Dimensional Securities Pvt Ltd.

Date: 13th April, 2020
CMP: 71
Recommendation: BUY
Target: 90

NOCIL Ltd

Initiating coverage

MARKET DATA	
NSE TICKER	NOCIL
Net worth FY19 (Rs in Crs)	1163.0
P/BV Ratio (FY19) (x)	2.1
EPS (FY19) (Rs.)	11.2
Market Price (Rs.)	74
P/E Ratio (FY19) (x)	9.85
52 Week High (Rs)	145
52 Week Low (Rs)	45
Market Capitalisation (Rs. Cr)	1,176.6

AVERAGE MONTHLY VOLUME ('000)	
BSE	173
NSE	1,540

SHARE HOLDING PATTERN	
Promoter	33.73
FII	3.14
DII	13.77
Public	49.37

RETURN (%)	3M	6M	12M
NOCIL	-36.2	-25.4	-47.7
Nifty	-25.4	-19.4	-21.9

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We expect NOCIL Ltd (NOCIL) to be a beneficiary of automobile recovery as the economic growth starts ticking. Having 45% domestic market share in rubber chemicals industry and ~5% market share globally, NOCIL has recently entered in high margin premium products with 55,000 MTPA Dahej expansion. Debt free balance sheet coupled with Rs 100 cr worth liquid investments gives sufficient war chest to NOCIL to fight the economic slowdown expected because of Corona pandemic.

Proxy to Recovery in Automobile Sector

Automobile industry consumes ~80% of the total rubber manufactured. Tyre specifically consumes ~65% of the total rubber. In India, the automobile sector is still under-penetrated. In 2019, India reported PV and CV sales of 33.8 lacs and 10.1 lacs respectively as compared to 237.1 lacs and 43.7 lacs respectively in China. For FY20, India reported 20% drop in 4-wheeler sales to 34.9 lacs. We feel the current down turn in Automobile industry is a cyclical phenomenon and the volumes are set to increase on steady rate as the economic growth starts ticking.

Aftermarket demand acts as stabilizer in overall tyre demand

Tyres industry has a strong off-market demand in conjunction with the OEM demand. As per CEAT website, tyres of PVs are expected to be replaced after every 4-5 years of use. In case of CV, the tyre replacement is even faster due to higher number of kilometres travelled in a year (9-12 months expected replacement cycle). Hence, replacement demand for tyre will support the growth for rubber chemicals.

Doubling capacity to 110,000 mtpa

NOCIL has been running on optimum capacity utilization till FY19. The company, through total capex of Rs 425 cr (fully funded by internal accruals) has doubled its capacity from 55,000 mtpa to 110,000 mtpa in March 2020. It might seem that the expansion has come at a bad time for NOCIL but we feel that the inherent strength of NOCIL's technology and cost competitiveness coupled with a debt free balance sheet and strong operating cashflows will allow it to tide over the current crisis and possibly come out stronger.

Implementation of effective manufacturing process and focus on high margin premium products

On back of improved manufacturing process at Dahej and technological advancement, NOCIL has been able to expand its gross profit margin by 900 bps over FY13 to FY18. Also, the company has focused on production of high margin premium products. This not only helps NOCIL gain the market share from international competitors but also help in maintaining profit margins.

Valuation & View

- On back of (a) expected revival of domestic automobile sector, (b) limited competition from China, (c) availability of requisite capacities and cash to withstand the current headwinds, (d) product premiumization and (e) unlevered balance sheet with strong cashflows, we expect NOCIL come out from the ongoing sector headwinds without any long term damage.

- We believe the current valuations are highly under-priced. The current Covid-19 pandemic can help NOCIL consolidate its position in global rubber chemical market and diversified product offerings can help company gain market share from the competitors. Shift by global tyre companies on sourcing only from China to having multiple sourcing options too will benefit NOCIL.

- We are valuing NOCIL at 12X FY22's normalized EPS of Rs 7.5 to arrive at our target price of Rs. 90 for the stock, which presents a potential upside of 27% from the CMP of Rs 71. Accordingly, we recommend a BUY on the stock.

