

Scrip Code
DAICHEQNR

Industry
Chemicals

CMP
85.35

Recommendation
Buy at CMP and add on declines

Add on Dips
Rs 70-76

Price Chart



Stock Details

BSE Code	526821
NSE Code	-
Bloomberg	DIK:IN
Price (Rs) as on 18 July, 2014	85.35
Equity Capital (Rs Cr)	7.45
Face Value (Rs)	10
Eq. Shares O/s (Cr)	0.75
Market Cap (Rs.)	63.59
Book Value (Rs)	112.46
Avg. Volume (52 Week)	6412
52 wk H/L (Rs)	92.0/34.3

Shareholding Pattern

(As on June 30, 2014)	
Indian Promoters	63.74
Institutions	0.02
Non Institutions	36.24
Total	100

Dai-Ichi Karkaria Ltd (Dai-Ichi) is engaged in manufacturing of Specialty Chemicals. The Company's activities are carried out at its plants located at Kasarwadi and Kurkumbh, Pune (Maharashtra).

Triggers

- The Indian Specialty Chemical Industry has the potential quadruple in size from US\$ 20 billion to US\$ 80 billion over the decade.
- Among Speciality Chemicals, the focus of the company has expanded to performance products that are used in larger volumes in the Oil Field and Construction Chemical Sectors, to maintain the integrity of its pipelines.
- The company has a 50:50 JV with global leader Nalco Champions, whose operations are taking off and sales and PAT have grown smartly in FY14.
- Its expansion has been delayed due to clearances but it has not hampered production; it has now embarked on debottlenecking.
- It is available at cheap valuation considering it's robust and growing earnings, the cash / current investments on books, inflow from sale of stake in Inogen labs in July 2014 (Rs.8.97cr) and value of shares held in Clariant Chem on its books.

Risks/Concerns

- Foreign currency risks and risks of volatility in raw material prices
- Slowdown in industry Dai-Ichi is catering to and Competition, domestic/overseas

Conclusion and Recommendation

At the current market price (of Rs 85), the company is trading at 6.1x its FY14 Adjusted EPS of Rs 13.9 We value the company at 8-9x its FY14 EPS to arrive at the sequential target prices of Rs 111 and 125. We feel investors could buy the stock at the CMP and add on dips to Rs.70-76 band (~5.25 xFY14 EPS) for the above target prices in 1-2 quarters. If the pace of growth in the company and its JV continues to be robust, its share price has the potential to go much higher.

Financial Summary (Consolidated)

P&L Statement (Rs in Cr)	FY12	FY13	FY14
Revenue from Operations	77.2	101.6	147.4
Expenses	75.2	95.9	134.8
Operating Profit	2.0	5.8	12.6
OPM (%)	2.5	5.7	8.5
Adjusted PAT	3.3	6.6	9.6
APATM (%)			
Reported PAT	3.3	6.6	15.6
Adjusted EPS (Rs)	4.5	8.8	13.9
Reported EPS (Rs)	4.5	8.8	20.9

(Source: Company, WealthZap.com)

Company Profile

Dai-Ichi Karkaria Ltd is engaged in manufacturing of Specialty Chemicals. The Company's activities are carried out at its plants located at Kasarwadi and Kurkumbh, Pune (Maharashtra). The company commenced commercial production in 1963, in technical collaboration with the world renowned Dai-Ichi Kogyo Seiyaku Co. Ltd., Japan. It has access to relevant and innovative technology, together with 42 years of experience in the development and manufacture of high performance specialty chemicals for different applications in industries such as Construction, Cosmetics and Pharma, Electronics, Oil field chemicals, Paper and pulp, Plastic and PVC, Textiles, etc.

Industry

The current size of the Indian Chemical Industry is US\$ 108 billion and accounts for 7% of the Indian GDP. The Indian Specialty Chemical Industry has the potential to quadruple in size from US\$ 20 billion to US\$ 80 billion over the decade. The Industry is expected to grow at 10% to 12% in 2017 on the back of increasing demand from growth of Urban population and infrastructure.

A large number of multinational companies are considering India as the sourcing & manufacturing hub due to its cost advantages. India can emerge as a major global player subject to availability of infrastructure, key feed stocks (raw materials) and energy essential to manufacture specialty chemicals at low cost. Bottlenecks at India's ports need to be streamlined to emerge as major exporter.

