Management Meet

August 10, 2016

Fineotex Chemical Ltd.

Niche player in textile chemicals

We met Mr. Sanjay Tibrewala, ED and CFO, Fineotex Chemical Ltd. (FCL) to get more insights into one of India's largest speciality textile chemical manufacturers. . Headquartered in Mumbai (India), FCL hasmore than 400 products in its portfolio and caters to the entire value chain for the textile industry including pre-treatment, dyeing, printing and finishing process. It also manufactures chemicals for various industries like agro, adhesives, construction and water treatment. With such a strong product portfolio, FCL has a presence in about 33 countries. The company has two manufacturing plants; one located at Mahape (Navi Mumbai, India) and the other at Bangi (Malaysia). During the last five years ended March 31, 2016, it achieved a consolidated revenue CAGR of 8%. However, over the same period, company witnessed a margin expansion of 15.1 ppts to 24.4% in FY16 as against 9.3% in FY12. Such robust margin expansion has led to a strong PAT CAGR of 29.8% between FY12-16. Debt free status, cash on books (Cash and cash equivalent of ~Rs.490mn), decent cash flows, strong return ratios i.e. RoE and RoCE of 20.3% and 32.3% respectively and consistent dividend payout are key positives for the stock. The stock is currently trading at 16.5x FY16 earnings.

Concrete hold on market with its extensive product portfolio

FCL is one of India's largest speciality textile chemical manufacturers with more than 400 products in its portfolio. With such an extensive portfolio, the company caters to the entire value chain for the textile industry including pre-treatment, dyeing, printing and finishing process. It also manufactures chemicals for various industries like agro, adhesives, construction and water treatment etc. FCL provides customized solution to its customers, which enables it to retain them. In its R&D facility, new products are constantly developed and continuous trials are conducted at customer's shop floor. In order to safeguard and further improve market share, company offers higher margins (as compared to MNCs) to its distributor's pan-India.

Analyst: Rahul Jain, Ankit Tikmany

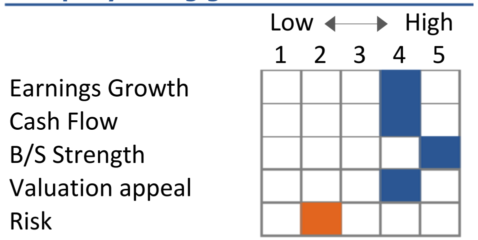
CMP (Rs) 25	Not rated

Stock data — **Sector: Chemicals**

Sensex:	28,085	Bloomberg code:	FTXC IB
52 Week h/l (Rs):	38 / 18	BSE code:	533333
Market cap (Rs mn) :	2,807	NSE code:	FCL
Enterprise value (Rs mn):	2,743	FV (Rs):	2
6m Avg t/o (Rs mn):	2.4	Div yield (%):	0.8

Prices as on August 9, 2016

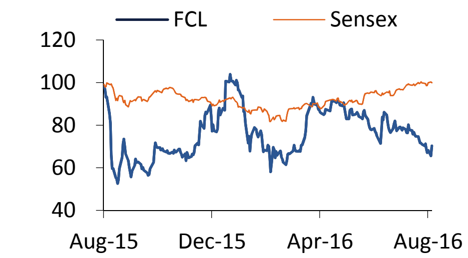
Company rating grid



Shareholding pattern (%)

Promoter	71.7
FII+DII	0.0
Others	28.3

Stock performance



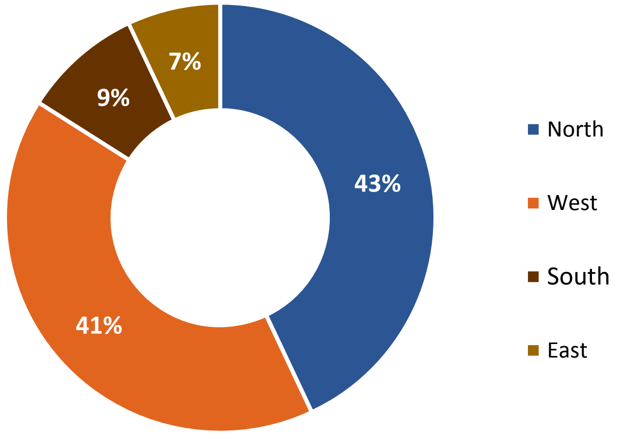
	1M	3M	1Y
Absolute return (%)	(10.7)	(15.3)	(24.7)

