

August 23, 2017

Apex Frozen Foods Ltd

Price band ₹ 171-175

Capex equity; growth to follow...

Apex Frozen Foods (Apex) is an integrated manufacturer and exporter of processed shrimp from India, based out of Andhra Pradesh. Apex started its journey way back in 1995 wherein they were exporters of processed shrimp to South East Asian countries. Post setting up its own manufacturing facility in 2004, the company started exports to the US & European countries. Apex is a prominent export house with two decades of valuable experience and is a 100% export oriented unit. Its current capacity is at 15,240 tonne per annum (TPA) with its own manufacturing capacity at 9,240 TPA & leased out capacity of 6,000 TPA. In FY17, it recorded sales of ~10,000 tonne with corresponding processed shrimp sales at ~₹ 660 crore with effective realisation of ~₹ 660/kg. On a consolidated basis (processed shrimp sales + export benefits + forex gains), Apex recorded sales of ₹ 710 crore, EBITDA of ₹ 56 crore with corresponding EBITDA margins of 8%. PAT in FY17 was at ₹ 24 crore.

Investment Rationale

Volume led growth to sustain over FY17-20E

With the IPO proceeds, Apex plans to set up a 20,000 TPA capacity for manufacturing processed shrimps (ready-to-cook), which also includes a 5,000 TPA capacity to manufacture value added products (ready to eat). The said facility will have an incremental revenue potential of ~₹ 700 crore with intended RoCE 30%+. With likely commissioning in early FY19E, we expect volume led growth to sustain. This may lead to further improvement in margins & robust bottom line growth, going forward.

Asset light business model; controlled NWC cycle, good return ratios

Apex has an asset light business model with asset turnover to the tune of ~7x (sales of ~₹ 660 crore, gross block of ~₹ 100 crore). This coupled with controlled working capital cycle at ~60 days, results in robust return ratios with core RoCE in excess of 25%. We expect this trend to continue, going forward. Apex has a debt of ~₹ 110 crore as of FY17, which post equity issuance (IPO proceeds) will result in a leverage ratio of ~0.5x.

Concerns

- Export benefits constitute ~6% of sales, high share of EBITDA
- Protectionist measure in its key markets i.e. US (82% of sales)
- Disease outbreak in domestic shrimp farm ponds (RM supply)

Available at 0.8x MCap/sales & 22x P/E (FY17); recommend SUBSCRIBE

At the upper price band of ₹ 175, Apex is available at a MCap/sales of 0.8x and P/E of 22x on FY17 numbers, which is inexpensive given its listed peers. Thus, given the government's focus on augmenting aquaculture in India, with growth equity in place and robust expansion plans, growth prospects of the company are strong. We advise **SUBSCRIBE** on Apex.

Exhibit 1: Key Financials

₹ crore	FY13	FY14	FY15	FY16	FY17
Net Sales	255.5	514.6	604.4	608.2	709.7
EBITDA	22.4	32.8	38.2	45.5	55.9
EBITDA Margins (%)	8.8	6.4	6.3	7.5	7.9
Depreciation	2.5	4.5	0.4	4.9	6.3
Interest	5.6	8.0	9.6	10.4	11.2
PAT	9.4	13.4	18.3	19.2	24.4
PAT Margins (%)	3.7	2.6	3.0	3.2	3.4
EPS (₹)	3.0	4.3	5.9	6.2	7.8

Source: RHP, ICICIdirect.com Research

Rating matrix

Rating : **Subscribe**

Issue Details

Issue Opens	22-Aug-17
Issue Closes	24-Aug-17
Issue Size (₹ Crore)	₹ 150 - 152 crore
Price Band (₹)	₹ 171 - 175
No of Shares on Offer (lakh)	87
QIB (%)	48
Non-Institutional (%)	19
Retail (%)	33
Minimum lot size	80 shares and in multiples of thereof

Objects of the Issue (₹ Crore)

The offer comprises a fresh issue of 72.5 lakh equity shares (~₹ 125 crore) and an offer for sale of 14.5 lakh equity shares (~₹ 25 crore). The IPO proceeds will be used for funding new shrimp processing unit of ~20,000 MTPA (~₹ 90 crore) and for general corporate purposes (~₹ 35 crore).