Financial Snapshot:

Year End	Revenue	EBITDA	EBITDA %	PAT	RoE (%)	RoCE (%)	P/E
FY19	1,042.9	292.7	28.1%	184.9	15.9%	24.8%	6.4
FY20E	731.3	137.5	18.8%	89.7	7.3%	11.6%	13.1
FY21E	800.9	158.7	19.8%	109.5	8.4%	13.4%	10.7
FY22E	911.8	194.1	21.3%	137.5	9.7%	15.7%	8.5

We expect a 29.8% fall in revenue in FY20 and marginal dip in FY21 due to drop in volumes as the automobile industry observed a cyclical slowdown, slowdown due to BS-VI implementation, country wide lock down due to Corona Virus as well as fall in realization on account of withdrawal of 5% Anti-Dumping Duty (ADD) on rubber chemicals. Despite of withdrawal of ADD, NOCIL remains cost competitive to Chinese players. However, we believe that the business will bounce back sharply in FY22 and as is often seen in automobile cycles (especially CV), the rebound is quite sharp and sustains for 3-4 years.

The drop in realization coupled with lower utilization will have a hit on the profitability of NOCIL in FY20 and the same has been factored in by us as we project the EBITDA margin to move down from 28.1% in FY19 to 18.8% in FY20 and a steady increase from that level.

About Company

An Arvind Mafatlal Group enterprise, NOCIL Ltd (NOCIL) is India's largest rubber chemicals manufacturer, with installed capacity of 110,000 MTPA. Rubber chemicals are additives blended with natural or synthetic rubber in the manufacturing process. NOCIL has ~45% market share in domestic market and ~5% market share globally. Company's product portfolio includes Accelerators, Anti-degradants, Antioxidants and other application products. Dahej facility serves as a one stop solution for new product development, product enhancement etc.

NOCIL's products are divided in four broad categories:

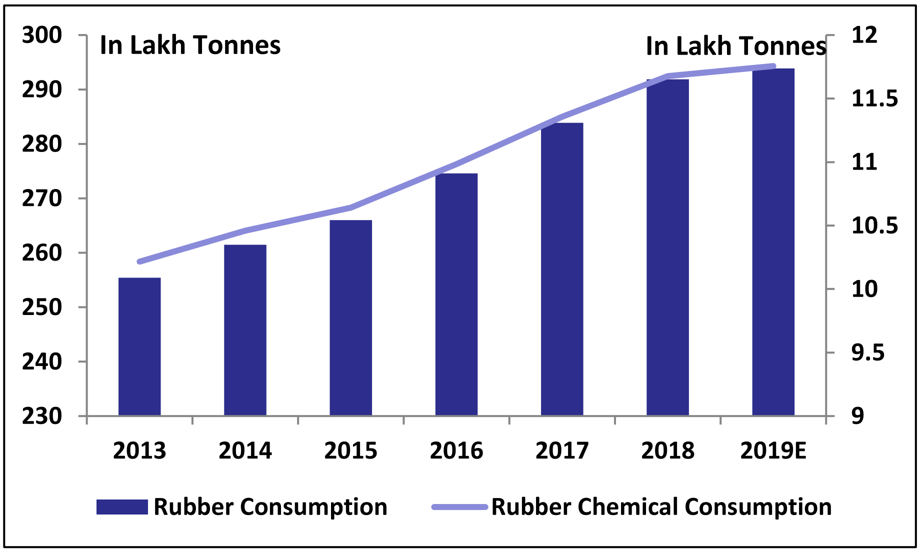
Name	Brand	Description	% Rev
Accelerators	Pilcure	Process of converting liquid latex to solid rubber is called vulcanization. It takes 45-50 hours for vulcanization process. Accelerators cuts down this process to 4-5 hours shorten the reaction time between rubber and sulphur leading to better productivity.	45%
Anti-oxidants	Pilflex/ Pilnox	These are ingredients in rubber compounds which deter the ageing and inhibit degradation due to oxygen attack of rubber products, thereby enhancing service life	45%
Pre-vulcanisation	Pilguard	Pre-vulcanisation chemicals are applied before start of vulcanisation process to prevent premature vulcanisation and reduce wastage	5%
Post-vulcanisation	Pilcure DHTS	Post-vulcanisation chemicals are applied once the vulcanisation process is completed	5%

NOCIL has also started manufacturing of Zinc based high margin specialized rubber chemical products. These products are primarily exported to Thailand.