Financial summary

Y/e 31 Mar (Rs m)	FY12	FY13	FY14	FY15	FY16
Revenues	798	959	867	1,018	1,085
yoy growth (%)	182.6	20.1	(9.6)	17.4	6.6
OPM (%)	9	10	10.7	16.2	24.4
Reported PAT	60	70	65	129	170
yoy growth (%)	44.7	13.9	(4.8)	92.9	31.9
EPS (Rs)	1.1	1.3	1.2	1.2	1.5
P/E (x)	23.4	19.9	21.6	21.7	16.5
Price/Book (x)	2.7	2.4	2.2	3.7	3.1
EV/EBITDA (x)	15.4	11.8	12.2	16.5	10.4
Debt/Equity (x)	0.1	0.1	0.0	0.0	0.0
RoE (%)	11.6	12.1	10.6	18.3	20.3

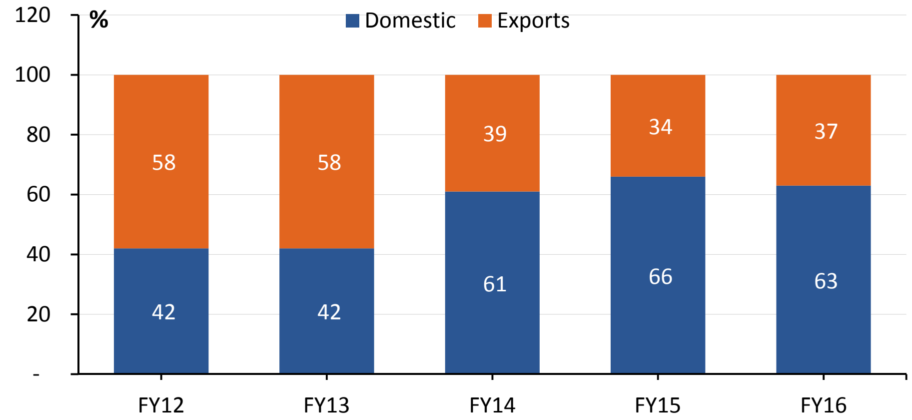
Source: Company, IIFL Research

Chart 1: North and west zone major contributors to domestic sales



Source: Company, IIFL Research

Chart 2: Geographic break-up of sales over FY12-16



Source: Company, IIFL Research

FCL has a global presence in about 33 countries including Australia, Germany, Turkey, Bulgaria, Argentina, South Africa, Brazil, Indonesia, Thailand, Mauritius, Vietnam, Malaysia, Singapore, UAE and Tanzania. Company is leveraging the brand reputation of its Malaysian subsidiary Biotex, to penetrate global markets. Its strategy to tap new markets globally is by tie-ups with reputed distributors across the globe with a sole selling policy to channelize its efforts in view of long term relationships. The company has over the years worked to expand its global reach. However, it faces stiff competition from pre-dominated European players such as Clariant, Archroma, CHT, BSSK, Huntsman, Rudolf and Pulcra.

Strong manufacturing facilities to support future growth

FCL has two manufacturing plants; one located at Mahape (Navi Mumbai, India) with current production capacity of 15,500 MTPA. The other plant at Bangi (Malaysia) came in from a 60% stake acquisition of Biotex. This plant has a production capacity of 6,500 MTPA. Currently, the company has overall utilization levels of ~55%. As a normal course of business, it enhances its production capacity by adding machinery and equipment. Also, the company keeps some idle capacity, to cater to any extra orders, which may require higher production time. Such kind of planning, helps it to be geared up for any additional orders in the course of their business. FCL has recently acquired land in Wada (India), Khopoli (India) and Ambernath (India) for future expansion. The company has made regular capital allocations to increase capacities whenever required. Such significant acquisition of land and expansion in capacities makes us believe than the company is well-placed to chart a new growth story.

