Sector – Specialty Chemicals **Date:- Nov 24, 2016.**

CMP – 15/-

M.cap – 405 cr.

Business Snapshot –

- **Overview**

  Vikas Ecotech is engaged in manufacturing of eco friendly specialty chemicals that are used across various sectors like construction (PVC pipes & wires/cables), footwear, pharma, automobiles, packaging, artificial leather, polymers, etc. These specialty chemicals are used to improve and enhance the quality of the end products. Vikas Ecotech is a pioneer in introducing lead free eco friendly heat stabilizers in India that are used in manufacturing of PVC pipes. Its flagship product MTM (Methyl Tin Mercaptide) replaces all the lead based stabilizers which were earlier used in PVC pipes. Vikas Ecotech is the only player in India with this technology. The best example is Maggi from Nestle. The lead content was said to be high in Maggi because the pipes through which water used to pass to prepare Maggi was contaminated with lead content which was coming from the lead based chemicals used in these PVC pipes. Major world economies like US and Europe have already banned lead based stabilizers and the same trend is expected to follow soon in India. However, major pipe manufacturers like Finolex (No.1 player) and Prince pipes (No. 3 player) have voluntarily started procuring MTM from Vikas Ecotech, which reflects huge demand coming in for the company's product. Anticipating a huge demand for its flagship product, company has started building capacities at its land at Dahej, Gujarat. Company already has 2 plants, one in Rajasthan and the other in Jammu. The new plant at Dahej, being the third one will have a capacity of 6000MT of MTM and 5000MT of special polymer compounds. Apart from MTM, company manufactures ATH (flame retardants) used in wires and cables to protect wires from catching fire. The tag line that Havells uses – " Wires that don't catch fire" is the magic of the chemical manufactured by Vikas Ecotech. Other products include, Plasticizers ESBO, Thermoplastic Rubber Compounds (TPR), Thermoplastic Elastomer Compounds (TPE), Ethylene Vinyl Acetate (EVA), Poly Vinyl Chloride (PVC) and Polythylene Terephthalate Compounds (PET). Company engages with its clients right from the product development stage and tries to understand the tailor made requirements of its clients; after which the R&D department of the company tries to develop a chemical which can serve the purpose of the client, ie- improved quality of the end product, for eg- wrinkle free shirts. This helps company to build relationships with big clients and focus on their tailor made requirements rather than scouting for small and standard orders from small clients. This not only brings higher margins but also helps company carve out a niche in the huge commoditized market. Company has developed a technology with which used cooking oil can be re used to manufacture plastizers (used in PVC pipes). It has also recently acquired a Hydal technology from a European company to convert waste cooking oil into PHA (bio-polymers).

- **Corporate History & Management Quality**

Vikas Garg
Promoter-Executive &
Managing Director

Jagadish Capoor
Independent &
Non-Executive Director

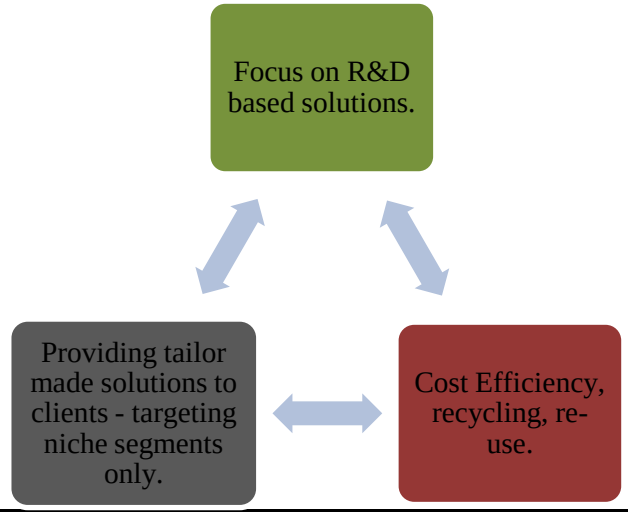
The journey of this company trace back to 1984 when it was incorporated as a NBFC company – Vikas Leasing. The company got listed on stock exchange in 1995 and started trading and distribution of petrochemical products in 1998. Vikas Garg is a very aggressive man and believes in taking short term pain for long term wealth creation. It was in 2008, that he decided to venture into manufacturing of chemicals and started 2 units in Jammu for TPR compounds and Organotin stabilizers. Since then, there was no looking back and company being a net importer in 2008, today is a net exporter of its products. Exports clocked in a CAGR of 126% over these years. Company's revenue mix consisted of 100% trading revenues in 2008 which has come down to just 20% in 2016. Today, company is transformed into a R&D based specialty chemical manufacturer, focusing on providing tailor made solutions to big players and bringing cost efficiencies. This has led to EBITDA margins going upwards from just 2% to 18% today. Vikas Garg, took over as the MD of the company in 2011. He brought in Mr. Asutosh Verma to strengthen the senior management team. Asutosh Verma brings with him excellent track record of 34 years, having worked at companies like Multibase India Limited (subsidiary of Dow Chemicals). His expertise in R&D, marketing, business development and technical support has truly helped the company to transform into a niche player in the specialty chemical business. He is the backbone of company's R&D expertise.

