22 April 2019

Neogen Chemicals IPO

Leader in bromine chemistry; OFS and fresh issue; Subscribe

Issue Price: ₹212-215

Subscribe

The leading manufacturer of bromine specialty chemicals in India: Commencing operations in 1991, at Mahape, Navi Mumbai, with a few bromine-based compounds and lithium salts, now Neogen has became one of India's leading manufacturers of bromine and lithium-based derivatives. Over the years, it has broadened the number of its products 198, comprising 181 organic and 17 inorganic chemicals.

Capacity expansion, focus on advanced specialty intermediates: The company has installed capacity for 130,400 litres of organic chemicals and 1,200 tons of inorganic chemicals,with utilisation at respectively 64% and 94%. It plans to double capacity to ~256,000 liters and 2,400 tons of organic and inorganic chemicals to cater to mounting demand. It is trying to forward-integrate bromination with other chemistries to make advanced intermediates, otherwise being manufactured by customers in-house.

Financials. Over FY14-18, it reported revenue, EBITDA and PAT CAGRs of respectively ~22%, 26% and 30%. Its EBITDA margin expanded 244bps to 18%. Debt-based capex funding led to its net-debt-to-equity touching 1.9x in FY18,up from 1.2x in FY15. Its RoE and RoCE have averaged ~20% and ~15% respectively over FY14-18. Its cash-conversion cycle wasa lengthy 145 days in FY18 due to business requirements of maintaining higher inventory for operational benefits.

Valuation. At the higher end of the issue price of ₹215 a share, the stock is valued at ~20.1x FY18EV/EBITDA and ~47.8x P/E. Arti Industries and Atul Industries trade at FY18 P/E multiples of 38-42, while Vinati Organics and Navin quote at respectively 21x and 63x. On the annualised 9MFY19 EPS of ₹7, the stock priced at 28.5xPE and 17.4x EV/EBITDA. We believe the higher multiple is justified given the company's ability to grow profitably and command better return ratios. **Risks:**Slow growth in underline sectors such as pharma, high working capital intensity and high debt great dependence on certain customers.

Key financials (YE Mar)	FY14	FY15	FY16	FY17	FY18
Sales (₹ m)	738	839	1,003	1,101	1,612
Net profit (₹m)	36	51	52	77	105
EPS (₹)	1.6	2.2	2.2	3.3	4.5
PE (x)	137.7	98.7	96.9	65.3	47.8
EV / EBITDA (x)	45.8	41.4	37.3	28.4	20.1
PBV (x)	25.6	21.4	18.2	12.0	10.0
RoE (%)	18.6	21.6	18.8	18.3	21.0
RoCE (%)	13.7	16.6	15.3	14.8	13.4
Dividend yield (%)	0.9	0.9	0.9	0.5	0.5
Net debt / equity (x)	1.2	0.9	0.9	1.6	1.6

Source: Company, Anand Rathi Research

Key data	
IPO issue date	24th – 26th April'19
Face value	₹10
Lot size	65 shares
Issue price	₹212-215
IPO issue size-OFS	₹624m
No. of shares-OFS	2.9 m
Fresh issue size	₹700m
No. of shares – Fresh issue	3.2 m
QIB	Up to 50%
Retail	35%
Non-institutional	15%

Shareholding pattern (%)	Pre-IPO	Post-IPO
Promoter	95.8	70
Non-promoter group	4.2	30
Total	100	100

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹m)

Year-end: Mar	FY14	FY15	FY16	FY17	FY18
Net revenues	738	839	1,003	1,101	1,612
Growth (%)	*-*	*13.7*	*19.5*	*9.7*	*46.4*
Direct costs	448	497	611	640	948
SG&A	175	215	251	260	373
EBITDA	**115**	**127**	**141**	**200**	**290**
EBITDA margins (%)	*15.5*	*15.1*	*14.1*	*18.2*	*18.0*
- Depreciation	9	9	10	13	19
Other income	4	10	2	3	7
Interest expenses	48	47	48	75	104
PBT	62	81	85	115	173
Effective tax rate (%)	*41.1*	*37.0*	*38.9*	*33.3*	*39.5*
+ Associates / (minorities)	-	-	-	0	0
Net income	36	51	52	77	105
Adjusted income	36	51	52	77	105
WANS	23	23	23	23	23
FDEPS (₹/ sh)	1.6	2.2	2.2	3.3	4.5
FDEPS growth (%)		39.6	1.9	48.3	36.6
Gross margins (%)	39.3	40.7	39.1	41.8	41.2