NOCIL is largest Rubber Chemicals Manufacturer in India enjoying dominant market share of ~50% in domestic market. Globally, NOCIL has a market share of ~5%. Of the overall revenue of Rs 1,043 cr, 30% is contributed by international sales while 70% is domestic sales.

Industry Overview

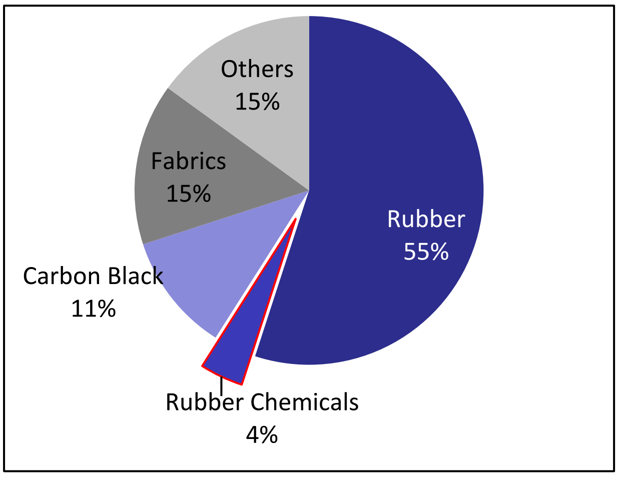
Rubber chemical consumption is directly linked to rubber consumption. Rubber Chemicals constitute ~4% of the Rubber Consumption (volume wise). Global Rubber Consumption (Natural + Synthetic) has grown from 255.4 lakh tonnes in 2013 to estimated 289.8 lakh tonnes in 2019.



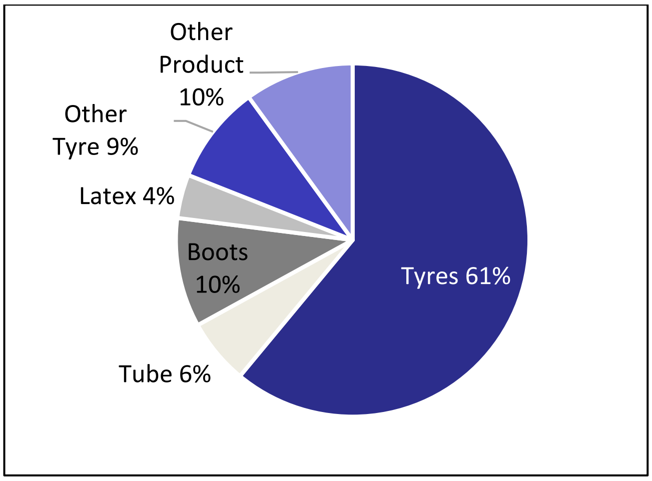
(Rubber Chemical consumption has been derived considering 4% of Rubber consumption)

Automobile industry consumes ~70% of the total rubber manufactured. Tyre specifically consumes ~65% of the total rubber. The key constituents of tyre are