Shareholding Pattern

	Pre-Issue	Post-Issue
Promoter & promoter group	99.9%	72.2%
Public & Others	0.1%	27.8%

Valuation Summary (at ₹ 175 ;upper price band)

	FY14	FY15	FY16	FY17
P/E	40.8	29.8	28.4	22.4
EV/EBITDA	19.0	16.7	13.7	11.7
P/B	14.5	9.8	7.3	5.7
ROCE	27.6	28.5	26.9	27.5
ROE	43.1	39.1	29.3	28.4

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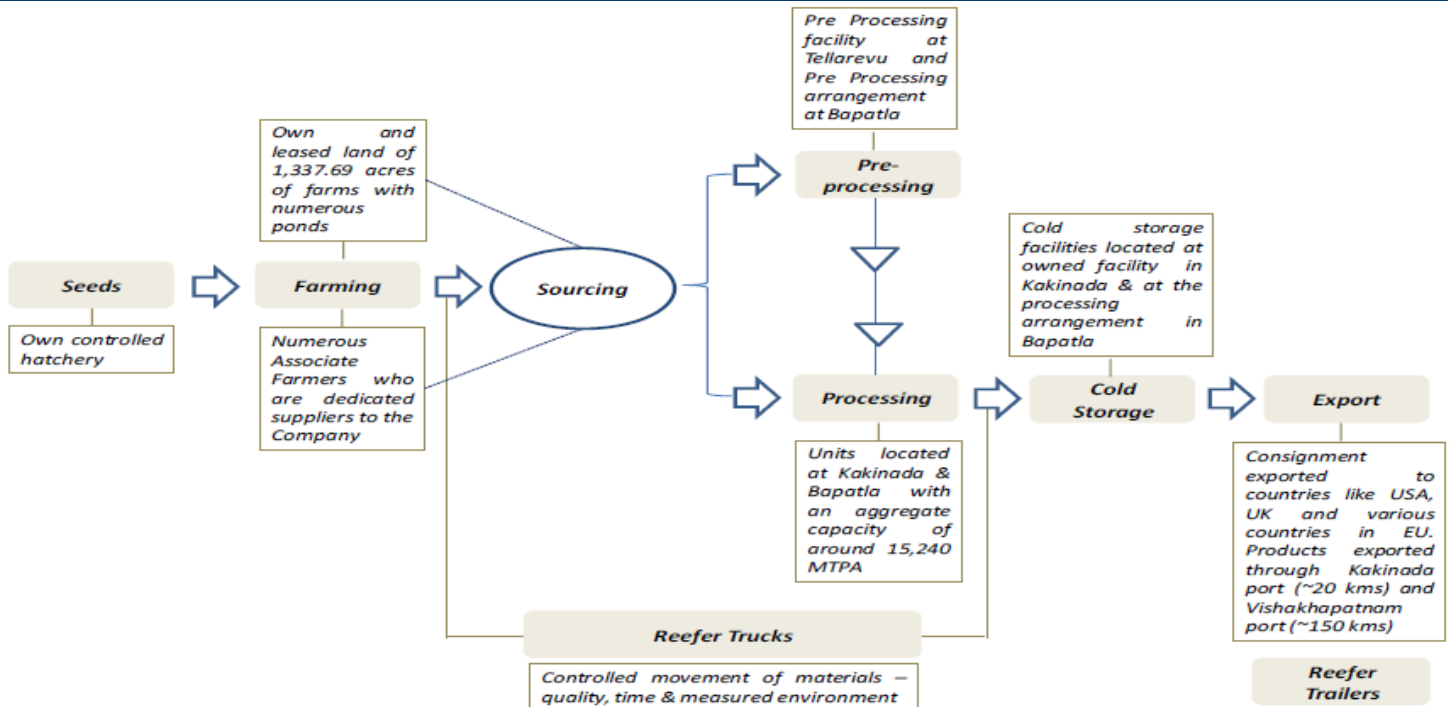
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Company Background

