



Done by Veer Bhartiya

Basic Facts

❖ Basic Facts

(Amounts in Rs. Crore)

As of 28/10/2016

Company Name	Balaji Amines	Ticker Symbol	
Market Cap	1,083.8	Current Stock Price	334.5
Enterprise Value	1,244.6	52 Week Range	114-374.9
Book Value	90.0	P/E (ttm)	12.8x
No. of Shares Outstanding	3.2	EV/EBIT (ttm)	8.2x
Div. Yield	0.6%	Daily Average Volume	

Source: HDFC Securities

Company Description

- Balaji Amines Limited (BAL), is the leading manufacturer of Aliphatic Amines in India. Was set up in the year 1988.
- BAL produces methylamine, ethylamine, amine derivatives, and specialty chemicals
- About 50-60% of BAL's revenue comes from the pharma and pesticide sectors while the rest is split amongst a number of other end users like oil refineries, water chemicals, rubber chemicals etc.
- Recently entered the hospitality business with a 5 star hotel in Solarpur Maharashtra

Company Description

Who is the customer?

- BAL has a strong presence in the domestic market with major clients from the pharma sector including the likes of Aurobindo, Aventis, Clariant, Dr. Reddy's, Glaxo, Merck, Ranbaxy, Sun Pharma, Wyeth, Wockhardt, etc.
- Other clients include rubber chemical companies in Kerala, Gujarat and North India and water companies like Ion Exchange and Thermax.
- Refineries like IOCL, HPCL etc
- pesticide companies like Rallis, Meghmani and Gherdia Chemicals

Industry Overview

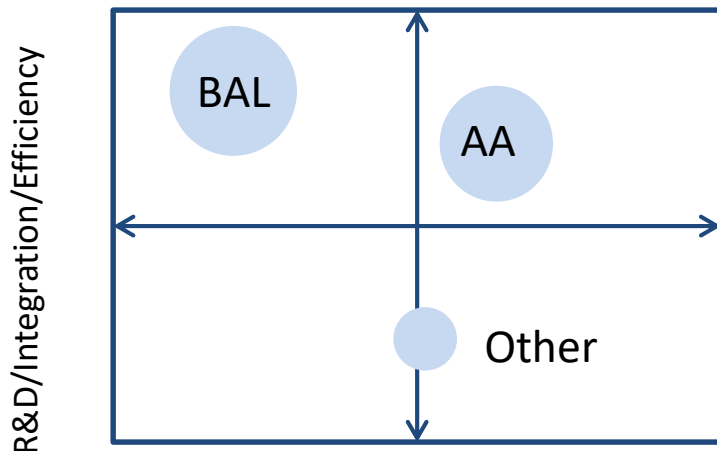
- The two largest aliphatic amines manufacturers are Balaji Amines and Alkyl Amines (AA).
- Both these companies produce methylamine (MA), ethylamine (EA), amine derivatives and specialty chemicals
- BAL has a larger MA capacity and AA has a larger EA capacity
- Both these chemicals are hazardous and hard to import, of the two MA is more hazardous
- As a result there is limited international competition but there has been an increase in imports from China/Saudi particularly for EA and some specialty chemicals
- There are other small players and perhaps a overcapacity situation for basic aliphatic amines
- Key is having an efficient forward/backward integration structure and R&D driven specialty chemicals & derivatives portfolio

Industry Overview

	BAL	Alkyl	Other Domestic Producers	Chinese/Saudi Producers	BASF, Dow, etc.
Larger Capacity	MA	EA	Either	NA	NA
Impact of Imports*	Low	High	Depends	Rising	Limited
R&D, Integration	Great	Good	Poor	Unclear	Great
Production Efficiency	Great	Great	Average	Unclear	Great

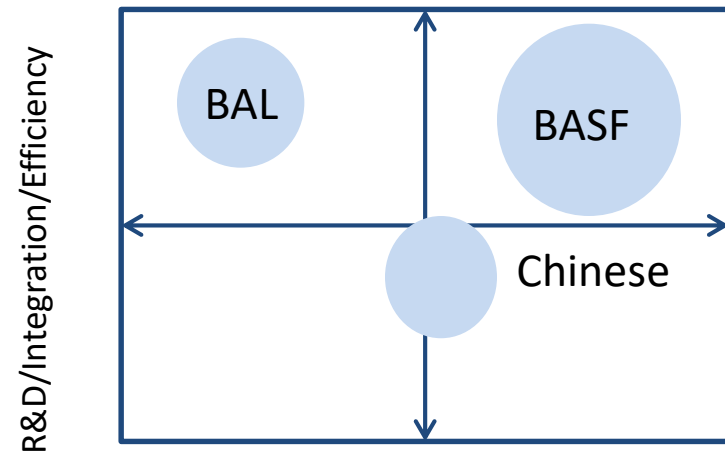
*In case of Chinese producers, BASF etc. how they contribute to threat of imports to domestic players