The Board of Directors of the company comprises of people like Mr. Jagdish Capoor – former deputy governor of RBI and ex-chairman HDFC bank. Recently, company has formed an advisory board that will advise the senior management and board of best industry practices. The advisory board will be chaired by Mr. GN Bajpai – ex- chairman SEBI.

Mr. B.N. Bajpai, ex- chairman SEBI

Grand Thornton has been selected to be the internal auditors of the company from this year.
One of the major clients of the company; Prince Pipes, has invested close to 10% in the company which reflects clients confidence in the company (The investment has been done in personal name, family members and company-Prince pipes).
All this reflects, that the promoter is willing to bring change, is willing to transform things and truly believes in long term wealth creation through ethical conduct and complete transparency.

- **Focus/Market Strategy**

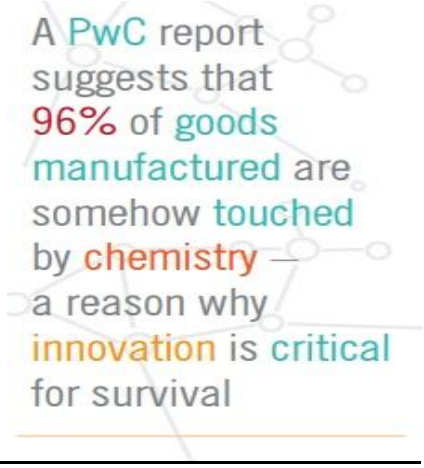


Result –

- **EBITDA margins improve from 2% in 2008 to 18% in 2016.**
- **Major companies like Finolex, Prince pipes, Liberty and Havells are clients of the company.**
- **Increased customer satisfaction due to R&D based niche solutions provided.**

- **Major Industries where the products are used**

- **Industry Update**



This means a CAGR of 15% for next 5 years.

With western economies experiencing demand stagnation and battling uneconomical costs of production, the next decade of manufacturing and economic demand consumption will have shifted to the East. Be it automobiles, construction, polymers, agriculture or pharma, specialty chemical players have followed their customers to the Asian markets of China and India. China's inability to produce as per global standards has led to softening of exports benefitting Indian specialty chemical players. Today, Indian players have a cost advantage of over Chinese firms after taking into account the additional investments by Chinese companies in environment, health and safety.

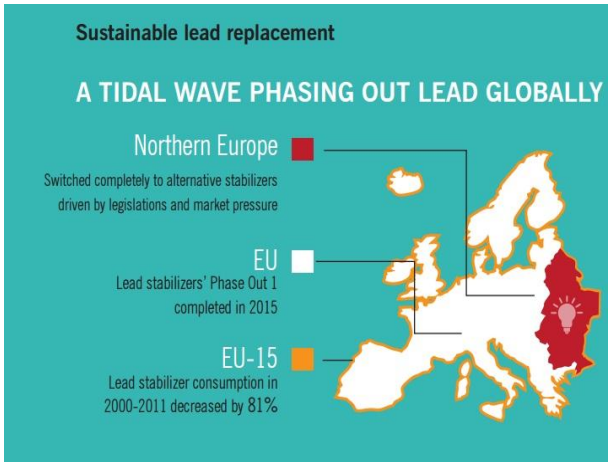
Today, the Indian specialty chemicals segment at $25 billion garners an abysmal share of 3% of the global specialty chemicals industry. This is due to industry fragmentation, low investments in R&D and most players targeting local markets. With Indian local consumption driving volumes and moving up the value chain, demand for premium specialty chemical applications is set to increase. Indian specialty chemical players will contribute 6-7% of the global demand by 2023, almost doubling their market share. This will include meeting the current local demand that is being met through expensive imports.

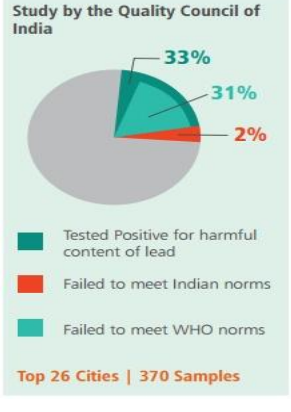
<u>Future of MTM</u> –

With the Indian market demand for Organotin Stabilizers at 6,000 MT p.a. (growing at 20% CAGR) and global market demand at 1,40,000 MT p.a., there is a continued demand for the product due to advantages that no other player in India currently provides. The nascent Indian market of CPVC (Chlorinated polyvinyl chloride) pipes and fittings in India is estimated to grow at more than 100% CAGR over the next 2-3 years and is giving leaders like Vikas Ecotech a distinct advantage. CPVC is a thermoplastic produced from PVC resin that is much more flexible and has the ability to withstand higher temperatures than standard PVC. It is eco-friendly, corrosion-resistant and has a long service life. CPVC is used in the manufacturing of pipes for hot & cold water and industrial liquids. Organotin is the only heat stabiliser used in the manufacture of CPVC (better in quality than uPVC) pipes & fittings and the dosage is 3 folds in CPVC as compared to UPVC pipes & fittings. During the current year company's market share in India for Organotin Stabilizers was approximately 10%. Company's vision is to attain 25% share of the expanded market in the near future. Recently, company has got trial orders from big petrochemical players in Latin America and Mexico and the commercial orders are expected to start from 3rd quarter of FY2017. The big PVC pipe players in India like Astral, Finolex and Ashirwad have been voluntarily adopting MTM and have been currently sourcing their demands from China. However, 70% of the PVC pipes market in India is still unorganized which still uses lead based stabilizer due to its low prices compared to the eco friendly chemicals. Adoption of GST and the demonetization move is expected to bring a huge shift in the market share from the unorganized to the organized sector. There is a huge demand expected out there for the company's MTM due to government focus on smart cities and housing for all. Vikas Ecotech is the only major player in India in this segment yielding it higher margins

