Dharamsi Morarji Chemical Co. Ltd

Industry	CMP	Recommendation	Add on Dips to band	Sequential Targets	Time Horizon
Chemicals	Rs. 65.95	Buy at CMP and add on declines	Rs. 56.5-59	Rs. 75.5-85	2-3 quarters

HDFC Scrip Code	DHAMOREQNR
BSE Code	506405
NSE Code	NA
Bloomberg	DMCC IN
CMP as on 28 Apr 16	65.95
Eq. Capital (Rs crs)	21.26
Face Value (Rs)	10
Equity Sh. Outs (Cr)	2.13
Market Cap (Rs crs)	140.20
Book Value (Rs)	14.53
Avg. 52 Week Vol	51000
52 Week High	99.00
52 Week Low	15.80

Shareholding Pattern-% (Mar-2016)	
Promoters	48.73
Institutions	5.79
Non Institutions	45.47
Total	100.00

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Established in 1919, Dharamsi Morarji Chemical Company Limited (DMCC) was the first producer of Sulphuric Acid and Phosphate fertilizers in India. Until recently, DMCC was known primarily as a fertilizer producer, with over 75% of revenue from Single Superphosphate (SSP). Through a painful restructuring process, DMCC exited the manufacturing of fertilizers almost entirely between FY10 to FY13. DMCC now has zero dependence on Government policy, net foreign exchange earnings, and sales to over 25 countries driven by a strong management and R&D team of over 20 people consisting of PHDs and engineers. The management of DMCC has decided to focus now onwards on improving technical expertise in Sulphur and Ethanol chemistry and manufacturing/selling speciality and performance chemicals based on these two.

Investment Rationale

- Robust bottomline growth in FY16 driven by changing product mix
- Focus on expanding specialty chemical business - Sulfones – strong growth opportunity
- Strong management track record
- Possibility of merger with group company (Borax Morarji) over the medium term.
- Encouraging financial metrics

Concerns

- No dividend paid in the last 13 years and is unlikely to do so in the next 2-3 years due to accumulated losses.
- Sharp topline growth is dependent on approval from government for its multi-purpose plant which might get delayed.
- Almost 40-45% of the revenues come from exports. Sharp appreciation of the rupee could hurt its revenues and profitability.
- Plants of DMCC are located at Roha resulting in geographical concentration and the attendant risks.
- Almost 25% of DMCC's revenues come from sulphuric acid which is a highly commoditized and volatile business.

Financial Summary

(Rs Cr)	3QFY16	3QFY15	*YoY (%)*	2QFY16	*QoQ (%)*	FY15	FY16E	FY17E	FY18E
Net Sales	19.2	24.7	*-22.5*	24.9	*-23.1*	120.1	101.3	116.5	137.4
EBITDA	0.3	3.2	*-90.8*	5.2	*-94.4*	19.4	16.7	20.6	25.9
PAT	-0.5	2.2	*-121.3*	4.6	*-110.2*	14.0	13.3	15.8	20.1
EPS (Rs)	-0.2	1.0		2.2		6.6	6.3	7.5	9.4
P/E (x)						10.1	10.6	8.9	7.0
EV / EBITDA (x)						8.3	9.6	7.8	6.2
RoE (%)						45.5	30.3	26.5	25.1

(Source: Company, HDFC sec)

View and Valuation

We like DMCC due to the fact that the company has moved out of fertilizers where it was facing problems and is now focusing on increasing the share of specialty chemicals. Accumulated losses of the past years would aid in reducing the tax liability for the next couple of years. It has competency in chemistry on sulphur and ethanol. With the approval of multi-purpose plant expected shortly, we believe revenues and margins of the company could improve over the next two years.

We feel investors could buy the stock at the CMP and add on declines to Rs 56.5-59 band (6-6.25x FY18E P/E) for sequential targets of Rs 75.5 (8x FY18E EPS) and Rs 85 (9x FY18E EPS) in 2-3 quarters.

