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NEOGEN
CHEMICALS LTD.

SNAPSHOT:

- Market Cap: **800** Cr.
- Book Value: **30.20**
- Stock P/E: **36.60**
- Debt to equity: **1.32**
- OPM: **18.19** %
- OPM 5Year: **17.16** %
- Average RoE 3Years: **24.54** %
- ROCE 3yr avg: **24.13** %
- Equity capital: **23.33** Cr.
- Sales Growth (3Yrs): **33.58** %
- Profit growth 3Years: **59.55** %
- Enterprise Value: **972.16** Cr.
- Promoter holding: **70.00** %

About:

→ Neogen Chemicals Ltd is a 27-year-old company specialising in Bromine based compounds, Grignard Reagents and Inorganic Lithium Salts.
→ The company was founded by Mr H T Kanani, a chemical engineer from IIT Mumbai.
→ Given his long association with Bromine he is known as the **"Bromine Man of India"**.

→ The Company operates out of its two manufacturing facilities located in Mahape, Navi Mumbai in Maharashtra, and Karakhadi, Vadodara in Gujarat.
→ It is presently, developing a Greenfield manufacturing unit in Dahej SEZ, in Gujarat.

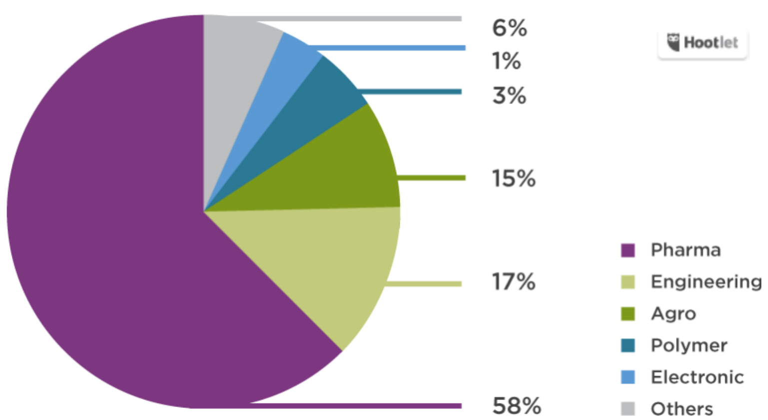
What are Specialty Chemicals:

→ 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.

→ They are widely used for specialized applications to meet industry-specific requirements.

Industry catered by Neogen:

REVENUE BY INDUSTRY



Business Segments:

a) **Organic chemicals (~80% contribution of topline):**

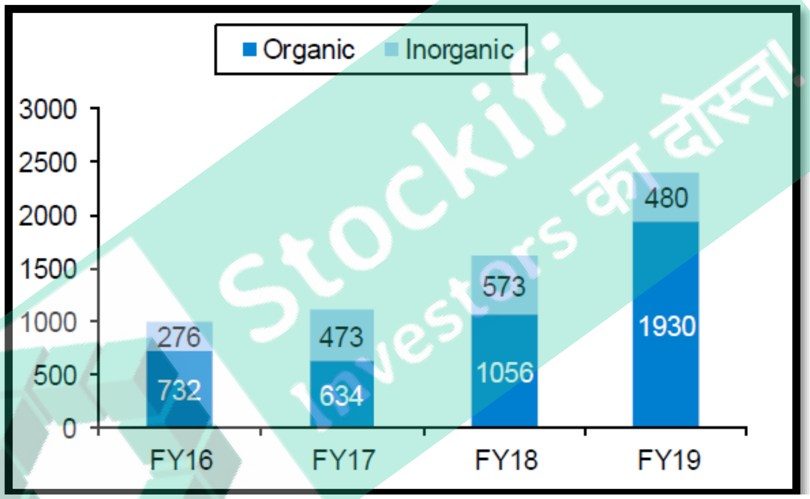
→ This segment comprises Bromine Compounds and other organic compounds containing chlorine, fluorine and iodine-based combinations thereof. Besides, the company also manufactures niche products like Grignard reagents.

