

## SH Kelkar & Company Ltd

Initiating coverage

### MARKET DATA

NSE TICKER	SHK
Net worth FY19 (Rs in Crs)	837
P/BV Ratio (FY19) (x)	1.2
EPS (FY19) (Rs.)	6.1
Market Price (Rs.)	77
P/E Ratio (FY19) (x)	12.1
52 Week High (Rs)	162
52 Week Low (Rs)	63
Market Capitalisation (Rs. Cr)	1,086.8

### AVERAGE MONTHLY VOLUME ('000)

BSE	22.9
NSE	72.5

### SHARE HOLDING PATTERN

Promoter	56.91
FII	20.17
DII	16.79
Public	6.12

RETURN (%)	3M	6M	12M
SHK	-29.2	-37.4	-50.1
Nifty	-25.4	-19.4	-21.9

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SH Kelkar (SHKL) is one of India's largest fragrance & flavour (F&F) companies with a market share of ~14% as of 2016. Fragrance chemicals manufactured by SHKL are used as raw materials in personal & fabric care, skin & hair care, fine fragrance and household products, while flavour products are used in baked & dairy products, beverages and pharmaceuticals. In October 2015, SHKL raised Rs 210 cr via IPO to repay its debt amounting to Rs 126 cr and subsidiary company debt of Rs 32 cr.

### Proxy play on Indian FMCG sector

SHKL has a diverse and large client base of over 4100 customers including national and multinational FMCG companies, blenders of F&F producers. Following the implementation of GST, a lot of unorganised players have exited the market across different FMCG categories creating growth room for organized players. Growth for organized players will lead to growth for chemical companies supplying products to FMCG players and SHKL will be a clear beneficiary of this shift. Higher spending by the government on rural infrastructure and economic stimulus package announced post Corona Virus break out could benefit rural incomes and thereby demand for FMCG products.

### Dominating share in domestic Fragrance market

In Flavours & Fragrances (F&F) segment, top 10 companies have ~78% market share globally. The largest company has revenue of \$ 4bn while the 10th largest has revenue of \$700mn. Industry is catered by large conglomerate or else small players, while there are very few intermediate size players like SHKL. SHKL dominates domestic F&F market with ~13% market share. It has sufficient room to grow more than the FMCG industry growth as it can acquire market share from other players on back of strong clientele relationship, continuous R&D, diversified product portfolio and strong brand name.

### Diversified product portfolio

Currently, SHKL's product basket is of over 9,700 products, which they supply to 4,000 customers in the fragrance and Flavours segment including long-term relationships with global MNCs, as well as with domestic players. Due to intensifying competition among FMCG companies, product innovation is expected to gain traction. The company's products, which are used as raw materials in many FMCG companies, thus will be a critical component of product success.



### Value creation by inorganic path

SHKL has done 8 acquisitions in last three years. Inorganic growth is the quickest way to not only increase market share, but also gain access to new customers and newer manufacturing capabilities. The acquisition has helped SHKL enter newer geographies and to cross sell the diversified product basket at a competitive price point due to its cost advantage. SHKL will focus on nine countries in the ASEAN and MENA regions with similar demographics, income patterns and aspirations like India. SHKL is well placed in terms of geographical exposure, which have high growth potential.

### Product innovation and strong R&D to play a key role

Currently, SHKL spends ~3% of revenue towards R&D while the global spends stands at 6–7% of sales annually. SHKL has tapped Paints industry as a new segment for growth. SHKL is also in process of developing product offerings for non FMCG products such as Air Conditioners or Plywood. The potential in these markets is tremendous and completely untapped till date. Hence, going forward, product innovation will play a key role for the company to beat the industry growth rate.

### COVID–19, an opportunity in disguise

Lockdown implemented to control the spread of COVID–19 is expected to cause unorganized F&F players an unprecedented financial challenge. ~28% of F&F segment is unorganized which amounts of ~Rs 10.14 bn. A shift due to shut down of unorganized F&F companies may create an opportunity for organized sector to penetrate deeper into the customer's products and gain market share.

### Valuation & View

- On back of (a) growth riding on increasing consumption of FMCG products, (b) diversified product portfolio, (c) inorganic expansion and cross selling of products, (d) product innovation and R&D and (e) shift from unorganized to organized post Covid–19 related shutdown of the latter, we expect SH Kelkar to come out from the ongoing sector headwinds more stronger.
- Going ahead, we expect SH Kelkar to clock 4.5% CAGR in revenues on conservative basis between FY19 to FY22 to Rs 1,190 Cr. EBITDA is expected to grow at a CAGR of 8.8% to Rs 172 Cr by FY22 at an EBITDA margin of 14.5%. PAT is expected at Rs 109 Cr. We expect the company's EPS to grow to Rs 7.72 by FY22.
- We are valuing SH Kelkar at 15X FY22's normalized EPS of Rs 7.7 to arrive at our target price of Rs. 116 for the stock, which presents a potential upside of 50% from the CMP of Rs 77. Accordingly, we recommend a **BUY** on the stock.