Company Overview

Dharamsi Morarji Chemical Company Limited (DMCC), established in 1919, was the first producer of Sulphuric Acid and Phosphate fertilizers in India. Over the years, the brand of the Company (“Ship”) came to be recognized as the quality standard for Single Superphosphate (SSP). Until recently, DMCC was known primarily as a fertilizer producer, with over 75% of revenue from SSP. As a strategy, DMCC moved gradually towards Speciality Chemicals over years. With focused Research and Development efforts, processes for downstream sulphur-based chemicals were commercialized. Simultaneously, the Marketing team engaged with customers in India and overseas to meet their requirements. Through a painful restructuring process, DMCC exited the manufacturing of fertilizers almost entirely between FY10 and FY13 due to losses and strained working capital.

Due to the non-viable operations of DMCC’s fertiliser and chemical business at its Ambernath factory, which resulted in continued losses, the company suspended operations in Jan-2009. Since then, the company has been disposing off the assets at Ambernath location and a major chunk was sold off in FY13 resulting in a profit of Rs 35.9 cr. DMCC utilised the proceeds to mainly pay off the dues of strategic investor who was earlier expected to provide financial resources to DMCC and provide synergies in sourcing of raw materials and Agri inputs (but later due to changed scenario as regards fertiliser, it opted out of association with the company).

Today, DMCC has zero dependence on Government policy, net foreign exchange earnings, and sales to over 25 countries in 5 continents driven by a strong management and R&D team of over 20 people consisting of PHDs and engineers. The management of DMCC has decided to focus now onwards on improving technical expertise in Sulphur and Ethanol chemistry and manufacturing/selling speciality chemicals based on these two. Its products are used in various applications such as agro, cosmetics, construction, detergents, dyes, electroplating, emulsion, fertilizers, fire retardants, ink, paper, pharmaceutical intermediates, pigments, polymer, textile processing, thermal paper coating, and water treatment. With the installation of multipurpose manufacturing facilities in 2005, DMCC caters to changing customer requirements and produces low–volume, high-value products.

Company growth

DMCC started its first plant to manufacture Sulfuric Acid in 1919 and later shifted to manufacture of commodity and speciality chemicals.

Year	Milestone
1919	Company was incorporated at Mumbai
1963	New company by the name of Borax Morarji Ltd formed in collaboration with Borax (Holdings) Ltd., London, to manufacture of Borax & Boric acid.
1965	Albright, Morarji & Pandit Ltd., for manufacture of phosphoric acid & industrial phosphatic, in collaboration with Albright & Wilson Ltd., London, Shri S.P. Pandit & Smt. Sharda Mukherjee
1980	The capacity of single superphosphate plant was expanded at Kumhari in phases from 95,000 to 1,61,000 tpa
1986	The single superphosphate plant was modernised and also expanded from 2,00,000 tpa to 3,00,000 tpa
1988	Capacity of sulphuric acid plant increased from 66,000 tpa to 1,01,900 tpa and that chloro-sulphonic acid plant from 3,600 tpa to 16,500 tpa in July
1990	The Company commissioned at Jhar, district Amreli, Gujarat, a sulphuric acid plant with a capacity of 33,000 tpa and a single superphosphate plant with a capacity of 66,000 tpa
1992	Sold the Alpha Olefin sulphonate plant at Roha to Albright Morarji and Pandit, Ltd. a company jointly promoted with Albright & Wilson Ltd., London. Commissioned sulphuric acid plant with a capacity of 3,000 MTPA at Roha
2013	Sold its Ambernath factory