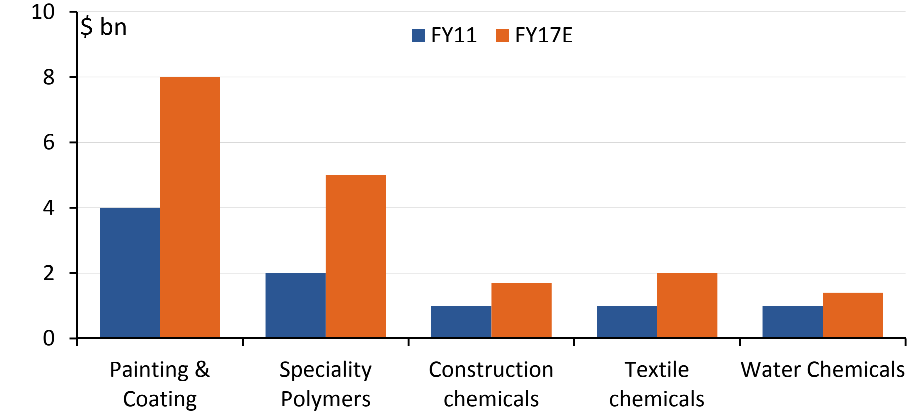
Focus on R&D leads to high level of product customization

Fineotex has state-of-the-art technology and updated in-house R&D at two laboratories in Mumbai. Such strong R&D facilities enable the company to increase its customization capabilities of products, which leads to customer retention. Also, extensive R&D is performed at the client's site, which acts as a vital foundation of new customized product. This exercise is done at client's site as there are various critical factors like the plant machinery type, its speed, water quality and timing that requires fine-tuning of the quality and performance of the products to be customized and developed. The acquisition of Biotex has provided FCL with technical knowledge and expertise to further enhance its product portfolio and processes. With such a strong focus on R&D, company is set to gain market share not only in textile chemical segment but is also looking to cater to non–textile part of speciality chemicals.

Increasing consumption and robust end user demand augers well for the domestic speciality chemical industry

The Indian chemical industry forms 3% of the total global chemical industry and is pegged at ~$108bn. Of this, the Indian speciality chemical industry market size is ~$17.7bn (excluding agro chemicals, dyes & pigments). It is expected to grow at a robust run rate in the coming years on the back of growth of end-user industry such as home care surfactants, paintings and coatings, speciality polymers, etc., and increase in consumption intensity vis-à-vis other countries. The textile chemical auxiliaries sold are assumed to be 1/10th of global fibre production in a year, which stands at ~6.4 mnmtpa. FCL majorly caters to textile industry with 85-90% of the revenue coming from this industry.

Chart 3: Outlook for Indian specialty chemicals industry



Source: Company, IIFL Research

Significant governments thrust over the sector

The Indian government has recently taken important steps, which will aid competitiveness in the chemical sector.

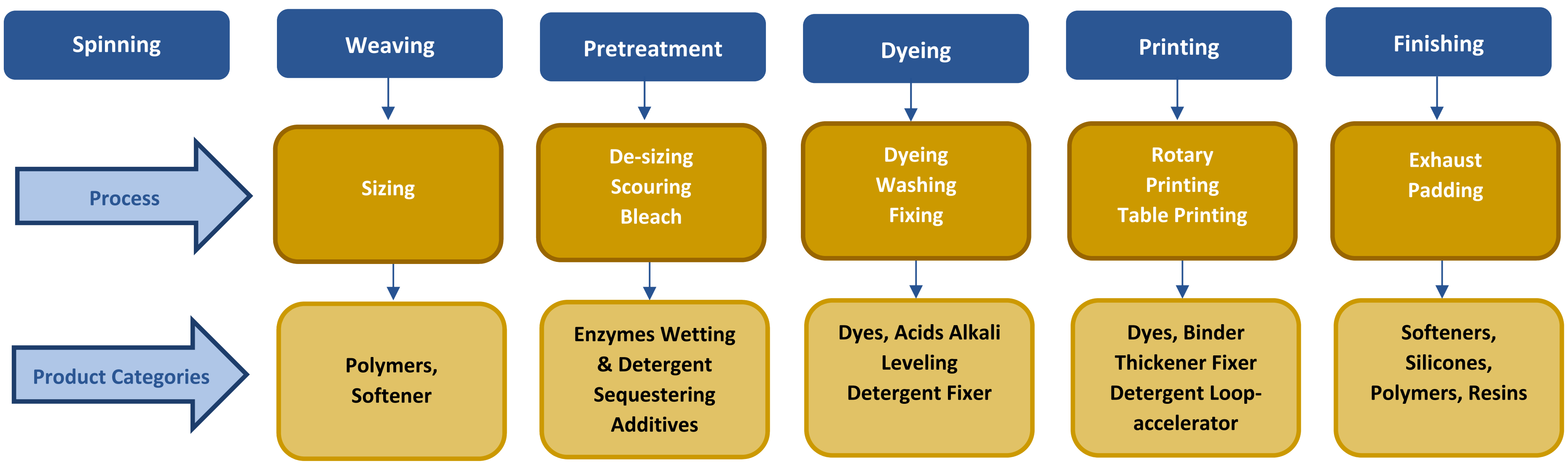
- Government has eliminated the licensing for most of the sub-sectors in the industry.
- Grant of 100% FDI in the chemical industry.
- In order to stimulate investment in technology up-gradation, the government is continuously reducing the list of reserved chemical items for production in the small scale sector.
- It is striving hard to make India as a manufacturing hub for chemicals, especially knowledge and speciality chemicals through 'Make-in-India' initiatives.
- Government has also launched the 'Draft National Chemical Policy', which intends to increase chemical sector's share in country's GDP.
- Policies have been initiated by the centre to set up chemicals & petrochemicals investment regions, which will spread across 250kms, dedicated for manufacturing of domestic and export-related products.

