Fineotex Chemicals – A Fine Tex Chem

Management Meeting Note

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Shailee Parekh
shaileeparekh@plindia.com
+91-22-66322302

Charmi Mehta
charmimehta@plindia.com
+91-22-66322274

We met the management of Fineotex Chemicals (FCL) – manufacturer of specialty chemicals predominantly for the textile sector. The company was set up in 1979 by Mr Surendra Kumar Tibrewal. It makes over 400 different products. They also supply to the adhesives, water treatment and fertilisers industry. Adhesives are largely commoditized segment with very little scope to add value hence FCL has consciously kept away from growing this segment.

Previously the company manufactured chemicals for different brands, but eventually launched their own brand hence moving up the value chain thereby making their customers their competitors. They face competition from various European players such as BASF, Huntsman, Tanatex, Pulcra Chemicals, Croda, Pulcra etc.

The company has a reputed clientele including the top names of the textile sector such as Arvind, Nahar Group, Raymond etc. Top 10 customers account for ~25% of their revenues indicating low client concentration.

Currently the company has a total capacity of 22,000 tons of which 15,500 is in India and the balance 6,500 tons in Malaysia. In FY17, the company sold ~12980 tons (11.5% up) and intends to grow volumes upwards of 20% going forward.

FCL has developed a path breaking product called "*Aquastrike VCF*" is non toxic, non poisonous and very easy to use to combat mosquito breeding problems. Currently, it awaits approval from WHO as well as CIB. We have not factored in any benefit from inorganic growth opportunities or sales from *Aquastrike*.

Assuming 20% growth in profits in FY18E and 30% thereafter in FY19E (in line with last 3 years PAT CAGR), we have arrived at rough cut EPS estimates of Rs 2.6 in FY18E and Rs 3.3 in FY19E. At the CMP, the stock is trading at 22.8x FY19E earnings. The company is on a strong growth trajectory with good management focus, healthy balance sheet and promising product basket. However, given the recent run up in the price (86% since December 16, 2017 - our first update on the company), the stock appears richly valued.

Rating	Not Rated
Price	Rs 76
Target Price	-
Implied Upside	-
Sensex	34,057
Nifty	10,531
Bloomberg Code	FTXC IN
Reuters Code	FINE.BO

(Prices as on December 29, 2017)

Tracking Data	
Market Cap (Rs bn)	8.5
Shares O/s (m)	111.3
3M Avg. Daily Value (Rs m)	152.2

Major Shareholders	
Promoters	72.4
Domestic Inst.	0.1
Public & Others	27.5

Stock Performance (%)	1M	6M	12M
Absolute	74.2	107.0	130.6
Relative	73.1	96.7	101.3

How we differ from Consensus: EPS (Rs)	PL	Cons.	% Diff.
2018E	-	2.1	NA
2019E	-	2.5	NA

Key financials (Y/e March)	2014	2015	2016	2017
Revenues (Rs m)	867	1,020	1,099	1,281
Growth (%)	*(9.6)*	*17.7*	*7.8*	*16.5*
EBITDA (Rs m)	92	165	277	302
PAT (Rs m)	80	146	197	239
EPS (Rs)	1.4	1.3	1.8	2.1
Growth (%)	*(1.4)*	*(8.9)*	*35.2*	*22.3*
CEPS (Rs)	0.7	1.4	1.8	2.2
Net DPS (Rs)	0.2	0.1	0.5	0.1
Profitability & Valuation	**2014**	**2015**	**2016**	**2017**
EBITDA margin (%)	*10.7*	*16.2*	*25.2*	*23.6*
RoE (%)	*13.1*	*20.8*	*23.7*	*24.3*
RoCE (%)	*12.4*	*19.7*	*22.6*	*23.2*
EV / sales (x)	9.7	8.2	7.6	6.5
EV / EBITDA (x)	90.8	51.0	30.4	27.7
PE (x)	106.1	58.3	43.1	35.6
P / BV (x)	13.2	11.2	9.4	8.0
Net dividend yield (%)	*0.3*	*0.2*	*0.7*	*0.2*

Source: Company Data, PL Research

Investment Highlights

Government taking steps to improve competitiveness of the industry

Industrial licensing is being abolished for most sub sectors. FDI up to 100% granted in the chemicals sector. The government is continuously reducing the list of reserved chemical items for production in the small-scale sector, thereby promoting Greater investment in technology up gradation and modernization. 'Make in India' initiatives and chemical industry can play a major role in this campaign by making India a manufacturing hub for chemicals, especially knowledge and specialty chemicals.