Apex is one of the integrated producers and exporter of shelf stable quality aquaculture products. They supply ready-to-cook products to a diversified customer base consisting of food companies, retail chains, restaurants, club stores and distributors spread across the developed markets of the US, UK and various European countries. Their output mainly comprises variants of processed Vannamei shrimp (white shrimp). It is sold under brands owned by customers and also through its own brands viz. Bay fresh, Bay Harvest and Bay Premium. Apex leased a shrimp processing facility and commenced operations in 1995. After this, they set up their own Modern shrimp processing facility in 2004. Apex' processing facility is located in Kakinada, Andhra Pradesh with a capacity to process ~9,240 TPA of finished products and an additional non-exclusive pre-processing and processing arrangement at a facility owned by Royale Marine Impex Pvt Ltd in Bapatla, Andhra Pradesh, for a capacity to process around 3,000 MTPA of finished products. The processing facilities are supplemented by cold storage facilities in Kakinada and Bapatla. Along with this, to further assuage its operations, they have their own fleet of vehicles with freezing capabilities.

Further, Apex has entered into an addendum to lease agreement dated April 9, 2017 with Royale Marine Impex Pvt Ltd for an additional processing capacity of 3000 MTPA of finished products

Exhibit 2: Business Overview



Source: RHP, ICICIdirect.com Research

Promoters

Karuturi Satyanarayana Murthy (Chairman & Managing Director)

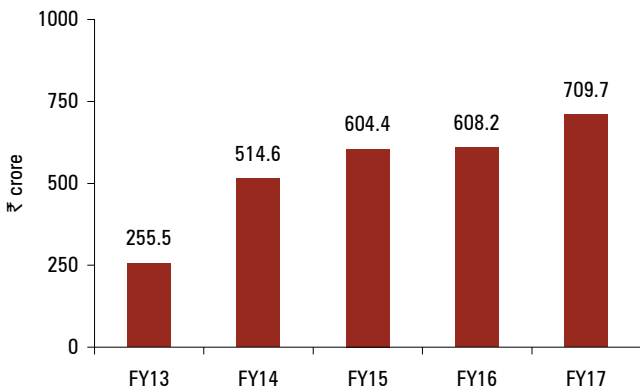
He commands experience of 20 years in the aquaculture industry. He had set up a partnership firm "Apex Exports" in 1995 to export shrimps, which was later converted into Apex Frozen Foods Pvt Ltd. He is responsible for making strategic decisions, decisions related to business development and overall administration of operations.

Karuturi Subrahmanya Chowdary (Executive Director)

He commands experience of 12 years in the aquaculture industry. He has been a director since the inception of the company. Mr Chowdary has played a significant role in developing the business. He is involved in business operations and marketing activities.

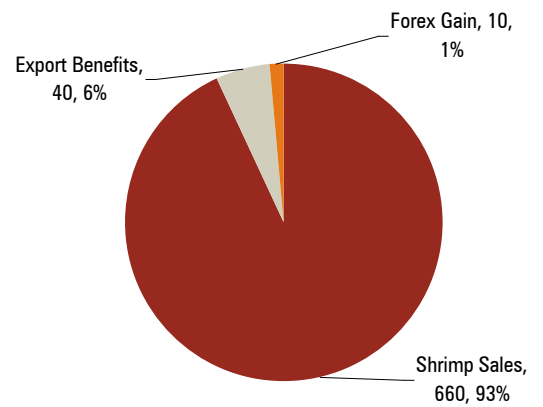
Key financials: Story in charts

Exhibit 3: Revenues grow at 29.1% CAGR in FY13-17



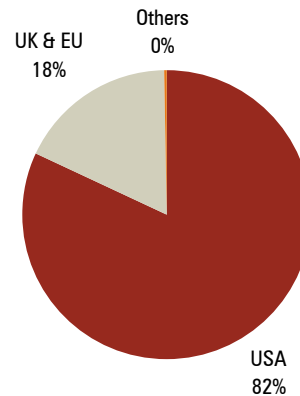
Source: RHP, ICICIdirect.com Research

Exhibit 4: Topline bifurcation (FY17)



