NOCIL

24th May, 2016

CMP: Rs.53.40   Weight 7%

STOCK DATA

Market Cap(Rs. cr)	857.80
Debt	15.87
Cash	15.38
Enterprise Value	858
Promoters Holding	37.61
52 week high/low	63.70/42.50
Shares outstanding	16.07

KEY FINANCIALS(Rs. in cr)

Y/E MARCH	2013	2014	2015	2016
Revenue	488	596	719	715
Operating exp	469	537	607	576
EBITDA	19	59	112	139
Depreciation	8	18	14	15
Interest Expense	4	17	17	9
PBT	44	35	86	115
Taxes	2	11	29	40
PAT	42	24	56	78

VALUATION

At Current juncture Nocil has an ROE of 17% and is currently trading at PE ratio of 11 times. We certainly believe that this nearly debt free company can get re-rated. It is a no-brainer at these levels.

NOCIL Limited

Thesis –

We at Stallion Asset are excited about the chemical space due to increasing environmental concerns in China. Supply side tightness in China can create a massive opportunity in India. Roughly 70-75% of global capacity of rubber chemicals is now concentrated in China. Of late, with environmental concerns being taken serious note of, by China, some exits have already happened. This can be a game changer for Indian Chemical industry as large MNC's have already started looking for supplies elsewhere.
The Chinese chemical giant HubeiChuyuan, had to shut down its operations as its government asked its Polluting plants to move from the east side to the west side as the former was heavily populated by humans.

KEY GROWTH TRIGGERS

1. **Anti-dumping Duty**
2. **Market Leader**
3. **Huge Capacity**
4. **Virtually debt free**

Government of India has imposed an anti-dumping duty on various chemicals (major produced by the company) starting June 2014 and is valid for next five years i.e. June 2019.The anti-dumping duty on the products ranges roughly between 20-30%.
This will benefit the company to improve its top line& bottom line.

India accounts for 65000 MT production capacity out of 850000 MT of total global market size. The Indian consumption of rubber chemicals comprise of 50000 MT. There are four other players in the market with Nocil having 75% market share.

Company has already incurred major Capex in FY12 and FY13 of 250 crores for its Dahej facility which is running at 80% capacity levels due to sluggish demand. The management has said that only 30% of Dahej land is utilized and it's easily scalable.
Company has reduced its debt from 125 crores in FY15 to 16 crores in FY16 via internal accruals.

About NOCIL

NOCIL Ltd is India's largest manufacturer and supplier of rubber chemicals. The company is a part of Arvind Mafatlal Group of Industries, a well-known Business House in India with diversified business interests. The company is engaged in the manufacturing and sale of rubber chemicals.
They offer a range of rubber chemicals, such as PILFLex, which is a rubber anti-degradant, PILnox, which is a rubber antioxidant, PILcure, which is a rubber accelerator, and PILGarD, which is a rubber pre-vulcanization inhibitor.The tyre industry is the largest consumer of rubber chemicals in the world (roughly 90% of the rubber chemicals is consumed by tyre industry).
Rubber chemicals are commodity products which are manufactured across the globe having tough competition with China and Korea.

Manufacturing Facilities: Dahej to ramp up capacity

The company has two plants at Navi Mumbai and Dahej respectively. The company has already incurred major Capex for its Dahej plant in FY 2012-2013. Moreover, only one third of the total area is used therefore the company can easily scale up its capacity further incase if its current capacity gets exhausted. We expect that company will be able to generate 100 crores of free cash flows every year at current prices of rubber chemicals.

Products

Company has 5 main products. These chemicals form an important part in the rubber manufacturing process (natural rubber and synthetic rubber).

Product	Brand
Accelerators	PILCURE
Antidegradants	PILFLEX
Antioxidants	PILNOX
pre vulcanization	PILGARD
post vulcanization stabilizer	PILCURE DHTS.

The major raw materials which go into making these products are sulphur and crude. Hence the costs of manufacturing these products are directly affected by the fluctuations in raw material prices.