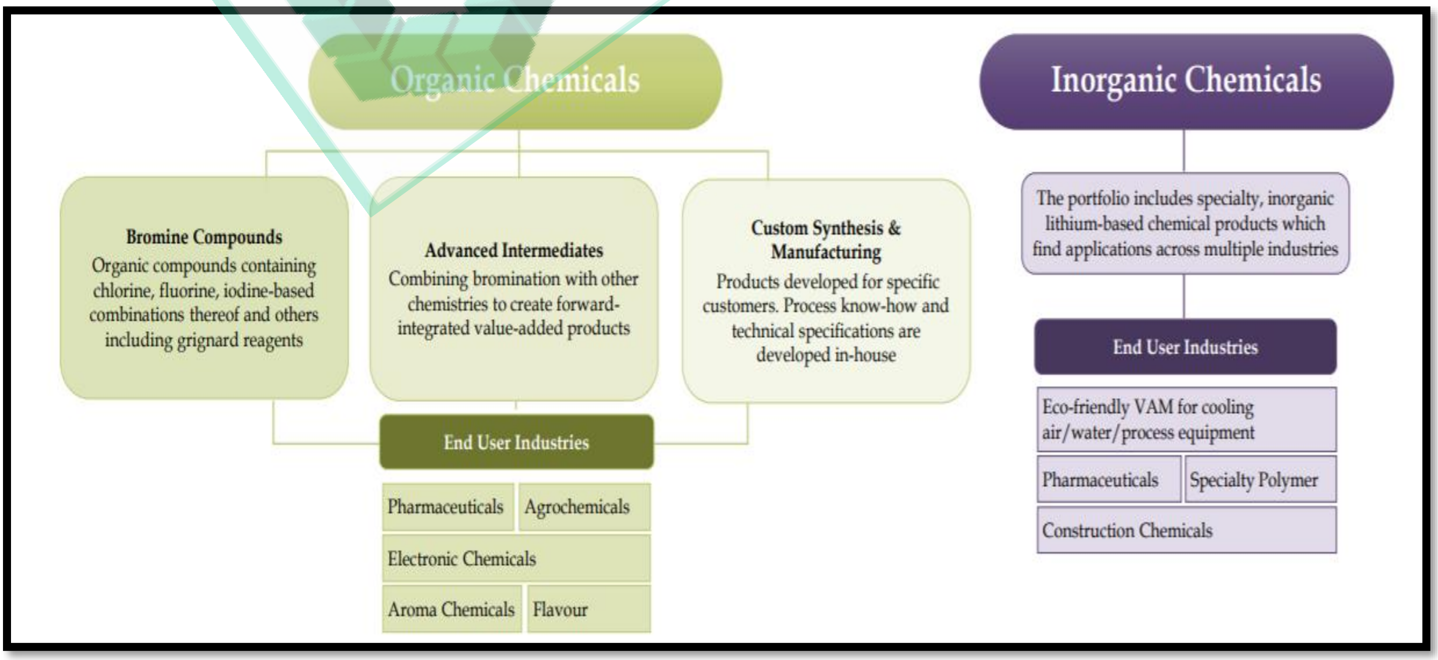
→ **Grignard reagents**: are the specialty organic chemical compounds find usage in diverse industries such as pharmaceutical, agrochemical, flavor & fragrance and electronic-chemical.

b) **Inorganic chemicals (~20% contribution to topline):**

→ This segment primarily comprises of **Lithium compounds** which are used in eco-friendly Vapor Absorption Machines (VAM) for cooling air/water/process equipment.

→ They find application in industries such as heating ventilation & air-conditioning (HVAC), refrigeration, construction chemicals, pharmaceutical and specialty polymer. Its key customers include Thermax, Voltas etc.





Industry Outlook:

→ The global specialty chemical market is expected to grow at a CAGR of 5.47% from USD 743.80 billion in 2017 to USD 970.55 billion in 2022.
→ Agrochemicals segment dominated the global specialty chemical industry followed by polymers and plastic additives segments.
→ In India, Specialty chemicals accounts for 20-25% of the overall chemicals industry and is expected to grow significantly at a CAGR of 12-13% over the next five years.