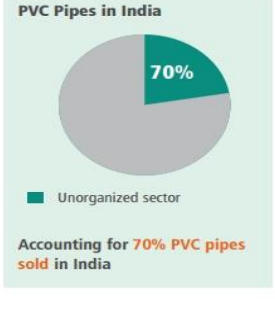
of 20%+. There are only 7 players with MTM technology in the world out of which 4 are in China. The price differential between company's MTM product price and the MTM coming from China is close to 5-7% (after customs duty). This is one of the reasons why Vikas ecotech has to offer a somewhat high credit period to its customers. All these factors contributing together is expected to do wonders for the company.

https://www.seair.co.in/methyl-tin-mercaptide-import-data.aspx - Import data of MTM. 80% China, 20% Indonesia.





in PVC pipes. While good quality pipe manufacturers follow these standards, the unorganized sector which accounts for 70% of the PVC pipes sold do not meet these standards.



The real culprit is not Nestle Maggi, it is the lead based chemicals used in PVC pipes and ultimately the contaminated water that is used to prepare maggi. This can be a valid reason for only some of the samples of maggi tested were found violating the standards. Delhi government was in favour of banning maggi while Goa government was not !!

Product Description[8,9]

ADVASTAB™ methyl tin heat stabilizers consist of two families commonly known as thioglycolates and reverse esters. Both families are mixtures of mono- and dimethyl tin mercaptides. They are clear, amber colored liquids that have low volatility and low water solubility.[10] Some products are approved for use in polyvinyl chloride (PVC) pipe used for potable water, and other products are approved for use in food-contact applications. These products are also approved for PVC pipe that carries water used for food processing, vinyl window frames, and vinyl siding.

As a result of safety and environmental assessments for organotin substances, government restrictions have been or are being considered for tri-substituted organotins, in particular tributyltin (TBT) and triphenyltin (TPT) compounds. Dioctyl tin (DOT) and dibutyl tin (DBT) PVC stabilizers in some applications also have restrictions.[11] ADVASTAB methyl tin heat stabilizers do not contain any of these substances.

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Source -
http://msdssearch.dow.com/PublishedLiteratureDOWCOM/dh_069d/0901b8038069d684.pdf?filepath=productsafety/pdfs/noreg/233-00776.pdf&fromPage=GetDoc – Dow chemical also manufactures MTM.

ADVASTAB™ methyl tin heat stabilizers are especially useful in the following PVC processing applications:

- Pipe
- Plastics additives packaging film
- Window profiles
- Foam pipe
- Foam profiles
- Fence, deck and rail
- Siding
- Pipe fittings
- Durables miscellaneous
- Building and Constructions miscellaneous
- Foam sheet

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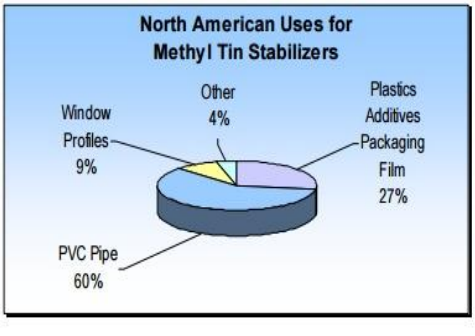
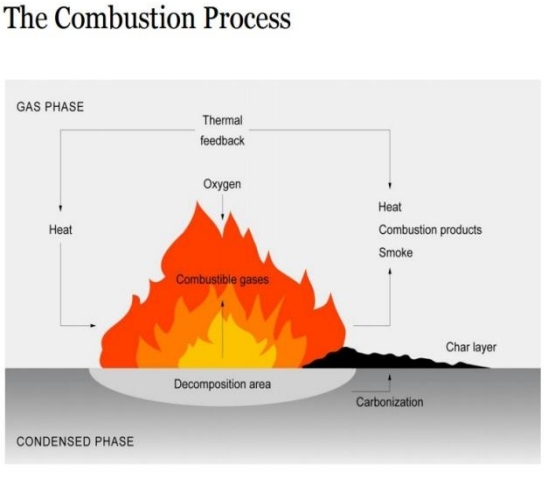
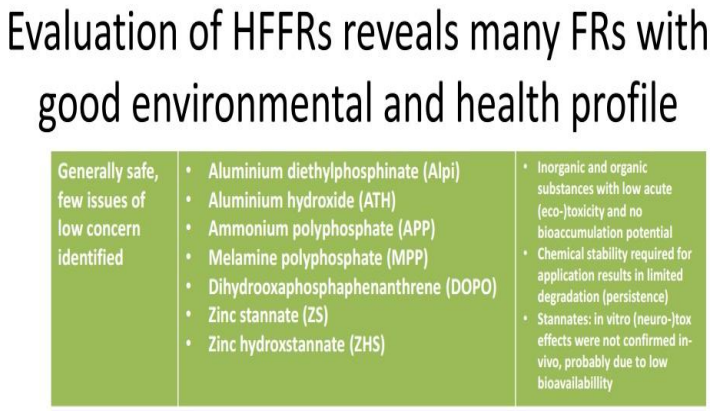


Huge opportunity lies for the company apart than the PVC pipe industry.

