**Company: Bharat Rasayan**

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| **Business Slotting**  🗹 B2B 🞏 B2C 🗹 Asset Heavy (Working capital heavy) 🞏 Asset Light 🞏 Intellectual Prop 🗹 Price Taker 🞏Price Setter 🞏Oligopoly   🞏Monopoly/ Duopoly 🗹 Customer Capex Led |

**Company Background:**

* Bharat Rasayan, incorporated in 1985 is part of the Bharat Group. Bharat Group has presence in the agrochemical space with Bharat Rasayan, Bharat Insecticides and Bharat Agrotech as its main companies. As a group it is one of the top 10 Agrochemical companies in India
* Bharat Rasayan is the only listed entity from the group. The company manufacturers technical grade pesticides (similar to API for drugs) which are then used by agro-chem companies to make formulations. Bharat Rasayan counts Bayer, Syngenta, Nissan, Adama among others as its customers. It also serves many domestic formulation companies.
* The company has 2 plants at the moment – 1 in Rohtak and the other in Dahej. The Rohtak plant has the capacity of ~ 4000 tonnes and Dahej plant with the recent expansion has the capacity of ~ 12,3000 tonnes. It has around 20-22 active molecules as its key products. Its key products includeMetaphenoxy Benzaldehyde, Lambda Cyhalothrin, Metribuzin, Chloropyrophil, Para Chloro Benzene Cyanide.
* The company generates ~ 62% sales from its top 9 products (H1FY20), 62% in FY19, 52% in FY18 and 70% in FY17 and 77% in FY16 from its top 10 products.
* It generated 52% in FY19 and ~ 35% revenue from its top 3 customers, 35% sales in FY18, 25% in FY17 and 22% in FY16 from its Top 5 customers
* Over the years the company has benefited from the shift of manufacturing facility away from China to India. Also given the strong execution, chemistry skills and long-standing relationships with its customers such as Nissan, Bayer etc the company has been able to bag orders and entered into contract manufacturing (for generic molecules) for MNC agrochem companies. The company has a stated focus to grow its MNC customer/export revenue and move away from the domestic business (owing to low profitability)
* The company generates ~ 60% of its business in the H1 and the rest in H2.



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| **Customer Industry Trend/Outlook ->** 🗹 Tailwinds  Headwinds  Secular |

Company is becoming a credible alternative to China as a mfg base for its customers. Over the years the company has been able to strengthen its relationship with global agro-chem players.

**Few articles highlighting the Issues in China and the purported shift of mfg from China to India**

* <http://news.agropages.com/News/NewsDetail---32362.htm>
* <https://www.mckinsey.com/industries/chemicals/our-insights/chinas-chemical-industry-new-strategies-for-a-new-era>
* <http://news.agropages.com/News/NewsDetail---29570.htm>

**To summarize the issues in general w.r.t China are**

* Stricter environmental norms in China – leading to high costs and unviability of few co’s
* Rising labour costs
* Concentration risk – Given issues like trade war and Corona virus crisis

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| **Elevator Pitch –** Bharat Rasayan is a well-run technical manufacturer. Post the capex in Dahej the company has been able to ramp up its sales with global agro chem major. Owing to its strong execution, cost competitiveness, competent chemistry skills and increased backward integration for manufacturing its share of CRAMS (patented & non patented molecules) is expected to rise. The proof of their strong execution is evidenced by their recent JV with Nissan Chemcials. CRAMS business is a sticky business and takes time to ramp up – Bharat Rasayan has been working with its clients for the last 7-8 years and it is now at a point where external tailwinds, companies’ ability to execute all seem to come together. Company is also ramping up its export business. Both CRAMS and exports are more profitable businesses |

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| **BUSINESS ATTRACTIVNESS** |

1. **Strongly differentiated business model -> Medium, should become High over time if patented CRAMS share increases**

* Evolving into CRAMS player – which is a very sticky business – order book visibility is quite high. Earnings as a result are predictable
* Co’s has been selling to various agro chem majors like Bayer, Syngenta, Adama and given their execution and capability – the volumes with such customers are increasing leading to growth.
* Getting the share of business from global customers is very difficult & time consuming- as a vendor one needs to show competent chemistry skills, backward integration capability (China dependence should be a bare minimum for raw materials). Bharat Rasayan has recently invested ~ 100 Crores to improve this aspect in its Dahej plant.
* The fact that not many players apart from PI have been successful in this shows how difficult it is to get the trust of customers. PI is largely into patented/innovator molecules- for Bharat Rasayan this is still a small share, however expected to grow over the next few years. (Currently <10% expected to grow to 20-30% over the next 3-5 years)
* JV with Nissan Chemicals is a clear show of Bharat Rasayan’s ability to execute on the same.