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY14	FY15	FY16	FY17	FY18
Share capital	45	45	200	200	200
Net worth	196	235	275	420	501
Debt	257	242	264	690	822
Minority interest	-	-	-	-	-
DTL/(Assets)	17	20	21	37	40
Capital employed	**470**	**497**	**561**	**1,147**	**1,363**
Net tangible assets	136	132	174	563	666
Net intangible assets	0	0	0	0	1
Goodwill	-	-	-	-	-
CWIP (tang. &intang.)	0	1	7	13	14
Investments (strategic)	-	-	-	5	4
Investments (financial)	-	-	-	-	-
Current assets (ex cash)	475	530	599	912	1,097
Cash	18	24	25	31	18
Current liabilities	160	190	243	377	437
Working capital	315	340	356	535	660
Capital deployed	**470**	**497**	**561**	**1,147**	**1,363**
Contingent liabilities	108	103	56	38	45

Fig 3 – Cash-flow statement (₹m)

Year-end: Mar	FY15	FY16	FY17	FY18
PBT	81	85	115	173
+ Non-cash items	9	10	13	19
Oper. prof. before WC	90	95	128	192
- Incr./(decr.) in WC	25	16	180	125
Others incl. taxes	26	31	39	65
Operating cash-flow	**39**	**48**	**-91**	**3**
- Capex (tang. +intang.)	6	58	408	124
Free cash-flow	34	-10	-499	-121
Acquisitions				
- Div. (incl. buyback& taxes)	-	-	-	-
+ Equity raised	-	155	-	-
+ Debt raised	-15	22	426	132
- Fin investments	-	-	5	-1
- Misc. (CFI + CFF)	12	167	-84	23
Net cash-flow	6	1	6	-13

Source: Company, AnandRathi Research

Fig 4 – Ratio analysis

Year-end: Mar	FY14	FY15	FY16	FY17	FY18
P/E (x)	137.7	98.7	96.9	65.3	47.8
EV / EBITDA (x)	45.8	41.4	37.3	28.4	20.1
EV / Sales (x)	7.1	6.2	5.2	5.2	3.6
P/B (x)	25.6	21.4	18.2	12.0	10.0
RoE (%)	18.6	21.6	18.8	18.3	21.0
RoCE (%) - after tax	13.7	16.6	15.3	14.8	13.4
RoIC	14.3	17.3	16.1	15.3	13.6
DPS (₹ / sh)	2.0	2.0	2.0	1.0	1.0
Dividend yield (%)	0.9	0.9	0.9	0.5	0.5
Dividend payout (%) - incl. DDT	24.7	17.7	77.2	26.0	19.1
Net debt / Equity (x)	1.2	0.9	0.9	1.6	1.6
Receivables (days)	82	78	58	107	94
Inventory (days)	173	178	190	228	192
Payables (days)	117	120	130	177	141
CFO:PAT%	-	77.4	92.0	-118.2	2.8

Source: Company, AnandRathi Research

Salient features of the issue

- The offer: ₹1,324m, consisting of
  - An offer for sale: 2.9m equity shares of ₹10 each.Size: ₹624m.
  - A fresh issue: 3.2m equity share of ₹10 each. Size: ₹700m.
  - Listing on the BSE and the NSE.
- Issue size: ₹1,314.80m–1,323.50m.
- Price band: ₹212–215.
- Bid lot: 65 shares and multiples thereof.
- Post-issue implied market cap:₹4,947m–5,017m.
- BRLMs: Inga Advisors, Batlivala & Karani Securities.
- Registrar: Link in Time India Pvt. Ltd.
- Issue opens 24th Apr'19; closes 26th Apr'19.

Fig 5 – Indicative timetable

Activity	Approximate Date
Finalisation of Basis of Allotment	03-05-2019
Refunds/Unblocking ASBA Fund	06-05-2019
Credit of equity shares to DP A/c	07-05-2019
Trading commences	08-05-2019

Source: Company

Fig 6 – Issue break-up

Category	(₹ m)	% of the issue
QIB*	657.4—661.8	50
NIB	197.2—198.5	15
Retail	460.2—463.2	35
Total	1314.8—1323.5	100

** Company may allocate up to 60% shares of the QIB portion to anchor investors*

Source: Company

Fig 7 – Shareholding (%)

	Pre-issue	Post-issue
Promoters &Promoter's Group	95.8	70.0
Public	4.2	30.0
Total	100.0	100.0