The Government has launched the Draft National Chemical Policy, which aims to increase chemical sector's share in country's GDP. Policies initiated to set up Chemicals & Petrochemicals investment regions which will be a region spread across 250 kms for manufacturing of domestic and export-related products of Chemicals and petrochemicals.

Promoters with rich industry experience

The management of Fineotex has been in the chemical business for the past four decades and has deep knowledge about the industry. The first generation promoter Mr. Surendra Kumar Tibrewala has been engaged in manufacturing of specialty chemicals and enzymes for various industries such as construction, water treatment, leather, paper etc. His son, Mr. Sanjay Tibrewala is a Chemical Engineer and has been instrumental for diversifying in to segments such as Agro, Adhesive and others. The company is present across 33 countries and has well established relations with their clients.

Sticky customers and high level of product customization prevent entry of new players

Chemicals manufactured by Fineotex are specialised in nature with high value addition having significant impact on properties of the end product. Owing to the criticality of these products to the end product, customers tend to be sticky. Further, the cost of these products as a percentage of the end product is very low thus customers don't switch suppliers easily. This also gives the company higher bargaining power and enable them to earn better margins. Customers are more focused on reliability and technical superiority versus the price. Their top 10 customers account for ~25% of their revenues indicating low client concentration.

Currently the company faces competition from various European players such as BASF, Hunsmen, Tunatex, Croda, Pulcra and other unorgainsed players.

Access to superior technological knowledge through Biotex, Malaysia

BioTex was founded by Dr. Cedric Veniat in 2002 in Malaysia. He is of European descent with over 25 years of experience in the specialty chemicals industries. Prior to founding Biotex, he was working with Thor group for more than a decade.

BioTex manufactures innovative specialty chemicals using French Technology. The manufacturing facilities are strategically located at an industrial hub in Selangor, Malaysia which helps it cater to key Asian and European markets. It has a state-of-the-art manufacturing facility meeting global chemical industry standards. It has a diverse basket of more than 50 high value products. Their products are complementary to Fineotex; it is a well established brand in Asia and Europe and provides technological edge to Fineotex's products. Fineotex Malaysia Limited acquired 60% stake in Bitoex for USD 1.8mn in 2011. Subsequently they have increased their stake to 68% as on FY17.

'*Aqua Strike VCF*' – Path breaking product

The company has developed a path breaking product called "*Aqua strike VCF*" which doesn't just kill mosquitoes but also kills its larvae and pupae thereby eradicating mosquitoes completely. This product is non toxic, non poisonous and is not a pesticide. It is very easy to use and can be used by the common man as well. It does not alter the properties of water hence leaving it suitable for drinking too. Currently, the company has applied for a patent and is awaiting approval from WHO as well as CIB, post which they will be able to supply Aquastrike to BMC and other municipal agencies. The company is already supplying ~20,000 letres to a hospitality company in Singapore through their subsidiary. The product appears to be extremely promising in its prospects and can catapult the company in to a different growth trajectory going forward should they receive the approval from CIB.

Reputed client base

Fineotex is one of India's largest and progressive specialties, textile chemical manufacturers. The Company manufactures chemicals for the entire value chain for the textile industry including pretreatment, dyeing, printing and finishing process. The company also manufactures other chemicals for various industries like agro, adhesives, construction, water treatment etc. It has more than 400 products catering to various industries.

Presently, textile chemicals account for ~90% of revenues. The company caters to a reputed clientele in textiles such as Arvind, UCO Raymond, Grasim, Bombay Dyeing, Vimal, Vardhman, Banswara, the Nahar group, the Aditya Birla group and the Bhilwara group. Other segments like adhesives and fertilizers include key clients such as Clariant, Pidilite, Durian, IFFCO, Deepak Fertilisers, H B Fuller etc and account for the balance 10% of revenues.

Reputed Client Base in Textile Industry

UCO Raymond	Arvind	GHCL	Deepak Fertilisers
Grasim	Bombay dyeing	Pidilite	Durian
Chenab Textile Mills	Vardhman	Clariant	H.B Fuller

Source: Company Presentation

Pan India dealer distribution network

They have a dealer distributor network of roughly 88 agents that are well spread across India. They contribute to ~75-80% of the business, balance being direct sales to customers. Distributors are generally natives of that particular area which gives them an edge due to their ability to communicate in the native language as well as understand the client's culture better. Agents enjoy a 30-90 days credit period.