Key Management Personnel

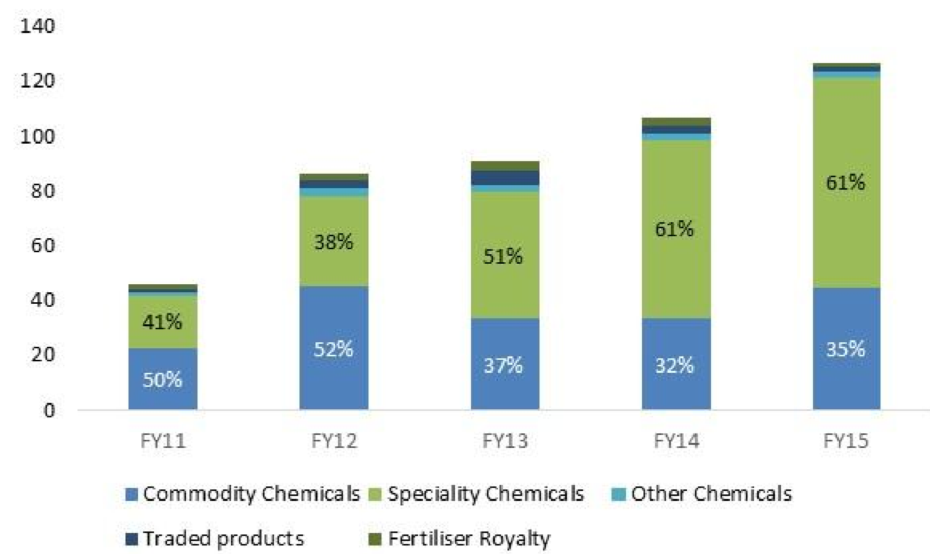
Name	Brief Profile
Mr. Bimal Lalitsingh Goculdas **CEO**	Mr. Goculdas is a Chemical Engineer from University Institute of Chemical Technology, Mumbai and has done MS degree in Chemical Engineering from University of Wyoming, USA. He also serves as Director on various boards of other companies.
Mr. Dilip Trimbak Gokhale **Executive VP & Company Secretary**	Mr. Dilip Gokhale is also responsible for Human Resources and Internal Audit. Earlier he served as VP of Legal & Corporate Affairs. He has been Director of Borax Morarji Since Nov 2013
Mr. D. Kalyan Sundaram **CFO**	Mr. Sundaram is responsible for the finance and accounting functions, as well as Information Technology. He has over three decades of functional experience with Indian and multinational companies.

Business Overview

DMCC is focusing on improvement in production process for its cost effectiveness and initiatives for development of new products. Increasing emphasis is being given on cost reduction, efficient operations and improvement in supply chain management as well as development of new commodity chemicals. The Management of DMCC has also decided to lay emphasis on improving technical expertise in Sulphur and Ethanol chemistry. Efforts are being made to have long term alliance with key customers to develop tailor made processes/products to meet their specifications and expectations.

DMCC has three factories at Roha (Maharashtra), Jhar (Gujarat) and Khemli (Rajasthan). It had disposed off its other factory at Ambernath (Maharashtra) due to non-viable operations. DMCC has already set up flexible manufacturing facilities termed as “Multi-purpose plant” which can be utilised for manufacture of various Specialty Chemicals which are the future growth areas. It is contemplating further investment in this segment. The Company has also set up a Solar power Plant in Roha with an initial capacity of 500 KW which will gradually be increased over a period of time. The solar energy is expected to partially replace expensive grid power with cheaper green energy and reduce marginally the Company’s energy cost.

Revenue breakup



(Source: Company, HDFC sec)

Investment Rationale

Robust bottomline growth in FY16 driven by changing product mix

The sulphur plants of the company are due for maintenance shutdown every 15-18 months. In Q3FY16 the sulphur plants were shut down for a period of 1 month for maintenance. Consequently revenues of the company declined by 22.5% in Q3FY16 to Rs 19.2 cr and higher repair/maintenance expenses were incurred by DMCC due to which it incurred loss of Rs 0.5 cr as compared to a profit of Rs 2.2 cr in the corresponding quarter of previous year. Inspite of lower sales in 9MFY16 (due to lower commodity prices), the PAT of the company has increased marginally aided by changing mix to higher margin specialty chemicals. With the next maintenance shutdown likely in Q1FY18, we believe FY17 will be a strong year for the company.

