

## Custom synthesis offers strong visibility ahead...

**About the stock:** Commencing operations in 1991, Neogen Chemicals manufactures specialty organic bromine-based chemical compounds as well as specialty inorganic lithium-based chemicals compounds.

- The company's products find application in pharmaceutical intermediates, agrochemical intermediates, engineering fluids, polymers additives and water treatment chemicals to name a few
- Neogen has two segments viz. (i) organic chemicals, (ii) inorganic chemicals of which organic chemical constitute ~80% of overall revenue while the rest comes from inorganic chemicals

**Q1FY22 Results:** Numbers were below estimates on account of spillover sales to the next quarter.

- Reported revenue growth of 11% YoY to ₹ 84.6 crore, led by higher growth from inorganic chemical segment (up 55% YoY)
- Gross margins rose 690 bps YoY to ~45% while EBITDA margin improved 80 bps YoY to 18.5%, due to higher other operating cost (up 50% YoY) and employee expenses (up 30% YoY)
- EBITDA was up 15% YoY to ₹ 15.6 crore
- PAT increased 20% YoY to ₹ 7.4 crore owing to lower taxes (28.1% vs. 30% in Q1FY21)

**What should investors do?** The stock appreciated at 65% CAGR in last two years.

- We retain **BUY** rating on the back of better growth outlook from custom synthesis business

**Target Price and Valuation:** We value Neogen Chemicals at 38x P/E FY23E EPS to arrive at a revised target price of ₹ 1095/share (earlier ₹ 1085/share).

### Key triggers for future price performance:

- Phase 1 and Phase 2 capex at Dahej bodes well for advance intermediates and custom synthesis revenue growth
- Higher share of value added business portfolio to improve margins profile of the business
- Allocation of incremental FCF towards organic/inorganic growth likely to expand return ratios further

**Alternate Stock Idea:** Apart from Neogen Chemicals, in our chemical coverage we also like Sumitomo Chemicals.

- Trigger for Sumitomo Chemical's future revenue growth would be increasing CRAMS opportunity from SCC Japan and Nufarm
- BUY with a target price of ₹ 505



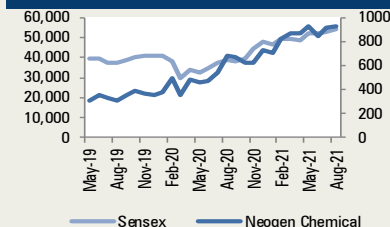
### Particulars

Particular	Amount
Market cap (₹ Crore)	2,093
FY21 Total Debt (₹ Crore)	202
FY21 Cash & Inv (₹ Crore)	1
EV (₹ Crore)	2,294
52 Week H/L	1028/590
Equity Capital (₹ Crore)	23.3
Face Value (₹)	10

### Shareholding pattern

in %	Sept-20	Dec-20	Mar-21	Jun-21
Promoter	64.3	64.3	64.3	64.3
DII	16.2	15.5	14.8	14.1
FII	4.8	4.8	4.8	4.7
Others	14.7	15.4	16.1	16.9

### Price Chart



### Recent event & key risks

- Trial batches from phase 1 project at Dahej started
- Key Risk:** (i) Lower lithium prices to impact inorganic chemical performance ii) Slowdown in the end user industry and thereby stretched WC to impact balance sheet

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### Key Financial Summary

(₹ Crore)	FY19	FY20	FY21	5 year CAGR (FY16-21)	FY22E	FY23E	2 year CAGR (FY21-23E)
Net Revenue	239.1	306.1	336.4	25.3%	446.3	585.9	32.0%
EBITDA	43.4	58.1	64.4	35.5%	87.0	120.1	36.6%
EBITDA Margins (%)	18.2%	19.0%	19.1%		19.5%	20.5%	
Adj. PAT	21.0	28.6	31.3	43.3%	43.9	67.2	46.4%
Adj. EPS (₹)	10.4	12.3	13.4		18.8	28.8	
EV/EBITDA	44.1x	38.3x	35.6x		26.7x	19.4x	
P/E	86.0x	73.1x	66.8x		47.7x	31.2x	
ROE (%)	29.8	18.3	17.1		19.8	23.7	
ROCE (%)	22.2	18.4	15.1		16.5	20.1	