On site product testing – helps improve product performance

All product research, development and testing is carried out at the client's factory as there are various variables involved that affect the performance of the chemicals. Factors such as water, quality of labor and machines in the factory vary from client to client and within that from factory to factory which makes it imperative for the chemical to be tested on site. A product developed in Mumbai need to deliver the same results at another location in India if the quality of water defers.

Key Risks

Fragmented industry structure with few scaled up Indian players

Most players operating in India are still small in scale. At the global level, however, there is significant level of concentration. Most segments in India witness a dominating presence of a few global leaders. This has implications on the competitiveness of Indian players. Only a few Indian players have the scale or capabilities to compete with the global giants on product development and innovation. As the global companies enter and strengthen their presence in the Indian market, they will also invest in marketing, distribution and production systems that local companies may struggle to match.

Commoditization

Several mature products in the sector have already been commoditized or are at risk of the same. Specialty chemical manufacturers need to strengthen their focus on niche applications and product innovation in order to protect their margins.

Similar products, little differentiation

A majority of the Indian players sell chemicals with little differentiation, thus competing largely on price. As a result they find it difficult to compete with MNCs who have an advantage with regard to access to high quality raw materials as well as being able to sell a quality product at a premium.

Cyclicality of textile business

Another challenge for Indian players is to deal with the cyclicality in the textile manufacturing business. There are hot and cold cycles. Surviving through periods of low demand is tough for the small players.

Single product dependencies

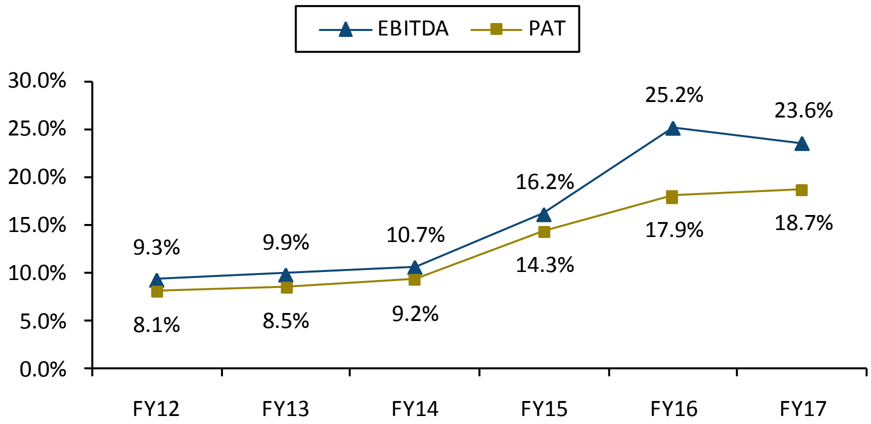
Many Indian players concentrate on manufacturing a single chemical or a small basket of chemicals. As a result, they are vulnerable to shift in regulations and/ or market trends. For example, banning formaldehyde resulted in a major loss for Chemipol.

Financial Overview & Valuations

Steady Margins and return ratios

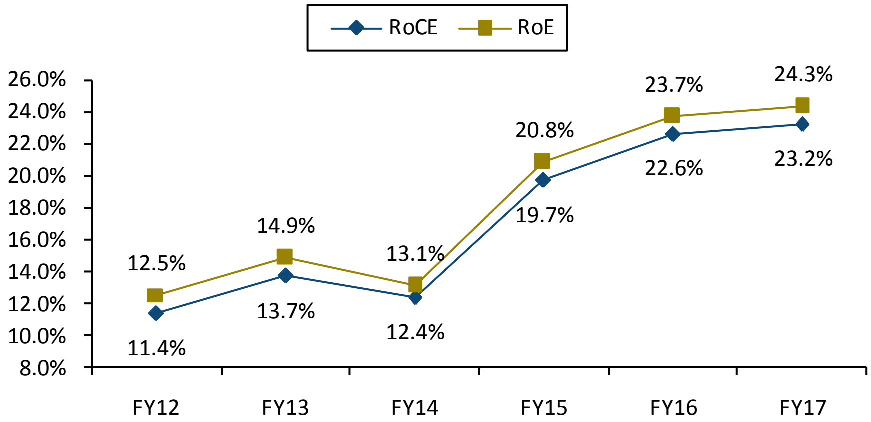
FCL is a manufacturer of specialty chemicals predominantly for the textile sector. They also supply to the adhesives, water treatment and fertilisers industry. Adhesives are largely commoditized segment with very little scope to add value. Hence, the management has consciously kept away from growing this segment. Due to higher contribution from value added products, EBITDAM have improved from 10.7% in FY14 to 23.6% in FY17. The company quotes on cost plus basis thereby insulating itself from volatility in raw material prices. The management is confident of maintaining margins of ~23% going forward as well. Correspondingly RoE and RoCE have also improved from 13.1% and 12.4% in FY14 to 24.3% and 23.2% in FY17.

