

Omkar Speciality Chemicals Ltd

Industry	CMP	Recommendation	Add on Dips to band	Sequential Targets	Time Horizon
Chemicals	Rs. 90.20	Hold and add on declines	Rs. 72-77	Rs. 95 & Rs. 112.50	2-3 quarters

HDFC Scrip Code	OMKSPEEQNR
BSE Code	533317
NSE Code	OMKARCHEM
Bloomberg	OSCL IN
CMP as on 12 Jun 17	90.20
Eq. Capital (Rs crs)	20.58
Face Value (Rs)	10
Equity Sh. Outs (Cr)	2.06
Market Cap (Rs crs)	185.61
Book Value (Rs)	40.20
Avg. 52 Week Vol	310,000
52 Week High	94.90
52 Week Low	70.55

We had issued a Pick of the Week report on Omkar Speciality Chemicals (OSCL) on May 02, 2017 (when its CMP was Rs. 167) to buy the stock at the CMP and add on declines to price band of Rs. 152-156 for sequential targets of Rs.195 and Rs.244 over the next 2-3 quarters. Refer: http://old.hdfcsec.com/Research/ResearchDetails.aspx?report_id=3022360. The 1st target was achieved on 8th May 2017. The stock went on to make a high of Rs.205.90 on May 09, 2017. We now issue a stock update incorporating recent corporate action (Demerger) and results review.

Corporate Action:

The stock of OSCL turned ex on 12th June 2017 for demerger of the veterinary API business segment to Lasa Supergenerics (LSL). The scheme involved issuance of equity shares of LSL to the shareholders of OSCL so that the share-holder will get one share of LSL upon demerger for each share held in OSCL. The shares of LSL will get listed on the BSE and the NSE in due course.

OSCL had fixed June 13th, 2017 as the record date for the purpose of determination of entitlement for allotment equity shares as per the composite scheme of arrangement. The speciality chemicals business of OSCL continued in the listed entity. The company has merged all its subsidiaries which it had acquired over a period of time and then demerged the veterinary API business. On 12th June 2017 (ex-date), OSCL (now consisting of Speciality Chemicals business) stock opened at Rs 94.90, and was locked at 5% lower circuit of Rs 90.2 on BSE.

Structural changes in the company:

OSCL has transferred its veterinary API business to Lasa Supergenerics which comprises of erstwhile Lasa Laboratories and Urdhwa Chemicals, manufacturing Unit VI and upcoming Unit V. Post-demergers, there are two companies Omkar Speciality Chemicals (speciality chemicals business) and Lasa Supergenerics (veterinary API business). While OSCL is already listed, LSL will also be listed later, which is subject to legal procedure. In FY17, the demerged business accounted for ~35% of the total sales. The group expects the demerger to assist it in managing both businesses and operations more efficiently and also to develop & execute growth plans and strategies effectively.

Key positives:

- OSCL has managed to negotiate with its creditors for a longer credit period. The company now gives LCs for 120-150 days against a shorter period earlier. Further it is focusing on increasing the share of niche products thereby garnering a stronger bargaining power with its customers and quicker payments. The receivables days has improved to 109 days vs 117 days in March 2016. Overall working capital cycle has improved from 135 days in March 2016 to 100 days in March

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2017. The combined effect would shrink the working capital cycle and reduce the liquidity stress on the company which was a key factor for underperformance of the shares over the last year.

- The company supplies 70% of its products to pharma companies. OSCL is not facing any pricing pressure as it is progressively getting into advanced and higher end intermediates. It is the only manufacturer in 80% of the specialty iodine compounds. Further it is getting into newer products in the FMCG sector where the working capital cycle is faster. It expects the revenue contribution from FMCG sector to increase from the current 10-12% to ~25% in FY18 and ~40% in the medium term.
- A significant portion of OSCL sales was to Lasa (12-15% of its sales) which was getting netted off in the combined financials till FY16. Now with two separate companies we believe OSCL would get the benefit of higher growth rate of Lasa.
- Exports of OSCL have increased by 25% in FY17 to Rs 64 cr from Rs 51 cr in FY16. Contribution from exports have increased from 16% in FY16 to 18.5% in FY17 and expected to grow at a strong pace in the coming years.