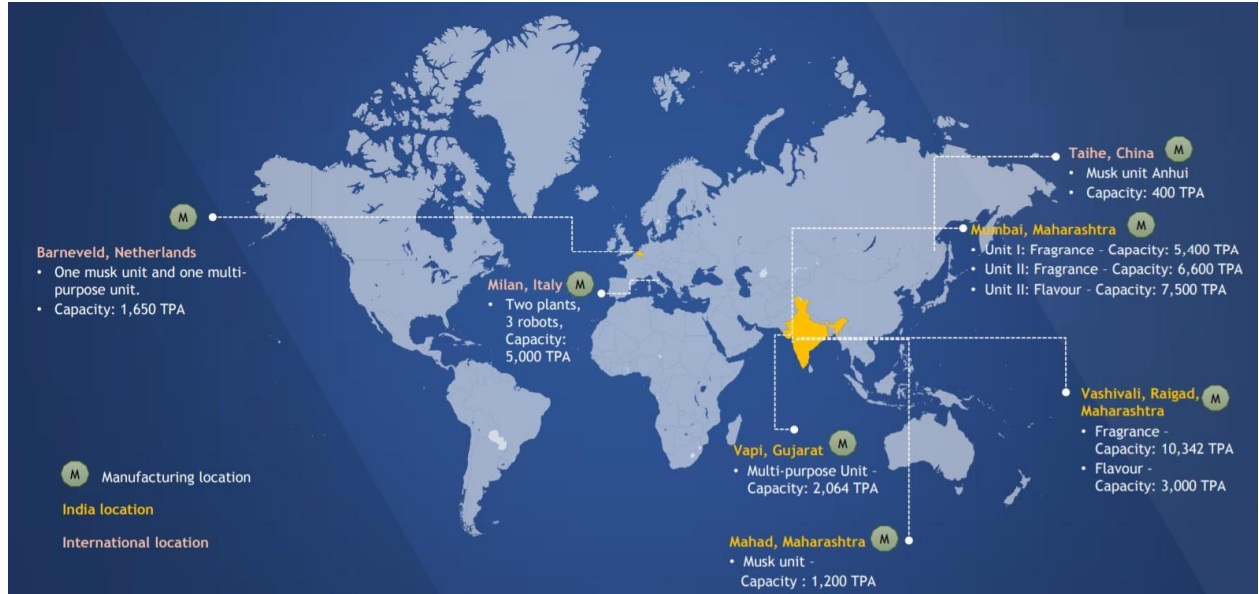
### Financial Snapshot:

Year End	Revenue	EBITDA	EBITDA %	PAT	RoE (%)	RoCE (%)	P/E
FY19	1,043.6	133.7	12.8%	87.9	15.9%	24.8%	13.2
FY20E	1,079.1	132.1	12.2%	34.5	7.5%	11.8%	33.0
FY21E	1,116.3	150.9	13.5%	89.3	7.2%	11.6%	12.8
FY22E	1,190.9	172.2	14.5%	109.0	8.9%	14.3%	10.5