Focus on expanding specialty chemical business

The management has stated that it would be looking to add more multi-purpose plant in the near future. Earlier approvals were given by the government product-wise. But with the approval now being given plant-wise it would enable the company to manufacture wide variety of products at its multi-purpose plants.

DMCC has already incurred capex of ~Rs 5 cr and its multi-purpose plant at Roha is ready. It is waiting for government approval which is expected shortly. Post that the company is considering setting up another multi-purpose plant at a capex of ~Rs 8-10 cr.

DMCC does not face any competition from China in ethanol products as China doesn't have an ethanol producing industry. In fact, DMCC exports its ethanol products to Chinese buyers. Indian players will likely do well because of better adherence to IP. Chinese manufacturers are currently facing headwinds in the form of rising costs, decline in subsidies and rising cost of environment protection measures.

Benzene and sulphur are the main raw materials of DMCC. Sulphur supply is set to increase over the medium term as refineries move to Euro IV/BS VI, which demand lesser sulphur content, which implies higher volume of sulphur byproduct. Specialty chemicals have low raw material values, so fluctuations in benzene prices do not impact significantly.

Management may not be incurring major capex in their sulphur commodity business and would focus on adding more multipurpose plants in the segment. Maintaining the sulphur business is key for DMCC as it provides for oleums, which are very difficult to transport due to their hazardous nature.

Strong management track record

Mr Bimal Lalitsingh Goculdas has been the CEO (cum promoter) of DMCC since April 2009. He is a chemical engineer from University Institute of Chemical Technology (UICT), Mumbai and has an MS degree in chemical engineering from University of Wyoming, USA. Post the CDR package in FY06, the promoters had provided liquidity by giving interest free unsecured loans to meet the liquidity needs of the company. At the end of FY15 outstanding loans from director stood at Rs 17 cr.

Possibility of merger with group company

There is a possibility that DMCC might merge its group company Borax Morarji (which is also into chemical space) with itself. Borax mainly manufactures boron based chemicals and a wide range of speciality chemicals, with application as Detergents additives, Micronutrient fertilizers, Timber Preservatives, Flame Retardants, and Catalysts at its Ambernath factory (operations suspended at Ambarnath in FY15 and shifted to Dahej). Borax Morarji is currently a loss making company due to uneven availability of raw material as also the increased cost of imported raw material. It also has a lot of land at Dahej (>90,000 sq mtr) which can then be partly used for future expansion of DMCC. The merger as and when it happens will offer a better product range, bigger land area for expansion and tax losses for set-off.

Sulfones – strong growth opportunity

DMCC is looking to manufacture sulfones at its multi-purpose manufacturing plant. A sulfone is a chemical compound containing a sulfonyl functional group attached to two carbon atoms. It is typically prepared, not by oxidation of the thioether, but by addition of sulfur dioxide to 1,3-butadiene, followed by hydrogenation of the resulting sulfolene. Sulfone is used to extract valuable aromatic compounds from petroleum, it is gaining prominence in the field of engineering plastics and also used in pharmaceutical industry. The management expects revenues from sulfones to cross ~Rs 100 cr in 4 years.

Encouraging financial metrics

It has little debt on its books, its fixed assets are depreciated to a large extent, its return ratios are healthy with RoNW at 45.5% in FY15, its current and quick ratios are healthy at 1.2 and 0.8 respectively.

Concerns

- The company has not paid any dividend in the last 13 years and is unlikely to do so in the next 2-3 years as it had accumulated losses to the tune of Rs 34.7 cr at the end of FY15.
- Sharp topline growth is dependent on approval from government for its multi-purpose plant. Although the management is confident of getting the approval soon, it might get delayed.
- Almost 40-45% of the revenues comes from exports. Sharp appreciation of the rupee could hurt DMCC's revenues and profitability.
- Plants of DMCC are located at Roha. Geographical concentration could lead to disruption of company's manufacturing activities on account of natural/manmade calamity.
- Almost 20-25% of company's revenues come from sulphuric acid which is a highly commoditized and volatile business.