Source: Company

Fig 8 – Objective of the Issue

	(₹ m)
Pre-payment or repayment of all, or a portion of, certain borrowings	205
Early redemption of 9.8% FRCPS	115
Long-term working capital	200
General corporate purposes	180

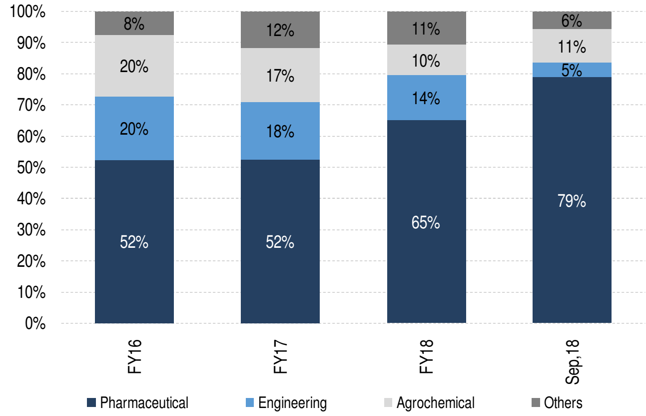
Source: Company

Leading manufacturers of bromine specialty chemicals in India

Commencing operations in 1991 at Mahape, Navi Mumbai, with a few bromine-based compounds and lithium salts, now Neogen has became one of India's leading manufacturers of bromine and lithium-based derivatives.

Its products are used in pharmaceutical and agrochemical intermediates, engineering fluids, electronic chemicals, polymer additives, water-treatment, construction and aroma chemicals, flavours and fragrances, specialty polymers, chemicals and VAM original-equipment manufacturers.

Fig 9 – Sale of products across industry segments



Source: Company

Products

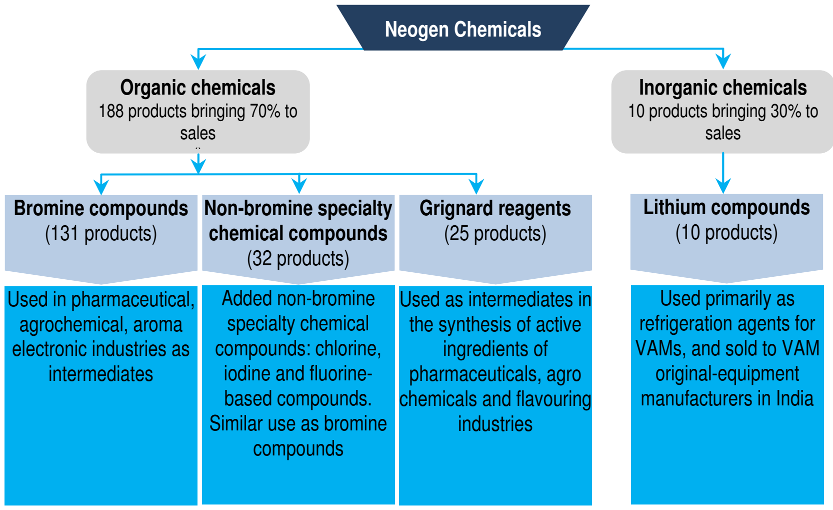
Organic chemicals (molecules containing carbon): 131 bromine compounds + 25 organic specialty-chemical compounds.

- Bromine compounds and/or other organic compounds containing chlorine, fluorine and iodine, and combinations of them.
- Niche products such as 25 types of Grignard reagents.

Inorganic (non-carbon-containing molecules): 10 lithium compounds.

- Lithium compounds manufactured by Neogen used in vapour absorption machines (VAM) for cooling air/water/process equipment.
- Use in industries such as heating ventilation and air-conditioning (HVAC) and refrigeration, construction chemicals, pharmaceuticals and specialty polymers.

Fig 10 – Products segment

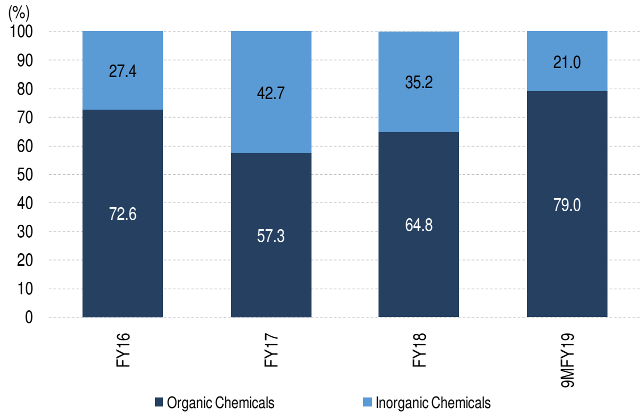


Source: Company

Custom synthesis and Contract manufacturing (CSCM)