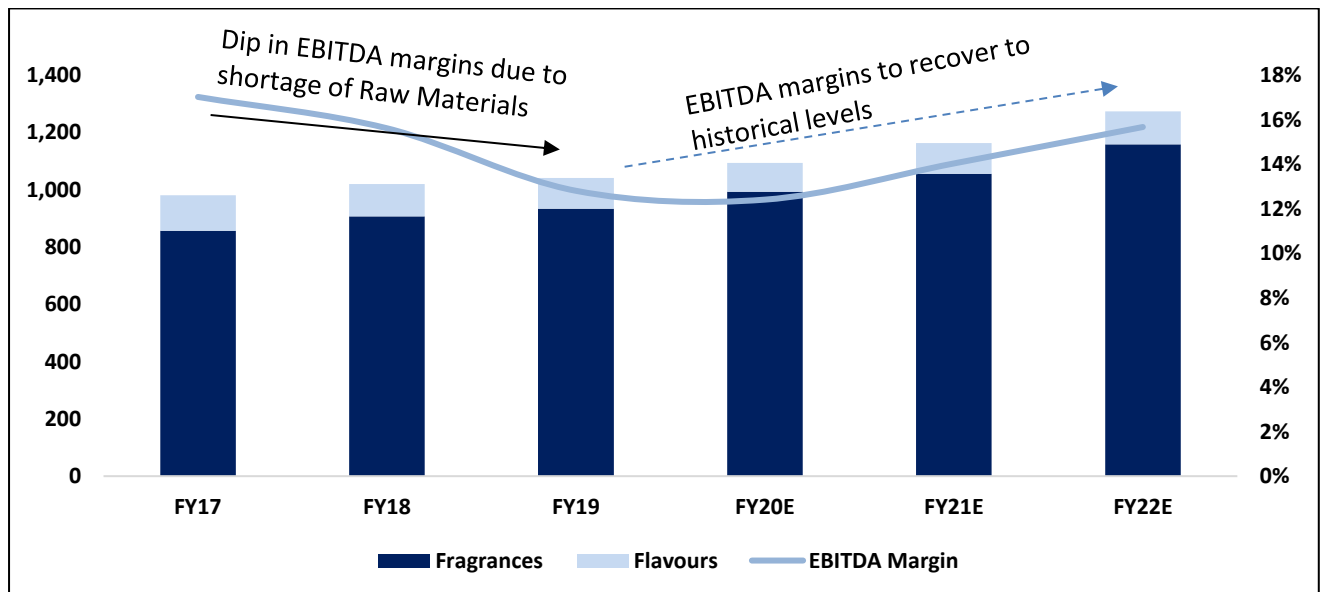
### About Company

Established ~90 years ago, SHKL is one of India’s largest F&F companies (by revenue) with ~12% market share. It is the largest domestic fragrance producer with ~20% market share, exporting products to 52 countries. In the flavour space, it is an emerging producer in India with ~2% market share, exporting products to 15 countries. The company four production facilities in India, two in Italy, one in Netherlands and one in China.



SHKL enjoys ~21% market share in the fragrance industry. SHKL’s products are used by leading companies engaged in personal care, hair care, skin care & cosmetics, household products, fine fragrances and F&F blends. SHKL caters to 3,600 customers, including Godrej Consumer Products, Marico, Wipro, HUL, VINI Cosmetics and J.K. Helen Curtis. The fragrance business contributed 90% of SHKL’s revenues in FY19 of which 67% is domestic sales and 33% of revenue is contributed by exports.

Flavours was a small division of SHKL started ~10 years ago and is now in a position to leap frog into growth trajectory as company has been able to successfully set up a strong base over past decade. SHKL has over 400 customers under this segment, including Britannia, Vicco Laboratories, Vadilal Industries and Ravi Foods. As on FY19, the Flavours segment contributed 10% to the top line with 40% domestic sales and 60% export revenue.





**Raw Material challenge faced by company in 2017**

- In Sept 2017, the RM cost jumped up due to multiple events:
  - China clampdown on environment – Affecting supply of Alpha Pinene
  - Fire in BASF plant in Germany – Affecting supply of Petrochemicals
  - Hurricane in Florida – Affecting supply of Citrus Oil

SHK -Raw material broad category	% of RM	Sourcing place
Alpha Pinene or Turpentine derivatives	25%	Domestic, Florida and China
Petrochemicals	25%	Domestic, BASF (Germany), and China and Europe
Citrus oils	25%	Florida
Aroma extracts	25%	Domestic/Import

Within Alpha Pinene and Petrochemical, roughly half of these products are sourced locally as the downstream processing happens in India. So, out of our total bucket, 50% by value is purchased domestically and 50% by value is purchased outside India. But the 50% produced in India is also dependent on Petrochemical and Alpha Pinene prices, which are a global phenomenon.

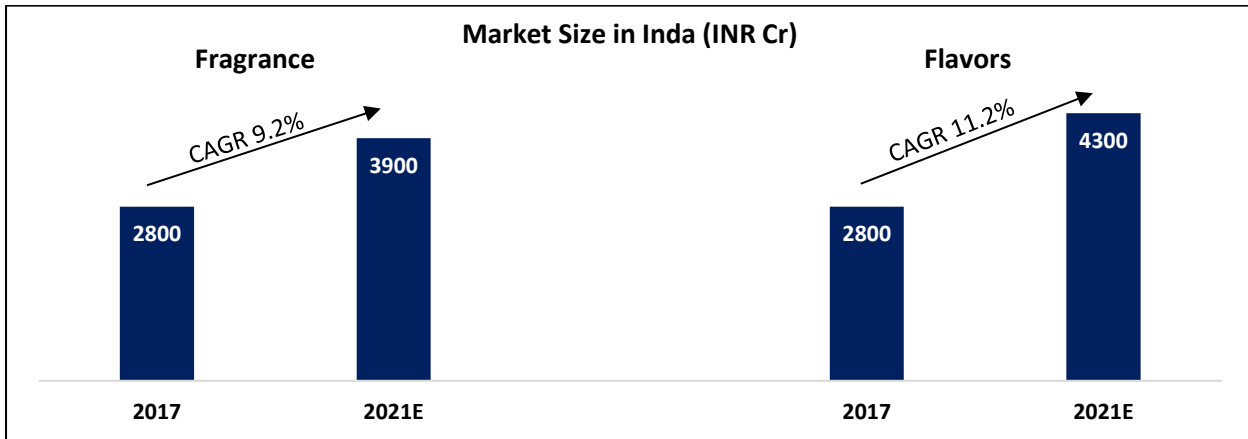
- As on date, the supply of all key raw materials has normalized.
- Florida and Brazil are key countries for supplying Citrus oils.
- Industry margin in normal circumstances are typically in range of 43–45% but due to sudden hike in RM prices led to shrink in Gross Margins to 39%.

