production (being the most dominant segment)
- synthetic rubber

On the basis of the end-user, the market is segregated into pharmaceuticals, agriculture (being the key segment) and industrial applications.

Geographically, the nitrobenzene market is segmented by North America, Europe, Asia Pacific, Middle East & Africa and Latin America.

The growth in the agricultural sector of Brazil, China and India owing to regulatory support and easy availability of raw materials is anticipated to boost the demand for fertilizers and thus, support the demand for nitrobenzene. The increasing investments in the domestic healthcare sector in developing economies such as India, China, Mexico, and Brazil are anticipated to impact the market positively.

SNAPSHOT				
52 week H / L	Mcap (INR mn)			
83.5 / 17.5	616			
Face value: 10				
BSE Code	NSE CODE			
506642	-			
Annual Performance				
(Rs mn)	FY15	FY16	FY17	FY18E
Sales (Net)	481	351	557	755
EBITDA	-35	21	70	113
EBITDA (%)	-7.4%	5.9%	12.5%	15.0%
Other Income	4	2	20	2
Interest	46	51	48	47
Depreciation	21	20	19	17
PBT	-99	-48	23	51
PAT	42	-48	23	51
Equity	92	92	92	92
EPS (INR)	5	-5	2	6
Quarterly Performance				
Parameters (Rs mn)	Jun 16	Sept 16	Dec 16	Mar 17
Sales (Net)	113	132	121	193
EBITDA	17	18	13	23
EBITDA (%)	15%	14%	11%	12%
Other Income	3	3	3	10
Interest	12	12	11	13
Depreciation	5	5	5	5
PAT	3	4	1	15
Equity (Rs mn)	92	92	92	92
Ratio Analysis				
Parameters (Rs mn)	FY15	FY16	FY17	FY18E
EV/EBITDA (x)	-24.9	45.7	12.8	8.4
EV/Net Sales (x)	1.8	2.7	1.6	1.3
M Cap/Sales (x)	1.3	1.8	1.1	0.8
M Cap/EBITDA (x)	-17.4	29.8	8.8	5.4
Debt/Equity (x)	2.2	4.7	3.0	2.4
ROCE (%)	-60%	2%	45%	40%
Price/Book Value (x)	5.1	8.5	6.5	4.2
P/E (x)	-7.0	-12.7	27.3	12.1
Share Holding Pattern as on 30th June 2017				
Parameters	No of Shares	%		
Promoters	6,533,938	71.01		
Institutions	1,181	0.01		
Public	2,665,711	28.97		
TOTAL	9,200,830	100.00		

OVERVIEW: Industry:(contd.)

Factors for growth:

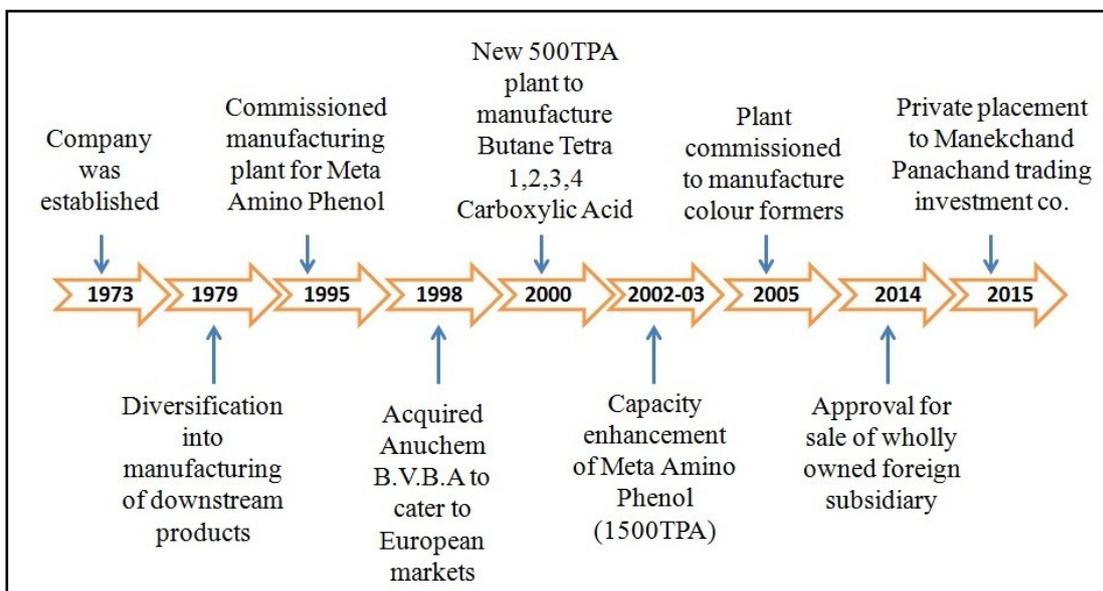
- Rising demand for rubber in the automotive industry fuels the growth of the nitrobenzene market
- Expansion of the construction industry is also one of the key factors likely to drive the nitrobenzene market
- Rapid urbanization in developing economies such as China and India among others has led to the growth of the construction industry, which has been one of the dominant factors driving the nitrobenzene market
- Growth of the agriculture industry coupled with the mounting demand for fertilizers is driving the nitrobenzene market globally
- Growth of the pharmaceutical industry is a driving market for nitrobenzene. The major players in the nitrobenzene market are BASF SE, Aromsyn Co., Ltd., Bann Quimica Ltda. and Finetech Industry Limited.