We believe that these steps will aid the sector in significant manner thereby making India's chemical industry as a major part of the global market.

Textile chemicals- major contributor to the top-line

FCL has a major emphasis on textile chemical industry where it caters to the entire value chain for the textile industry including pre-treatment, dyeing, printing and finishing process. Textile is a major contributor to the topline forming 85-90% of the total revenue. The company is a leading player in finished chemicals segment in India, with a major focus on dyeing and finishing chemicals that have higher applicability on textiles, which are more profitable. It consumes more than 300 raw materials like DCDA, DMA, 2 Ethyl Hexanol, Maleic Anhydrite, Acrylamide, Organic Surfactants, Butyl & Styrene Acrylate, Deta and Para formaldehyde.

Chart 4: Catering to the entire value chain of textile industry

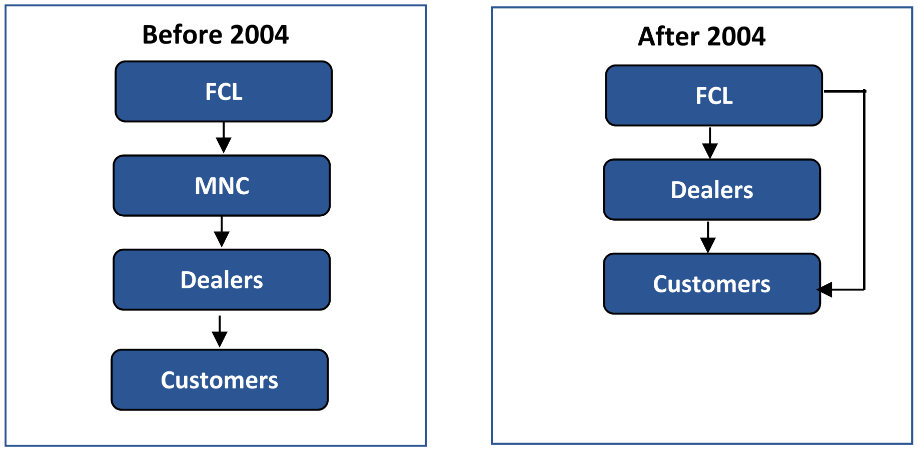


Source: Company, IIFL Research

Gain in market share on account of structural changes in the market

FCL faces stiff competition from multi-national companies (MNC) like Clariant, Archroma, CHT, BSSK, Huntsman, Rudolf and Pulcra. However, competition in the speciality chemical industry is going down as the MNCs have major focus on top selling products, thereby shying away from small size orders. Also, recent mergers and acquisitions in big MNC players have resulted in reduction of competition as the number of players have reduced in the market and the share of merged/acquired MNCs have reduced due to the spill over effect of some dealers and consumers to Fineotex. MNCs that supply their product in India are also reluctant to give distributors sufficient margins. Such restructuring in the market coupled with inflexibility of MNCs to market their products have led to market share gain by FCL. Moreover, FCL market share got a boost post 2004. Before 2004, the company used to sell its product through MNC in the domestic market. Post 2004, it changed its strategy and started selling directly to dealers/distributors and customers.

