

## **NEOGEN CHEMICALS LIMITED**

**IPO Note**

**(SUBSCRIBE)**

**Analyst:**

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**24 April 2019**

# IPO details

Key Data	
Issue Opens	24-Apr-19
Issue Closes	26-Apr-19
Equity Shares Offered (in mn.)	6.16
QIB	Up to 75%
NIB	Min 15%
Retail	Min 10%
Face Value (Rs.)	10
Price Band (Rs.)	212-215
Max. Issue Size (Rs. mn)	2,946
Lot Size (Eq. Shares)	65 and multiple thereof

Valuation	@ 212 per share	@ 215 per share
Market Cap (₹ mn)	4,947	5,017
Net Debt (₹ mn)	62	62
Enterprise Value (₹ mn)	5,009	5,079
EV/ Sales	3.1	3.2
EV/ EBIDTA	17.3	17.5
P/B	10.0	10.0
P/E	47.1	47.8

	Pre Issue		Post Issue <sup>^</sup>	
	# mn Shares	% Holding	# mn Shares	% Holding
Promoters	19.2	95.8%	16.3	70.0%
Public	0.8	4.2%	0.8	3.6%
Offer for sale			2.9	12.4%
Fresh Issue			3.3	14.0%
<b>Total</b>	<b>20.1</b>	<b>100.00%</b>	<b>23.3</b>	<b>100.0%</b>

## Object of the issue

- Prepayment or repayment of all or a portion of certain borrowings availed by company.
- Early Redemption of 9.8% FRCPS
- Long Term Working capital
- General corporate purposes

## Recommendation

On valuation front, based on the higher price band, Neogen is demanding a P/E valuation of 47.8x (to its FY18 EPS of Rs. 4.5), which is high than its peers. However, considering its historical growth profile, proposed expansion activities, we believe the higher multiple is justified given the company's ability to grow profitably and command better return ratios than its peers. Therefore we recommend **SUBSCRIBE** over the issue.

Source: Red Herring Prospectus, Dealmoney Research

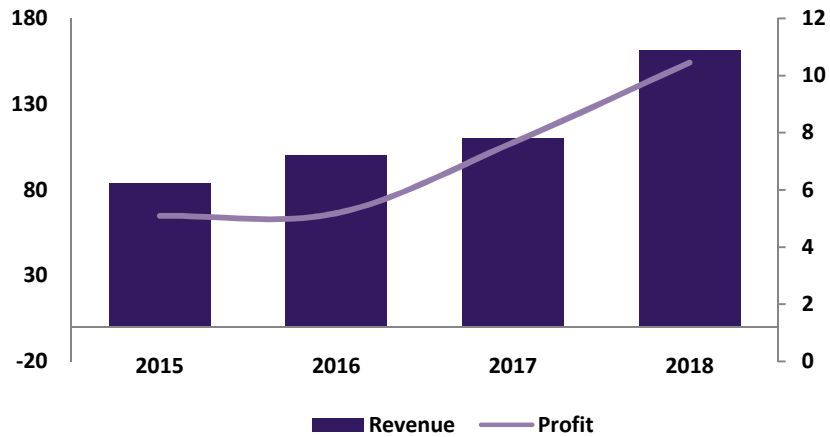
## One of India's leading manufacturers of bromine-based, and lithium-based, specialty chemicals..

- ❑ Neogen Chemicals (Neogen) commenced its business operations in 1991, at Mahape, Navi Mumbai manufacturing with a few Bromine Compounds and Lithium Compounds. Over the years it has expanded range of products and, presently, manufacture an extensive range of specialty chemicals which find application across various industries in India and globally. As on September 30, 2018, it has manufactured an aggregate of 187 products comprising 170 organic chemicals and 17 inorganic chemicals.
- ❑ Specialty chemicals are those chemicals that impart different properties to a variety of products (i.e. the effect that specialty chemicals have varies based on the product) and have a high degree of value addition.
- ❑ Specialty chemicals are, also generally, in the Indian context, manufactured in smaller volumes when compared to non-specialty chemicals. Specialty chemicals, including bromine and lithium-based compounds, comprise pharmaceutical intermediates, agrochemical intermediates, engineering fluids, electronic chemicals, polymers additives, water treatment chemicals, construction chemicals and flavours and fragrances.
- ❑ Specialty chemicals are widely used for specialised applications to meet industry-specific requirements and can be classified based on application industries. Neogen Chemical manufactures specialty organic bromine-based chemical compounds (Bromine Compounds) and other specialty organic chemical compounds as well as specialty inorganic lithium-based chemicals compounds (Lithium Compounds and together with the Bromine Compounds the Products).
- ❑ Its specialty chemicals product offerings comprise
  - **Organic chemicals** – these are chemicals containing carbon in combination with hydrogen, and, or, other elements with a covalent bond (i.e. a chemical bond atoms sharing at least one pair of electrons between them). The product offering in this segment comprises Bromine Compounds and other organic compounds containing chlorine, fluorine and iodine-based and combinations thereof. In addition, it also manufacture niche products such as Grignard reagents. Its specialty organic chemical compounds find use in application industries such as pharmaceutical, agrochemical, flavor and fragrance and electronic-chemical. Neogen market and sell the products in India and export primarily to Europe, USA and Japan.
  - **Inorganic chemicals** – these are chemicals with an ionic bond (i.e. a chemical bond between a non-metal and a metal ion involving transfer of electron from one element to another, creating positively and negatively charged ions with together form the compound). The product offering in this segment primarily comprises Lithium Compounds. The Lithium Compounds manufactured are used in eco-friendly Vapor Absorption Machines (VAM) for cooling air/water/process equipment and find application in industries such as heating ventilation and air-conditioning (HVAC) and refrigeration, construction chemicals, pharmaceutical and specialty polymer. It market and sell the Lithium compounds in India and export to the USA, Europe and Japan