One of the key drivers of growth of the Nitrobenzene market globally as well as on the domestic front is the increasing use of polyurethane foam. (Polyurethane foam has two major constituents namely toluene diisocyanate (TDI) and methylene diphenyl isocyanate (MDI). MDI is primarily used to produce rigid polyurethane foams, whereas, TDI is used as the key raw material to manufacture flexible polyurethane foams. This foam is used in the automotive, transportation, and bedding and furniture industries. The demand for polyurethane is increasing since they exhibit environmental benefits such as reduction in wastage. Additionally, polyurethane foams have high recyclability and sustainability and they also have high resistance to chemicals, high elastic and insulating properties, and mechanical strength. This will increase the applications of polyurethane foam, which in turn, will have a positive impact on the growth of the nitrobenzene market- as per market research reports.)

Owing to the expanding population and the economic development the economies are witnessing growth of major end-user industries including automotive, aerospace and defence, building and construction, electrical and electronics and construction. This will subsequently drive the growth of the market since nitrobenzene acts as the precursor to aniline which is used for various applications including insulation, rubber products, consumer goods, transportation, and packaging. (Almost 98% of nitrobenzene is used to manufacture aniline. Aniline is an aromatic amine and is used to create insulation products, rubber products, packaging products, and agriculture products. They are also used in industrial applications as a precursor to manufacture methylene diphenyl isocyanate (MDI). MDI is used to manufacture rigid and flexible PU foam, coatings, elastomers, sealants, and adhesives. The growing demand for aniline in applications such as furnishing, consumer goods, and automotive interiors and upholstery will directly influence the adoption of nitrobenzene across various industries - (as per market research reports).

About the company:

Sadhana Nitrochem Limited (SNCL) is engaged in the manufacture of chemical intermediates, heavy organic chemicals and performance chemicals. Since its inception in 1973, SNCL has built a strong reputation of manufacturing quality products along with excellence in service to clients worldwide. Production of intermediates under strict quality standards has been the hallmark of SNCL's success in propelling it to customer requirements. The company is highly committed to produce high quality chemicals. The company has Mr. Asit D. Javeri as the Chairman and Managing Director and Mr Abhishek A. Javeri as the Director and CFO of the company. SNCL is headquartered in Mumbai and has its manufacturing facility in Roha (Dist. Raigad), Maharashtra.



Source: Company

INVESTMENT RATIONALE

(A) Key products and Customers:

The company has a range of products that caters to a diversified range of industries ranging from paper, pharmaceuticals, agro chemicals, thermal dyes, light stabilizer, aerospace, dyes and hair dyes etc. The major products of the company include Meta Amino Phenol (contributing 71.25% of the revenues as of FY16) and Nitrobenzene (contributing 8.75% of the revenues as of FY16). The different products offered by the company are listed below, which indicate the diversification of the end users as well. This also insulates the company from the downturn in any specific industry.

Presently, SNCL is engaged in the manufacture and marketing of Nitrobenzene, its downstream derivatives and other intermediates for various applications in aerospace, Pharma and agro, optical brightening agents, plastic additives, special fibres, epoxy resin hardeners, dyes and performance chemicals.

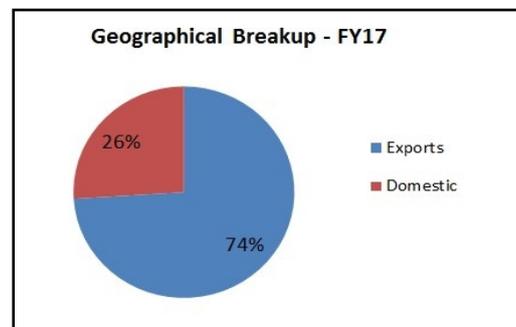
Product Profile	Key Application
Nitrobenzene (NB)	Used in the manufacture of Aniline, Dyes, Pharamceuticals & Agrochemicals
3,3 Dinitro Diphenyl Sulphone (33DDS)	Used in epoxy resin hardener
Metanilic Acid (M/ACID)	Dye Intermediate used in the manufacture of Azo Dyes, Direct Dyes, Reactive Dyes, Flourescent brightening agent.
Aniline 2,5 Disulfonic Acid (AD25DSA)	Intermediate used in the manufacture of Optical Brightening Agents & Dyes
Aniline 2,4 Disulfonic Acid(AD24DSA)	Manufacture of Dyes
Meta amino Phenol (MAP)	Color Formers, Dyes, Leather Dyes, Hair Dyes, Agrochemicals, Pharmaceutical & M-Fibers
Butane 1,2,3,4 Tetra Carboxylic Acid (BTCA)	Light Stabilizer
Dibutyl Keto Acid (DBKA)	
Diethyl Keto Acid (DEKA)	
3,3 Diamino Diphenyl Sulphone	Curing agent for polymers
Sodium Meta Nitrobenzene Sulphonate (SMNBS / MNBS)	Used as a mild oxidising agent in textile printing of clothes and also in electro plating industries, and dyes.
Colour Formers	
a) SND-9 (ODB-1)	Color formers
b) SND-27 (ODB-2)	
c) SNG-36	
N,N Diethyl Meta Amino Phenol (DEMAP)	Dyes & Color formers