Constituents of tyre



Product wise rubber chemical consumption

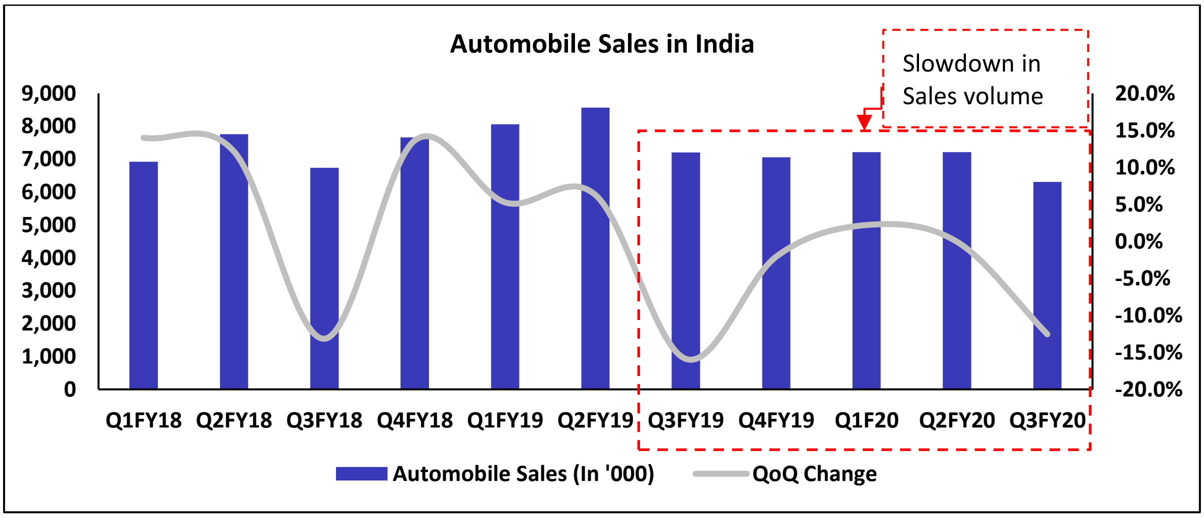


Automobile is the key driving factor for rubber chemicals. As 70% of NOCIL's revenue is through domestic sales, growth of domestic automobile industry plays a crucial role for NOCIL.

❖ Investment Rationale:

❖ Recovery in Automobile Sector

Overall domestic automobiles sales increased at 7% CAGR between FY13-18 with 2.1 cr vehicles getting sold in FY18. In 2019, India reported PV and CV sales of 33.8 lacs and 10.1 lacs respectively as compared to 237.1 lacs and 43.7 lacs respectively in China. For 9MFY20, India reported 16% drop in 4-wheeler sales to 31.8 lacs.



We feel the current down turn in Automobile industry is a medium-term disruption and the volumes are set to increase on steady rate as the economic growth starts ticking.

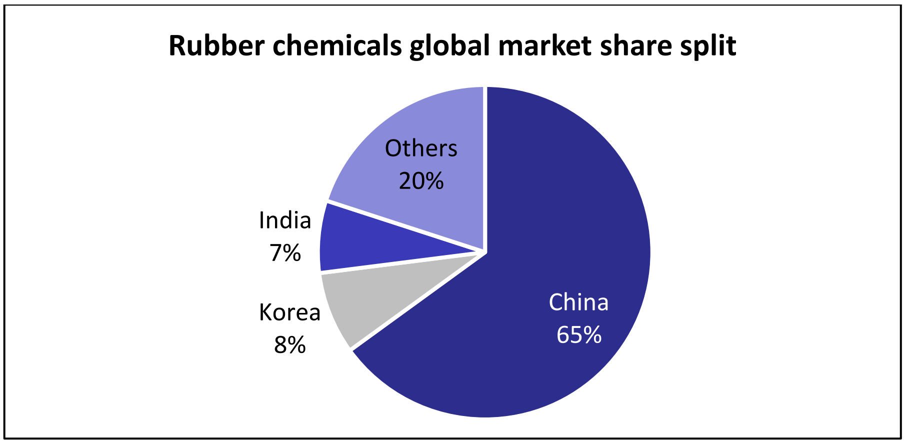
Automotive Mission Plan: 2016-26 shows clear vision of government where it aims to develop India as a global manufacturing centre. Reforms like GST to help boost the sector's growth. Incubation centre to be set up for start-ups working in electric vehicles space.

NOCIL will be a clear beneficiary when growth picks up in the automobile sector.