Margin expansion on back of higher contribution from value added products



Source: Company Data, PL Idea Research

Improving return ratios



Source: Company Data, PL Idea Research

Short working capital cycle and zero debt levels

The company has zero debt as of now. It has a fairly short working capital cycle of 27 days. They source their raw materials locally which are easily available even at short notice; hence there is no need to maintain huge inventories (company maintains about 20-30 days inventory). There is no major capex lined up for the next few years as current capacities are not yet fully utilised. Maintenance capex of ~Rs 80-100mn pa will continue but it will be funded through internal accruals. Thus, we do not foresee the debt levels to rise.

Easy sourcing of raw materials

FCL uses over 300 different raw materials like DCDA, DMA, 2 Ethyl Hexanol, Maleic Anhydrite, Acrylamide, Organic Surfactants, Butyl & Styrene Acrylate, Deta, Para formaldehyde etc. Top 15 raw materials account for 27% of the total cost of raw material consumed. All the materials are easily available which helps to keep the inventory days below 30. This in turn helps shorten the working capital cycle.

Consistently rewarding shareholders with dividends and buyback

The company has consistently been rewarding shareholders by way of dividends since 20007. During FY17, FCL completed buyback of 0.99mn (998,110) shares at ~Rs 29 per share thereby reducing the equity to 111.3mn shares. The company is on the lookout for inorganic growth opportunities in textile chemicals, water chemicals or bio pesticides.

Strong earnings growth

Over the last four years, the company has grown its revenues and profits at 16.8% and 30.9% CAGR respectively to Rs 767mn and Rs 159mn in FY17. During H1FY18, the revenues were up by 19.6% to Rs 218mn and the profits grew by 37.5% to Rs 54mn in spite of GST overhang in the textile industry. The management has guided that the company will be able to sustain 25%-30% CAGR in profits going forward as well on back of higher volumes and increasing share of value added products. FY18 is likely to witness lower growth due to muted demand scenario in the textile industry due to GST implementation. This does not include any benefits from *Aquastrike VCF* or any inorganic opportunities.

Valuations appear rich

Assuming 20% growth in profits in FY18E and 30% thereafter in FY19E (which has been in line with the PAT CAGR over the last 3 years), we have arrived at rough cut EPS estimates of Rs 2.6 in FY18E and Rs 3.3 in FY19E. At the CMP, the stock is trading at 22.8x FY19E earnings. We have not factored in any benefit from inorganic growth opportunities or sales from *Aquastrike*. The company is on a strong growth trajectory with good management focus and healthy balance sheet and promising product basket. However, given the recent run up in the price (86% since December 16, 2017 - our first update on the company), the stock appears richly valued.

Company and Management Background

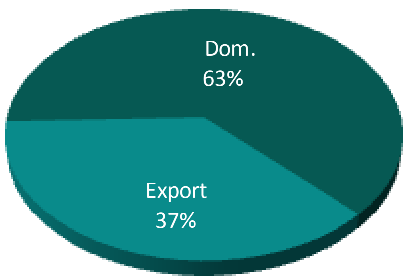
Fineotex Group was established in 1979 by Mr.Surendra Tibrewala. FCL was incorporated as a public limited company in 2007. The company was listed on Bombay Stock Exchange in March 2011, and listed on the National Stock Exchange in January 2015.

Fineotex is one of India's largest and most progressive specialty textile chemical manufacturers. The company manufactures over 400 specialty chemicals and enzymes to Textile, Garment, Construction, Leather, Water treatment, Agrochemicals, Adhesives and others industries.

Headquartered in Mumbai, it has manufacturing facilities in India and Malaysia with a combined production capacity of 22,000MT/p.a.