Key negatives:

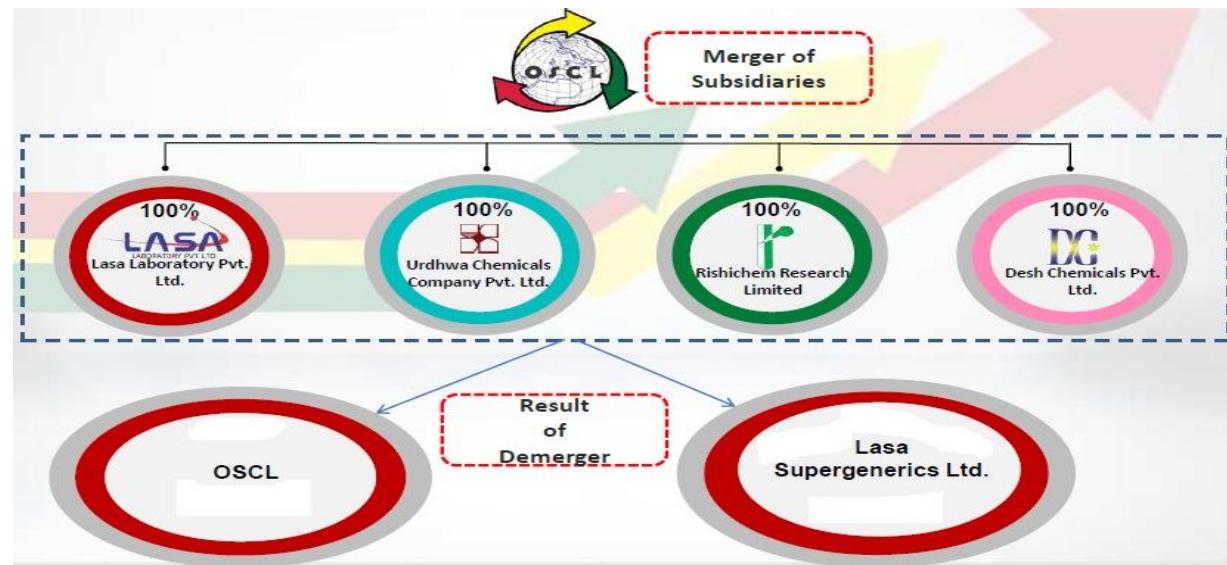
- Debt of the company has gone up substantially from Rs 185 cr in FY16 to Rs 218 cr in FY17. Although Rs 60 cr is interest free loan from the promoter, it would remain a key monitorable for re-rating of the stock. Management has guided for Rs 10-15 cr debt reduction in FY18.
- Management had on earlier occasions said that sale of pledged shares has ended and may not recur in future. However, shares have been sold by the promoters subsequently. The proportion of pledged shares has come down from 38.3% as on Sep-16 to 10.2% in March 2017 to 8.6% in May-17 and the management has once again said that pledged shares would not be sold. Earlier Mr. Pravin had pledged his shares and in May 2017 Mr. Omkar has pledged 3.79% of total shares. Hence the total pledged shares (by promoter Mr Pravin & his group and the non-promoter Mr Omkar) has again inched upto 12.4% of the equity.

Company Description

Incorporated in 1983, Omkar Speciality Chemicals Ltd (OSCL) is primarily engaged in the production of Specialty Chemicals. It manufactures a range of organic, inorganic and organo inorganic intermediates that find application in various industries like pharmaceutical, chemical, glass, cosmetic ceramic and poultry feeds. Its products are also exported to companies in Europe, Australia, North America and Asian countries.