BAL vs. Domestic Competition



Threat of Imports

BAL vs. International Competition



Difficulty in Supplying to Indian Market

Market Share

- BAL is India's largest manufacturer of methylamines and their derivatives, with a market share of over 60%.
- Through judicious and far-sighted backward/forward integration, BAL internally consumes over 70% of its methylamines production.
- BAL is the world's largest producer of Di-Methyl Amine Hydrochloride (DMA-HCL) commanding nearly 90% of the global market share.
- BAL is the the only manufacturer in India of N-Methyl- 2- Pyrrolidone (NMP). Morpholine, 2- Pyrrolidone (2-P) Gamma Butyrotactone (GBL), Poly Vinyl Pyrrolidone (PVP K30) and N-Ethyl-2-Pyrrolidone (NEP), which are widely accepted by customers across the world.
- AA has mentioned on its website that it produces NEP, NMP, and morpholine, it is unclear as to how significant the production is and whether it has been able to take away market share from BAL

Investment Thesis

- **BAL has a wide moat** due to a variety of factors - switching costs for customers, lower production cost due to forward/backward integration and R&D, and a location advantage due to the hazardous nature of its products (limited threat of imports)
- **Narrative is backed by a very impressive track record** – No competitor has breached the moat over the last 26 years. BAL has produced an ROIC of 20% with stable margins over the last decade.
- **BAL has good reinvestment opportunities** – because demand is derived from markets that are growing – Pharma and agrochem are growing at 10% + and are likely to keep growing for a long time.
- **Valuations are reasonable** - At 13x ttm earnings, and with insignificant institutional ownership, there is scope for a multiple expansion for a quality business like BAL
- **Good degree of pricing power** – To a large extent BAL can pass on changes in raw material price onto customers, mitigating the impact of input price volatility

Historical Financials

Balaji Amines Ltd.

Selected Financials

(Amounts in Rs. Crore)	201603	201503	201403	201303	201203	201103	201003	200903	200803	200703	200603	CAGR 5 yr	CAGR 10 yr
Revenue	643.1	618.8	610.1	511.8	449.5	346.8	261.9	251.7	217.8	175.5	128.6		
% Change	3.9%	1.4%	19.2%	13.9%	29.6%	32.4%	4.1%	15.5%	24.1%	36.5%		13.1%	17.5%
Raw Material Cost	356.2	359.5	381.0	312.2	262.7	191.7	143.7	155.8	135.1	104.9	76.3		
Gross Margin	44.6%	41.9%	37.6%	39.0%	41.6%	44.7%	45.1%	38.1%	38.0%	40.2%	40.7%		
Operating Margin	16.2%	13.2%	11.6%	13.0%	15.3%	15.8%	15.0%	12.7%	11.5%	12.1%	12.0%		
Operating Income	103.9	81.7	70.9	66.6	68.9	54.8	39.2	32.0	25.1	21.2	15.5		
% Change	27.2%	15.3%	6.4%	-3.3%	25.8%	39.7%	22.7%	27.2%	18.6%	36.8%		13.7%	21.0%
EPS Diluted	17.8	10.6	10.3	9.6	11.0	8.2	6.3	4.6	4.0	3.1	2.9		
% Change	68.1%	2.3%	7.5%	-12.5%	34.0%	30.2%	35.5%	16.0%	29.4%	5.8%		16.7%	19.8%
FCF	36.8	17.1	32.7	(15.9)	(23.2)	(54.8)	5.1	(17.6)	(14.4)	(11.2)	(10.9)		
% Change	115.0%	-47.7%	-305.8%	-31.6%	-57.6%	-1170.4%	-129.1%	22.3%	28.4%	3.1%		-192.4%	#NUM!
Dividend	3.9	3.2	4.2	2.6	1.9	1.6	1.3	1.0	1.0	1.5	0.9		
Dividend Payout Ratio	6.7%	9.5%	12.6%	8.3%	5.5%	6.1%	6.3%	6.5%	7.3%	14.9%	10.2%		
Buybacks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Net Change in LT Debt	0.0	0.0	0.0	0.0	(64.1)	64.1	0.0	0.0	0.0	0.0	0.0		
Interest Coverage	4.7x	2.3x	2.2x	2.6x	3.3x	4.0x	4.0x	3.1x	3.2x	3.4x	3.5x		
Debt/Equity	0.6x	1.1x	1.3x	1.4x	1.5x	1.3x	1.1x	1.5x	1.5x	1.5x	1.7x		
No. of Shares Outstanding	3.24	3.24	3.24	3.24	3.24	3.24	0.65	0.65	0.65	0.65	0.30		
% Change	0.0%	0.0%	0.0%	0.0%	0.0%	400.0%	0.0%	0.0%	0.0%	116.0%			