- The company undertakes custom synthesizing and contract manufacturing (CSCM) of a few specialty chemicals for multinational companies based in Europe, Israel, China and Japan. FY16, FY17, FY18 and 9MFY19 income from CSCM was respectively ₹1.2m, ₹24.2m, ₹38.9m and ₹150.6m.
- It has entered into contract-manufacturing arrangements with a few international companies engaged in pharmaceuticals, agrochemicals, aromas and specialty polymer industries. Under some of these arrangements, it has already delivered products.

Fig 11 – Segment-wise revenue break-up



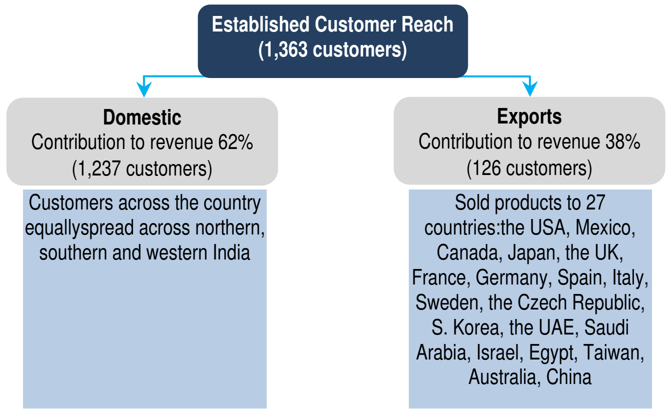
Source: Company

Strong client base

Over the last 25 years, it has established a customer base of ~1,363, of which ~1,237 are domestic and ~126 international.

Itmarkets its products in India and abroad(50% each), in particular to the USA, Europe and Japan (incl. 16% deemed exports where the company supplies its products to customers who will eventually export the end-product).

Fig 12 – Strong customer base



Source: Company

Major raw materials

The primary raw materials used in the manufacturing process of organic and inorganic specialty chemicals are:

- Bromine source
- Lithium source
- Organic raw materials
- Inorganic acids.

The prices of raw materials procured in India are lower than those of China.

Employees

On 28thFeb'19, Neogen employed

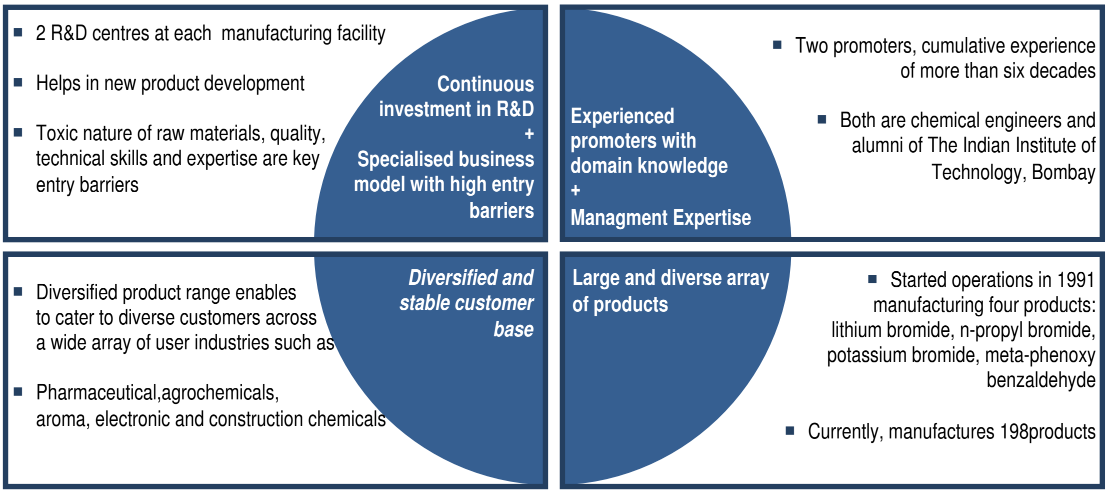
- 152 full-time,
- 45 fixed-term contract employees (generally five-year contracts)
- Four retainers.

Research and Development

- Two R&D facilities, at
  - Vadodara and
  - Mahape
- A dedicated 20-member R&D team (10% of its workforce).
- Key contribution from the R&D team: From Dec'01, the number of its products has grown from around 20 to 198 at present (excl. CSCM).