Triggers

Scope in industry

Some studies have shown that the per capita consumption of specialty chemicals in India is far below world standards. India's demographics together with its expanding middle class with expanding per capita incomes will automatically lead to consumption led growth. Higher growth expectations and improved environmental standards could lead to double digit growth within certain segments.

The industries to which Dai-Ichi caters to have great potential to grow which translates into a higher growth potential for Dai-Ichi who is looking at new opportunities for expansion of its innovative specialty chemicals. Dai-Ichi's focus has expanded to performance products that are used in larger volumes in the Oil Field and Construction Chemical Sectors, to maintain the integrity of its pipe lines and thus the revenues.

50:50 JV with Nalco Champions

The Company has a Joint Venture with CTI Chemicals Asia Pacific Pte. Ltd., in the ratio of 50:50. It has invested Rs.67.5 lacs for its stake.

The Company's capabilities in complex synthesis, and its ability to meet exacting delivery schedules, has opened up a new opportunity with its JV partner Nalco Champion. Products are jointly developed by the two partnering companies. This Joint

Venture attitude of two production partners, enables innovative new applications to be developed with chemicals from renewable or other sources. Every month new products are being added to the portfolio, based on cost performance, compatibility and stability. Synergistic blends of both companies' products are catering to some effective performance solutions whilst remaining in the competitive space.

Successfully developing and commercializing new production chemicals will therefore cover not only cost performance and environmental issues, but also compatibility and stability issues. Stimulus responsive chemicals and combination products are the innovations that will be the new way forward in this area.

Nalco Champion is a global oilfield chemical company formed in 2013 following the acquisition of Champion Technologies by Ecolab, the parent company of Nalco. Ecolab, Inc. headquartered in USA is a global provider of water, hygiene and energy technologies and services to the food, energy, healthcare, industrial and hospitality markets. In December 2011, Nalco became a wholly owned subsidiary of Ecolab Inc., after it completed its US\$5.4 billion acquisition.

In May 2012, Microsoft co-founder, Bill Gates through his investment vehicles - Cascade Investment and Bill & Melinda Gates Foundation; increased the current stake of 10.8% in Ecolab to 25% and in October 2012, Ecolab entered an agreement to acquire Champion Technologies, whose purchase closed in April 2013.

For FY14, due to the company's focus on Oil Field Chemicals and the Oil Sector (along with the JV partner) allowed it to survive the lackluster environment in some of the other areas of operation.

For FY14, the 50% share of this JV in Dai-Ichi's consolidated revenue increased by nearly 90% to Rs 39.61crore from Rs 20.84 crore in FY13 and its share of profitability increased by 41% to Rs 3.09 crore from Rs 2.19 crore in FY13.

Product innovation encourages greener products

The Company continues to re-evaluate the products it manufactures and those under development. Dai-Ichi's focus on safety and environment issues has moved it towards greener chemistries and cleaner processes that have proved economically beneficial for the Company. The Company exited products that were economically non-viable. And some products with greener footprints and higher value addition are being developed as substitutes.

Innovation is essential for the Company to remain competitive and maintain its pioneering position. The company's new focus will be on sustainable chemistry, and a continued re-evaluation of energy use, water consumption, use of renewable feedstock, use of natural products like fatty acid derivatives will be the future trend.

Dai-Ichi is focusing on ecologically sustainable solutions in all its key market segments including emulsifiers for emulsion, polymerization, metal cleaning, bio-pesticides, textiles, etc. The Company has developed APEO free equivalents for some of its standard products, which are slowly gaining momentum as export markets open up for its customers.

Expansion delayed but did not hamper production

During October 2012, Dai-Ichi purchased a plot of about 11 acres for Rs 4.98 crore in Dahej for future expansion of its operations. However, the recent policy paralysis, in the past year has considerably delayed the expansion plan. The Company's expansion plans at Dahej have been stalled for want of environmental clearances, due to the political stalemate.

Decisions of expansions and reorientation of business have been put on hold for several months partly because of the prevailing uncertainties in the economic system and mainly due to delay in environmental clearances at its new site.

The Company has therefore moved ahead with debottlenecking its present plant in Pune, in order to achieve higher capacities required immediately. The Company is moving forward with replacing its older reactors in Pune with newer more efficient reactors which will enhance capacities in the interim.

The Company has gradually switched over to automation of its processes, for all its new reactors. Automation brings with it enormous potential for effective utilization of manpower whilst standardizing batches to highly precise levels.