ROIC Calculation

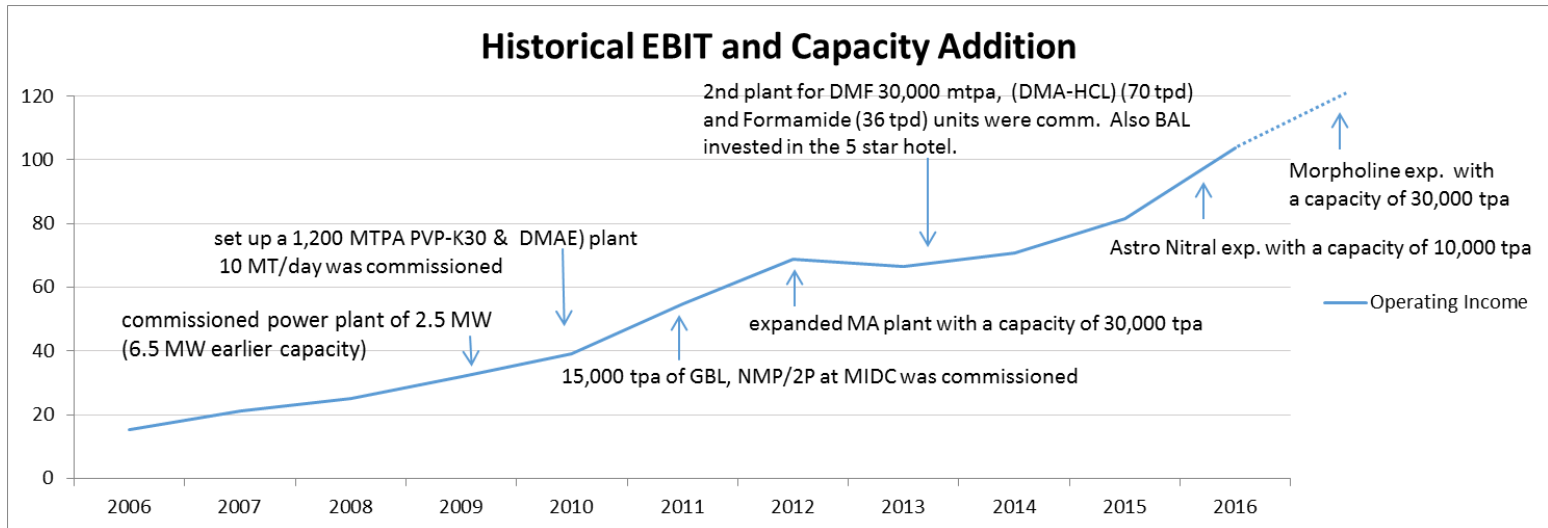
Operating Income	103.9	81.7	70.9	66.6	68.9	54.8	39.2	32.0	25.1	21.2	15.5		
/													
(Net WCAP +Net PPE)	122.3	160.9	111.5	104.4	144.5	101.0	80.6	69.7	70.3	56.7	36.7		
	340.8	341.1	325.4	234.4	196.0	160.1	120.7	77.5	71.1	59.9	55.5		
ROIC	21.5%	17.4%	18.3%	19.6%	22.9%	23.7%	22.5%	22.1%	19.5%	20.3%	33.6%		