**Industry Overview**

The F&F Industry is highly concentrated globally as top 10 F&F players control ~79% of market share as compared to 64% in 2000. Top 4 of the 7 control 58% of the market in CY17. The global F&F market size stood at USD 25.9 bn in 2017 which is expected to reach USD 31.5 bn by 2021 growing at a CAGR of 5%.

Indian F&F industry Rs 34.29 billion		Indian Fragrance industry Rs 18.8 billion		Indian Flavour industry Rs 15.5 billion	
Major players	Market share	Major players	Market share	Major players	Market share
Givaudan	23.0%	Givaudan	26.0%	IFF	21.0%
IFF	14.0%	Firmenich	21.1%	Givaudan	19.0%
Firmenich	14.0%	SH Kelkar	20.5%	Symrise	10.0%
SH Kelkar	12.0%	Symrise	10.0%	Firmenich	6.0%
Symrise	7.0%	IFF	7.0%	SH Kelkar	2.0%
Goldfield	1.0%	Goldfield	3.0%	Others	42.0%
Others	28.0%	Others	12.0%		

Emerging markets such as India continuing to grow with premiumization & broadening of product offerings. The growth will be primarily driven by strong growth in FMCG sector, increasing buying of sophisticated premium personal care products, shift in consumer preferences from synthetic to natural fragrances and increasing acceptance of private labels in India.



❖ **Investment Rationale:**

❖ **Proxy play on Indian FMCG sector**

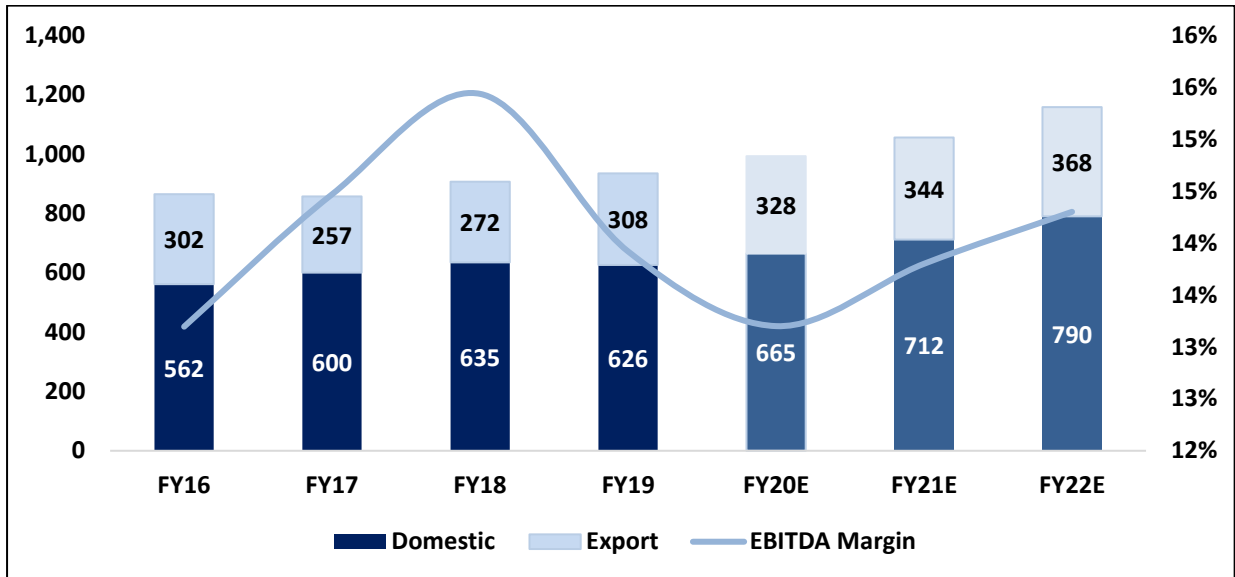
The chemicals manufactured by SHKL are used in personal care, hair care, skin care & cosmetics, household products, fine fragrances and F&F blends. Growth for SHKL depends largely on growth of these FMCG products. Cost of F&F ingredient in final product is typically in range of 0.5%-2%. However, it is a very critical component as product success highly depends on fragrance of the final product.

In order to ride the FMCG growth, direct investment in the listed FMCG space can be risky due to premium valuations being commanded by FMCG companies. SHKL is a direct beneficiary of this growth and is available at a relatively lower valuation.