Investment in Inogen Laboratories Pvt Ltd and Clariant Chemicals (India) Ltd

During October 2005, Dai-Ichi alongwith GVK Biosciences Pvt Ltd and Inogen Laboratories Pvt Ltd formed a JV in which Dai-Ichi had 26 lac shares at a cost of Rs.4 cr. However, in September 2013, Dai-Ichi sold about 16.13 lakh shares (10% stake) to GVK BIO and its Parent Company - GVK Davix Technologies P. Ltd for a consideration aggregating to Rs. 8.50 crore. This resulted in an extraordinary gain of Rs.6 cr (pretax). The balance of 6.12% stake which comes to about 9.88 lakh shares were sold during July 2014 for a total consideration of Rs 8.97 crore. This income would be reflected in Q2FY15 which will further aid its profits.

Dai-Ichi has about 57,000 shares in Clariant Chemical as an investment (cost Rs.13.62 lacs – CMP Rs.540 lacs), which when sold could garner a good amount of profit and cashflow

Available at cheap valuations

As per its FY14 accounts, the company has a balance of Rs 36 crore in cash and current investments and an equity capital of Rs 7.45 crore (Rs.10 paid up). So the cash per share comes at Rs 48. As indicated earlier, Dai-Ichi had an exceptional gain in FY14 due to the profit on sale of its investment in Inogen Laboratories. After having adjusting the same, the EPS arrived at on a consolidated basis is Rs 13.91 in FY14 (as against reported of Rs 20.94) vs Rs.8.8 in FY13. The value of sale of Inogen Labs in July 2014 and value of Clariant Chem held on its books also add upto another Rs.15 per share.

Risks/Concerns

- The company is a net exporter, so it does face a **foreign currency fluctuation risks**. However, it does hedge some portion of its earnings.
- Any **slowdown in the industries** the company caters to will have an impact on its earnings.
- **Competition** in domestic and foreign markets also persist which can affect its revenues

- **Volatility in prices of raw materials** (Ethylene oxide, Fatty Alcohol, Phenol, Glycol etc) could impact the margins to the extent they are not passed on to the customers.
- **Wage agreement** at Kasarwadi Plant was expired on 30th November, 2008. Negotiations with employees are in progress. The Company does not expect any significant additional liability on this account.
- Being a smallcap stock, **the daily traded volumes on the BSE is not large**, resulting in relatively larger impact cost.

Conclusion

According to Frost & Sullivan, the Indian chemicals industry is likely to grow at a rate of 11-12 percent in the next two to three years. This along with the strong JV (which is doing well), de-bottle necking of its existing plant, innovative products, huge cash balance and cheap valuation will augur for a re-rating for Dai-Ichi.

At the current market price (of Rs 85), the company is trading at 6.1x its FY14 Adjusted EPS of Rs 13.9 We value the company at 8-9x its FY14 EPS to arrive at the sequential target prices of Rs 111 and 125. We feel investors could buy the stock at the CMP and add on dips to Rs.70-76 band (~5.25 xFY14 EPS) for the above target prices in 1-2 quarters. If the pace of growth in the company and its JV continues to be robust, its share price has the potential to go much higher.

Financials

Profit & Loss (Standalone)

P&L Statement (Rs in Cr)	FY12	FY13	FY14
Revenue from Operations	70.34	80.78	107.77
Expenses	69.46	78.62	100.62
Raw Material Cost	49.93	56.73	75.04
Employee Cost	9.03	9.56	10.57
Other Expenses	10.5	12.33	15.01
Operating Profit	0.88	2.16	7.15
Other Income	4.3	4.99	3.87
EBITDA	5.18	7.15	11.02
Depreciation	1.14	1.48	1.57
EBIT	4.04	5.67	9.45
Interest	0	0.02	0.09
PBT	4.04	5.65	9.36
Tax	0.69	1.26	2.86
Adjusted PAT	3.35	4.39	6.5
Exceptional Item	0	0	6.02
Reported PAT	3.35	4.39	12.52
Adjusted EPS (Rs)	4.5	5.9	9.7
Reported EPS (Rs)	4.5	5.9	16.8

OPM (%)	1.3	2.7	6.6
APATM(%)	4.8	5.4	6.0

Profit & Loss (Consolidated)