China clampdown – An opportunity for NOCIL

Due to China's revised environmental protection laws and shut down of companies due to relocation, the disruption in chemical prices helped NOCIL not only improve the operating margins but also assisted in gaining market share globally. Going forward, we expect the status quo to be maintained as far as Chinese situation is concerned.

(In Mn Tns)	CY 13	CY 14	CY 15	CY 16	CY 17	CY 18	CY 19E
Rubber Consumption Globally	25.53	26.15	26.60	27.45	28.42	29.20	29.20
Rubber Chemical Consumption Globally (Industry)	**1.02**	**1.05**	**1.06**	**1.10**	**1.14**	**1.17**	**1.17**
Rubber Consumption China	9.30	9.70	9.60	9.90	10.30	9.90	10.10
Rubber Chemicals Consumption China	0.37	0.39	0.38	0.40	0.41	0.40	0.40
Capacity in China	0.76	0.78	0.79	0.80	0.85	0.80	0.75
China's capacity as a % of Global Rubber Chemical Consumption	74.4%	74.6%	74.2%	72.9%	74.8%	68.5%	64.2%



In domestic market, NOCIL enjoys 40-45% market share. Approximately 40-45% rubber chemicals are imported from China and balance market share is owned by other smaller players.

Unaffected by EV transition

The key advantage for NOCIL is that EV disruption in automobile sector will remain unaffected for the company. The inherent long-term growth story of Automobile Industry will play proxy for growth of NOCIL.

Large off market tyre consumption stabilize slowdown in tyre demand

Tyres not only have OEM demand but also has large after market demand, especially in CV segment. On an average, life of a passenger vehicle is 8-10 years where as that of tyres is typically 4-5 years (as per Ceat website). Hence, tyres are replaced at least once in the entire life span of a PV. For CV, the replacement of tyres is typical once a year as number of kilometres driven each year is much higher.

Doubling to capacity

NOCIL has been running on full capacity utilization till FY19. The company, through a total capex of Rs 425 cr fully funded by internal accruals has doubled its capacity from 55,000 mtpa to 110,000 mtpa in March 2020. NOCIL can serve the rubber chemicals demand arising for next 5-7 years through the incremental capacity. The capacity constraint has been sufficiently addressed by the company. Also, we do not expect major capex in next couple of years thereby leading to higher FCF and better cashflow yields. *Upfronting the capex now will ensure NOCIL will take incremental market growth and increase their market share.*

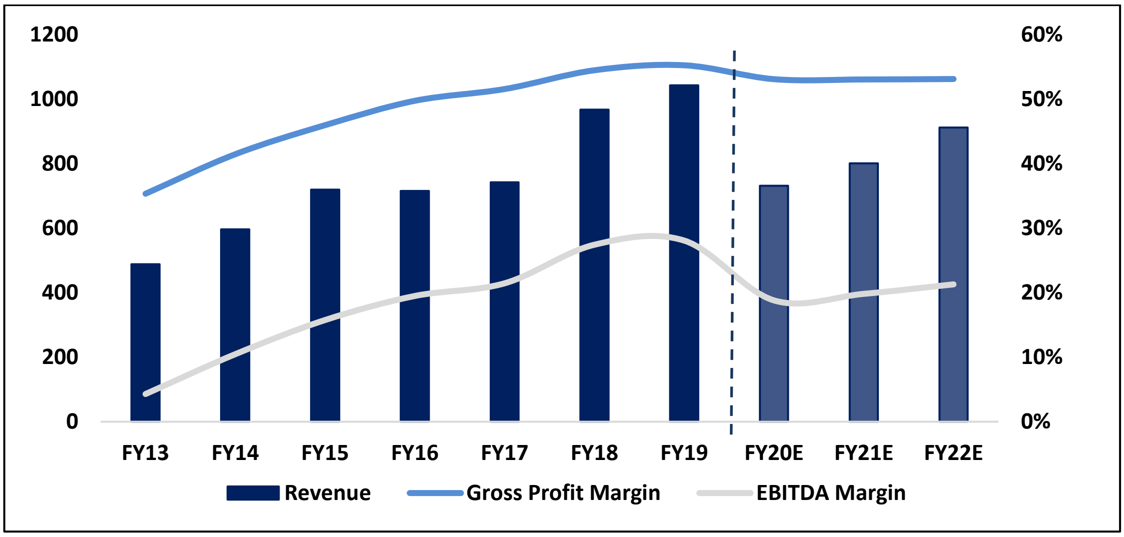
It might seem that the expansion has come at a bad time for NOCIL but we feel that the inherent strength of NOCIL's technology and cost competitiveness with a debt free balance sheet with strong operating cashflows will allow it to tide over the current crisis and possibly come out stronger.