Source: RHP, ICICIdirect.com Research

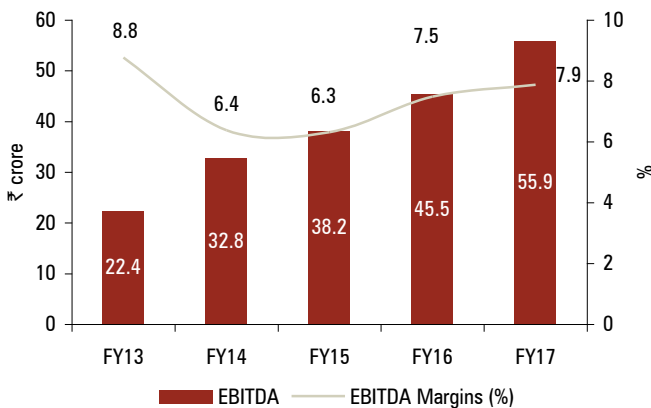
Exhibit 5: Exports composition (FY17)



Apex is a 100% export oriented unit with majority i.e. 82% of exports to the US while UK & other EU nations constitute the remaining 18% of sales (FY17)

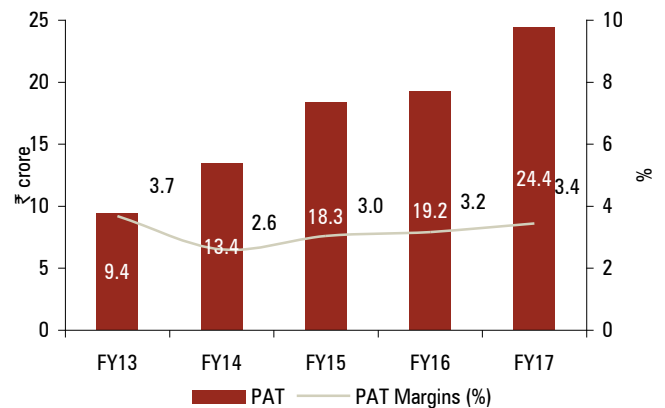
Source: RHP, ICICIdirect.com Research

Exhibit 6: EBITDA & EBITDA margins trend



Source: RHP, ICICIdirect.com Research

Exhibit 7: PAT & PAT margins trend



Source: RHP, ICICIdirect.com Research

Investment Rationale

Integrated business model; present across value chain

Apex has an integrated business model wherein it supplied quality seeds from its own as well contracted hatcheries to farmers for cultivation of shrimp in their farm lands. Apex Frozen Foods has numerous ponds across 1,337.69 acres of land of which 105.78 acres is owned land & 1,231.91 acres is leased land. At least 15-20% of shrimps are procured in-house, enabling cost effective procurement & processing. Henceforth, Apex has an integrated business model with healthy check and control over its raw material sourcing thereby realising economies of scale and healthy profitability. The company sources ~40% of its shrimp needs from Andhra Pradesh. It procures the remaining ~60% of shrimps from Gujarat, Odisha and West Bengal. A diversified procurement base also mitigates the seasonality risk associated with the business model of Apex with continuous supply of shrimps (key raw material) across the year. Apex is primarily based out of Andhra Pradesh which is indeed a progressive state for the entire aquaculture industry. It has the best climatic conditions and coastline to support the same.

Credible export house adhering to international quality standards

Apex has been in this business of exporting shrimp feeds for over two decades and is a credible name in the export market. Since 2004, it has also been exporting to the quality conscious US and EU markets. To maintain strict quality standards, products & processes are inspected by well-trained teams of quality controllers. The facilities are approved by Export Inspection Council for export to all countries excluding Australia & Custom Union. Further, facilities are also certified with BRC Food Grade, Best Aqua Culture Practices, HACCP and ASC. With appropriate certifications in place and a healthy customer relationship, Apex is on a firm footing with robust export growth prospects, going forward.

Impressive capex plan; intended RoCE in excess of 30%

As of FY17, Apex had a manufacturing capacity of 12,240 TPA (own capacity 9,240 TPA + leased capacity 3,000 TPA) with sales of ~10,000 TPA thereby operating at ~82% utilisation levels. However, with the IPO proceeds the company intends to incur a capex of ~₹ 90 crore for setting up a new manufacturing capacity of 20,000 TPA with intended commissioning in early FY19E. Moreover, the new capex also includes a 5,000 TPA value added product facility (ready to eat), which will fetch enhanced realisations and associated profitability (ready to eat shrimp realisations at ~₹ 800-900/kg vs. the usual ready to cook realisations at ~₹ 600-700/kg).

In addition, Apex also has pre-possessing & bio-security units, which keep quality under check. It is also working on a customised shrimp feed composition, which when put into operation will further augment the shrimp yield.