Demand Side Analysis

About 65% of Nocil's Revenue comes from Tyres companies, and hence that sector is of prime importance. ICRA expects Tyre Industry to grow at 6% CAGR for the next 3 years. The company has been losing share in exports due to increasing competition from China and Korea but going forward we expect export sales to go well as environment concerns in China and Europe Increase.

Year	2012	2013	2014	2015
Sales(Cr.)	481	488	596	719
Export(Cr.)	193	188	222	230
Export %	40%	39%	37%	32%

Environmental Concern

Out of the total capacity of 850,000MT of rubber chemicals in the world, roughly 250,000MT is in Europe, 500,000MT is in China, 70,000 in Korea and India is 65,000MT.Now there has been massive shutdowntaking place in European countries and China in the last 2 years.

"**The gradual realignment of supply and demand in rubber chemicals business due to restructuring / exits by certain prominent players from the developed world, have also ensured that there is a greater awareness amongst customers of the need for dependable, stable and quality suppliers. The excessive dependence on one supplying country and its attendant risks has made customers conscious of the need to encourage other competent suppliers Your Company, being one such acknowledged player, may gain from this recent awareness"- NOCIL, Annual Report 2015.**

If the environmental situation in China and Europe worsens(which is likely) Nocil will have a double benefit – one from increased demand and increased prices due to supply shortage.

Strengths

Market leader: NOCIL is a market leader with 75% of the total market share in domestic market.

Commodity Niche Business: The Company is into making niche products with specialization and experience in rubber chemicals and enjoys high barriers to entry. Chemicals are about 4-6% of cost as a % of revenue for Indian Tyre companies but the process is of high importance.

Operating leverage Advantage: Company will enjoy operating leverage as the capacity ramp up in Dahej facility will help them create larger operating cash flows with little Capex requirement.

Anti-Dumping Duty: Chemical industry is highly regulated mainly because environmental issues. Hence any change in any polices will affect the company's operations. In 2014, government came up with anti-dumping duty against the cheaper imports from countries like china,in order to protect the domestic industry. Since the industry is enjoying favourable factors at least till the duty doesn't expire (i.e. June 2019), we can expect the company getting more business at improves margins.

Financial Summary

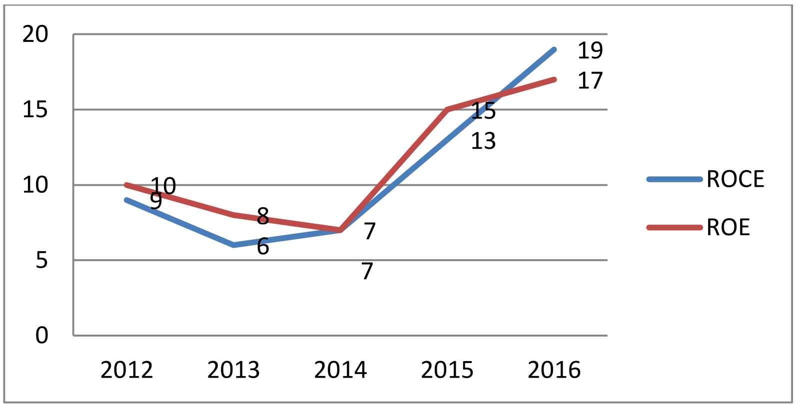
Nocil has generated 128 cr. of free cash flow in 2016 (Calculated). The company paid off 110 Crores of debt which will save 14 crores of Interest expense pre-tax next year. We expect the company to generate high levels of cash flow due to no immediate Capex needs.

Company has grown its sales at a CAGR growth rate of 9.5% whereas the bottom has growth at a CAGR growth of 19% in last 5 years.It has generated operating cash flows of more than 100 cr. and it also enjoys the best margins in a long time with a 10.90% net profit margin in FY2016.