Financial Statements

Income Statement

Particulars	FY14	FY15	FY16E	FY17E	FY18E
Income from operations	**101.3**	**120.1**	**101.3**	**116.5**	**137.4**
Material Cost	56.8	71.4	60.7	68.6	79.6
Employee Cost	6.6	6.4	5.9	6.5	7.4
Other expenses	22.6	23.0	18.0	20.8	24.5
Total expenses	85.9	100.7	84.6	95.9	111.5
EBITDA	**15.4**	**19.4**	**16.7**	**20.6**	**25.9**
Depreciation	3.5	2.4	2.2	2.6	2.8
EBIT	11.9	17.0	14.4	18.0	23.1
Other Income	0.4	0.3	0.3	0.3	0.4
Interest	2.4	1.9	1.4	1.1	1.0
PBT	16.1	14.0	13.3	17.2	22.5
Tax Expenses	0.0	0.0	0.0	1.4	2.5
PAT	**16.1**	**14.0**	**13.3**	**15.8**	**20.1**
EPS	7.6	6.6	6.3	7.5	9.4

(Source: Company, HDFC Sec)

Balance Sheet

Particulars	FY14	FY15	FY16E	FY17E	FY18E
EQUITY AND LIABILITIES					
Share Capital	21.3	21.3	21.3	21.3	21.3
Reserves and Surplus	-4.2	9.4	22.7	38.6	58.6
Shareholders' Funds	**17.1**	**30.7**	**44.0**	**59.8**	**79.9**
Long Term borrowings	28.8	25.8	23.9	18.9	13.9
Deferred Tax Liabilities (Net)	-26.5	-26.5	-26.5	-26.5	-26.5
Other Long Term Liabilities	14.8	0.7	0.6	0.6	0.5
Long Term Provisions	2.3	2.1	1.8	2.1	2.2
Non-current Liabilities	**19.4**	**2.1**	**-0.3**	**-5.0**	**-9.9**
Short Term Borrowings	0.0	0.0	0.0	0.0	0.0
Trade Payables	18.1	14.9	12.4	14.2	16.8
Other Current Liabilities	16.5	13.1	10.2	11.1	12.3
Short Term Provisions	1.0	1.1	0.9	1.1	1.1
Current. Liabilities	**35.5**	**29.1**	**23.5**	**26.4**	**30.2**
TOTAL	**72.0**	**61.8**	**67.2**	**81.2**	**100.2**

ASSETS					
Fixed Assets					
Gross Block	104.0	104.0	107.0	117.0	122.0
Less: Acc. Depreciation	78.4	79.5	81.8	84.4	87.2
Net Block	**25.6**	**24.4**	**25.2**	**32.6**	**34.8**
Capital work-in-progress	0.9	0.6	0.6	0.6	0.6
Non current Investments	0.3	0.3	0.3	0.3	0.3
Long-Term Loans and Advances	1.9	1.6	1.6	1.6	1.6
Other Non-current Assets	0.0	0.0	0.0	0.0	0.0
Non-current Assets	**2.2**	**2.0**	**2.0**	**2.0**	**2.0**
Current Investments	0.0	0.0	10.0	15.0	26.0
Inventories	8.1	12.0	9.6	10.4	13.0
Trade Receivables	17.1	14.3	11.5	12.6	14.9
Cash and Bank Balances	1.8	3.4	4.2	3.2	3.3
Short-Term Loans and Advances	0.0	0.0	0.0	0.0	0.0
Other Current Assets	16.3	5.1	4.1	4.7	5.6
Current Assets	**43.3**	**34.8**	**39.5**	**46.0**	**62.8**
TOTAL	**72.0**	**61.8**	**67.2**	**81.2**	**100.2**

(Source: Company, HDFC Sec)