<u>Future of ATH</u> – Aluminum hydroxide (ATH) is an eco friendly flame retardant widely used in various applications like wires and cables, paints, textiles, adhesives, foams, thermoplastics, etc. This is one of the various types of flame retardants which has been proved to be safest and effective. The coating of this chemical around the wires and cables enables release of water upon heating due to short circuits/fire, leading to cooling of the combustion process. Vikas Ecotech has developed this product in house by doing reverse engineering. Vikas is a very small player in this segment. Other players include Pac-India, Tinaorganic, Chemtex, etc. However, the opportunity size seems huge due to govt. thrusts on housing for all, smart cities and make in India. This is a high EBITDA generating segment of close to 40%. However, this segment is at a very nascent stage and company has a target of achieving 4-5 cr this year which is just 1% of the total sales. However, they see a huge opportunity going forward.





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http://www.soci.org/~/media/Files/Conference%20Downloads/2015/Bromine%20Flame%20Retardants%20Life%20Savers%20or%20Eco%20Villains_2015/FMG_2015_Adrian_Beard.ashx. Clariant is a global player in flame retardants.

<u>Specialty Rubber-Plastic Compounds</u> - Company manufactures variety of plastic and rubber based compounds that are used in various industries like pharma, footwear, automobiles, packaging, agriculture, etc. Company has crafted out a niche position in such a commoditized market by providing tailor made solutions to its clients. Company's R&D staff works with the client's R&D department from the inception of the product development

stage at the client's end. Vikas's R&D staff tries to understand the specific requirements of its clients, develops the required chemical composition through R&D and enables client in their product development stage. The whole exercise enables clients provide value added products and Vikas Ecotech earn higher margins compared to their peers. For eg – developing a pen grip to enable smooth writing or a shoe sole with enough softness to absorb excess jerk on knees or a wrinkle free shirt. Vikas Ecotech develops tailor made solutions for all this.

TPE ⇧ **TPR** ⇧

R&D focus has led company develop a niche chemical process whereby waste cooking oil can be used to manufacture a specialty additive. Company has entered into a contract with Haldiram, India's largest and reputed Indian snack manufacturers for supply of waste cooking oil. It is currently manufacturing plastizers from virgin soyabean oil. With sourcing used cooking oil from Haldiram, company will be able to manufacture the same quality plasticizer at throw away cost.

R&D focus has led company to create few interesting solutions like compounds for soles of snow resistant boots for the Indian Army through company's tie up with FDDI - Footwear Design & Development Institute (under the Ministry of Commerce & Industry, Government of India).

One of the key innovations has been in re-engineering used PVC material to produce a high performance PVC compound that matches the quality attributes of virgin PVC. Typically, products

made from recycled PVC are considered to be of lower grade and hence command lower prices. Company has been able to defy this through 'intelligent' chemical application. This has helped clients benefit from near-to-equal finished products at a better price while improving company's margins. This is still at a very nascent stage with few clients like Apollo pipes. Company sees huge potential in this segment.

- **Valuations**

Particulars	Value (in Cr.)
TTM Sales	366
TTM Net Profit	38
M.Cap	405
TTM PE	10.67
TTM EPS	1.49

- **Market Cap Analysis -**

Current Market Price (INR)	BSE (November 24,2016)	Rs 15
Market Capitalization (INR cr.)	Full	Rs. 381 (100%)
	Free Float	Rs. 216 (56.49%)

Comment –

Promoter holds 43.51% stake in the company. In 2011, promoter pumped in funds through warrants which were required for the business. After that, Vikas Garg has sold 0.85% of his stake in the market in June 2014 and further 1.18% in November 2015. In July 2016, Vikas Garg enetered into a block deal with Prince Pipes, one of the biggest customer of company. Vikas Garg gave his 0.83% stake in the company to the promoter of Prince pipes. Hence, in total, he has sold close to 2.86% of his stake in the company since 2008. None of the other promoter group has sold their stake in market except 1.66% stake given to Prince pipes by Seema Garg and Moonlite technochem Pvt. Ltd. The stake held by promoter and promoter group is going to further get diluted due to the equity dilution planned through QIP of 73 cr. The promoter's stake is set to come down to 37% only.