1. **Competitive Position getting stronger/weaker -> Stronger** 
   * Backward integration for its RM – Reduced dependency on China- major competitive advantage
   * Share of business from CRAMS (within that patented molecules) and export should increase both these segments are more profitable.
   * Success in CRAMS will make it difficult for any one to dis-lodge Bharat Rasayan as customers won’t like to change suppliers
2. **Next Level of business -> Medium**
   * JV with Nissan Chemicals should act as a strong vote of confidence for other companies/customers to give similar business
3. **Value Migration Curve -> High** 
   * India/Indian manufacturers as a potential 2nd source supplier to global agro chem players is a tail-wind which is getting stronger by the day
   * Business mix improving towards patented CRAMS manufacturing increasing in overall mix
   * Export business Increasing
4. **Quality of earnings -> Medium** 
   * Low gross margins (30-35%)
   * Mediocre cash flows- driven by high working capital. CFO/PAT is quite low over the 10 years However, on the positive side debt levels are still manageable at 0.4x Net debt/equity
   * Going forward margins should improve driven by ↑ CRAMS and Exports revenue



1. **Key growth drivers** 
   * Capex in Saikha & Dahej -> Dahej capex will be largely for backward integration- should improve gross/operating margins. Saikha plant is a greenfield capex which should help the company drive growth in the next 3-4 years. In the AGM the management mentioned Saikha capex will be 300 + Crores and will be done over phases. Past track record of management to ramp up sales and utilization is very good ***-> Medium***
   * Growth in Export markets ***-> Medium***
   * JV with Nissan and other similar contracts with other vendors for CRAMS
   * The above + backward integration efforts should help Profit to grow faster than sales
2. **Intellectual Property – Low**

* Low R&D spend by the company.

**Operating Leverage led by** 🗹 **Gross Margin** 🞏 **Asset Turns** 🗹 **Product Mix** 🞏 **Employee Costs**

* In the past margin expansion has been driven by better utilization of assets – as evidenced by gross margins being at 30-35%, but EBITDA margins expanding significantly- driven by high plant utilization/better absorption of costs as capex have been largely brown-field in nature.
* **Gross Margin & Product mix –** Gross margins of the company have been around 30-35% over the last decade. CRAMS being higher share of business, should improve the gross margins going forward. Further the backward integration efforts taken by the company will improve the gross margins. (China dependency to reduce by half).  
  Also, Exports have higher margins. This should help the overall margins



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| **KEY MONITORABLE** |

* ***Share of CRAMS (patented) in revenue*** – This is the key monitorable as this is the main thesis in Bharat Rasayan. As a part of this, one more monitorable would be if the company is able to get more partnerships like the one with Nissan
* ***Share of exports in revenue***
* ***Gross Margins*** – Improvement in product mix should be visible in Gross margins
* *Working capital &Cash Flows*

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| **MANAGEMENT QUALITY** |

1. **DNA of business**

Large market opportunity to serve global agro-chem customers. Company has been on the path to take advantage of this opportunity. First step in the journey to set up Dahej plant. Cost focused driven by running the plant at near full utilizations levels. Strong execution by the company has given the company the opportunity to scale up its operations in CRAMS

* + **Cost Efficiency Focus – High**

Have been able to run plants at high utilizations. Based on my interaction with the management at the AGM this seemed to be the most important parameter for the CMD

* + **Production Efficiency**
  + **Capital Efficiency/Allocation – Low**

Gross Block Asset Turnover is one of the highest in the industry; however, working capital levels are also high. When compared with Industry, Rallis and Bharat Rasayan have seen most deterioration on debtor days.







* + **Innovation – Low**
  + **New Revenue Stream/ Geography – High**

Exports is an opportunity – Brazil and US markets are opportunities where the management is looking to ramp up over the next few years. Further share of CRAMS, especially from patented molecules is expected to rise

* + **Value Chain Migration -High**

Already explained

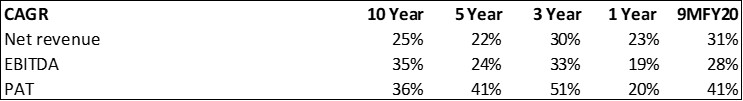
* + **Strategic Thinking – High**

Dahej plant came up in FY12- with the vision to ramp up business with global agro chem companies. Over the years have been able to ramp up capacity in this plant and also have been able to build and nurture relationships with strategic customers- resulting in JV with Nissan Chemicals

* + **Ability to manage downturns –**

Post the major expansion in 2012 – there have been no major downturns for the company/economy. Company handled the demonetization crisis in a good way by clocking a strong 30% + growth in sales and profits.

* + **Walking the Talk -High** 
    - Ability to gain share with global agro chem players; JV with Nissan Chemicals
    - Strong historical financial track record in terms of sales & profit growth



1. **Execution Skills**
   * **Workforce Handling – Not sure**
   * **Customer Trust/Win – High**

Getting CRAMS business is a sign of high trust- with customers willing to give you more share of business. The recent JV with Nissan is an indication of the same thing

* + **Deeper/Broader customer penetration –High**

Bharat Rasayan has been working with existing customers for a long time and over time has increased its wallet share with them. Share of revenue from top 5 customers has gone up in the last 2-3 years.