Implementation of effective manufacturing process

On back of improved manufacturing process at Dahej and technological advancement, NOCIL has been able to expand its operating margins. The technology upgradation led to lower use of raw materials, improved yields and higher utilization levels which led to operating leverage for the company. From FY15-FY19, NOCIL recorded ~900 bps jumps in its gross margin. There are 3 key factors for this stellar performance are:

- <u>300 bps jump due to change in export product mix towards premium products</u>: Till FY16, the company's export contributed 30% of revenue. Of the total exports, 70% were commodity products and 30% were specialty grade products. Over two years, the share of specialty grade products went up to 65%. Specialty grade products offer 400-500 bps higher margins compared to commodity products.
- <u>300 bps jump due to price rise because of China Clampdown</u>: The China Clampdown due to environmental issues shot up the rubber chemical prices across globe. The Chinese companies had to mandatorily install effluent treatment plant which led to increase in manufacturing cost by 50 cents/kg while the realization price is ~USD 3/kg (i.e. additional cost is 15-16% of realization).
- <u>300 bps improvement due to high operating leverage</u>: As the utilizations level went up, the company's operating leverage helped improve gross profit margin of company. Also, the company started

recovering some RM & Finished goods from waste and spent more towards R&D for process optimization.



Moreover, the newer technologies implemented in Dahej plant made cost of manufacturing competitive with global prices.

Going forward, due to increasing demand from domestic tyre manufacturing companies, we expect the capacity utilizations to improve further. The conscious change in product mix and shift towards specialized high margin products will also benefit NOCIL.

➢ Strong Cashflows coupled with debt free balance sheet

NOCIL has able to remain debt free in-spite of doubling its manufacturing capacity at total capital expenditure of Rs 425 cr fully funded by internal because of the strong operating cashflows and control on working capital cycle. The company also has current investments worth Rs 104 crore in balance sheet which acts as a war chest in unexpected tough times. On top of this, the company has been paying dividend every year.

The major capacity expansion will take care of the demand for next 6-7 years. The company holds 2 months equivalent operating expenditure requirements in form of Cash and Current Investments. This gives us a comfort on the balance sheet strength of NOCIL and we expect a substantial increase in dividend pay-outs in coming years.

➢ Impact of COVID-19

Corona Virus pandemic will dampen growth prospects for NOCIL in near term. The sale of automobiles will take a hit as income levels are expected to fall leading to pay cuts and job losses. However, NOCIL being a debt free company (with Rs 100 cr worth of liquid investments), is expected to sail the tide successfully. In the mega capex project for antioxidants and accelerators at Dahej NOCIL started manufacturing TBBS (Tert-butyl-benzothiazole sulphonamide; 4500 tonne capacity). TBBS's domestic demand is estimated to be 9,000 tonnes which was erstwhile imported from China. In a scenario of lower imports of rubber chemicals from China in the near future can in fact help NOCIL ramp up its production.

The key thing to monitor for NOCIL would be the production shutdown by the leading Chinese rubber chemical company - China Sunshine Chemical. Its key facilities are about 600 km away from the epidemic epicentre.