- **Profit & Loss Analysis -**

(INR Cr.)	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	CAGR 2006-2016

												(%)
Sales (A)	NA	NA	35.30	44.02	61.58	98.30	110.46	156.79	169.68	211.02	307.15	31.05
Operating profit (B)	NA	NA	0.83	1.39	3.10	6.44	7.39	7.85	10.21	16.93	48.99	66.49
Operating profit margin (B/A)	NA	NA	2.35%	3.16%	5.03%	6.55%	6.69%	5.01%	6.02%	8.02%	15.95%	
Net profit after tax (C)	NA	NA	0.37	0.32	3.03	6.08	8.72	3.42	3.32	3.79	25.53	69.77
Net profit margin (C/A)	NA	NA	1.05%	0.72%	4.92%	6.18%	7.89%	2.18%	1.95%	1.79%	8.31%	

Comment –

Top line has consistently grown over last 8 years at a healthy CAGR of 31.05%. Bottom line has grown at 70% CAGR over the same period. Top line growth of 31%, increase in EBITDA margins and operating leverage contributed to such a high CAGR in bottom line. Operating margins have been consistently increasing over 8 years,. Sustainable OPM range between 18-20%.

- **Tax Analysis –**

INR CR	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total
Profit Before tax (A)	NA	NA	0.39	0.63	3.38	6.25	8.79	3.52	4.06	6.22	39.26	
Tax provision (B)	NA	NA	0.02	0.31	0.35	0.17	0.07	0.09	0.74	2.44	13.72	17.91
Tax Rate(B/A)	NA	NA	5.13%	49.20%	10.35%	2.72%	0.79%	2.55%	18.22%	39.23%	34.94%	
Tax Paid	Extracted from Cash flow Statement - screener.in											5.8

Comment –

Need to verify with the management.

- **Leverage Analysis -**

INR CR	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
EBIT (A)	NA	NA	0.56	1.19	2.78	5.59	5.8	6.17	8.3	13.51	45.62
Interest Expense (B)	NA	NA	1	0.98	1.65	2.74	3.87	4.51	6.46	10.79	11.36
Interest Coverage (A/B)	NA	NA	0.56	1.21	1.69	2.04	1.49	1.37	1.28	1.25	4.01

Comment –

The ratio is not so satisfactory over years. Company's balance sheet has been kept highly leveraged over years, which brings huge risk to the business operations. However, the ratio seems to be improving now.

INR CR	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Debt(A)	NA	NA	6.72	8.07	16.07	24.34	25.46	36.58	42.91	67.61	93.59
Equity(B)	NA	NA	10.89	11.22	13.79	25.9	36.03	36.87	40.94	43.29	66.24
Debt Equity(A/B)	NA	NA	0.62	0.72	1.16	0.94	0.71	0.99	1.04	1.56	1.41

Comment –

Debt Equity ratio has been increasing. The ratio was 0.99 times in 2013 which has now increased to 1.41 times. Company has to rely on debt to invest in working capital, capex, pay dividends and finance costs (interest) since company is still not generating positive OCF.

- **Working Capital Analysis -**

Particulars	Amount (cr.)	Turnover (times)	Days
Debtors	140.63 cr.	2.86 times	128 days
Inventory	37.54 cr.	7.64 times	48 days
Creditors	44.89 cr.	6.28 times	58 days
Advance given to suppliers	8.74 cr.	26.63 times	13 days
Cash Conversion Cycle	N.A.	N.A.	131 days
Funding through Short Term Borrowings	81.47 cr.	57%	
Funding through Retained Earnings	61.81 cr.	43%	

Comment –

Working capital cycle of the company is a bit stretched which is having an impact on the cash flows. Vinati Organics takes 66 days, Meghmani Organics takes 109 days, Solar industries takes 62 days, Nocil takes 77 days, Sudarshan Chemicals takes 88 days to recover money from their debtors. Vikas Ecotech takes the highest time to recover compared to its industry average – 166 days (based on closing balance of debtors). However, the company is in its nascent stages and its products are very new in the markets for which customer acceptance is required. Till 2013, the debtors to sales ratio was in comfortable zone after which it has shoot up to 45% in FY 16. During the said time, company launched MTM on a large scale and other products like ATH and specialty compounds. Company also has to pay advance to its suppliers for procuring raw materials. This is assumed to be because of starting of a new relationship with its suppliers. As the company grows bigger and builds relationships with its suppliers the bargaining power of company is expected to increase.

- **Debtors To Sales Analysis –**

(INR Cr.)	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Debtors (A)	NA	NA	12.39	9.95	14.80	21.24	26.36	36.36	53.85	74.75	140.64
Sales (B)	NA	NA	35.30	44.02	61.58	98.30	110.46	156.79	169.68	211.02	307.15
% (A/B)	NA	NA	35.09	22.60	24.03	21.60	23.86	23.19	31.74	35.42	45.79

Comment –

This ratio is not at comfortable levels. Since 2013, the ratio has shoot up to 45% in FY 16. This coupled with stretched working capital cycle and negative cash flows surely reflects poor financial position of the company. The EBITDA margins have consistently increased which gets reflected in the ROE and ROCEs consistently improving. All the growth parameters like top line and bottom line growth also have been amazing. However, consistent negative cash flows, due to consistent investment in working capital forces company to either raise debt or dilute its equity. Moreover, company has been paying dividend by raising debt since the operating cash flows have been negative since last 3 years, which is quite alarming. To improve the overall financial position, company will have to reduce its cash conversion cycle and for that debtors to sales ratio has to be brought down.