Overview of key end-user industries for specialty chemicals:

→ **Pharmaceutical Intermediates market:** Specialty chemicals are used by pharmaceutical manufacturers as intermediates in making drugs. India has emerged as a key manufacturing hub of Active Pharmaceutical Ingredients (APIs) and generic formulations.

→ **Agrochemicals:** Specialty chemicals are used as intermediates in agrochemical industry. With strong growth drivers in place, the agrochemical consumption is expected to grow at a CAGR of 8-10% in the next 5 years.

→ **Heating, ventilation and air conditioning (HVAC) / Electronic Chemicals:** Growth is expected to be driven by higher demand for commercial spaces, development of smart cities, on-going and upcoming airport and metro infrastructure.

→ **Polymer, Paints, Coatings and Construction Chemicals:** India is expected to become the third largest construction market globally by 2022. CRISIL Research expects construction industry in India to grow at a CAGR of 8-10% led by an increase in housing and infrastructure investments.

Investment Thesis:

Strategy & Strengths:

- ✓ **Experienced promoters with domain knowledge**
- ✓ **Large and diverse array of products**
- ✓ **Diversified and stable customer base**
- ✓ **Growth led by continuous investment in R&D**
- ✓ **Specialised business model with high entry barriers**
- ✓ **Established and stable relationship with suppliers**
- ✓ **Expanding production capacities**
- ✓ **Increasing contract manufacturing portfolio**
- ✓ **Augmenting growth in domestic and global markets**
- ✓ **Improving financial performance through focus on operational efficiencies and functional excellence**
- ✓ **Focus on advanced specialty intermediates which offer higher value addition**

- **Expanding the production capacities:**

→ **Two major capex**: One is a 12,00,000 kg inorganic specialty chemical greenfield project in Dahej for which the construction activities have already commenced. It will help cater the anticipated demand increase in lithium compounds.

→ The other is a 1,26,000 litres of Organic reactor capacity also at Dahej which will help in capturing demand from international markets, which in turn will help **double organic chemicals capacity** to support the growth of custom synthesis and manufacturing business.

→ Acquisition of Solaris in Dec2016 also accelerated their growth trajectory.

→ With high utilization levels, the company is on track to double the capacity in stages by Q4FY21, which will double revenues by FY22E.

→ Once both organic and inorganic capacities come into place, management is expected to do ~Rs. 500 Cr.+ topline because both the expansions will double the capacity.

- **Increasing the share of contract manufacturing portfolio:**

→ The Company has entered into contract manufacturing arrangements with a few international pharmaceutical, agrochemical, aroma and specialty polymer companies.

→ NCL aims to increase the size and scale of contract manufacturing business to be able to enter into **long term contracts with assured margins** and product off-take

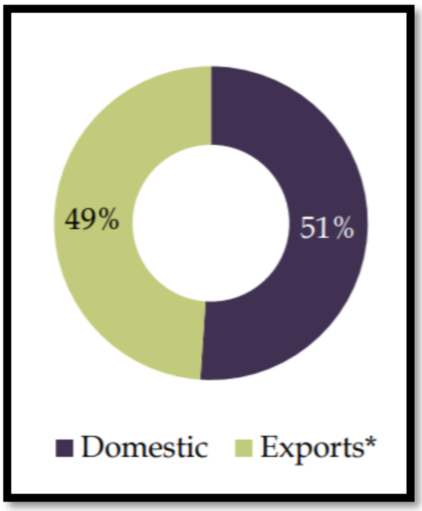
→ The Company has several projects in the R&D which are enquiries from Innovator and Generic companies. The Management has a clear strategy to focus on development of the Custom Synthesis and Contract Manufacturing business.

- **Focus on advanced specialty intermediates which offer higher value addition**

→ Over years, Neogen has focused on forward integration by moving to high value advanced intermediates (AI) that combines bromination with other chemistries.

→ This helps customers to focus resources on final molecules such as API, specialty polymers, electronic chemicals etc.