Particulars	CMP	Mcap	Sales (TTM)	EBITDA Margin (TTM)	PAT Margin (TTM)	RoE (FY19)	RoCE (FY19)	TTM PE	1 Yr Fwd PE
HUL	2,461.0	5,32,736.0	40,773.0	25.0%	16.7%	82.0%	116.0%	76.6	58.1
Nestle	16,871.0	1,62,665.0	12,369.0	23.0%	15.9%	45.3%	70.9%	82.6	61.3
GSPL	600.0	61,339.0	10,210.0	22.0%	21.6%	31.6%	20.2%	27.7	35.4
SH Kelkar	81.0	1,059.0	1,113.0	14.0%	3.9%	15.9%	24.8%	13.5	11.6

❖ **Dominating share in domestic Fragrance market**

SHKL commands ~20.5% market share in Rs 18.8 Bn fragrance market. It is the largest domestic player in India Fragrances space and third overall following Givaudan (26% share) and Firmenich (21.1% share). SHKL has a client base globally as 33% of the fragrance revenue is contributed by exports.



Going forward, we expect the Fragrance segment to clock a revenue growth of 9.2%. The growth is in line with the FMCG sector growth. We also expect the EBITDA margin stabilization for the company after sudden swings over past 3 years due to challenges in raw material availability, inorganic expansions and shift of Netherlands plant to India.

❖ **Diversified product portfolio**

Currently, SHKL’s product basket is of over 9,700 products, which they supply to 4,000 customers in the fragrance and Flavours segment. The SHKL offers products across categories.



Moreover, SHKL has also launched branded small pack products “Cobra” sold to hundreds of traders and re-sellers across India. It has over 35,000 formulations form part of library. Diversified and comprehensive product portfolio and large customer base spread across several countries and customer categories, diminishes the risks associated with the dependence on any particular product or customer.



### ❖ Value creation by inorganic path

Year	Company	Description	Amount (Rs in Cr)
Feb-16	High Tech Technologies Pvt Ltd	To pursue strategic acquisitions route to expand its presence in flavours segment.	28.6
Mar-16	Rasiklal Hemani Agencies Pvt Ltd	Expansion of Marketing and field activities in Northern region	30
Aug-16	Gujarat Flavours Pvt Ltd (GFPL)	The company, through its affiliate Keva Flavours Pvt. Ltd, acquired the flavour unit of the GFPL, marketed under the brands Three Birds and Wheel.	14.5
Apr-17	Tanishka Fragrance Encapsulation Technology	Technology transfer agreement	NA
Sep-17	VN Creative Chemicals Pvt Ltd	Flexibility in backend manufacturing operations and leverage existing presence	13.59
Jan-18	Creative Flavours & Fragrances S.p.A (CFF-Italy)	To strengthen global product offerings, particularly in Fine Fragrances and Fabric Care segments	93.9 (51% stake)
May-18	Anhui Ruibang Aroma (China)	Provides access to another Tonalid manufacturing facility-to enable SHK to consolidate its market leadership in the segment	18.9 (67% stake)
Nov-18	Purandar Fine Chemicals Ltd.	Business of manufacturing and trading of aroma ingredient (manufacturing facility at Jejuri)-180 tons	(50% stake)

Growing inorganically is the quickest way to not only increase market share, but also gain access to new clients. Here is the rationale of the latest three acquisition transactions by SHKL

- SHKL acquired 51% of Italy-based Creative Flavours & Fragrances S.p.A (CFF) to strengthen global product offerings, particularly in Fine Fragrances and Fabric Care segments.
- Similarly, SHKL acquired 67% equity stake in China-based Anhui Ruibang Aroma as the acquisition provides access to another Tonalid manufacturing facility – to enable SHK to consolidate its market leadership in the segment.
- SHKL acquired 50% stake in Purandar, an aroma ingredients manufacturing company having 180 tons manufacturing facility at Jejuri, Maharashtra. The acquisition allows SHKL to seamlessly utilize Purandar facility together with Mahad and Vapi facilities of the group which would facilitate sharing of resources and deputation of trained personnel for quality enhancement.

### ❖ Product innovation and strong R&D to play a key role

SHKL has filed 13 patent applications in respect of molecules, systems and processes developed by it, of which 2 have been commercially exploited in deodorant and fine fragrance categories. It is the only company of Indian origin to file patents in field of Fragrance and Novel Aroma Molecules. SHKL also has Creation & Development Centers (CDCs) which works in collaboration with customers, as an extended R&D arm. These initiatives help maintain long term sustainable relationship with customers as SHKL becomes one stop shop for all the customer needs.