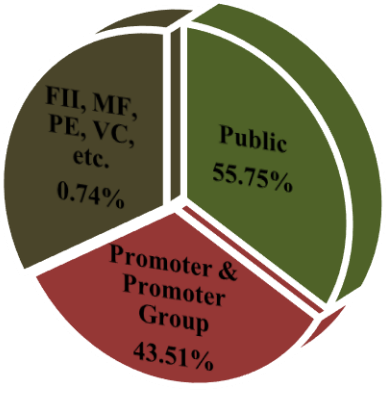
- **Du Pont Analysis -**

Net Profit Margin	Asset Turnover Ratio	Financial Leverage	ROE%
8.18%	2.33 times	2.45 times	46.69%
		ROCE (before tax)	37.62%

Comment –

Company earns a decent ROE from its business. However, this is majorly due to high debt on its balance sheet. Assuming this company to be a debt free company, the ROE would shrink down to 24-26% (NPM of 10.41% - based on TTM figures) which is still a good number.

Shareholding pattern Analysis –



Comment -

Merrill Lynch bought 19 lac shares in the company on 5th February 2016 at a price of 20.85/-; 0.74% of the total equity of the company. Promoter stake is at decent levels, however, the equity dilution announced recently is going to bring down the promoter stake to 37%.

- **Cash Flow Analysis -**

(INR Cr.)	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total
Cash from Operating Activity	NA	NA	-12.37	-0.04	-1.23	-3.38	8.64	-4.81	2.88	-11.57	-4.14	-26.02
Cash from Investing Activity	NA	NA	-1.07	-1.69	-6.48	-8.28	-4.64	-1.20	-2.19	4.29	-10.11	-31.37
Cash from Financing Activity	NA	NA	13.92	1.36	7.54	11.55	-3.83	6.07	-0.60	13.42	12.07	62.04
Net Cash Flow	NA	NA	0.48	-0.37	-0.17	-0.11	0.17	0.06	0.09	6.14	-2.18	

Comment –

Poor performance shown on cash flow front. Company has generated negative cash flow of 26 crores over last 8 years, which reflects that all the operating profit is reinvested in working capital (mainly debtors). Company has to consistently borrow money from banks to invest in capex and working capital. Further, company has been paying dividends by raising debt which further deteriorates the financial condition. In 2014, it was observed, that company sold off its investments in one of its subsidiaries, the proceeds of which were used to invest in capex and working capital. The margins have been consistently improving and if company is able to improve its working capital situation, things can start improving.

- **EBITDA vs. CFO Analysis :**

(INR Cr.)	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total
Operating Profit (OPM)	NA	NA	0.81	1.08	2.75	6.27	7.32	7.76	9.47	14.49	35.27	85.22
Cash from Operations (CFO)	NA	NA	-12.37	-0.04	-1.23	-3.38	8.64	-4.81	2.88	-11.57	-4.14	-26.02
Investment In working capital	NA	NA	-13.56	-0.51	-4.65	-11.10	-3.04	-13.55	-9.32	-28.66	-54.25	-138.64

Comment –

Since last 8 years company has generated 85 cr of total operating profit compared to which CFO is negative figure of 26 cr, which indicates that 138 cr has been invested in working capital over last 8 years. The working capital figure has been taken from screener.in. The balancing figure of 27cr is on account of taxes, other income which are recorded in either one of them – CFO or OP and not in both of them.

- **Retained Profits v/s Mcap Increase -**

(INR Cr.)	2008-16
Total retained profits of last 8 years (A)	37.78
Total increase in market capitalization in 8 years (B)	406
Value created per INR of retained profits (B/A)	10 times

Comment –

Company has retained 37.78 cr over last 8 years over which the market cap has increased by 406 cr which reflects that management has been allocating retained capital rationally which has led in decent growth in EPS over years. Such a huge increase in Mcap was majorly due to PE re rating. However, all this was due to better execution by mgmt. If they would have allocated capital irrationally and had made huge losses, the Mcap wouldn't have gone up.

Management Analysis-

Salary of Promoters vs. Net Profits –

(INR Cr.)	2010	2011	2012	2013	2014	2015	2016
Profit after tax	3.03	6.08	8.72	3.42	3.32	3.79	25.53
Fixed Component (100%)	0.036	0.036	0.036	0.036	0.036	0.057	0.06
Variable Component (0%)	-	-	-	-	-	-	-

Total salary (100%)	0.036	0.036	0.036	0.036	0.036	0.057	0.06
Remuneration as % of Net profit	1.18	0.59	0.41	1.05	1.08	1.50	0.23

Comment –

Industry standard is 5-6% of PAT. The promoter has been taking very low salary. This clearly reflects his belief in creating maximum wealth in long term through his stake in the company by growing the business of the company in a fair and transparent manner.