Competitive strengths

Fig 13 – Strong customer base

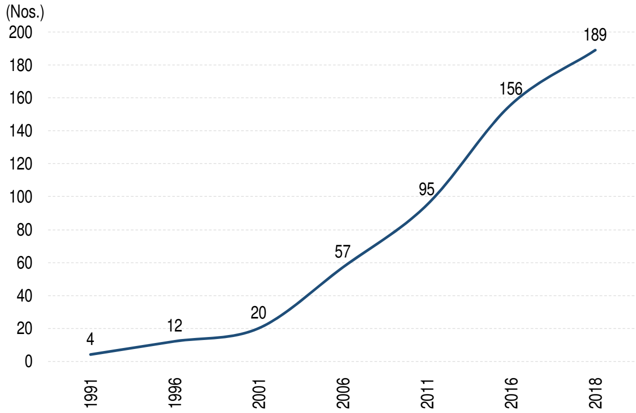


Source: Company

Large and diverse array of products

Neogen started operations in 1991 manufacturing four products: lithium bromide, n-propyl bromide, potassium bromide and meta-phenoxy benzaldehyde. Over the years, it widened its product range. By31Dec'18, it had manufactured 198products.

Fig 14 – Expanding product portfolio



Source: Company

Diversified and stable customer base

The company has a diversified product range, which helps it cater to diverse customers across a wide array user industries such as pharmaceuticals, agrochemicals, aroma, electronic and construction chemicals, specialty polymers and VAM original-equipment manufacturers. This helps mitigate risks from customers, industry and geographic concentration.

Growth driven by continuous investment in R&D

The company has made regular investments in R&D to expand its product range and streamline its manufacturing processes.It has two R&D facilities, one each in Vadodara and Mahape, with a dedicated 16-member team, constituting ~9% of its workforce. The team comprises five senior personnel (including one retainer) with doctorates in science from reputed institutions. Chairman and MD Haridas Thakarshi Kanani leads the R&D initiatives.

Further, since the commencement of the dedicated R&D department, in Dec'01, the number of its products has grown from around 20 to 198 at present (excl. those developed under contract manufacturing).

Per management, product and process innovations will be key factors ahead and continuing investment in R&D will benefit fromcoming opportunities.

Specialised business model with high entry barriers

The bromine-specialty-chemicals industry is highly knowledge-intensive. The end use of products is to manufacture high-value proprietary and specialised products. This requires that each process and product is measured against exacting quality standards and stringent impurity specifications.

Further, product use has been formally recognised in filings with Regulatory agencies. Any change in the vendor of a product may require significant time and cost to a customer. These factors are significant entry barriers.

Over the years, the company has built strong relations of more than a decade with customers who recognise technical capabilities and timely deliveries and associate the brand with good and consistent quality.

Moreover, some of the chemicals used such as bromine and lithium are highly corrosive and toxic. Therefore, handling them requires a high degree of technical skill and expertise. Operations involving such hazardous chemicals ought to be undertaken only by qualified and proficient personnel.

Per management, the level of technical skill and expertise essential to handle such chemicals can only be achieved over time, creating as further barrier to new entrants.

Established, stable relations with suppliers

The company's consistent track record of business growth over the years and repeated business from customers have enabled it to develop long-standing relations with suppliers. It has relations of over a decade with large producers of bromine and lithium.

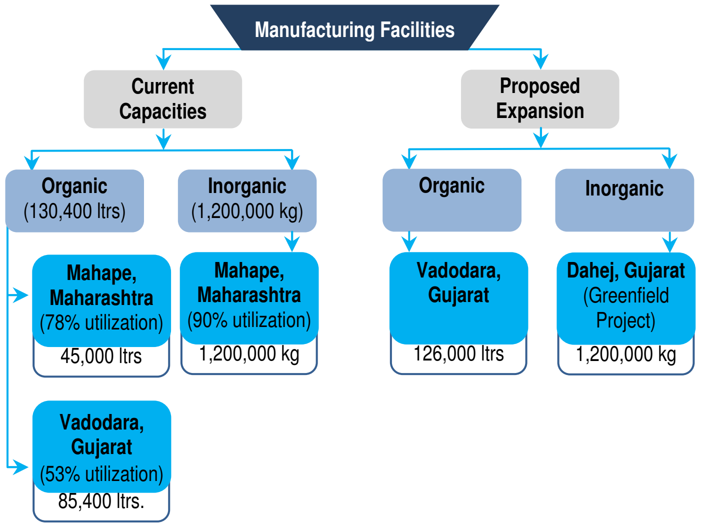
The company has annual contracts, offering stable pricing to customers. Further, due to large volume of the annual contracts, it is able to negotiate attractive pricing compared to local competitors. This gives it an edge.