❖ Valuation and View:

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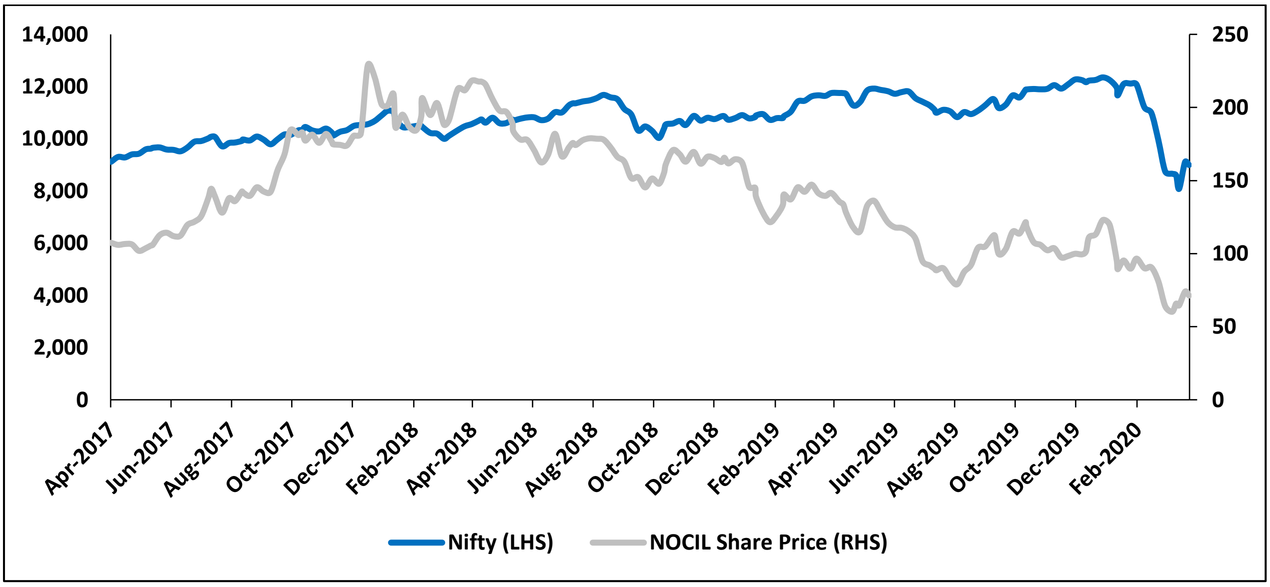

❖ Risks & Concerns:

- Threat from Chinese manufacturers
- Slower than expected growth in Automobile sector
- Adverse movement in raw material prices
- Long term slowdown due to adverse impact of COVID 19 in India as well as globally

Financials:

NOCIL Ltd.- Statement of Profit & Loss					
DESCRIPTION	FY18	FY19	FY20E	FY21E	FY22E
Net Sales	**967.6**	**1042.9**	**741.1**	**728.9**	**852.1**
EXPENDITURE:					
Raw Material Cost	440.6	466.8	347.7	342.3	399.6
as % of Sales	*45.5%*	*44.8%*	*46.9%*	*47.0%*	*46.9%*
Fuel & Manufacturing overheads	120.2	134.7	106.0	105.4	123.9
as % of Sales	*12.4%*	*12.9%*	*14.3%*	*14.5%*	*14.5%*
Employee Cost	71.2	70.2	78.3	81.4	84.7
Other Admin & Fixed overheads	34.9	38.1	37.1	34.3	35.8
S&D Overheads	35.3	40.4	31.7	28.4	32.4
EBITDA (Ex OI)	**265.4**	**292.7**	**140.3**	**137.1**	**175.8**
EBITDA Margin	*27.4%*	*28.1%*	*18.9%*	*18.8%*	*20.6%*
Depreciation	24.0	24.3	26.4	26.2	27.4
EBIT	**241.4**	**268.4**	**114.0**	**111.0**	**148.4**
Other Income	14.6	10.0	9.4	14.4	17.7
Interest	1.2	0.6	0.6	0.7	0.7
Profit Before Taxation	**254.7**	**277.7**	**122.8**	**124.7**	**165.4**
Provision for Tax	84.8	92.9	30.9	31.4	41.6
Profit After Tax	**169.9**	**184.9**	**91.9**	**93.3**	**123.8**
Adjusted EPS	**10.3**	**11.2**	**5.6**	**5.6**	**7.5**