Dividend Payout –

(INR Cr.)	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	CAGR
Net profit	NA	NA	0.37	0.32	3.03	6.08	8.72	3.42	3.32	3.79	25.53	69.77%
Dividend Paid (INR)	NA	NA	0	0	0.50	1.01	0.50	0.50	0.49	1.27	1.27	12.36%
Dividend Payout (%)	**NA**	**NA**	**0**	**0**	16%	16.59%	5.79%	14.76%	15.29%	33.57%	4.97%	

Comment –

Company had announced bonus shares in 2014. Hence, in 2015 and 2016 company has announced dividend on all the shares including the bonus shares at the same levels as in the past. This is the only reason for the spike in the payout ratio in 2015. However, as noted above, almost 5.5 cr have been paid through dividends over these years which is obviously raised through debt. This provides promoter with nearly 2.4 cr of cash dividends over these years which he can pump in the company and increase his stake in future. The amount of dividends earned by the promoter is far higher than his salary of mere 3.6 lacs (now 6 lacs). However, promoter has not used this money indirectly to increase his stake in the company. Last time promoter pumped in funds was in 2011.

Valuations -

Particulars	
PEG Ratio	**0.137 times**
Earnings Yield	**9.93%**
Sum of Parts	**NA**
Price To Book	**NA**

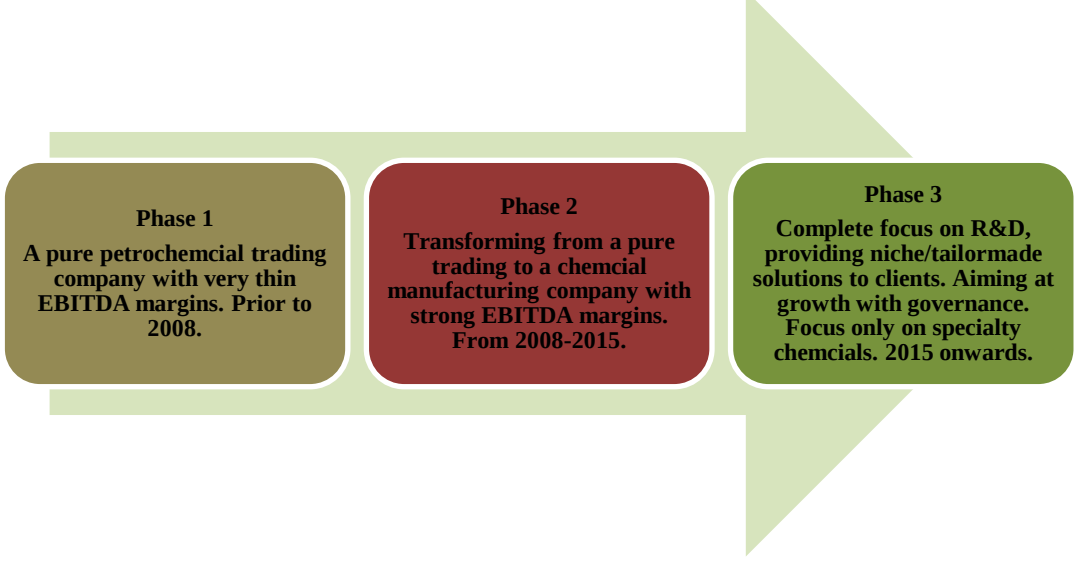
Risks –

- **In 2011, when Vikas Garg took over as the MD of the company; the company announced purchase of 8 acre land at Dahej, Gujarat for manufacturing of paraffin wax, hydrochloric acid and Epoxidized Soya bean oil. Company also announced plans to set up polyester /PET compounding unit at Silvassa. Both the plans somehow failed for which there has been no mention from the company's side about the failure in the subsequent annual reports. Silvassa plan was however only on paper, but the Dahej plan had been already commissioned with the 8 acre land purchase. Today, company has announced expansion by building a facility at Dahej, Gujarat and so investment in 8 acre land 5 years back will finally come to the**

business use of the company. However, this time the things look different. Company seems much more mature and has already been successful with its MTM product generating close to 80 cr in topline.

- **Huge attrition rate in CS and CFO designations. In last 5 years, none of the appointed CS or CFO has stayed with the company for more than a year on an average. This is attributed to lower salaries paid for these designations. However, the things seem to have changed now. These designations are now on an average given salary of 5-7 lacs per annum. However, we need to ask the management for the specific reasons other than salary for such high attrition rates.**
- **Company ventured into agricultural commodity trading business in 2013 to diversify the offerings by the company. Company also deals into real estate which forms 2-3% of the total revenues. Company was also forwarding agent for Lupin from which it used to earn franchisee revenue. Today, company has terminated its agreement to with Lupin, slowed down its real estate activity and terminated its agro division completely. It seems that after making mistakes, company has realized that focus is more important than diversification.**
- **Company announced investment plans in Dubai and Singapore in its FY 15 annual report. It had plans to start a JV in Dubai. There was no mention of that in FY 16 annual report.**
- **High Debtors to sales ratio of close to 45% in FY 16 is a huge red flag. However, one should try to understand the dynamics of this company. Trading business was 70% of the total sales in 2011. In 5 years, the manufacturing segment contribution shot up to 80%, bringing trading segment contribution down to just 20%. Interestingly, the debtors to sales ratio has kept increasing all these 5 years. Company started manufacturing MTM on large scale from last year only. The company is at its nascent stage, trying to develop a market for its products. The ratio should normalize over next 2 years.**
- **Promoter's stake is set to reduce to 37% (6% down) due to the recent equity dilution. The funds are required to fund the working capital needed for the expansion planned at Dahej plant. Company does not generate positive OCF to fund its increasing working capital requirements and capital expenditure needed. Company's debt equity ratio has been also deteriorating since last couple of years. Company will have to start generating positive OCF soon, else its financial position might worsen.**
- **Company had only 2 plants till 2015. In 2015, company claimed to have added two more plants, one at Delhi and the other at Uttarakhand. In FY 16 annual report, company claims to have realized that economies of scale could be achieved only by manufacturing all the products at one place rather than creating a satellite plant structure and hence, the two plants were shut down and merged into the old plants at Jammu and Rajasthan.**