ROE Calculation

Net Income	57.6	34.3	33.5	31.2	35.6	26.6	20.4	15.1	13.0	10.0	8.8		
% Change	68.1%	2.3%	7.5%	-12.5%	34.0%	30.2%	35.5%	16.0%	29.4%	14.3%			
/													
Book Value of Equity	280.2	227.9	201.1	171.4	145.1	112.5	88.2	69.6	56.1	44.2	32.5		
ROE	22.7%	16.0%	18.0%	19.7%	27.7%	26.5%	25.9%	24.0%	25.9%	26.2%	54.1%		

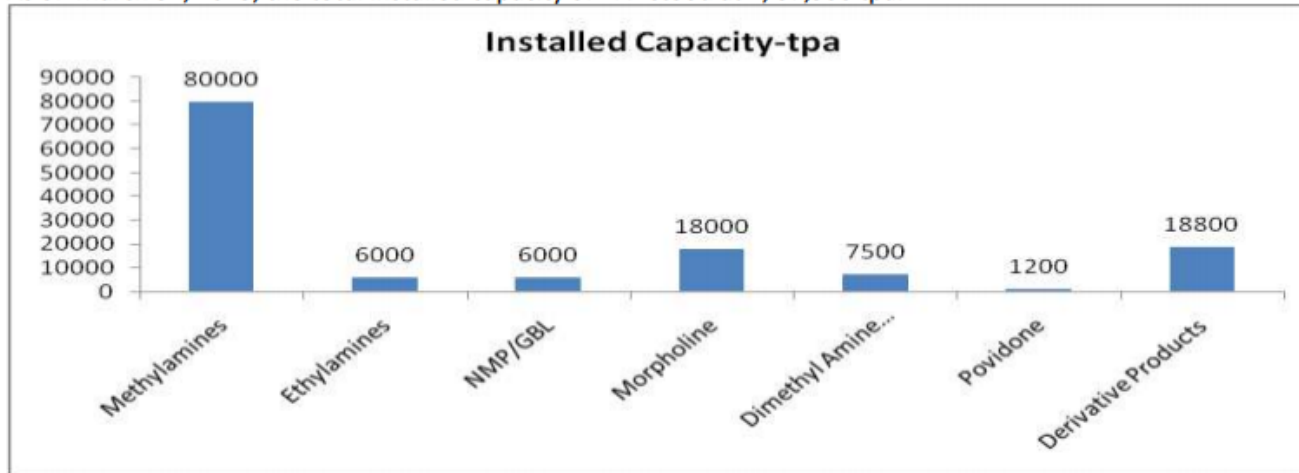
Source: ACE Equity

Historical Financials



Installed Capacity:

As of March 31, 2015, the total installed capacity of BAL stood at 1, 37,500 tpa.



(Source: Company, HDFC Sec)

Competitive Advantage

1. Product portfolio/process/R&D

- Process, quality of products at par with international players like BASF, Taminco
- In some cases in house developed process is even more efficient than international players
- Niche specialty chemicals developed by R&D team, hard to replicate
- Some specialty chemicals are supplied by international players

2. Forward/Backward Integration

- BAL internally consumes over 70% of its methylamines production.
- Not hard to set up a methylamine plant, but it requires in house R&D to produce derivatives and SC and create an efficient forward/backward integration structure. This leads to an overall cost advantage

Competitive Advantage

3. Switching costs

- Customers are mainly from pharma and agrochem industries
- Benefit to cost ratio is high for inputs used in these industries
- From Q1FY13 ECT - *"The quality control guy doesn't want to change the documentation, doesn't want to take the pain of changing all the procedures"*

4. Location Advantage

- Products are largely hazardous customers do not want to import or store large quantities
- Customers will prefer sourcing locally vs. importing
- The two main aliphatic amines are ethylamine and methylamine
 - BAL's closest competitor AA, produces more EA and BAL produces more MA
 - While both are hazardous, MA is far more hazardous
 - It is possible to import EA – Chinese players have been selling aggressively
 - Importing MA is not feasible and so this is not a threat

Empathize With...