SHKL spends ~3% of revenue towards R&D as compared to global standard of 6-7% of sales. SHKL has foreseen Paints industry as a new segment for growth. SHKL is also in process of developing products offerings for non FMCG products such as Air Conditioners, Plywood etc. The potential in these markets in

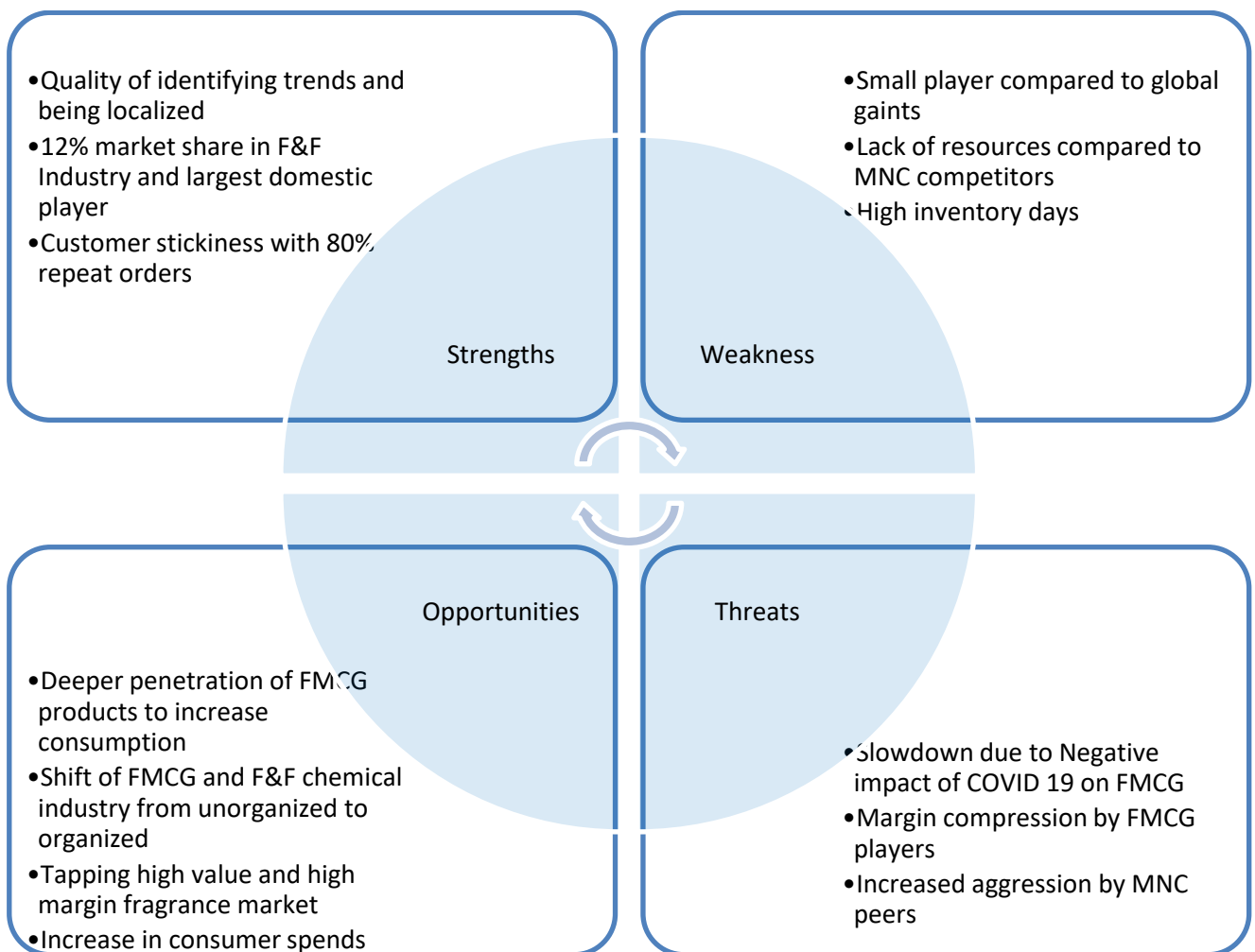


tremendous and completely untapped till date. Hence, going forward, product innovation will play a key role for the company to beat the industry growth rate.

❖ COVID-19, an opportunity in disguise

As discussed earlier, The F&F Industry is highly concentrated as top 6 F&F players in India have ~72% of market share. The balance 28% is largely unorganized smaller players. The COVID-19 lockdown is expected to bring in consolidation in the industry. SHKL can take an advantage of this consolidation being the largest domestic player and strengthen its position in the market.