Chart 5: Change in strategy



Source: Company, IIFL Research

Customization and technicality more important for competition than pricing

FCL is in an industry where the need for customization of the product is very critical. Hence, the industry is dominated by few players that have strong technical expertise with which they provide quality customized solution to the customers. Also, these chemicals are critical and have a substantial impact on the end product of the customer i.e., it can significantly change the properties of the end product. Such advance technology that leads to customization of the products is one of the major entry barriers in this industry. On account of such sensitivity of these chemicals, customers holds on to one supplier.

Customers don't switch suppliers

The cost of the chemicals used by customers per metre of textile is extremely low i.e. not more than 2%. This is the reason why the prices do not play an important role as far as competition is concerned. Quality of the chemicals is very important as the issues in quality could damage the specific lot of output. Thus the focus is on reliability and quality of the chemical supplier than the price. Such unique combination of low cost per metre compared to total cost and risk of significant loss in case of change of the supplier ensures stickiness of customers.

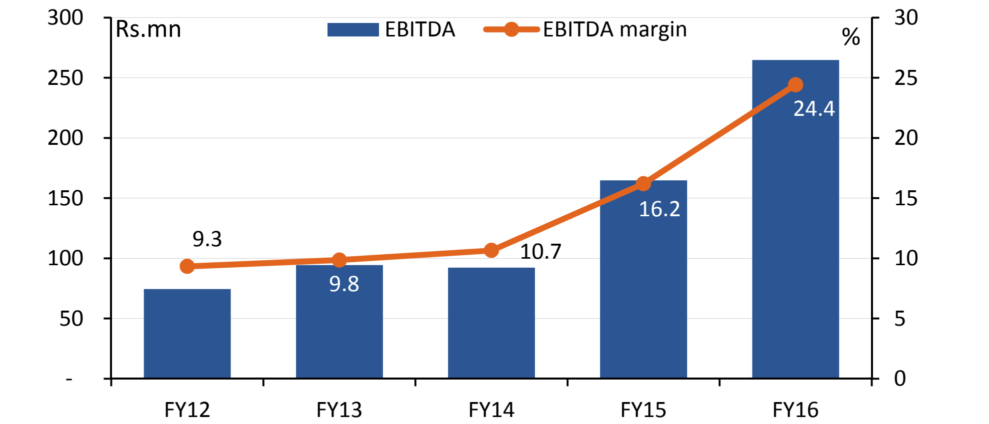
No impact of crude oil prices on raw material

FCL consumes more than 300 raw materials like DCDA, DMA, 2 Ethyl Hexanol, Maleic Anhydrite, Acrylamide, Organic Surfactants, Butyl & Styrene Acrylate, Deta and Para formaldehyde of which 60% of the raw materials are imported. No Single raw material weighs more than 5% of the total raw material cost. Raw material cost is not impacted much by movement in crude prices as the key determinant of the raw material price is the demand and supply situation globally. Crude oil prices is a small determinant of the company's raw materials prices and it should hardly have any impact on the gross margins, if any.

Sustainable margins and green shoots could be expected

The industry have significantly high margin as the products are value-added chemicals that are used for the specialty finishes and the customers do not generally change the products. European competitors in businesses namely Clariant, Archroma, CHT and BASF also have high margins. Most of the textile companies in India worry about ETP, pollution norms, energy and steam consumptions and labour cost. To address such problems, FCL has come up with products that help these companies to lowers their labour and utility cost, reduce temperature that leads to lesser steam consumption, and streamline the processes thereby increasing the productivity. For these products, the company charges higher mark ups. It has more than 400 products in the textile segment and has decided to increase its focus on high margin orders.

Chart 6: EBITDA margins expanded 15.1 ppts over FY12-16



Source: Company, IIFL Research

Financials insights

During the last five years ended March 31, 2016, FCL has achieved a consolidated revenue CAGR of 8%. Based on our interaction with the management, we expect the company clock a CAGR of 11-13% during FY17-19. Over FY12-16, company witnessed a margin expansion of 15.1 ppts to 24.4% in FY16 as against 9.3% in FY12. Such robust margin expansion has led to a strong PAT CAGR of 29.8% over the same period. Management expects the margin to further expand 200-300 bps by FY18. As a part of future strategy, FCL's major focus would be on finishes in textile industry. As in the past, the company's concentration is on introducing newer and high margin products, which meets the customer requirements in the textile industry.