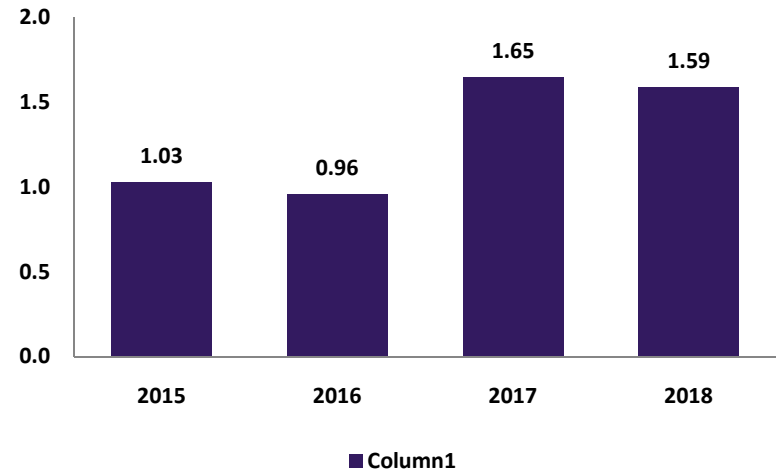
Source: Red Herring Prospectus, Dealmoney research

# Operating metrics

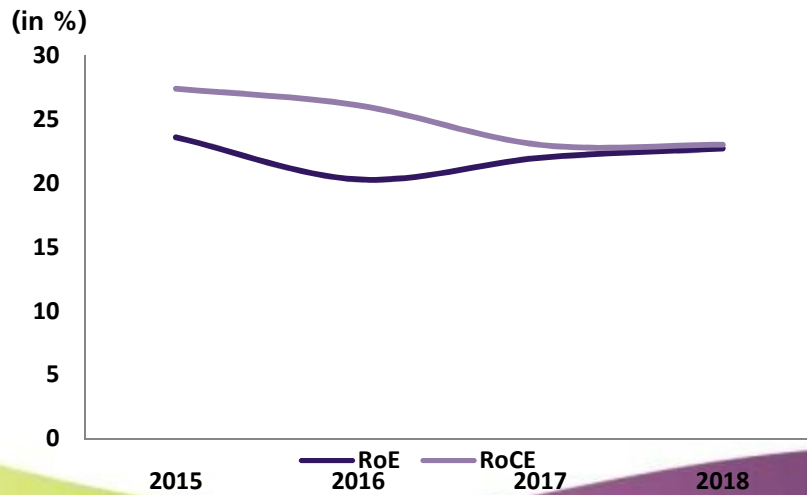
### Revenue and PAT (In Crs)