Cash Flow Statement

Particulars	FY14	FY15	FY16E	FY17E	FY18E
Profit Before Tax	16.1	14.0	13.3	17.2	22.5
Depreciation	3.5	2.4	2.2	2.6	2.8
Others	-3.8	1.9	1.3	1.0	1.0
Change in working capital	-3.1	3.7	0.3	0.6	-1.7
Tax expenses	0.0	0.0	0.0	-1.4	-2.5
Cash flow from Operating activities	**12.7**	**22.0**	**17.1**	**20.1**	**22.1**
Net Capex	-2.4	-1.5	-3.0	-10.0	-5.0
Other investing activities	-0.3	-0.1	-10.0	-5.0	-11.0
Cash flow from Investing activities	**10.9**	**-1.5**	**-13.0**	**-15.0**	**-16.0**
Proceeds from Eq Cap	0.0	0.0	0.0	0.0	0.0
Borrowings / (Repayments)	3.5	1.8	-1.9	-5.0	-5.0
Dividends paid	0.0	0.0	0.0	0.0	0.0
Interest paid	-2.4	-1.9	-1.4	-1.1	-1.0
Cash flow from financing activities	**-23.6**	**-18.9**	**-3.3**	**-6.1**	**-6.0**
Net Cash Flow	**0.1**	**1.6**	**0.8**	**-1.0**	**0.1**

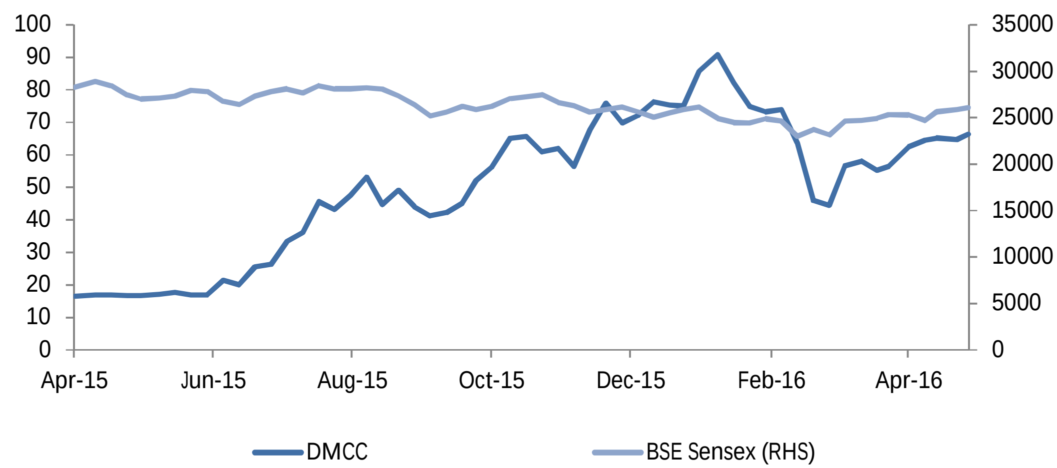
(Source: Company, HDFC Sec)

Financial Ratios

Particulars	FY14	FY15	FY16E	FY17E	FY18E
EPS	7.6	6.6	6.3	7.5	9.4
Cash EPS (PAT + Depreciation)	9.2	7.7	7.3	8.7	10.8
Book Value Per Share(Rs.)	8.0	14.4	20.7	28.1	37.6
PE(x)	8.8	10.1	10.6	8.9	7.0
P/BV (x)	8.2	4.6	3.2	2.4	1.8
Mcap/Sales(x)	1.4	1.2	1.4	1.2	1.0
EV/EBITDA	10.4	8.3	9.6	7.8	6.2
EBITDAM (%)	15.2	16.2	16.5	17.7	18.9
EBITM (%)	11.8	14.1	14.3	15.5	16.8
PATM (%)	15.9	11.6	13.2	13.6	14.6
ROCE (%)	25.9	30.0	21.3	22.9	24.6
RONW (%)	94.0	45.5	30.3	26.5	25.1
Current Ratio	1.2	1.2	1.7	1.7	2.1
Quick Ratio	1.0	0.8	1.3	1.4	1.6
Debt-Equity	1.7	0.8	0.5	0.3	0.2

(Source: Company, HDFC Sec)

1 year price movement comparison with Sensex



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