❖ SWOT Analysis

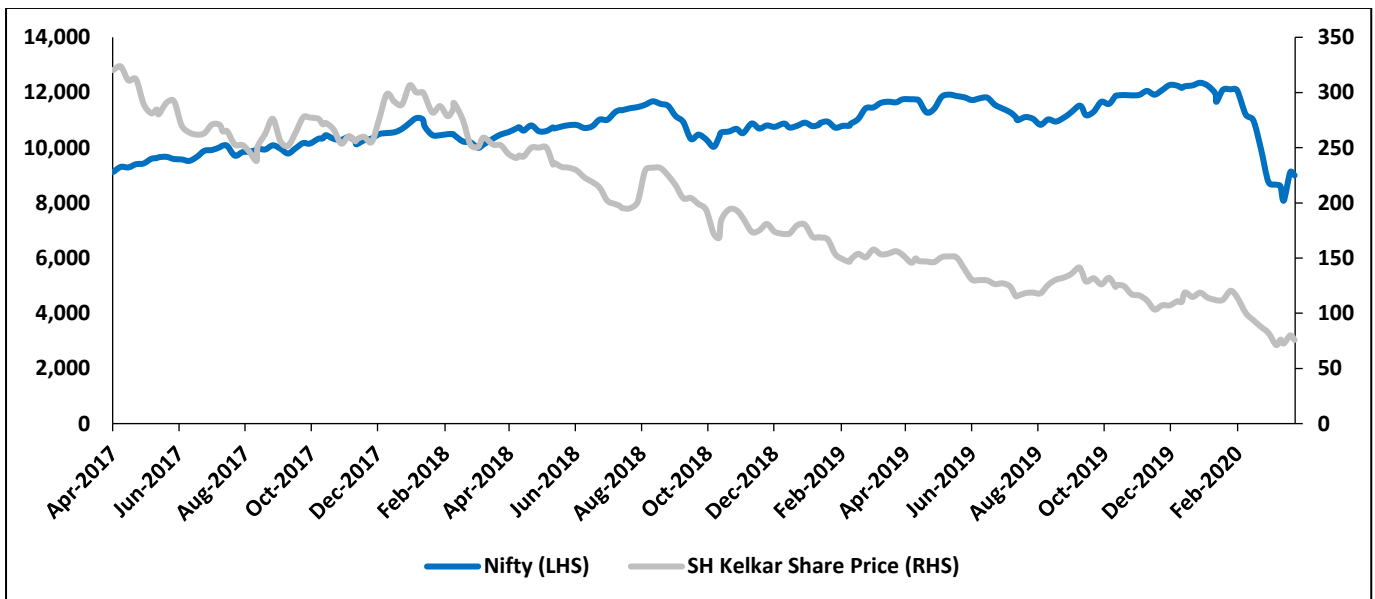






➤ Valuation and View:

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Financials:

SH Kelkar – Statement of Profit & Loss					
DESCRIPTION	FY18	FY19	FY20E	FY21E	FY22E
<b>Net Sales</b>	<b>1021.0</b>	<b>1043.6</b>	<b>1079.1</b>	<b>1116.3</b>	<b>1190.9</b>
EXPENDITURE:					
Raw Material Cost	544.4	571.3	592.4	608.4	647.8
<i>as % of Sales</i>	<i>53.3%</i>	<i>54.7%</i>	<i>54.9%</i>	<i>54.5%</i>	<i>54.4%</i>
Fuel & Manufacturing overheads	60.0	64.1	63.9	62.5	66.7
<i>as % of Sales</i>	<i>5.9%</i>	<i>6.1%</i>	<i>5.9%</i>	<i>5.6%</i>	<i>5.6%</i>
Employee Cost	125.2	128.1	139.6	143.8	148.1
Other Admin & Fixed overheads	69.3	75.6	75.5	75.9	78.6
S&D Overheads	62.7	70.8	75.5	74.8	77.4
<b>EBITDA (Ex OI)</b>	<b>159.5</b>	<b>133.7</b>	<b>132.1</b>	<b>150.9</b>	<b>172.2</b>
<i>EBITDA Margin</i>	<i>15.6%</i>	<i>12.8%</i>	<i>12.2%</i>	<i>13.5%</i>	<i>14.5%</i>
Depreciation	23.8	31.2	52.6	39.2	40.8
<b>EBIT</b>	<b>135.6</b>	<b>102.6</b>	<b>79.5</b>	<b>111.7</b>	<b>131.4</b>
Other Income	25.7	27.9	28.2	28.4	28.7
Interest	5.3	15.6	25.1	20.8	14.6
Exceptional Items	-12.9	0.0	-36.5	0.0	0.0
<b>Profit Before Taxation</b>	<b>143.2</b>	<b>114.9</b>	<b>46.1</b>	<b>119.4</b>	<b>145.6</b>
Provision for Tax	50.6	27.0	11.6	30.0	36.6
<b>Profit After Tax</b>	<b>92.6</b>	<b>87.9</b>	<b>34.5</b>	<b>89.3</b>	<b>109.0</b>
<b>Adjusted EPS</b>	<b>6.5</b>	<b>6.1</b>	<b>2.5</b>	<b>6.3</b>	<b>7.7</b>