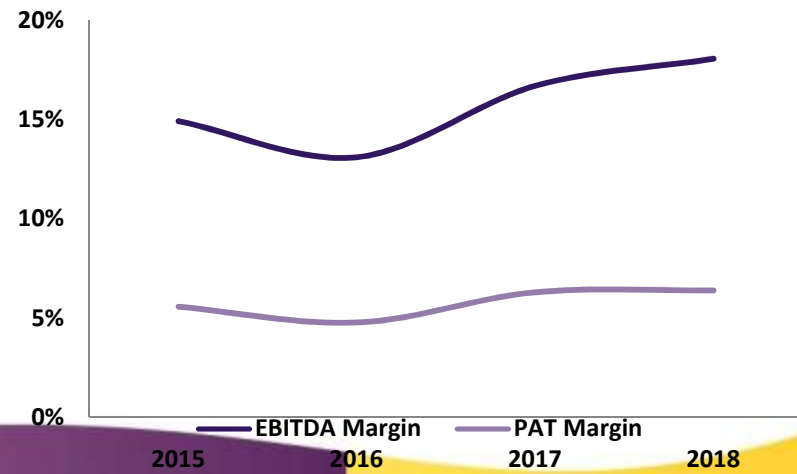
### Debt-to-Equity Ratio



### Return Ratio



### EBITDA and PAT Margin



# Peers

	MCAP (Rs. mn)	Total Operating Revenue (Rs. mn)	PAT (Rs. mn)	EPS (Rs.)	RoE (%)	RoCE (%)	P / E (x)
<b>Neogen Chemicals Ltd.</b>	<b>5,017</b>	<b>1,640</b>	<b>105</b>	<b>5</b>	<b>22.7%</b>	<b>23.0%</b>	<b>47.8</b>
Aarti Industries Ltd.	141,955	38,061	3329.6	38	20.1%	15.5%	42.6
Atul Ltd.	105,049.0	32,957.7	2764.8	93.2	12.2%	16.9%	38.0
Navin Fluorine International Ltd.	35,421.0	9,126.9	1797.8	36.4	18.3%	14.4%	19.7
Paushak Ltd.	6,783.0	1,034.2	214.7	69.7	19.0%	22.6%	31.6
Vinati Organics Ltd.	89,431.0	7,433.6	1438.8	28.0	18.1%	23.1%	62.2

*All financials and ratio based on FY18 data*

## Strengths

- ❑ **Experienced promoters with domain knowledge :** The promoters, Haridas Thakarshi Kanani and Harin Haridas Kanani, have a cumulative experience of more than 6 decades. Both are chemical engineers and alumni of the Indian Institute of Technology, Bombay. Harin Haridas Kanani also completed his Ph.D. in chemical engineering from the University of Maryland, College Park, USA. Haridas Thakarshi Kanani has over the years worked as a consultant with chemical manufacturing companies in India before setting up the Company in 1989. Prior to joining the Company, Harin Haridas Kanani worked with Asian Paints Limited.
- ❑ **Large and diverse array of products:** The Company was set up in 1989 and started operations in 1991 manufacturing 4 products viz., lithium bromide, n-propyl bromide, potassium bromide and meta-phenoxy benzaldehyde. As of September 30, 2018, it has manufactured an aggregate of 187 Products comprising 170 organic chemicals and 17 inorganic chemicals.
- ❑ **Diversified and stable customer base:** The diversified Product range enables it to cater to diverse customers across a wide array of user industries such as pharmaceutical, agrochemical, aroma chemical, electronic-chemical, construction chemicals, specialty polymer and VAM original equipment manufacturers. This helps to mitigate risks emanating from customer, industry and geographic concentration. In addition, diversified customer base would enable benefit from the expected growth in application industries such as the Pharmaceuticals, including advanced pharmaceutical intermediates, pesticides and the HVAC industry.
- ❑ **Growth led by continuous investment in R&D:** The Promoters, who are also Managing Directors, have inculcated the culture of innovation and instilled a firm belief that R&D is a key element of growth and, will continue to remain so. In line with this thinking, the Company has over the years made regular investments in R&D to expand its bouquet of Product offerings and to streamline manufacturing process. It has 2 R&D facilities, one each in Vadodara and Mahape manufacturing units. The company has dedicated 16-member R&D team constituting around 9% of total workforce. The team comprises 5 senior personnel (including 1 retainer) with doctorates in science (Ph. D.) from reputed institutions.
- ❑ **Specialised business model with high entry barriers:** The specialty chemicals industry is highly knowledge intensive. The Products are used for specialty applications in the pharmaceutical, agrochemical, aroma chemical, construction chemical, specialty polymer and electronic-chemical industries where they are used to manufacture high value proprietary and specialised products. Given the nature of the application of Products, the processes and products are subject to, and measured against, exacting quality standards and stringent impurity specifications. Further, where the Products are used, and such use has been formally recognised in filings with regulatory agencies, any change in the vendor of the product may require significant time and cost for the customer. These factors create significant entry barriers.