It has deployed quality assurance checks at each stage of the product life cycle and carries out periodical inspection of its facilities

Sensing the constraints, it has further leased out a 3,000 TPA capacity effective Q1FY18. This will result in volume led growth in FY18E (incremental revenues of ~₹ 150 crore)

Exhibit 8: New capex revenue & RoCE potential

Pasticulars	units	Amount
New Capacity	TPA	20,000
Closure of leased units	TPA	6,000
Effective Net Addition	TPA	14,000
Blended Realisations (assumption)	₹/kg	650
Revenue Potential	₹ crore	700
EBITDA margins (assumption)	%	7.50%
EBITDA	₹ crore	52.5
Depreciation (@10%)	₹ crore	9
EBIT	₹ crore	43.5
Capital Employed	₹ crore	90
RoCE	%	48.3

Source: Company, ICICIdirect.com Research

Therefore, with impressive capex plans in place, good control over costs and the company moving up the value chain, we expect Apex to witness a healthy topline and even better bottomline growth, going forward.

Key risks and concerns

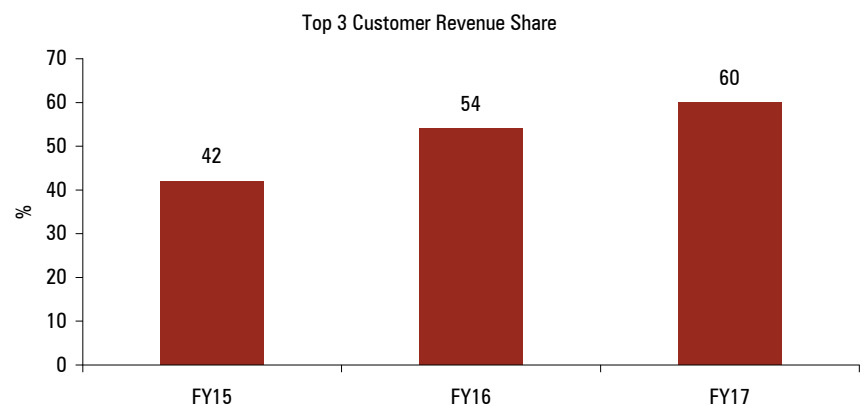
High proportion of export incentives

Apex currently realises ~6% as its net export benefits (MEIS+ duty drawback scheme - anti dumping duty) while its EBITDA margins are in the range of ~8%. Therefore, a large part of its EBITDA margins are derived from export benefits. Absence of this will dent the profitability, going forward. One notable point here is that any reduction in export incentives will also hit farm gate prices of shrimp, which is a key raw material for Apex and, hence, will lead to a reduction in raw material cost.

High geography & client concentration

Apex realises 80%+ sales from US and is, hence, susceptible to geography risks. It is most vulnerable in case there is further augmentation of anti dumping duty in the US on imports of processed shrimps from India (from present levels of ~2.2%). On the client side, it has ~25 customers with six or seven large clients, which periodically constitute ~60% of its overall processed shrimp sales and, hence, is susceptible to client concentration risk. A few of its key clients are: Chicken of the Sea Frozen Foods (US), Ocean World Ventures LLC (US) & Pacific Sea Food Group (US) among others.

Exhibit 9: Top three customer revenue share (FY15-17)



Source: RHP, ICICIdirect.com Research

Disease outbreak in farm ponds

Apex procures raw shrimps for farm ponds that are susceptible to disease outbreak. Hence, this can lead to loss of critical raw material supply for processing further. It can be either on account of impure seed or also be largely weather driven. Thus, any insufficient supply of raw material (raw shrimp) will hamper the processing ability at Apex. However, to mitigate the same, Apex is actively supplying seeds to domestic farmers through its own as well as contracted hatcheries. The company also has access to farmland spread across 1,337.7 acres with 105.8 acres of owned land & 1,231.9 acres of leased land. Farming initiative has enabled raw material sourcing to the tune of 15-20% through in-house farms.

Net exporter: appreciation of rupee to marginally dent margins

Apex is an export unit with exports constituting 100% of its processed shrimp sales. Hence, it is vulnerable to appreciation of the Indian currency. The company mitigates this risk by venturing into forward contracts on its exports. Also, Apex usually has a monthly (maximum quarterly) price negotiation with its key customers, which helps account for any steep adverse movement in the rupee. However, any steep appreciation of the rupee is likely to marginally dent EBITDA margins, going forward.