Growth triggers

Capacity expansion, focus on advanced specialty intermediates

With installed capacity of 130,400 litres of organic chemicals and 1,200 tons of inorganic chemicals and utilisation at respectively 64% and 94%, the company plans to double capacity to ~256,000 litres and 2,400 tonnes of organic and inorganic chemicals to cater to growing demand in the industry. It is trying to forward integrate bromination with other chemistries to make advanced intermediates, otherwise being manufactured by customers in-house.

Fig 15 – Existing and forthcoming expansions



Source: Company

Augmenting growth in domestic and global markets

Its domestic and export businesses contribute almost 50% each (including 16% deemed exports, where the company supplies products to those who eventually export end-products).

The company believes that demand for bromine-based and lithium-based products will grow in India and overseas owing to growth in industries where theyare finally utilised (pharma, agrochemicals, refrigeration, polymer syntheses, flavour and fragrances, etc.).

It is poised to exploit opportunities thrown up by the expected growth in the industries which finally use the chemicals due to

- Strong manufacturing capabilities
- Established customer relations
- Strong R&D capabilities
- Robust product range.

Specialty chemicals manufacturedin China comprised a significant proportion of the specialty chemicals global market. The decline in China due to environmental concerns regarding manufacturing specialty chemicals, will leaves the field open to the company regarding its future growth.

About the management

Experienced promoters with domain knowledge

Promoters Haridas Thakarshi Kanani and Harin Haridas Kanani have cumulative experience of more than six decades. Before setting up Neogen in 1989, the former was a consultant to many chemical manufacturing companies in India. The latter was with Asian Paints. He also worked with a research company, Pioneer Hi-Bred International,a DuPont Company, USA.

Fig 16 – About the management

Haridas Kanani Chairman & MD	A chemical engineering from IIT- Bombay.He oversees the manufacturing, R&D and general operation along with general management of Company's manufacturing units.
Harin Haridas Kanani Joint Managing Director	A chemical engineer from IIT- Bombay and a master's degree and a doctorate in chemical engineering from the University of Maryland. He heads various divisions ofCompany including R&D, business development, quality control, purchase, marketing and finance.
Sanjay Natwarlal Mehta Independent Director	Practicing CA with 42 years' experience;expertise in corporate audit and taxation, regulatory compliances, international taxation and corporate law
Hitesh B. Reshamwala Independent Director	Chartered Accountant with 29 years' expertise in tax and statutory compliances
Ranjan Kumar Malik Independent Direct	Gold medalist in engineering and technology from Kanpur University;Master's, chemical engineering from IIT, Kanpur; PhD from the University of Wisconsin-Madison, USA
Avi Kersi Sabavala Independent Director	B.Sc.(Hons.) from Delhi University; LLB from Maharaja Sayajirao University, Baroda, M.A. (Social Work) from Delhi University and Diploma in Management from The Indira Gandhi National Open University
Anurag Surana Non-Executive Director	B.Com (Hons.) from the University of Delhi; was previously executive director on the Board of PI Industries for 14 years
Shyamsunder Upadhyay Executive Director	M.Sc. from Vikram University, Ujjain. 41 years' experience in chemicals. Oversees maintenance, logistics, administration and the engineering store

Source: Company

SWOT analysis

Strengths

- The company's consistent track record of business growth over the years and repeated business from existing customers have enabled it to develop long-standing relations with suppliers.
- It has relations of over a decade with large producers of bromine and lithium.
- It has annual contracts, which offer stable pricing to customers.
- Further, its large volume of annual contracts gives it the ability to negotiate attractive pricing compared to local competitors. This gives it an edge.

Weakness

- Significant dependence on few suppliers.
- Explosive growth proportion of use by end-consumers cannot be envisaged.

Opportunity

- With greater capacitiesin organic and inorganic chemicals will help to cater the growing demand in the industry.