Transformation -



Segmental Breakup

Revenue

In Rs. Crores

Products	Q2 FY17	Contribution	Q2 FY16	Contribution	YoY%
Manufacturing	66.1	79.1%	53.9	75.2%	22.6%
Trading	17.4	20.9%	17.8	24.8%	(2.0)%
Grand Total	83.5		71.7		

EBIT

Products	Q2 FY17	Contribution	Q2 FY16	Contribution	YoY%
Manufacturing	13.6	98.0%	7.0	96.8%	95.6%
EBIT Margins	*20.6%*		*12.9%*		
Trading	0.3	2.0%	0.2	3.2%	50.0%
EBIT Margins	*1.6%*		*1.3%*		
Grand Total	13.9		7.2		

Cross Verification done with a major player in MTM in China

- **What is the future of MTM technology in India?**
  MTM technology has good future in India. MTM is an eco friendly heat stabilizer and the awareness among PVC players has been increasing. Vikas is a big and known player in MTM in India. However, it is not the only player in India. Sheetal is one another company that deals in MTM. However, Vikas Ecotech is emerging as a big player in India.

- **Zuaba import data shows that MTM is still imported in India from China and other countries like Europe and USA. Almost 80-85% of the total MTM imported in India, comes from China. So, does Chinese players have a cost advantage over Indian players like Vikas Ecotech?**
  Yes. There is a cost advantage that Chinese players enjoy over Indian players. We are (the Chinese company dealing in MTM) supplying our products to various small PVC pipe manufacturers in India.

- **Does having MTM technology provide any competitive advantage?**
  Yes it does. The technology is very unique and is known to be with very few players globally.

- **What credit period does your company provide to its clients? Vikas Ecotech offers a credit period of 120+ days.**

We do LC at sight mostly. We don't accept standby LCs, we only accept commercial LCs. So, we do not provide any credit to our customers in India. But, we do provide 30 to 60 days credit to some of our old customers in China. In India the entire business happens through Letter of Credit only. We supply to one of the biggest PVC pipe manufacturer in India at these terms.

Difference between Commercial and Standby LC –
http://www.investopedia.com/terms/l/letterofcredit.asp

Our interaction with management – Vikas Garg and his colleagues – Points to be noted.

- **There are only 7 players all over the world with the MTM technology. – Cross verified with China Fellow.**
- **MTM (organotin) is the only safest option that can be used in PVC pipes. - Cross verified with China Fellow.**
- **Vikas Ecotech is the only player in India in MTM – Shital industries has the technology for the last process only. There are 5 processes in manufacturing MTM. Vikas ecotech has technology for all the 5 processes. Vikas Ecotech imports tin alloy (process 1 raw material).**
- **There is a 5-7% differential in price of our MTM and MTM provided by China. This is one of the reasons why we have to offer higher credit period to customers.**
- **Our product is very new in the market. We launched MTM on a large scale just last year. We got Finolex and Prince Pipes as our customer last year only. They want to check the quality of our raw material. Naturally, we get our payments late. We are still building relationship. However, the quality of our debtors has gone up. Currently, we are providing 50-60 days more credit than other players in the chemical industry. Currently, debtor days are 150 days (H1,17), which should come down to at least 110 days in next year. This will directly improve our cash flows. We would be cash flow positive at operational level in FY18.**
- **ATH is a high margin business and we see a huge potential in this segment.**
- **We have taken a land on lease at Kandla to manufacture MTM for exports. The expansion plans at Dahej, Gujarat is delayed by 2 months. It is taking a lot of time in getting environmental clearance from govt.**
- **Our customer has invested in us. That customer has very good reputation in the market. His business is a huge success and is today India's No.3 pipe manufacturer. He knows our business and has invested in it. That reflects our reputation.**
- **Tin is our main raw material. We are able to pass on the high tin prices to our customers with a time lag.**

Conclusion -

Specialty chemical business is a working capital intensive business. This business requires less capex vis a vis working capital. In 2008, this company was into pure trading business earning thin EBITDA margins of 2%. Over next 7 years, the contribution of trading business consistently fell recording just 20% in H1,17. Company has completely transformed itself from a mere trading concern to a completely R&D focused specialty chemical manufacturer, earning sustainable margins of close to 18%. Company has been doing all the right things by appointing Grand Thornton as their internal auditors, bringing Mr. BN Bajpai, ex- chairman SEBI on its advisory board. Debtors to sales ratio is too high, but for a reason. The company is still in its nascent stage with its products very new in the market. As the customer acceptance for the product improves, we expect working capital days to come down considerably, which will enable the company to generate positive operating cash flows. At a PE of 10, there is a good margin of safety too.