Valuations

At the upper price band of ₹ 175, Apex is available at a MCap/sales of 0.8x & P/E of 22x on FY17 numbers, which is inexpensive vs. its listed peers. Although for Apex does not have a like-to-like peer, we have compared it with listed players viz. Avanti Feeds & Waterbase that are manufacturers of shrimp feed though they also undertake a small amount of shrimp processing. Both companies trade at rich valuations in comparison to Apex, which gives us comfort in assigning a **SUBSCRIBE** rating to the issue. On the MCap/sales ratio on FY17 numbers, Avanti Feeds trades at 3.2x, Waterbase trades at 1.4x while Apex is available at 0.8x. On a P/E ratio (TTM basis), Avanti Feeds trades at 26.9x while Waterbase trades at 28.1x and Apex is available at 22.4x. It also has a controlled working capital cycle at ~60 days. The topline & bottomline has grown at a CAGR of 29.1% & 27.0%, respectively, in FY13-17. In addition, it realises 25% RoEs and core business RoICs in excess of 30%, providing a margin of safety on the stock. Absolute debt on Apex' books is ~₹ 110 crore with pre-dilution debt: equity at 1.1x, which, post issuance of equity (IPO proceeds), would get trimmed to comfortable levels of ~0.5x. Thus, given the government's focus on augmenting aquaculture in India, with growth equity in place and robust expansion plans, growth prospects are strong with incremental topline and bottomline growth, going forward. We have a **SUBSCRIBE** rating on the issue.

Exhibit 10: Peer comparison

Company	Mcap (₹ crore)	FY17										TTM		
		Sales (₹ Crore)	EBITDA (₹ Crore)	EBITDA Margins (%)	PAT (₹ Crore)	PAT Margins (%)	ROCE (%)	RoE (%)	NWC days	Mcap/Sales	P/E	P/B	EV/EBITDA	
Avanti Feeds	8735	2732.7	331.9	12.1	226.8	8.3	44.8	33.5	17.0	3.2	26.9	13.6	17.5	
Waterbase	479	332.0	23.6	7.1	12.6	3.8	16.2	11.3	117.0	1.4	28.1	4.3	15.9	
Industry Average				9.6		6.0	30.5	22.4	67.0	2.3	27.5	9.0	16.7	
Apex Frozen Foods	547	709.7	55.9	7.9	24.4	3.4	27.5	28.4	60.0	0.8	22.4	5.7	11.7	

Source: RHP, Capitaline, ICICIdirect.com Research

*Apex frozen foods market cap @ ₹ 175 (upper price of the price band i.e. ₹ 171-175)

Financial summary

Profit and loss statement		₹ Crore			
(Year-end March)	FY14	FY15	FY16	FY17	
Revenue	514.6	604.4	608.2	709.7	
Growth (%)	101.4	17.5	0.6	16.7	
Total Raw Material Costs	401.3	489.0	467.5	549.2	
Employee Cost	22.6	25.8	23.3	24.9	
Other Operating Expense	57.8	51.4	72.0	79.7	
Total Expenditure	481.7	566.2	562.7	653.8	
EBITDA	32.8	38.2	45.5	55.9	
Growth (%)	46.6	16.2	19.2	22.9	
Depreciation	4.5	0.4	4.9	6.3	
EBIT	28.3	37.8	40.6	49.6	
Interest	8.0	9.6	10.4	11.2	
Other Income	0.0	0.0	0.0	0.0	
PBT	20.4	28.2	30.2	38.4	
Tax	7.0	9.6	10.5	13.5	
PAT	13.4	18.3	19.2	24.4	
Minority Interest	0.0	0.0	0.0	0.0	
Reported PAT	13.4	18.3	19.2	24.4	