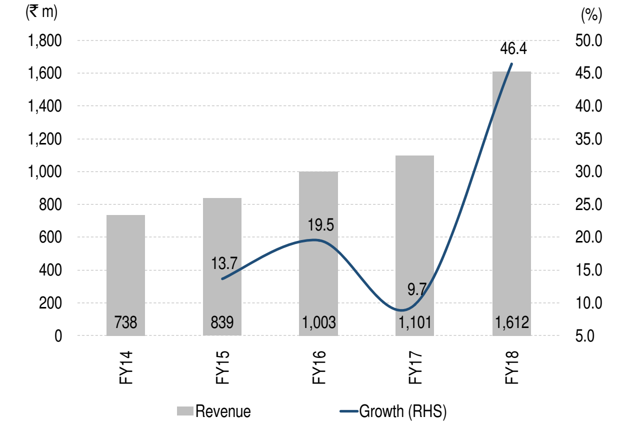
Threats

- Risk to pass on the rise in the raw material prices
- Volatility in forex rates
- Working capital intensive business
- Any environmental issues.

Financials

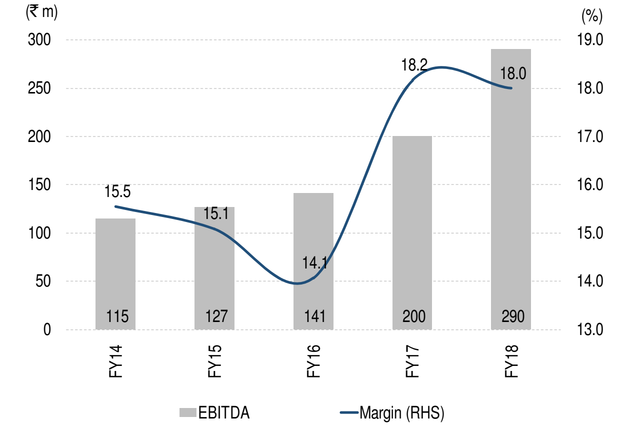
Over FY15-18, the company reported revenue, EBITDA and PAT CAGRs of respectively ~22%, 26% and 30%. Its EBITDA margin expanded 244bps over FY14-18 to 18%. Capex funding pushed up its net-debt-to-equity to 1.6x in FY18, from 1.2x in FY15. In FY18 its RoE was 21%; its RoCE 13.4%. Higher inventory days lengthened its cash-conversion cycle to average 140 days over FY14-18; 159 days in Dec'18.