- 1. The Customer – Why will the customer not buy a competitors product?**
 - BAL is the only seller for certain products, developed in-house
 - Can offer a lower price due to efficient cost structure
 - Importing is dangerous and inconvenient
 - Benefit/Cost ratio is high for pharma customers
- 2. The Competitor – Why can't the closest competitor take away market share?**
 - Has to match cost/product range in addition to overcoming switching cost
- 3. The Entrepreneur – What is driving the promoter(s)**
 - At 55%, promoter ownership is high, they have a vested interest in the company
 - Founder is still at the helm of affairs, serving as MD
- 4. Mr. Market**
 - Price has consistently been increasing but so has value
 - Market cap has gone from 400cr to 1000cr in the last 6-7 months
 - Valuation is still reasonable at 13x

Competition

❖ BAL vs. Alkyl Amines

Name	Return Ratios & Margins				Growth		Other Operating Metrics			Trading Multiples	
	5 yr avg ROIC	5 yr avg Asset Turns	5 yr avg EBITM	TTM EBITM	5 yr CAGR EBIT	2 yr CAGR EBIT	LTM D/E	5 yr tot. R&D	LTM CCC	TTM EV/EBIT	TTM P/E
Balaji Amines	18.9%	1.8x	13.6%	19.1%	13.7%	21.1%	0.6x	23.0	78.6	9.6x	13.7x
Alkyl Amines	25.0%	1.8x	14.1%	16.8%	28.8%	2.0%	0.5x	20.5	74.6	10.2x	13.8x

- Over the last 5 years AA's operating metrics have been better
- However, over the last 3 years AA has been facing margin pressure, EBIT has been flat
- BAL's margins have improved
- The competitive dynamics for EA are worse and AA is facing the heat

How will the competitive dynamic change as AA seeks to double MA capacity?

Switching cost and forward/backward integration will play a key role. There is and has been an overcapacity situation for MA for some time. It is BAL's ability to use MA to produce derivatives and specialty chemicals that differentiates it. This is a key monitorable. AA however, is a very credible competitor, with a very successful track record itself. Has entered into products for which BAL was the only domestic producer.

Management

1. Ownership Trends

- Promoters own 55%, their ownership has remained constant over the last 5 years

2. Compensation

- Promoters pay themselves pretty handsomely
- Collectively they paid themselves 10cr in FY16, quite high for a company with a PAT of 60cr
- No stock options or dilution, I think even though their compensation is high, they have earned it

3. Track Record

- BAL has been in business for 26 years, produced an ROIC of 20% over the last decade
- Business grew in the face of 2008 recession, has grown every year for the past 18 years

4. Capital Allocation

- Have spent a good amount on R&D and have added capacity appropriately
- Delivered and reduced D/E
- Sold stake in trading company to invest in Balaji Greentech, rationale given was sound
- 7cr investment in Balaji Greentech has so far lost 18cr, they have gone wrong with this
- Bought 3.35 acre land in Shorapur for 2.7cr in 08' (market value of which is pegged at above 25cr)
- To utilize this land BAL set up a 129 room 5 star hotel in 13', spent ~60cr on this project, 16cr in rev as of FY16, loss of 2cr.

Management

5. Other red flags/positives/moments while assessing management

- Pledged their own stock to finance expansion of the company
- Their interest cover never fell below 2, I am assuming they could have maybe taken the loan in the company
- Bought land in 08 when the chips were down
- Even though their investments outside their core business may not have worked out well yet, they did not invest large sums, displays innovation/risk-taking at a low cost
- Can also be thought of as diworsification – matter of perspective
- Management is fighting to lower prices

“BAL has been consistently adding capacities and fine tuning process to provide quality products at lowest cost to the customers.” – BAL website

Alkyl's commitment to customer satisfaction by delivering quality products and services has helped it to become one of the world's leading amine manufacturers. – AA Website