## Future road ahead

- ❑ **Expanding production capacities:** The company has increased production capacities through organic and inorganic growth. The company has also broadened the product range by setting up facilities for the manufacture of inorganic chemicals at Mahape. Further, in Fiscal 2016, it acquired the Vadodara Facility for augmenting the organic chemicals manufacturing capability. Presently, it has proposed to further increase the manufacturing capacity at Vadodara facility by an additional 126,000 litres (reactor volume in litres) which will nearly double the organic chemicals manufacturing capacity from 130,400 litres to 256,400 litres. Further, the Vadodara Facility is spread over approximately 39 acres and on completion of the Proposed Vadodara Facility it will still have over 32 acres of freehold land which the company can use for further growth and expansion.
- ❑ **Increasing contract manufacturing portfolio:** The contract manufacturing business will enable to enter into long term contracts with assured margins and product off-take which will help strengthen the repeat business as year on year repeatability is confirmed by these customers. At present, the Company has entered into contract manufacturing arrangements with a few international companies, engaged in the pharmaceutical, agrochemical, aroma and speciality polymer industries and it has already delivered products under some of these arrangements. The company aims to increase the size and scale of the contract manufacturing business over the next few years. Neogen is in discussions with various companies in Europe and Japan to develop the proprietary products for which it has already executed nondisclosure and secrecy agreements. Further, it also propose to increase the focus on custom synthesis business by augmenting the share of business with innovator companies.
- ❑ **Augmenting growth in domestic and global markets:** Presently, the revenue from domestic and export business is almost 50% each, (including 16% deemed exports, where it supply the Product to customers who will eventually export their end product). In India, over the last 3 immediately preceding fiscal years, the pharmaceuticals, agrochemical, refrigeration and specialty polymer, industries have, generally, contributed in excess of 90% of Revenue from Operations. Going forward primary focus would be to continue growth in export. It strongly believes that the demand for bromine-based and lithium-based products will grow, in India and overseas, owing to the growth in their final application industries such as pharmaceutical, agrochemical, refrigeration, polymer synthesis, flavour and fragrances, etc. iNeogen believes to be well positioned to exploit the opportunities offered by the expected growth in the final application industries due to its strong manufacturing capabilities, established customer relationships, strong R&D capabilities and robust Product portfolio

Source: Red Herring Prospectus, Dealmoney research

## Future road ahead

- ❑ **Improving financial performance through focus on operational efficiencies and functional excellence :** It believes that focus on functional excellence and providing integrated solutions for a gamut of Bromine Compounds and Lithium Compounds has contributed to financial strength and performance whilst also strengthening the trust and engagement that it share with customers. The various strategic initiatives that it has implemented, including the continued investment in the manufacturing facilities such as the use of bromine in 6,000 litre ISO storage tanks in Vadodara Facility instead of in 1 litre glass bottles at Mahape which reduced manpower cost for transfer and addition of bromine, permits a much faster rate of addition of bromine, thereby increasing reactor productivity.
- ❑ **Focus on advanced specialty intermediates which offer higher value addition:** Over the last few years the Company has been focusing not only on manufacturing Bromine Compounds but also combining bromination with other chemistries to make advance intermediates which otherwise would have been manufactured by customers internally. Such forward integration allows customers to reduce processing at their end freeing up their specialized capacity for making final molecules such as APIs, specialty polymers, electronic chemicals etc. Such forward integration enables the company to offer higher value addition and generate higher margin and increased profitability.

Source: Red Herring Prospectus, Dealmoney research



## Top 10 Shareholders

Name of the Shareholder	No. of Equity Shares	No. of Equity Shares	Percentage of pre-Offer shareholding (%)
Haridas Thakarshi Kanani		13,999,680	69.7
Beena H. Kanani		2,226,711	11.1
Harin H. Kanani		2,000,000	10.0
Pallika H. Kanani		1,000,000	5.0
Anurag Surana		300,000	1.5
Kagashin Global Network Private Limited		300,000	1.5
Kalpana H. Mehta		34,122	0.2
Pragna J. Thacker		16,061	0.1
Mitesh Anil Parikh		15,000	0.1
Khorshed J. Ghadiali		12,061	0.1
<b>TOTAL</b>		<b>19,903,635</b>	<b>99.1</b>