OSCL has 3 manufacturing units and 1 R&D centre. It manufactures more than 100 products and exports to around 40 countries including regulated markets of Europe, North America, China and other Asian countries. Exports account for 15-20% of sales. OSCL is the largest and only manufacturer of Selenium Sulphide in India.

Group structure post-merger and demerger



(Source: Company, HDFC Sec)

Q4FY17 results review

OSCL reported results of Q4FY17 on 20th May 2017 post corporate structuring. The results were not comparable to prior periods on account of merger of four wholly-owned subsidiary of OSCL and demerger of veterinary API business. OSCL reported revenues of Rs 91.6 cr for the quarter. EBITDA stood at Rs 18.9 cr with an EBITDA margin of 20.7%. For the full year FY17 reported revenues were Rs 345 cr with EBITDA of Rs 57.4 cr and EBITDA margin of Rs. 16.6%. PBT before exceptional item stood at Rs 7.3 cr and Rs 32 cr for Q4FY17 and FY17 respectively. OSCL took a one-time loss of Rs 63 cr on account of difference in the fair value and book value of the assets being transferred to the demerged company.

Particulars (Rs Cr)	Q4FY17	Q4FY16	YoY (%)	Q3FY17	QoQ (%)	FY17	FY16	YoY (%)
Operating Income	91.6	89.8	1.9	82.0	11.6	345.0	319.1	8.1
Material consumed	62.8	57.8	8.6	57.1	10.0	236.4	227.6	3.9
Employee expenses	2.1	2.4	-13.0	2.4	-13.6	9.8	11.0	-10.8
Other expenses	7.7	10.8	-28.7	10.6	-27.3	41.4	35.2	17.6
Total expenses	72.6	71.0	2.3	70.1	3.6	287.6	273.8	5.0
EBITDA	18.9	18.8	0.6	11.9	58.5	57.4	45.3	26.8
Depreciation	1.0	1.5	-35.5	2.8	-65.3	8.2	4.3	92.5
Other Income	-5.5	1.8	-412.0	2.9	-288.2	2.2	8.9	-74.7
Finance cost	5.1	7.0	-26.7	4.4	17.0	19.4	16.5	17.6
PBT before Exceptional Item	7.3	12.0	-39.1	7.6	-3.8	32.0	33.4	-4.1

Exceptional Item	-63.2	0.0	NA	0.0	NA	-63.2	0.0	NA
PBT after Exceptional Item	-55.9	12.0	-564.3	7.6	-834.0	-31.2	33.4	-193.6
Tax expenses	-11.6	5.2	-323.6	1.7	-796.3	-5.7	11.2	-150.8
Reported PAT	-44.3	6.9	-746.4	6.0	-844.5	-25.6	22.2	-215.1
Adjusted PAT	5.8	6.9	-15.2	6.0	-2.4	26.2	22.2	17.9
Adj. EPS (Rs)	2.8	3.3	-15.2	2.9	-2.4	12.7	10.8	17.9
EBITDA (%)	20.7%	20.9%	-27 bps	14.6%	612 bps	16.6%	14.2%	245 bps
PAT (%)	6.3%	7.6%	-128 bps	7.3%	-91 bps	7.6%	7.0%	63 bps

(Source: Company, HDFC sec)

We are incorporating the separate financials and projections of Omkar.

View and Valuation

OSCL has witnessed strong growth momentum during the year with operating margins of 20.7% in Q4FY17 as against 16.6% for the entire year. All its business segments have contributed to this growth. With the demerger out of the way the management can now entirely focus on growing the balance business of speciality chemicals. The company has taken some vital steps towards improving their working capital cycle which should ease the liquidity stress on the company. Increasing demand for its products both in domestic as well as export markets should result in decent topline growth and the move towards niche products could drive higher valuations.