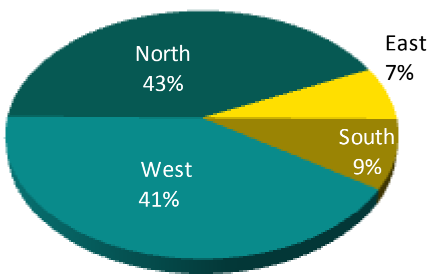
It has a global presence across 33 countries and caters to well known companies in India and overseas. FCL along with its subsidiary Biotex Malaysia, has a global presence as a reputed producer of specialty chemicals.

Geographical Breakup of FY17 revenues



Source: Company Presentation

Region wise breakup of FY17 domestic rev.



Source: Company Presentation

Industry Overview

The global textile chemicals market was valued at US $ 19 billion in 2012 and is further expected to grow at a CAGR of 3.7 percent from 2014 to 2020.

Global Specialty chemicals

The specialty chemicals market has witnessed a growth of 14% in the last five years; the market size is expected to reach USD 70 Billion by 2020.

The Indian Chemical Industry which is 3% of the global market is pegged at approximately $ 108 bn.

Globally, specialty chemicals are driven by extensive product R&D and innovation. However, in the Indian context, this line of demarcation is almost non-existent due to the "genericized" nature of the specialty industry. This also leads to a visible difference in margin structure of global and Indian specialty chemical companies.

Specialty chemicals can be sub-divided based on end-user industries in to:

- Agrochemicals
- Personal care ingredients
- Polymer additives
- Water chemicals
- Textile chemicals and
- Construction chemicals

It can also be divided based on application-driven segments

- Surfactants
- Flavors and fragrances and
- Dyes and pigments.

These are the largest constituents of the specialty chemicals industry and cumulatively constitute over 80% of the specialty chemicals universe.

Segments within specialty chemicals vary in attractiveness and witness varying levels of competitive intensity, margin profiles, defensibility against raw material cost movements, and growth (including growth of the end-user segment in many cases)

Textile Chemicals Industry

The global market for Textile Chemicals is estimated to be USD 20.3 bn, and is expected to reach USD 24.3 bn in 2019. The volume of the international textile chemical market in the year 2013 was 9230.1 kilo tons and is speculated to reach 11,462.5 kilo tons by the year 2020.

China, Western Europe, United States of America, India, Turkey, and Japan are some of the largest consumers of textile chemicals in the world. The market for textile chemicals in India is highly fragmented and comprises of over 300 large and small players in India.

Growth drivers

The market for textile chemicals is driven by

- Growth of apparels and technical textiles.
- A large domestic demand for textiles
- Growth in branded apparel,
- Strength in exports and opportunities for technical specialty textiles

Increase in penetration of solutions such as negative ion therapy, anti microbial effect, stain release growing @20% CAGR from FY11-17. The textile chemicals market is expected to grow at a CAGR of 3.6% for the next 5 years. Coating and sizing chemicals are closely followed by colorant auxiliaries with ~29% share of the market each. These chemicals enable dyeing or printing to be carried out more effectively and help give effects like color deepening. Finishing agents constitutes 19% of the market, though the share is expected to increase in future years. Finishing refers to the method whereby deficiencies in textiles are corrected or specific properties are introduced. Surfactants, desizing agents, bleaching agents and yarn lubricants together form the remaining 22%. The Indian textile chemicals market is estimated at USD 1.1 bn in 2014. It is expected to reach USD 1.9 bn by 2019, growing at 11.9% p.a. Growth is driven by domestic demand and exports of high quality textiles. The latter has been growing at a CAGR of 11.6%. Increasing penetration of solutions such as negative ion therapy, stain releases, anti-microbial effect (growing at 20% CAGR over FY11 to 17) are additionally driving market growth.