* + **Successful Project – High**

Based on interactions with other investors who have tracked the company – the company’s execution on Dahej plant has been quite stellar. They were ahead of the game by setting up a plant there and executed this without any mishaps. Just to put things in perspective, setting up Dahej plant was a big step for the company- capex in FY12 and FY13 was ~ 120 Crores, while revenue was around ~ 120 Crores and N/W around 55-60 Crores

1. Reputation
   * **Family Business – High**

Not sure about the second level team. Reliance on the promoter still quite high

* + **Minority Shareholder Treatment - Med**

Does not pay dividend- which is fair given the expansion plans of the company.

* + **Corp. Governance – Low**
    - High Related Party transactions - ~ 23% of sales to related party entities
    - Promoter salary at 14% of PAT; 4-year average at 15%
    - Shareholders include questionable entities- historical issue?

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| **GROWTH/SCALABILITY** |

1. **Linear Growth – High**

* Wallet share gains with customers – Earn the fruits of the relationships developed over the last 8-10 years with strategic customers
* Product mix improvement – replace low profit margin product with higher profitable products
* Industry tailwinds – Ability to win new customers given the increased shift of business towards India from China

1. **Expansionary Growth – High**

* Patented CRAMS to increase revenue mix- Value migration towards higher quality revenue-predictable and stable
* Exports – Looking at Brazil and US as key markets to ramp up exports. Historically company was constrained by the cost of registrations in these markets
* New Revenue Stream – None

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| **Business Vulnerability / Strength** |

1. **Vulnerability**
   * Concentration risk **–** Plant (Dahej), Products, Customers
   * **Regulatory risk –** Compliance, delay in getting regulatory approval for plants
   * Weak cash flows owing to high working capital
   * Volatility in crude prices – can impact profit margins and working capital
   * Over dependence on Nissan JV- leading to company not being able to take other projects/customers? – Need to dig more on this
2. **Strengths/opportunities:**
   * Strong tailwinds in the business; large opportunity
   * Has been able to win trust of customers to move up the value chain

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| **VALUATION** |

**Undervaluation : 🞏 Screaming 🞏 High** 🗹 **Fair**

Fairly valued at 15x P/E with earnings growth of around 15% -18% p.a. over the next 3-4 years. If the execution on the Nissan JV isn’t good (historical execution track record has been very good and they have been preparing for this, so it may not actually play out) then thesis can fail

**Valuations to be led by:**

1. **Earnings Trajectory –** Conservatively speaking, earnings growth could be around 15-17% p.a. over the next 3 years. There are couple of question on this however. Ex of Saikhya what would be the growth given the incremental capex at Dahej will be largely for backward integration, if my understanding is correct. Also does the Nissan JV put any restriction on the company to win other similar business/JVs?
2. **Value Migration-** Business is moving higher up in the value chain from where it was 5 years back
3. **Re-rating-** As share of CRAMS business has a strong chance of getting re-rated

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| **Valuation Overhang**  🗷 PSU 🗷 Not Understood 🗷 Sector Apathy 🗷 Regulatory 🗷 Political 🗹 Corp. Governance |

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| **Valuation Support**  🗷 Dividend 🗹 Low Float 🗷 Capital Allocation |

* Doesn’t pay dividend
* Float is low – given promoters, promoters’ friends own close to 85-90% of the stock

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| **Risk and Mitigations** |

1. **Business Risks**

* **Supply and/or demand disruption – High**

Dependence on China, though reducing, is still a risk.

* **Single Point of Failure – High**

Any mishap/regulatory issue on Dahej plant can impact the business materially

* **Environmental – High**

Delay in getting environmental approvals for new plant can delay growth. If regulations become stringent then it can also impact economics of the business.

* **Buyer Power – High**

As evidenced by high working capital

* **Competition – Med**

Fairly competitive market on the technical side. CRAMS business has not seen many players who have been able to ramp up this segment.

1. **Valuation Risks**

**Risk covered in the valuation multiples** 🗷 Everything 🗹 20% Downside 🗹 2-3X upside in 2-3 years

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| **Liquidity Stress Test: Can sit tight for 1-2 years despite:**  🗹 **Execution Delay**  🞏 **Business Temporary Issues** |

I have been tracking the co for only a few months, So I am not very sure what to write here

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| **MEDIUM TERM VISIBILITY – Medium** |

* + - 1. Earnings - 🗹 Capex Completion. 🗷 Order Book/Sales. 🗹 Mgmt. Guidance

Dahej & Saikha Plant coming on-stream.

* + - 1. Margins – 🗷 Pricing 🗹 Raw Material 🗷Employee Costs 🗹 Product Mix

Improvement in product mix – patented CRAMS and Exports & Backward integration

* + - 1. Efficiency – 🗹 Asset Turns 🗷 Capital Turns

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| **INVESTMENT RATIONALE**  🗷 **Strategic** 🗹 **2-3x in 2-3 years** 🗷 **10x in 10 years** 🗷 **Opportunistic (50-100% pop)** |

**Sources referred:**

1. VP Thread
2. AR’s, Credit Rating reports
3. AGM notes/Management Interactions
4. Discussion with other investors who have tracked the company for the last 3-4 years