P&L Statement (Rs in Cr)	FY12	FY13	FY14
Revenue from Operations	77.17	101.62	147.38
Expenses	75.21	95.86	134.79
Raw Material Cost	54.03	68.16	98.52
Employee Cost	9.44	10.61	12.4
Other Expenses	11.74	17.09	23.87
Operating Profit	1.96	5.76	12.59
Other Income	4.44	4.86	3.66
EBITDA	6.4	10.62	16.25
Depreciation	1.23	1.57	1.69
EBIT	5.17	9.05	14.56
Interest	1.14	0.03	0.17
PBT	4.03	9.02	14.39
Tax	0.69	2.45	4.81
Adjusted PAT	3.34	6.57	9.58
Exceptional Item	0	0	6.02
Reported PAT	3.34	6.57	15.6
Adjusted EPS (Rs)	4.5	8.8	13.9
Reported EPS (Rs)	4.5	8.8	20.9
OPM (%)	2.5	5.7	8.5
APATM(%)	4.3	6.5	6.5

Balance Sheet (Consolidated)

Balance Sheet (Rs in Cr)	FY12	FY13	FY14
Equity & Liabilities			
Shareholders' Funds	67.19	74.00	87.33
Equity Share Capital	7.45	7.45	7.45
Reserves & Surplus	59.74	66.55	79.88
Non-Current Liabilities	3.66	3.31	2.85
Long Term borrowings	1.22	1.13	0.87
Deferred Tax Liabilities	0.42	0.08	0.00

Other Long Term Liabilities	1.31	0.80	0.80
Long Term Provisions	0.71	1.30	1.18
Current Liabilities	12.47	20.06	29.22
Trade Payables	7.35	13.02	20.42
Other Current Liabilities	3.19	4.07	6.11
Short Term Provisions	1.93	2.97	2.69
Total Equity & Liabilities	83.32	97.37	119.40
Assets			
Non-Current Assets	31.82	33.67	36.39
Fixed Assets	15.14	22.82	23.65
Tangible Assets	14.84	17.06	16.84
Intangible Assets	0.03	0.02	0.01
Capital Work-in-Progress	0.27	5.74	6.80
Non Current Investments	11.16	2.24	2.24
Deferred tax assets	0.00	0.04	0.50
Long -term Loans and Advances	5.52	8.57	10.00
Current Assets	51.49	63.62	83.08
Current Investments	22.15	17.30	28.58
Inventories	7.10	11.77	13.83
Trade Receivables	10.85	20.09	30.13
Cash & Cash Equivalents	9.80	10.89	7.44
Short Term Loans & Advances	1.57	3.40	2.87
Other Current Assets	0.02	0.17	0.23
Total Assets	83.32	97.37	119.40

Balance Sheet (Standalone)

Balance Sheet (Rs in Cr)	FY12	FY13	FY14
Equity & Liabilities			
Shareholders' Funds	65.05	67.24	77.53
Equity Share Capital	7.45	7.45	7.45

Reserves & Surplus	57.60	59.79	70.08
Non-Current Liabilities	2.25	3.16	2.75
Long Term borrowings	1.14	1.13	0.86
Deferred Tax Liabilities	0.19	0.00	0.00
Other Long Term Liabilities	0.00	0.80	0.80
Long Term Provisions	0.92	1.23	1.09
Current Liabilities	15.30	14.88	17.83
Trade Payables	10.61	8.44	9.25
Other Current Liabilities	2.55	3.87	5.91
Short Term Provisions	2.14	2.57	2.67
Total Equity & Liabilities	82.60	85.28	98.11
Assets			
Non-Current Assets	30.73	29.81	30.83
Fixed Assets	15.48	21.63	22.14
Tangible Assets	15.42	15.87	15.33
Intangible Assets	0.03	0.02	0.01
Capital Work-in-Progress	0.03	5.74	6.80
Non Current Investments	9.16	2.93	2.93
Deferred tax assets	0.00	0.04	0.43
Long -term Loans and Advances	6.09	5.22	5.33
Current Assets	51.87	55.47	67.28
Current Investments	17.84	17.02	28.28
Inventories	9.18	10.49	10.45
Trade Receivables	13.47	14.91	20.17
Cash & Cash Equivalents	9.80	9.93	5.60
Short Term Loans & Advances	1.47	2.91	2.64
Other Current Assets	0.11	0.21	0.14
Total Assets	82.60	85.28	98.11

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