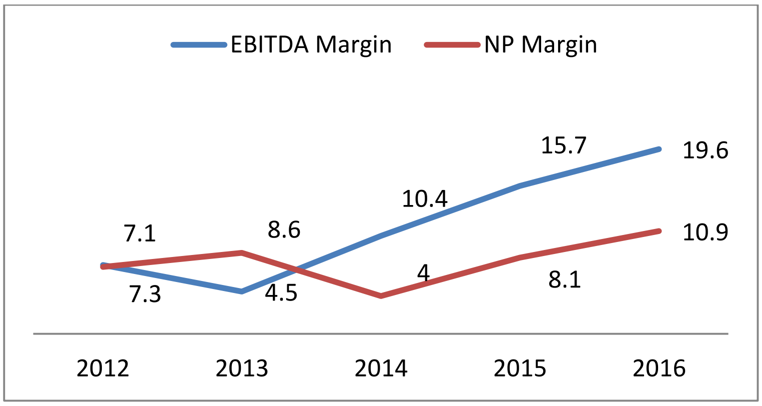
Financials	2016
ROE (%)	17%
ROCE (%)	19%
EPS(Rs.)	4.81
Sales (in cr.)	715
Profit (in cr.)	78
Market Cap (in cr.)	857

Return Ratios

Return Ratios have shown a massive improvement; the longer there are crisis in China and around the globe for environment reasons the more sustainable these ratios are.



Improving Margins
Company is enjoying the best margins and on back of reduced debt and favourable market conditions we believe that these margins are sustainable.



India has a global rubber chemical market share of 7-8% and even a 2-3% change in share can change the fortunes of this company. The company has a free cash flow yield of 15% and dividend yield of 2.3%. There have been large numbers of MNC's who are now thinking to diversify their rubber chemical supply from other places like India where environment laws are less stringent. We believe that environment concerns in China and Other European nations can be a big catalyst as the company can increase its exports.

Margin of Safety

1) Nocil has been consistently paying dividends for last 10 years.
2) Nocil has investments in NavinFloruide and Mafatlal Industry worth 135 crores.
3) The company trades at 11 times with an ROE of 17% and ROCE of 19% clearly suggesting that markets are not ready to believe that rubber chemical prices will stay at these prices.

Risks

- **Volatility in Raw Material Prices:** We don't forecast commodities prices as they are primarily driven by short term supply and demand factors. Since there is no control over them any losses incurred due to fluctuations in the raw material prices has to be borne by the company. The risk of loss can be mitigated by passing on prices but that generally happens after a lag.
- **Cheaper Imports:** Cheaper substitutes have always been a threat to the chemical industry specially because China (largest exporter) dumps their products at much lower prices and hence Indian players loose competitive advantage. This risk got partially mitigated when the government of India came up with new anti-dumping policies in 2014 and china facing environmental problems.
- **Overdependence on Tyre Industry:** Company is specialized in Rubber chemicals which are mainly used in tyre industry while processing the rubber. Tyre industry is cyclical in nature and thus NOCIL gets exposed to business cycle risk as well. The expected growth of tyre Industry is 4-6% as per Icra which is lesser the expected nominal GDP growth of India.

Conclusion

Company is going to benefit due to anti-dumping rules imposed by the government. Company is into niche products with high barriers to entry (mainly due to environmental issues it is difficult to get a permission) and since this company enjoys the position of a market leader, it can easily scale up the business without infusing any further capital. This also promises strong operating cash flows(approx. 100 cr. is what we expect)

Now let us look at different valuation scenarios:

Base case: Here we assume that the prices of the chemicals will remain unchanged from current levels. In this scenario we don't see the margins rising further but they can sustain the current levels. The stock's fair value using Discounted cash flow is 83 per share and stock moves there in the next 1 year.

Best Case: Here we assume that environment concerns get elevated which will cause supply shortages and hence the company will benefit from pricing improvement and volume increase. If this happens the company will expand its margins further with return ratios improving (lower base).This company can then get re-rated to 100+ levels i.e. a doubler from these levels.

Worst Case: We believe the worst case is limited to 40.50 a share using sensitivity analysis.

Case	Fair Value
Base	83
Best	100+
Worse	40.5

Equity investing is a game of odds, margin of safety and conviction. Nocil stock performance has been very week for the last 10 years but we believe that the fortunes of the company can change with environment concerns globally. Only a 3% shift of activity towards India could mean exports rising by 3x for Nocil which is a high margin business. Domestic tyre business will act as a margin of safety providing stable cash flow.

NOCIL

Disclosure: Amit Jeswani and Family have positions

Analyst Disclosure: No Positions

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