→ For FY19, AI accounted for 31% of revenues and company expects capacity expansion to cater towards rising demands from different industries.



- **Expanding growth in domestic and global markets:**

→ There is a strong demand potential for bromine and lithium-based products in India and overseas, owing to growing demand in their final application industries.

→ The Company targets to increase its exports share by leveraging its strong manufacturing capabilities, long-standing customer relationships, strong R&D competencies and robust product portfolio.

- **Aiming for sizable market share**:

  → With their FY19 bromine consumption at 2,000 tons, opportunities for specialty bromine compounds are at 50,000 tons.
  →The management has charted growth opportunities worth ~$1 Billion in the organic chemistry space given strong customer loyalty, high quality standards and lowest cost of operation.

- **Growth led by continuous investment in R&D:**

  → Neogen was started by a technocrat promoter and company has persistently maintained strong focus on R&D.
  → **10% of company's workforce is into R&D** and this has helped the company expand product portfolio **to 198 as on FY19 end**.
  → The team includes 5 senior personnel with doctorates in science (Ph.D.) from reputed institutions. All R&D initiatives are led by the Senior Leadership.

- **Established and Stable Relations with Suppliers**

  → 10+ years of strong relationships with bromine and lithium producers leading to Product supply and price stability.

- **High Entry Barrier Business:**

  → Among handful of companies having extensive experience and expertise in the niche and specialised business area of bromine and lithium-based compounds

  → Products necessitate meeting stringent quality and impurity specification along with formal filing with regulatory agencies by our customers in many cases

- **Large and Diverse Portfolio**

  → 131 bromine, 10 lithium and 32 non-bromine specialty chemical compounds and 25 grignard reagents

  → Products meet niche requirements of customers from diverse industries

- **Diversified and Stable Customer Base**

  → Customers across pharmaceutical, agrochemical, aroma chemical, electronic-chemical, construction chemicals, specialty polymer and VAM (vapor absorption machines) original equipment manufacturing industries.

  → 1,237 domestic and 126 international customers served so far in more than two decades.

Financials:

→ Profit & Loss Statement

NEOGEN CHEMICALS LTD						
Rs Cr	**Mar-15**	**Mar-16**	**Mar-17**	**Mar-18**	**Mar-19**	**CAGR%**
Sales	**84**	**100**	**110**	**161**	**239**	**23.3%**
% Growth YOY	14%	20%	10%	46%	48%	
Expenses	73	89	94	132	196	**21.7%**
Material Cost (% of Sales)	63%	65%	63%	64%	67%	
Power and Fuel	6%	5%	5%	4%	3%	
Other Mfr. Exp	8%	9%	9%	9%	9%	
Employee Cost	6%	5%	5%	5%	5%	
Selling and Admin Cost	8%	8%	8%	5%	6%	
Operating Profit	**11**	**12**	**17**	**29**	**43**	**32.7%**
Operating Profit Margin	13%	12%	15%	18%	18%	
Other Income	1	0	0	1	1	
Other Income as % of Sales	1.2%	0.2%	0.4%	0.5%	0.3%	
Depreciation	1	1	1	2	3	
Interest	5	5	8	10	12	
Interest Coverage(Times)	2	2	2	3	3	
Profit before tax (PBT)	6	6	8	18	29	**37.5%**
% Growth YOY	43%	2%	34%	115%	67%	
PBT Margin	7%	6%	7%	11%	12%	
Tax	3	3	4	7	8	
Net profit	**3**	**3**	**4**	**11**	**21**	**47.7%**

→ **Margins improvement**: EBIDTA margins have improved to 18.2% for FY19 against 13% in FY15 led by high operating leverage and favourable product mix. With leverage play on higher volumes after capacity expansion, we expect margins to expand further going further.

→ Over the last 5years, Neogen grown their bottom line by ~47% CAGR while maintaining strong capital utilization efficiency.