FCL has a lean balance sheet with robust cash flow to support its working capital requirement and future expansion. The company's return ratios have significantly expanded over the years. In FY16, ROE and ROCE stood at 20.3% and 32.3% as against 11.6% and 15.7% respectively in FY12. Based on our interaction with the management, we believe the long term outlook of FCL remains strong on the back of focus on high margin products, benefits accruing from strong dealer network established in recent years, supply of additional products to companies in which they are already empaneled, debt free status, robust cash flow, strong return ratios and consistent dividend pay-out.

Financials

Balance sheet

Y/e 31 Mar (Rs m)	FY12	FY13	FY14	FY15	FY16
Equity capital	112	112	112	225	225
Reserves	408	469	535	539	688
Net worth	**520**	**581**	**648**	**763**	**913**
Minority interest	25	35	43	54	48
Borrowing	58	35	7	10	30
Deferred tax liab (net)	(5)	(5)	(4)	(5)	(5)
Total liabilities	**597**	**647**	**694**	**822**	**987**
Fixed assets	48	66	76	117	131
Intangible assets	54	54	61	61	61
Investments	-	0	-	293	390
Other Non-current Asset	73	75	81	80	60
Net working capital	**106**	**127**	**189**	**171**	**250**
Current Assets					
Inventories	**100**	**112**	**114**	**104**	**115**
Sundry debtors	166	167	219	217	254
Other current assets	-	7	7	9	5
ST. Loans & advances	22	5	30	21	27
Cash	316	324	285	100	95
Current Liabilities					
Sundry creditors	(144)	(128)	(137)	(138)	(131)
Other current liabilities	(31)	(29)	(34)	(15)	(5)
Provision	(7)	(7)	(9)	(28)	(14)
Total assets	**597**	**647**	**694**	**822**	**987**

Income statement

Y/e 31 Mar (Rs m)	FY12	FY13	FY14	FY15	FY16
Revenue	798	959	867	1,018	1,085
Operating profit	**74**	**94**	**92**	**165**	**265**
Depreciation & Amortization	(3)	(3)	(3)	(5)	(6)
PBIT	72	91	90	160	259
Interest expense	(5)	(5)	(4)	(3)	(4)
Other income	23	25	28	45	33
Exceptional items	(2)	-	(2)	-	-
Profit before tax	**88**	**111**	**112**	**202**	**289**
Taxes	(25)	(30)	(33)	(56)	(91)
Minorities	(3)	(11)	(13)	(17)	(27)
Reported profit	**60**	**70**	**65**	**129**	**170**
Adj. Net profit	**62**	**70**	**67**	**129**	**170**

Cash flow

Y/e 31 Mar (Rs m)	FY12	FY13	FY14	FY15	FY16
Cash flow from operation					
Profit before tax	88	111	112	202	289
Depreciation	3	3	3	5	6
Tax paid	(25)	(30)	(33)	(56)	(91)
Working capital Δ	(11)	(21)	(62)	18	(79)
Other operating items					
Operating cashflow	55	63	18	169	124
Cash flow from Investing Activities					
Capital expenditure	(63)	(21)	(20)	(45)	(20)
Change in other non curr assets	(73)	(2)	(7)	1	21
Free cash flow	(81)	40	(8)	125	124
Cash flow from Financing activities					
Equity raised	2	(3)	4	(1)	6
Investments	59	(0)	0	(293)	(97)
Debt financing/disposal	57	(23)	(28)	3	20
Dividends paid	(7)	(7)	(5)	(12)	(26)
Other items	25	1	(3)	(6)	(32)
Net Δ in cash	**56**	**8**	**(39)**	**(185)**	**(6)**