Income Statement (Rs m)				
Y/e March	2014	2015	2016	2017
Net Revenue	**867**	**1,020**	**1,099**	**1,281**
Raw Material Expenses	567	627	580	701
Gross Profit	300	393	519	579
Employee Cost	35	37	38	46
Other Expenses	173	191	204	231
EBITDA	**92**	**165**	**277**	**302**
Depr. & Amortization	3	5	6	6
Net Interest	4	3	4	4
Other Income	28	45	21	40
Profit before Tax	**114**	**202**	**289**	**332**
Total Tax	33	56	91	93
Profit after Tax	**80**	**146**	**197**	**239**
Ex-Od items / Min. Int.	13	17	27	33
Adj. PAT	**67**	**129**	**170**	**206**
Avg. Shares O/S (m)	**56.2**	**112.3**	**112.3**	**111.3**
EPS (Rs.)	**1.4**	**1.3**	**1.8**	**2.1**

Cash Flow Abstract (Rs m)				
Y/e March	2014	2015	2016	2017
C/F from Operations	69	336	144	206
C/F from Investing	(35)	(351)	(176)	(109)
C/F from Financing	(25)	104	(0)	(1)
Inc. / Dec. in Cash	9	89	(32)	96
Opening Cash	117	127	100	95
Closing Cash	127	216	69	190
FCFF	35	(15)	(31)	97

Key Financial Metrics				
Y/e March	2014	2015	2016	2017
Growth				
Revenue (%)	(9.6)	17.7	7.8	16.5
EBITDA (%)	(2.3)	78.6	67.9	9.1
PAT (%)	(1.4)	82.1	35.2	21.2
EPS (%)	(1.4)	(8.9)	35.2	22.3
Profitability				
EBITDA Margin (%)	10.7	16.2	25.2	23.6
PAT Margin (%)	9.2	14.3	17.9	18.7
RoCE (%)	12.4	19.7	22.6	23.2
RoE (%)	13.1	20.8	23.7	24.3
Balance Sheet				
Net Debt : Equity	0.0	0.0	0.0	0.0
Net Wrkng Cap. (days)	51.2	34.7	39.8	26.5
Valuation				
PER (x)	106.1	58.3	43.1	35.6
P / B (x)	13.2	11.2	9.4	8.0
EV / EBITDA (x)	90.8	51.0	30.4	27.7
EV / Sales (x)	9.7	8.2	7.6	6.5
Earnings Quality				
Eff. Tax Rate	29.5	27.7	31.7	27.9
Other Inc / PBT	0.2	0.2	0.1	0.1
Eff. Depr. Rate (%)	1.7	2.5	2.5	2.3

Source: Company Data, PL Research.

Balance Sheet Abstract (Rs m)				
Y/e March	2014	2015	2016	2017
Shareholder's Funds	644	759	908	1,057
Total Debt	-	-	-	-
Other Liabilities	43	54	48	72
Total Liabilities	**686**	**812**	**956**	**1,129**
Net Fixed Assets	138	178	193	234
Goodwill				
Investments	2	293	390	438
Net Current Assets	473	261	314	389
Cash & Equivalents	*127*	*100*	*95*	*129*
Other Current Assets	*527*	*352*	*401*	*460*
Current Liabilities	*181*	*191*	*181*	*201*
Other Assets	81	80	60	68
Total Assets	**694**	**812**	**956**	**1,129**

Quarterly Financials (Rs m)				
Y/e March	Q3FY17	Q4FY17	Q1FY18	Q2FY18
Net Revenue	**298**	**384**	**304**	**349**
EBITDA	**72**	**93**	**68**	**80**
% of revenue	*24.0*	*24.1*	*22.3*	*23.0*
Depr. & Amortization	2	2	2	2
Net Interest	1	1	1	1
Other Income	11	9	10	20
Profit before Tax	**80**	**99**	**75**	**97**
Total Tax	26	25	19	31
Profit after Tax	**54**	**75**	**56**	**66**
Adj. PAT	**54**	**75**	**56**	**66**

Operating Metrics				
Particulars	2014	2015	2016	2017
Capacity (MTPA)				
India	15,500	15,500	15,500	15,500
Malayasia	6,500	6,500	6,500	6,500
Sales volumes (MTPA)				
India	6,967	7,725	8,275	9,077
Malayasia	3,450	3,609	3,353	3,898
Realisations (Rs/ kg)				
India	76.7	84.1	82.8	83.4
Malayasia	96.3	102.5	123.6	134.4
EBITDA (Rs /kg)				
India	7.2	14.6	22.5	21.2
Malayasia	12.2	14.5	27.0	28.2
EBITDA margins (%)				
India	9.4	17.3	27.2	25.4
Malayasia	12.7	14.2	21.8	21.0

Source: Company Data, PL Research.

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Prabhudas Lilladher Pvt. Ltd.

3rd Floor, Sadhana House, 570, P. B. Marg, Worli, Mumbai-400 018, India
Tel: (91 22) 6632 2222 Fax: (91 22) 6632 2209