	Mar-15	**Mar-16**	**Mar-17**	**Mar-18**	**Mar-19**
Sales Growth	13.7%	19.5%	9.7%	46.4%	48.3%
PBT Growth	42.8%	1.7%	34.3%	115.1%	67.4%
Net Profit Growth	82.3%	-7.4%	56.0%	147.5%	96.8%

→ Neogen has a long working capital cycle of 138 days in FY19 due to high inventory of multiple work in progress customized products for each customer.

→ Also, raw material inventory is pushed higher due to import of lithium from Chile and Argentina. Going forward, the company will consciously move towards more Long-Term agreements to reduce high WIP requirements. Also, start of dedicated reactors for large clients will help avoid regular change in processes.

→ Balance Sheet

Rs Cr	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19
Equity Share Capital	5	20	20	20	20
Reserves	19	8	22	31	50
Borrowings	24	26	69	69	108
Other Liabilities	21	27	41	63	69
Total	**69**	**80**	**152**	**182**	**248**
Net Block	13	17	56	67	83
Capital Work in Progress	0	1	1	1	0
Investments	-	-	0	0	0
Other Assets	55	62	94	113	164
Total	**69**	**80**	**152**	**182**	**248**
Working Capital	34	36	53	51	95
Debtors	18	16	32	41	61
Inventory	24	32	40	50	72

Strong Balance Sheet → would help in sustainable growth in future

Strong business model → would help in operational efficiencies.

Key Ratios:

→ **Efficiency Ratios**:

	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19
Debtor Days	78.1	57.7	106.6	93.7	92.6
Inventory Turnover	3.5	3.2	2.8	3.2	3.3
Fixed Asset Turnover	6.4	5.8	2.0	2.4	2.9

→ **Solvency Ratios: manageable debt and adequate interest coverage**

	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19
Debt/Equity	1.0	1.0	1.6	1.4	1.5
Debt/Assets	35.2%	32.8%	45.3%	37.8%	43.7%
Interest Coverage (Times)	2.3	2.3	2.1	2.7	3.5

→ **Return Ratios: Return ratios continue to remain impressive**

	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19
Return on Equity	12.7%	10.1%	10.3%	21.1%	29.9%
Return on Capital Employed	22.3%	20.1%	14.1%	23.4%	23.1%

Key Risks:

→ **Innovation Risks:** NCL has inculcated the culture of innovation in product and processes to ensure sustainable growth. Inappropriate investment in processes and technology and poor R&D could adversely impact the Company's business integrity along with its reputation.

→ **Forex risks:** NCL derives approximately 50% of its revenues from outside India including 16% deemed exports (where the Company supplies products to its EOU, SEZ customers who eventually export their end products). Being exposed to a significant number of geographies, any unfavourable movement in currency will lead to financial losses.

→ **Raw Material Risk:** The Company is exposed to the risk of availability of raw materials and fluctuation in raw material prices. However, NCL has built a long-standing relationship with its suppliers to ensure steady availability of raw materials at competitive prices.

→ **Intellectual Property Risk:** Neogen Corporation has filed a commercial intellectual property suit against NCL which if determined against NCL may have an adverse effect on this Offer, its business and results of operations.

→**Customer Concentration Risk:** Significant reliance on certain select customers and customers in application industries, in particular customers in the sectors such as pharmaceutical, agro-chemicals, refrigeration and construction chemicals;

View:

→ We anticipate Neogen can grow bottom line at about ~30% over the next 5 years through growth and margin expansion as more of its business moves downstream. (Over the last 5 years, the share of its business from downstream has increased from ~10% to-25%.)

→ Many well-run Chemical companies in India have compounded PAT by ~20 % for the last 15 years starting from much larger base. (PI Industries, Aarti, Divis etc)
→As per management guidance in con call transcript, we anticipate Neogen to double the topline to ~Rs. 500 Cr after the capex is done along with a stable EBITDA margins in range of 18-19%.
→ Neogen focused in a niche product, growing at such a great speed, aggressive capex, maintain great return ratios shall continue to command a premium going forward.

→ With just ~240 Cr of topline (FY19), a very small starting base, long run-way of growth and a management team that instigates confidence, we believe Neogen has a long way to go and a great addition in a portfolio in the range 340-370.

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