Ratio analysis

Y/e 31 Mar (Rs m)	FY12	FY13	FY14	FY15	FY16
Growth matrix (%)					
Revenue growth	182.6	20.1	(9.6)	17.4	6.6
Op profit growth	23.9	26.8	(2.2)	78.6	60.7
EBIT growth	49.8	23.9	0.9	74.5	42.5
PBT growth	39.9	27.0	0.3	80.9	42.9
EPS growth	40.6	17.2	(7.6)	(0.7)	31.9
Profitability ratios (%)					
OPM	9.3	9.8	10.7	16.2	24.4
EBIT margin	11.8	12.2	13.6	20.2	27.0
Net profit margin	7.5	7.3	7.5	12.7	15.7
RoCE	15.7	18.0	17.6	27.1	32.3
RoNW	11.6	12.1	10.6	18.3	20.3
RoA	7.7	8.7	7.7	13.8	15.9
Per share ratios (Rs)					
EPS	1.1	1.3	1.2	1.2	1.5
Dividend per share	0.1	0.1	0.1	0.1	0.2
Cash EPS	1.1	1.3	1.2	1.2	1.6
Book value per share	9.3	10.3	11.5	6.8	8.1
Payout (%)					
Dividend payout	10.9	9.3	7.3	9.6	15.4
Tax payout	28.3	27.1	30.0	27.7	31.7
Liquidity ratios					
Debtor days	75.7	63.6	92.3	77.9	85.4
Inventory days	45.8	42.5	48.2	37.3	38.6
Creditor days	65.7	48.9	57.9	49.3	44.0
Leverage ratios (x)					
Interest coverage	20.2	22.3	29.3	62.8	75.3
Net debt / equity	(0.5)	(0.5)	(0.4)	(0.1)	(0.1)
Net debt / op. profit	0.8	0.4	(3.0)	(0.5)	(0.2)

Y/e 31 Mar (Rs m)	FY12	FY13	FY14	FY15	FY16
Valuation ratios (x)					
P/E	23.4	19.9	21.6	21.7	16.5
P/BV	2.7	2.4	2.2	3.7	3.1
EV/EBITDA	15.4	11.8	12.2	16.5	10.4
Net Cash Equiv./Mcap (x)	0.2	0.2	0.2	0.1	0.2
Dividend Yield	0.4	0.4	0.4	0.4	0.8
MCAP/Sales (x)	1.8	1.5	1.6	2.8	2.6
Component ratios (%)					
Raw material	74.5	72.3	71.1	67.0	58.7
Staff cost	4.5	4.5	4.1	3.6	3.5
Other operating exp	11.7	13.4	14.2	13.3	13.6

Du-Pont Analysis

Y/e 31 Mar (Rs m)	FY12	FY13	FY14	FY15	FY16
Tax burden (x)	0.7	0.6	0.6	0.6	0.6
Interest burden (x)	0.9	1.0	0.9	1.0	1.0
EBIT margin (x)	0.1	0.1	0.1	0.2	0.3
Asset turnover (x)	1.0	1.2	1.0	1.1	1.0
Financial leverage (x)	1.5	1.4	1.4	1.3	1.3
RoE (%)	**11.6**	**12.1**	**10.6**	**18.3**	**20.3**

IIFL Wealth Research bags 2 Best Analyst Awards

IIFL Wealth Research has bagged two prestigious awards at the ***Zee Business Market Excellence Awards 2016***.

Prayesh Jain was conferred the Best Analyst Award for Auto sector and **Bhavesh Gandhi** bagged the Best Analyst Award for Pharma sector.

Besides the twin awards, IIFL Wealth Research was also nominated in the categories of Oil/Gas, Banking and Industrials.

IIFL Research, as you know, has always prided itself on its unique value proposition in a swarming market space of cut-throat competition, among other things, on our wealth of actionable ideas, tailored portfolio approach and thorough research in line with client needs and priorities, distinctive practice of following up with Call Success post recommendations and a vast coverage universe of as many as 300 companies (comprising 70% of India's equity mcap).

In the past, the research team has won Zee Biz Awards under different categories; Bloomberg has rated our research as the most accurate, while we have twice been winners of Business Standard Smart Portfolios, having received awards at the hands of luminaries including President Pranab Mukherjee, Prime Minister Narendra Modi and Minister of State Piyush Goyal.

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Buy – Absolute return of over +15%

Accumulate – Absolute return between 0% to +15%

Reduce – Absolute return between 0% to -10%

Sell – Absolute return below -10%

Call Failure - In case of a Buy report, if the stock falls 20% below the recommended price on a closing basis, unless otherwise specified by the analyst; or, in case of a Sell report, if the stock rises 20% above the recommended price on a closing basis, unless otherwise specified by the analyst

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