Source: RHP, ICICIdirect.com Research

Balance sheet		₹ Crore			
(Year-end March)	FY14	FY15	FY16	FY17	
Source of Funds					
Equity Capital	20.0	24.0	24.0	24.0	
Reserves & Surplus	17.8	32.0	51.3	72.8	
Shareholder's Fund	37.8	56.0	75.3	96.8	
Long Term Borrowing Funds	17.7	12.9	15.0	25.4	
Long Term Provisions	0.1	0.1	0.2	0.0	
Current Liabilities	84.9	96.1	88.3	135.3	
Short Term Borrowing	62.6	77.7	64.2	84.7	
Trade Payables	16.3	11.5	16.1	30.9	
Other current liabilities	-0.3	0.8	1.0	1.5	
Short term provisions	6.4	6.1	7.0	18.1	
Source of Funds	140.5	165.1	178.8	257.4	
Application of Funds					
Net Block (Incl Intangibles)	40.3	52.3	55.2	82.9	
Capital WIP	0.0	0.0	8.0	0.8	
Total Fixed Assets	40.3	52.3	63.2	83.6	
Non-current investments	0.0	0.0	0.0	0.0	
Long Term loans & advances	0.0	0.0	0.0	0.0	
Other non-current assets	0.1	0.1	0.1	2.1	
Current Assets	100.1	112.8	115.6	171.7	
Inventories	50.5	50.3	59.6	63.8	
Trade Receivables	34.0	50.2	41.5	82.8	
Cash & Bank Balances	3.4	1.6	1.8	4.6	
Current Investments	0.0	0.0	0.0	0.0	
Short Term Loans & Advances	12.2	10.7	12.7	20.5	
Other Current Assets	0.0	0.0	0.0	0.0	
Application of Funds	140.5	165.1	178.8	257.4	

Source: RHP, ICICIdirect.com Research

Cash flow statement		₹ Crore			
(Year-end March)	FY14	FY15	FY16	FY17	
Profit Before Tax	20.4	28.2	30.2	38.4	
Add: Depreciation	4.5	0.4	4.9	6.3	
Cash Profit	24.9	28.6	35.1	44.7	
other changes	0.4	0.6	-0.4	-3.9	
Increase/(Decrease) in CL	17.2	-4.4	5.2	27.0	
(Increase)/Decrease in CA	-33.1	-12.4	-2.5	-56.2	
CF from Operating Activities	9.4	12.3	37.3	11.7	
Purchase of Fixed Assets	-18.5	-12.4	-16.1	-26.7	
Others	1.6	0.4	0.1	-1.8	
CF from Investing Activities	-16.8	-12.0	-16.0	-28.6	
Inc/(Dec) in Loan Funds	15.8	9.8	-11.0	29.6	
Others	-5.3	-11.8	-10.2	-9.9	
CF from financing activities	10.5	-2.0	-21.2	19.7	
Net cash/cashflow	3.1	-1.7	0.2	2.8	
Cl. Cash and cash Eq.	3.3	1.6	1.8	4.6	

Source: RHP, ICICIdirect.com Research

Key ratios					
(Year-end March)	FY14	FY15	FY16	FY17	
Per share data (₹)					
Book Value	18.9	23.3	31.4	40.3	
Cash per share	1.7	0.7	0.8	1.9	
EPS	6.7	7.6	8.0	10.2	
Cash EPS	9.0	7.8	10.1	12.8	
Profitability & Operating Ratios					
EBITDA Margin (%)	6.4	6.3	7.5	7.9	
PAT Margin (%)	2.6	3.0	3.2	3.4	
Inventory Turnover (Days)	35.9	30.4	35.8	32.8	
Debtor (Days)	24.1	30.3	24.9	42.6	
Creditor (Days)	11.5	6.9	9.7	15.9	
Return Ratios (%)					
RoE	43.1	39.1	29.3	28.4	
RoCE	27.6	28.5	26.9	27.5	
Valuation Ratios (x) @ ₹175 (post dilution)					
PE	40.8	29.8	28.4	22.4	
Price to Book Value	14.5	9.8	7.3	5.7	
EV/EBITDA	19.0	16.7	13.7	11.7	
EV/Sales	1.2	1.1	1.0	0.9	
Leverage & Solvency Ratios					
Debt to equity (x)	2.1	1.6	1.1	1.1	
Interest Coverage (x)	3.6	3.9	3.9	4.4	
Debt to EBITDA (x)	2.4	2.4	1.7	2.0	
Current Ratio	1.2	1.2	1.3	1.3	

Source: RHP, ICICIdirect.com Research

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