Valuation: Pro - Formas

<u>Base Case</u>	<u>201603</u>	<u>201603.N</u>	<u>201703</u>	<u>201803</u>	<u>201903</u>	<u>202003</u>	<u>202103</u>
Revenue	643.1	643.1	758.9	895.5	1029.8	1184.3	1362.0
<i>Growth</i>			18.0%	18.0%	15.0%	15.0%	15.0%
EBITDA Margin	19.2%	18.0%	22.0%	20.0%	18.5%	18.5%	18.5%
EBITDA (Excluding OI)	123.3	123.3	167.0	179.1	190.5	219.1	252.0
D&A	19.4	19.4	22.9	27.0	31.0	35.7	41.0
As a % of Sales	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%
EBIT	103.9	103.9	144.1	152.1	159.5	183.4	210.9
Tax Rate	34.5%	34.5%	34.5%	34.5%	34.5%	34.5%	34.5%
Tax	35.8	35.8	49.7	52.5	55.0	63.3	72.8
NOPAT	87.4	87.4	117.3	126.6	135.5	155.8	179.2
<i>Growth</i>			34.1%	8.0%	7.0%	15.0%	15.0%
wcap/sales	4.6%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%
wcap	29.7	28.8	34.0	40.1	46.2	53.1	61.1
Change in wcap	-28.8	0.9	-5.2	-6.1	-6.0	-6.9	-8.0
Interest	22.2	22.2	21.0	20.0	19.0	18.0	17.1
Tax adjusted interest	14.5	14.5	13.8	13.1	12.4	11.8	11.2
Other Income	3.0						
Tax adjusted other income	2.0	2.0	2.0	2.0	2.0	2.0	2.0
CFO	46.1	75.7	100.2	109.4	119.0	139.0	162.0
<i>% change</i>			32%	9%	9%	17%	16%
Maintenance CAPEX	19.4	19.4	22.9	27.0	31.0	35.7	41.0
Growth CAPEX	0.0	0.0					
FCF	26.7	56.4	77.4	82.4	88.0	103.4	120.9
MI	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
FCF (after deducting MI)	26.7	56.4	77.4	82.4	88.0	103.4	120.9
<i>% change</i>			37%	6%	7%	17%	17%

Valuation: DCF Multiple Check

	<u>0</u>	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>	<u>6</u>	<u>7</u>	<u>8</u>	<u>9</u>	<u>10</u>	<u>11</u>
	201603	201703	201803	201903	202003	202103	202203	202303	202403	202503	202603	202703
FCF	100	110	121	133.1	146.41	161.051	169.1036	177.5587	186.4367	195.7585	205.5464	215.8237
Growth		10%	10%	10%	10%	10%	5%	5%	5%	5%	5%	5%
Discount Factor		1.1	1.3	1.4	1.6	1.8	2.0	2.2	2.5	2.8	3.1	3.5
Discounted FCF		98.2	96.5	94.7	93.0	91.4	85.7	80.3	75.3	70.6	66.2	62.0

Perpetuity Value 3083.2
Discounted 992.7

Total Equity Value 1844.6
Cash/Investments 0
Total EV + NC 1844.6

Discount Rate
Growth for years 1-5 10%
Growth rate for years 6-10 5%
Discount Rate 12.0%
Perpetuity Growth Rate 5%

Multiple 18.4x

What factors determine discount rate / multiple	Range
risk free rate	6.50%
risk premium for a good business in India	6%
additional discounting required	
questionable longevity	1.0% 1-3%
mediocre to below average corporate governance	1-3%
leverage	1.0% 1-3%
management	-1.5% (3)-3%
low industry base rate	1-3%
win-win ecosystem	-1%
pricing power	-1.0% (1)-1%
influence of govt. on demand/supply/receivables/COC	1-2%
Cost of Capital	12.00%

Valuation: Base

❖ Base Case							
<i>(Amounts in Rs. Crore)</i>							
	Actual		Projection				
	201503	201603	201703	201803	201903	202003	202103
Buyback			0.0	0.0	0.0	0.0	0.0
FCF, Levered		56.4	77.4	82.4	88.0	103.4	120.9
FCF Growth			37.3%	6.5%	6.8%	17.5%	17.0%
Shares Repurchased			0.0	0.0	0.0	0.0	0.0
Shares Issued			0.0	0.0	0.0	0.0	0.0
Diluted Shares Outs.		3.2	3.2	3.2	3.2	3.2	3.2
FCF Per Share	▼ #DIV/0!	17.4	23.9	25.4	27.1	31.9	37.3
Assumed Multiple					18.4x		18.4x
Upside Price					499.6		686.7
Dividend	0.0	3.9	7.7	8.2	8.8	10.3	12.1
Dividend Payout Ratio		6.9%	10.0%	10.0%	10.0%	10.0%	10.0%
Dividend Post DDT	0.0	3.3	6.6	7.0	7.5	8.8	10.3
Dividend Growth	N/A	▼ #DIV/0!	1.0	0.1	0.1	0.2	0.2
Including Dividend Value per Share			2.0	2.2	2.3	2.7	3.2
Future Value of Dividends			3.0	2.9	2.8	3.0	3.2
					508.2		701.5
Change %					78.3%		146.2%
CAGR %					21.3%		19.7%