Fig 17 – Revenue registered a 21.6% CAGR over FY14-18



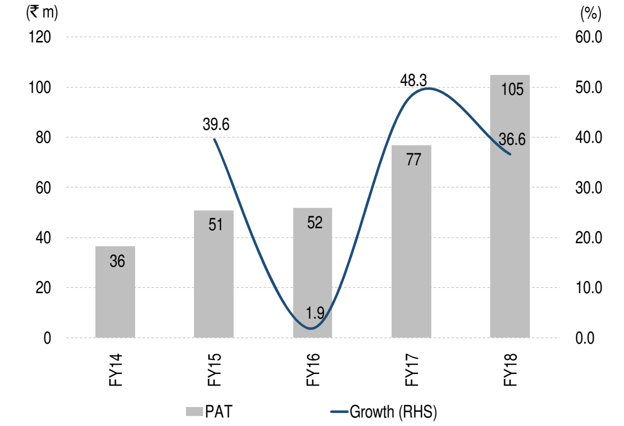
Source: Company

Fig 18 – EBITDA margin expanded 244bps over FY14-18



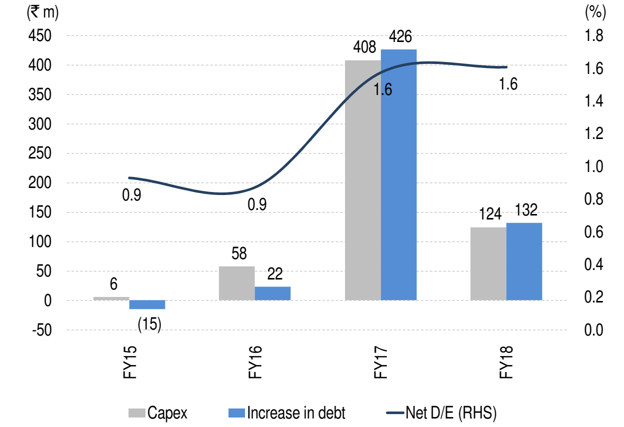
Source: Company

Fig 19 – PAT clocked a 30% CAGR over FY14-18



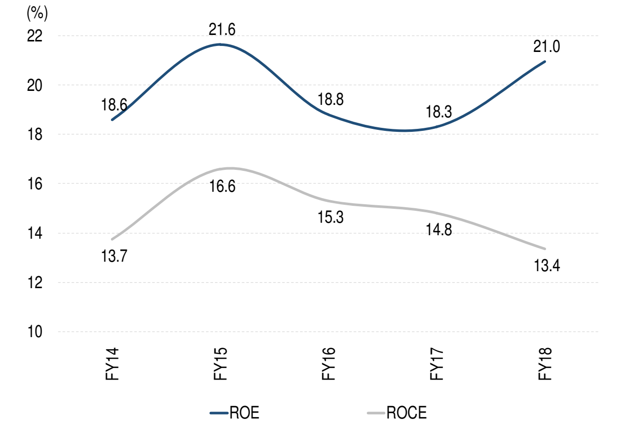
Source: Company

Fig 20 – Net D/E touched 1.6x due to capex



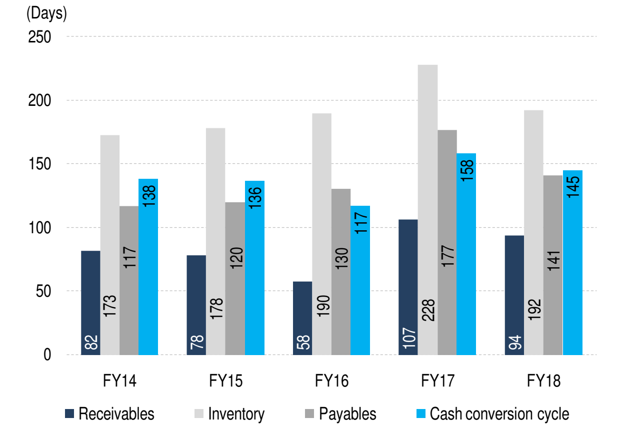
Source: Company

Fig 21 – Healthy return ratios



Source: Company

Fig 22 – Lengthy working-capital cycle



Source: Company

Reasons for high working-capital

Inventory days

The company manufactures many products. Customers'specifications are different, with different impurity profiles. Consequently, production time from a given reactor to makeone tonne of a product can range from five to 30 days. To support such requirements, the company has, in the past, maintained ~120-145 days of work-in-progress on the cost-of-goods sold.

Receivable days

The company had 83 and 94 days of receivables in respectively FY18 and FY17. With the expected increase in letter-of-credit-backed domestic sales and exports, the company expects receivables to improve to 75 days in FY19.

Payable Days

The company had had 163 and 131 days for payables in respectively FY17 and FY18 due to maintaining buyer's credit for import purchases. In the absence of buyer's credit, it expects the payables cycle to contract to 75 days.

Peer comparison

Fig 23 – Peer valuation

(₹ m)	M. Cap (₹ bn)	EV/EBITDA				P/E			
		FY17	FY18	FY19e	FY20e	FY17	FY18	FY19e	FY20e
Aarti Inds.	115.7	22.6	21.8	15.8	14.3	42.3	39.7	30.9	27.7
Atul	101.6	20.9	20.7	16.1	13.5	32.6	38.1	27.7	23.8
Navin Fluorine*	35.0	20.6	14.5	13.4	11.1	25.4	21.1	21.5	19.0
Vinati Organics*	90.5	41.4	42.4	24.4	18.1	64.8	62.9	34.7	26.9

*Source: Company, Anand Rathi Research, *Bloomberg Consensus*

Fig 24 – Financials of peers

	CAGR % (FY14-18)			Gross margins (%)	EBITDA margins (%)	RoCE(%)			RoE(%)			Cash-conversion cycle (days)		
Company	Revenue	EBITDA	PAT	FY18	FY18	FY16	FY17	FY18	FY16	FY17	FY18	FY16	FY17	FY18
Aarti Inds.	9.7	14.9	19.7	42.7	18.4	14.2	14.6	12.8	22.6	23.2	21.1	101.4	115.8	120.2
Atul	7.6	8.6	6.0	45.3	15.3	15.4	15.9	12.3	17.0	16.4	12.3	91.8	86.4	69.5
Navin Fluorine	17.0	34.3	26.0	55.9	23.6	11.5	16.4	19.2	11.4	16.4	16.9	76.1	106.8	76.3
Vinati Organics	1.7	8.4	13.7	49.2	28.4	23.4	20.4	17.6	24.2	20.6	18.1	92.3	119.3	105.1
Neogen	21.6	26.1	30.3	41.2	18.0	15.3	14.8	13.4	18.8	18.3	21.0	117.0	158.1	145.0

Source: Company, Anand Rathi Research

Appendix

Analyst Certification

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