NOCIL Ltd.- Balance Sheet					
DESCRIPTION	FY18	FY19	FY20E	FY21E	FY22E
Share Capital	168.1	169.6	169.6	169.6	169.6
Total Reserves	878.6	993.4	1057.6	1127.6	1220.4
Shareholder's Funds	**1046.7**	**1163.0**	**1227.2**	**1297.2**	**1390.1**
Total Borrowings	0.0	0.0	0.0	0.0	0.0
Other Non-Current Liabilities	120.0	124.4	124.9	125.4	125.8
Total Non-Current Liabilities	**120.0**	**124.4**	**124.9**	**125.4**	**125.8**
Trade Payables	115.7	98.3	71.4	70.3	82.1
Other Current Liabilities	48.8	56.5	58.0	59.5	61.1
Total Current Liabilities	**164.4**	**154.8**	**129.4**	**129.9**	**143.2**
Total Liabilities	**1331.1**	**1442.3**	**1481.5**	**1552.4**	**1659.1**
Fixed Assets	527.3	656.6	770.2	794.0	816.7
Other Non-Current Assets	130.7	201.9	158.0	208.7	234.4
Total Non-Current Assets	**657.9**	**858.5**	**928.3**	**1002.8**	**1051.1**
Inventories	155.3	170.7	123.8	120.0	137.9
Sundry Debtors	243.4	232.2	162.4	159.8	186.8
Cash and Bank	32.0	42.4	82.2	69.1	56.7
Other Current Assets	242.5	138.5	184.9	200.8	226.7
Total Current Assets	**673.2**	**583.8**	**553.3**	**549.7**	**608.0**
Total Assets	**1331.1**	**1442.3**	**1481.5**	**1552.4**	**1659.1**

NOCIL Ltd.- Cash Flow Summary					
DESCRIPTION	FY18	FY19	FY20E	FY21E	FY22E
PBT	254.7	277.7	122.8	124.7	165.4
Add: Depreciation	24.0	24.3	26.4	26.2	27.4
Add: Interest Paid	1.2	0.6	0.6	0.7	0.7
Less: Other Income	2.0	-8.5	-9.4	-14.4	-17.7
Less: tax Paid	-80.6	-88.1	-30.9	-31.4	-41.6
Change in WC	-88.3	-42.0	45.3	-8.5	-57.0
Cash from Operating Activities	**102.3**	**164.1**	**154.7**	**97.2**	**77.2**
Cash from Investing Activities	**-141.5**	**-100.7**	**-96.2**	**-100.7**	**-75.7**
Cash from Financing Activities	**-42.6**	**-50.2**	**-18.8**	**-9.6**	**-14.0**
Net Change	-81.7	13.1	39.7	-13.1	-12.4
Opening Cash Balance	106.0	24.4	42.4	82.2	69.1
Closing Cash Balance	**24.2**	**37.5**	**82.2**	**69.1**	**56.7**

NOCIL Ltd. - Key Ratios					
DESCRIPTION	FY18	FY19	FY20E	FY21E	FY22E
EBITDAM (%)	27.4%	28.1%	18.9%	18.8%	20.6%
ROE (%)	16.2%	15.9%	7.5%	7.2%	8.9%
ROCE (%)	25.1%	24.8%	11.8%	11.6%	14.3%
Receivable days	92	81	80	80	80
Inventory Days	129	133	130	128	126
Payable days	96	77	75	75	75
Total Debt/Equity(x)	0.0	0.0	0.0	0.0	0.0
Current Ratio(x)	4.1	3.8	4.3	4.2	4.2
Interest Cover(x)	197.8	426.0	175.6	166.0	215.6
BV per share	63.4	70.1	74.2	78.4	84.0
Adjusted P/E Ratio	6.9	6.4	12.8	12.6	9.5
Price/ Book value	1.1	1.0	1.0	0.9	0.8

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