Key Assumptions	
Price	285
Volume Growth	15%
N.EBIT Margin	15.5%
FY21 FCF Multiple	~18.5x

Valuation: Downside

❖ Downside Case							
<i>(Amounts in Rs. Crore)</i>							
	Actual		Projection				
	201513	201613	201713	201813	201913	202013	202113
Buyback			0.0	0.0	0.0	0.0	0.0
FCF, Levered		26.7	54.1	76.8	67.1	61.1	68.9
<i>FCF Growth</i>			102.6%	41.9%	-12.6%	-8.8%	12.7%
Shares Repurchased			0.0	0.0	0.0	0.0	0.0
Shares Issued			0.0	0.0	0.0	0.0	0.0
Diluted Shares Outs.		3.2	3.2	3.2	3.2	3.2	3.2
FCF Per Share	#DIV/0!	8.2	16.7	23.7	20.7	18.9	21.3
Assumed Multiple					12.0x		12.0x
Upside Price					248.4		255.3
Dividend	0.0	3.9	5.4	7.7	6.7	6.1	6.9
Dividend Payout Ratio			10.0%	10.0%	10.0%	10.0%	10.0%
Dividend Post DDT	0.0	3.3	4.6	6.5	5.7	5.2	5.9
<i>Dividend Growth</i>	N/A	#DIV/0!	0.4	0.4	-0.1	-0.1	0.1
Including Dividend Value per Share			1.4	2.0	1.8	1.6	1.8
Future Value of Dividends			2.1	2.7	2.1	1.8	1.8
					255.3		265.8
Change %					-10.4%		-6.7%
CAGR %					-3.6%		-1.4%

Key Assumptions	
Price	285
Volume Growth	10%
N.EBIT Margin	12.5%
FY21 FCF Multiple	~12x

Risks

1. MNC players like BASF, Taminco set up manufacturing units in India

- This is possible, mainly if the market becomes is large enough for them to enter

2. Additional capacity from Alkyl Amines lowers margins

- There is already an overcapacity situation for MA.
- They key is to use MA to produce derivatives and specialty chemicals
- Even if AA can deploy capacity in a similar manner, business will do fine due to barriers to entry for smaller players and growing demand

3. Threat of Chinese/Saudi Competition

- Hazardous nature of MA mitigates import risk to a large extent
- Growing volume and margins imply that DMF issue may have started easing
- BAL has been applying for anti-dumping duties

Technology Risk as business is R&D driven

- This risk will always be there for a business like this
- BAL does not have any patents

Catalysts

1. Institutional ownership increases

Shareholding Pattern as of 201606	No of Shareholders	% of Shares
Promoter and Promoter Group		
Indian Promoters	18	54.42
Foreign Promoters	0	0
Total of Promoter and Promoter Group	18	54.42
Public Shareholding		
Institutions	9	1.44
Non-Institutions	6656	44.14
Total Public Shareholding	6665	45.58
Total of Promoter and Public Shareholding	6683	100

Shareholding Pattern as of 201609	No of Shareholders	% of Shares
Promoter and Promoter Group		
Indian Promoters	18	54.42
Foreign Promoters	0	0
Total of Promoter and Promoter Group	18	54.42
Public Shareholding		
Institutions	12	3.08
Non-Institutions	6941	42.5
Total Public Shareholding	6953	45.58
Total of Promoter and Public Shareholding	6683	100

- A quality business like BAL should trade at >13x, at 1,000cr mcap should be on the institutional radar
- The Pabrai Investment Fund picked up a 2% stake in BAL in Q2FY17

2. Hotel business turns profitable

- Has not made a profit in the first 3 years of operation, but gestation period for a new hotel is presumably long
- As per Q2FY17, hotel business is producing a cash profit, loss due to acc. depreciation
- Reviews are good, revenue has been increasing every year
- At 4,100 per night they are already at 75% occupancy

Conclusion

- Balaji Amines is a business with strong competitive advantages, catering to growing industries, likely to benefit from a multiple expansion.
- The business has a stellar track record – has consistently grown eps for the last 18 years across business cycles
- This provides curability to the narrative and future earnings projections
- Difficult to lose money investing in a business like this