However, we will have to watch how the final settlement of shares and cash between the two set of promoters regarding the holding in each other's companies is structured and implemented and the resulting turbulence on the stock price. Debt reduction and de-pledging of shares would remain key monitorables for re-rating of the stock. Lasa could see faster growth in topline and earns higher operating margins (~22%) due to its focus on veterinary APIs where it is the only player in a number of products and hence would quote at better valuations than Omkar when it gets listed. OSCL is burdened with high debt and though its margins are good at 16-17%, its EV/EBITDA will be higher due to high debt. On a pre-demergers basis, the stock was quoting at 8.5x FY17 earnings. We assign a conservative P/E of 6.5x FY19E EPS to Omkar till its shows results on the above two monitorables. In better times this can go up to 7.5x.

At CMP of Rs. 90.2 the stock quotes at 7.1x of its FY17 adjusted EPS and 6x FY19E EPS. We feel investors who had earlier bought the shares can hold the stock and add on dips to Rs. 72-77 band (~5.0x FY19E EPS) for a target of Rs. 95 (6.5x FY19E EPS) in 1-2 quarters. If the street is generous, the stock could quote at 7.5x FY19E EPS resulting in a target of Rs. 112.50 in the next 2-3 quarters.

Financial Statements

Income Statement

Particulars	FY16	FY17P	FY18E	FY19E
Income from operations	319.1	345.0	377.8	411.8
Material Cost	227.6	236.4	258.0	281.7
Employee Cost	11.0	9.8	11.0	12.4
Other expenses	35.2	41.4	44.6	48.2
Total expenses	273.8	287.6	313.6	342.2
EBITDA	45.3	57.4	64.2	69.6
Depreciation	4.3	8.2	5.8	6.2
Other Income	8.9	2.2	1.1	1.2
EBIT	49.9	51.4	59.6	64.6
Interest	16.5	19.4	21.5	19.7
Profit before Excep. Item	33.4	32.0	38.1	44.9
Exceptional Item	0.0	-63.2	0.0	0.0
Profit before tax	33.4	-31.2	38.1	44.9
Tax Expenses	11.2	-5.7	12.2	13.9
Profit After Tax	22.2	-25.6	25.9	31.0
Adj. PAT	22.2	26.2	25.9	31.0
EPS	10.8	12.7	12.6	15.0

Balance Sheet

Particulars	FY16	FY17P	FY18E	FY19E
EQUITY AND LIABILITIES				
Share Capital	20.6	20.6	20.6	20.6
Reserves and Surplus	160.9	62.2	86.6	116.1
Shareholders' Funds	181.4	82.8	107.2	136.7
Long Term borrowings	79.2	124.6	114.6	99.6
Deferred Tax Liabilities (Net)	8.0	7.2	7.2	7.2
Other Long Term Liabilities	0.0	0.0	0.0	0.0
Long Term Provisions	2.4	2.2	2.7	3.7
Non-current Liabilities	89.7	134.0	124.5	110.5
Short Term Borrowings	95.5	82.6	87.6	92.6
Trade Payables	50.5	95.9	100.4	108.0
Other Current Liabilities	15.9	9.8	10.4	10.2
Short Term Provisions	13.7	4.4	5.6	7.6
Current Liabilities	175.6	192.8	203.9	218.4
TOTAL	446.7	409.5	435.6	465.5
ASSETS				
Fixed Assets				
Net Block	190.6	168.5	174.7	183.4
Capital work-in-progress	0.0	0.0	0.0	0.0
Non current Investments	13.9	0.1	0.1	0.1
Long-Term Loans and Advances	26.5	1.7	1.9	2.9
Other Non-current Assets	0.0	0.0	0.0	0.0
Non-current Assets	40.4	1.9	2.0	3.0
Current Investments	0.0	0.0	0.0	0.0
Inventories	61.8	73.1	77.6	84.6
Trade Receivables	102.3	103.5	114.9	125.2
Cash and Bank Balances	6.6	10.6	11.5	11.7
Short-Term Loans and Advances	44.1	51.1	53.8	56.4
Other Current Assets	0.9	0.9	1.0	1.1
Current Assets	215.7	239.2	258.9	279.1
TOTAL	446.7	409.5	435.6	465.5

One year Price (adjusted) chart

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