# Consolidated Summary Financials

## Income Statement

₹Cr	Mar-14	Mar-15	Mar-16	Mar-17	Mar-18
Total Income	73.8	83.9	100.3	110.1	161.2
Operating Expense	62.3	71.3	86.2	90.1	132.2
<b>EBIDTA</b>	<b>11.5</b>	<b>12.7</b>	<b>14.1</b>	<b>20.0</b>	<b>29.0</b>
Depreciation	0.9	0.9	1.0	1.3	1.9
Other Income	0.4	1.0	0.2	0.3	0.7
Finance Costs	4.8	4.7	4.8	7.5	10.4
<b>PBT &amp; (EI)</b>	<b>6.2</b>	<b>8.1</b>	<b>8.5</b>	<b>11.5</b>	<b>17.3</b>
Exp Income	-	-	-	-	-
<b>PBT</b>	<b>6.2</b>	<b>8.1</b>	<b>8.5</b>	<b>11.5</b>	<b>17.3</b>
Tax	2.5	3.0	3.3	3.8	6.8
<b>PAT</b>	<b>3.6</b>	<b>5.1</b>	<b>5.2</b>	<b>7.6</b>	<b>10.5</b>
Less : Minority Intrest	-	-	-	-	-
Share of Associate	-	-	-	-	-
<b>Net Profit</b>	<b>3.6</b>	<b>5.1</b>	<b>5.2</b>	<b>7.6</b>	<b>10.5</b>

₹ mn	FY14	FY15	FY16	FY17	FY18
EBIDTA Margin	15.5%	15.1%	14.1%	18.2%	18.0%
Net Margin	4.9%	6.1%	5.2%	6.9%	6.5%
ROE	18.6%	23.6%	20.3%	22.0%	22.7%
ROCE	24.3%	27.4%	26.1%	23.0%	23.0%

## Balance Sheet

₹ Cr	Mar-14	Mar-15	Mar-16	Mar-17	Mar-18
<b>Liabilities</b>					
Share capital	4.5	4.5	20.0	20.0	20.0
Reserves and surplus	15.1	19.0	7.5	22.0	30.1
Minority Interest	-	-	-	-	-
Long-Term Borrowings	0.6	3.5	2.5	21.8	22.8
Unsecured Loans	4.2	1.3	2.2	14.9	15.7
Deferred Tax Assets / Liabilities	1.7	2.0	2.2	3.7	4.0
Other Long Term Liabilities	-	0.2	0.2	2.2	2.2
Long Term Provisions	0.2	0.3	0.2	1.2	1.7
Trade Payables	14.4	16.4	21.8	31.0	36.7
Other Current Liabilities	3.4	3.1	3.3	5.2	5.0
Short Term Borrowings	19.0	18.3	20.1	30.1	41.2
Short Term Provisions	0.0	0.2	0.4	0.3	0.7
<b>Total Liabilities</b>	<b>62.9</b>	<b>68.8</b>	<b>80.5</b>	<b>152.3</b>	<b>180.1</b>
<b>Assets</b>					
Net Block	13.6	13.2	17.4	56.3	66.7
Capital Work in Progress	0.0	0.1	0.7	1.3	1.4
Non Current Investments	-	-	-	0.5	0.4
Long Term Loans & Advances	2.9	2.3	1.5	4.5	4.8
Other Non Current Assets	0.2	0.0	-	-	-
Currents Investments	-	-	-	-	-
Inventories	21.2	24.3	31.8	40.0	50.0
Sundry Debtors	16.6	18.0	15.8	32.2	41.4
Cash and Bank	1.8	2.4	2.5	3.1	1.8
Other Current Assets	4.9	5.5	8.1	9.0	10.1
Short Term Loans and Advances	1.7	2.9	2.8	5.5	3.5
<b>Total Assets</b>	<b>62.9</b>	<b>68.8</b>	<b>80.5</b>	<b>152.3</b>	<b>180.1</b>

Source: Red Herring Prospectus, Dealmoney research

# Key Risks

- ❑ Failure to meet quality standards required by customers for products and processes may lead to cancellation of existing and future orders and expose us to warranty claims.
- ❑ The company is completely reliant on third-party transportation service providers for the movement of raw materials and finished products
- ❑ The company does not have long-term agreements with suppliers for raw materials and an increase in the cost of, or a shortfall in the availability or quality of such raw materials could have an adverse effect on business and results of operations
- ❑ It has incurred significant indebtedness which exposes the company to various risks which may have an adverse effect on the business, results of operations and financial condition
- ❑ The company is heavily reliant on certain customers and significant part of revenue is generated from select clients and it does not have long term contracts with these customers
- ❑ The company is heavily reliant on the demand from application industries such as pharmaceuticals, agrochemicals, refrigeration and construction chemicals. Any downturn in the application industries could have an adverse impact on the company's business and results of operations
- ❑ The operations are subject to varied business risks and insurance cover may prove inadequate to cover our economic losses.
- ❑ It is yet to make applications for necessary approvals for establishing a green-field manufacturing facility at Proposed Dahej Facility
- ❑ Dependence on a number of key management personnel and senior management personnel

Source: Red Herring Prospectus, Dealmoney research

# Dealmoney Securities Private Limited

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