Source: Company

(B) Geographical Presence

Besides the leading position in the domestic markets, exports constitute about 74% of the overall revenues from operation (as of FY17) including other income, well diversified in terms of product range as well as the countries of Export. SNCL has set up a 100% subsidiary Anuchem b.v.b.a. in Antwerp, Belgium with the objective of providing immediate and assured service to the vast European clientele. *(The turnover during the year was EURO 778.913,43 (2014 - EURO 475.977,24). The loss for the year was at EURO 11.748,98 (2014 Loss for the year - EURO 35.383, 63).*

With the strong standing reputation, the company is well positioned to enter into contracts with foreign companies for custom and toll manufacturing.



Source: Company

(C) Efforts to improve operational efficiency:

In the past, the company has faced liquidity crunch which adversely affected it at operational levels. Prices of raw materials were higher that affected the margins despite improved operating efficiency and keeping overheads under check. However, there has been a change in the scenario as well as approach. With the lowering of crude prices, improving energy efficiency and other factors; SNCL in recent times is become competitive with the Chinese competition and is well positioned to leverage the advantage of a better quality product. The Company continued to focus on cost control at every level to improve the operational efficiency which along-with the increased operating level and upward revision of product prices is expected to improve the margin. Continuous efforts are being made for efficient energy and raw material consumption. The rate of flow of orders is also encouraging. It has realigned the production facilities to meet the demand.

All of these efforts should help the company further improve the turnover and performance.

Financials:

The company has been facing working capital pressure for the last 3 or 4 years which has been impacting the performance. Last few quarters results indicate a slight easing of positions, the positive factor for the company is strong order inflow. It appears that we may see a strong turnaround in the company's performance from the current year onwards. Investors are however warned that this is a High Risk High Gain (HRHG) Stock.

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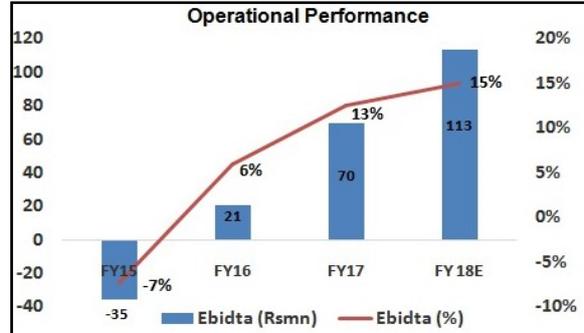
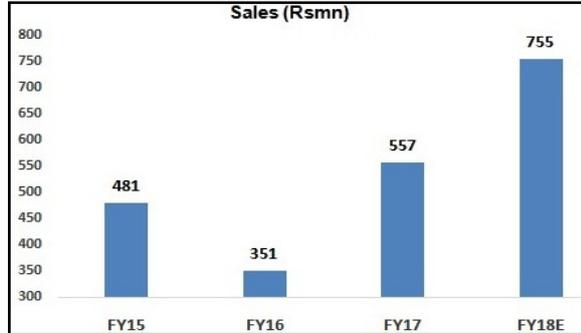
BUY

CMP: Rs.67

TARGET PRICE: Rs.100

TIME : 12 months

Financials: (contd.)



Risks and concerns:

The major threats faced by the company are escalating raw material prices, crude oil prices, increasing interest rate and volatile foreign exchange market. On the larger picture, macro-economic factors like the slowdown, sluggish demand conditions, monetary policy & fiscal policy, unforeseen political and social upheavals, natural calamities may affect the business of the company as also the industry. With competition intensifying in all segments of the industry, increasing the market shares and the consumer base is a continuing challenge.

Outlook and valuations:

A better product mix, operational efficiency and stringent control on the cost have contributed towards increasing productivity, production and operating margins for the company. Being one of the known players in its offerings domain, SNCL has strong growth prospects going forward. We initiate a BUY on the stock with a target price of Rs100 over a 12 months horizon. As already mentioned this would be a HRHG category stock. One must also keep in mind that it is an illiquid stock and thus the movements could be volatile.

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