SH Kelkar Ltd.– Balance Sheet					
DESCRIPTION	FY18	FY19	FY20E	FY21E	FY22E
Share Capital	144.6	144.6	144.6	144.6	144.6
Total Reserves	712.3	718.7	753.4	842.9	952.0
<b>Shareholder's Funds</b>	<b>856.9</b>	<b>863.4</b>	<b>898.0</b>	<b>987.5</b>	<b>1,096.6</b>
Minority Interest	0.0	10.8	11.0	11.2	11.5
Total Borrowings	164.3	334.0	294.0	239.0	144.0
Other Non-Current Liabilities	5.7	-4.7	-4.7	-4.7	-4.6
<b>Total Non-Current Liabilities</b>	<b>170.0</b>	<b>329.2</b>	<b>289.3</b>	<b>234.3</b>	<b>139.4</b>
Trade Payables	155.6	134.3	133.0	137.6	146.8
Other Current Liabilities	92.7	81.9	85.6	89.4	93.4
<b>Total Current Liabilities</b>	<b>248.3</b>	<b>216.2</b>	<b>218.6</b>	<b>227.0</b>	<b>240.3</b>
<b>Total Liabilities</b>	<b>1,275.2</b>	<b>1,408.8</b>	<b>1,405.9</b>	<b>1,448.8</b>	<b>1,476.2</b>
Fixed Assets	337.6	656.6	770.2	794.0	816.7
Other Non-Current Assets	239.1	201.9	158.0	208.7	234.4
<b>Total Non-Current Assets</b>	<b>576.7</b>	<b>858.5</b>	<b>928.3</b>	<b>1,002.8</b>	<b>1,051.1</b>
Inventories	348.0	373.9	378.4	379.2	391.5
Sundry Debtors	276.6	284.5	295.6	305.8	316.5



Cash and Bank	23.9	40.9	21.0	58.0	44.0
Other Current Assets	48.5	69.5	72.0	74.7	77.4
<b>Total Current Assets</b>	<b>698.5</b>	<b>550.3</b>	<b>477.6</b>	<b>446.1</b>	<b>425.2</b>
<b>Total Assets</b>	<b>1,275.2</b>	<b>1,408.8</b>	<b>1,405.9</b>	<b>1,448.8</b>	<b>1,476.2</b>

**SH Kelkar Ltd.– Cash Flow Summary**

DESCRIPTION	FY18	FY19	FY20E	FY21E	FY22E
PBT	143.2	114.9	46.1	119.4	145.6
Add: Depreciation	23.8	31.2	52.6	39.2	40.8
Add: Interest Paid	4.0	14.0	25.1	20.8	14.6
Less: Other Income	-10.3	14.8	36.5	0.0	0.0
Less: tax Paid	-36.1	-35.9	-11.6	-30.0	-36.6
Change in WC	139.5	113.2	144.5	174.2	188.5
<b>Cash from Operating Activities</b>	<b>103.3</b>	<b>118.5</b>	<b>133.8</b>	<b>145.0</b>	<b>152.9</b>
<b>Cash from Investing Activities</b>	<b>-163.6</b>	<b>-137.4</b>	<b>-88.6</b>	<b>-32.2</b>	<b>-57.3</b>
<b>Cash from Financing Activities</b>	<b>27.7</b>	<b>48.7</b>	<b>-65.1</b>	<b>-75.8</b>	<b>-109.6</b>
Net Change	-32.6	29.7	-19.9	37.0	-14.0
<b>Opening Cash Balance</b>	<b>41.9</b>	<b>11.2</b>	<b>40.9</b>	<b>21.0</b>	<b>58.0</b>
<b>Closing Cash Balance</b>	<b>11.2</b>	<b>40.9</b>	<b>21.0</b>	<b>58.0</b>	<b>44.0</b>

**SH Kelkar Ltd. – Key Ratios**

DESCRIPTION	FY18	FY19	FY20E	FY21E	FY22E
EBITDAM (%)	15.6%	28.1%	18.9%	18.8%	20.6%
ROE (%)	10.8%	15.9%	7.5%	7.2%	8.9%
ROCE (%)	16.2%	24.8%	11.8%	11.6%	14.3%
Receivable days	99	81	80	80	80
Inventory Days	124	133	130	128	126
Payable days	56	77	75	75	75
Total Debt/Equity(x)	0.2	0.4	0.3	0.2	0.1
Current Ratio(x)	2.8	2.5	2.2	2.0	1.8
Interest Cover(x)	25.7	6.6	3.2	5.4	9.0
BV per share	59.3	59.7	63.5	69.9	77.6
Adjusted P/E Ratio	12.5	13.2	33.0	12.8	10.5
Price/ Book value	1.4	1.4	1.3	1.2	1.0



## ANALYST CERTIFICATION

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