Source: Company, ICICI Direct Research

## Key takeaways of recent quarter & conference call highlight

### Q1FY22 Results: Better performance from inorganic chemical leads overall growth

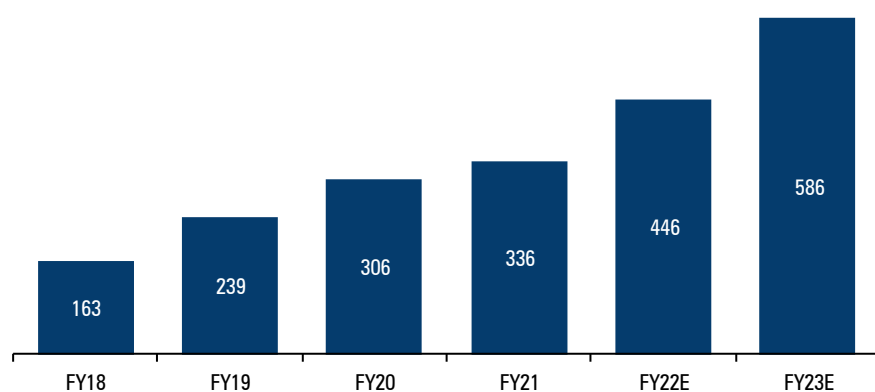
- **Organic Chemical:** Revenues were up 3% YoY to ₹ 68 crore. There was higher COGS for this quarter (76.2% of revenue vs. 56.8% in Q1FY21), while there have been changes in inventory of around -₹ 18 crore. We believe part of this is spillover sales owing to some challenges (primarily logistic related). The company had already started batch production from its phase 1 capacity at Dahej. Two contracts for custom synthesis at the initial stage are expected to contribute around ₹ 60-80 crore for this fiscal year. Thus, we believe entire part would be distributed in the remaining three quarters
- **Inorganic Chemical:** The company had set up 1200 MT of capacity at Dahej last year. Thus, better utilisation of new capacity led higher volume growth. This, in turn, supported strong revenue growth during the quarter. Revenue was up 55% YoY to ₹ 17 crore

### Q1FY22 Earnings Conference Call highlights

- The company has been witnessing favourable demand trends across its key segments
- Mahape and Baroda units are operating at more than 80% utilisation
- **Custom Synthesis** – The company supplies to around 10 odd customers under its portfolio. It is engaging with eight to 10 new customers for several projects. The endeavour remains to add new customers under this portfolio going ahead
- Advance intermediates currently comprise ~25-30% of overall revenue. It is expected to inch up to 40% once Dahej capacity gets commissioned
- **Phase 1 Dahej Capex** – Trial production has commenced. They have received product approval from several customers. They will start dispatching from Q2FY22
- **Phase 2 capex:** Around 75% of reactors would be installed by the end of Q2FY22, Q3FY22
- Due to product mix changes, gross margins trend would be expected at 40-44% against earlier guided 38-42%
- Two new customers would contribute revenues to the tune of ₹ 60-80 crore this year
- The revenue guidance for the year remained unchanged at ₹ 450 crore

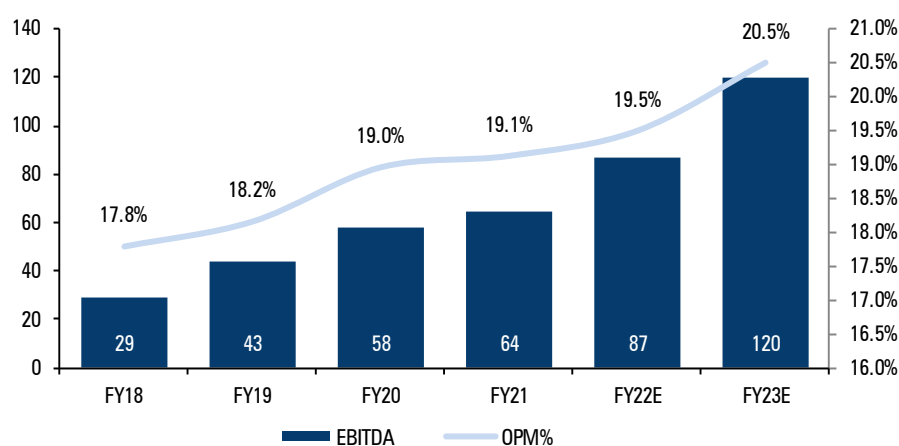
## Financial story in charts....

**Exhibit 1: Revenue trend (₹ crore)**



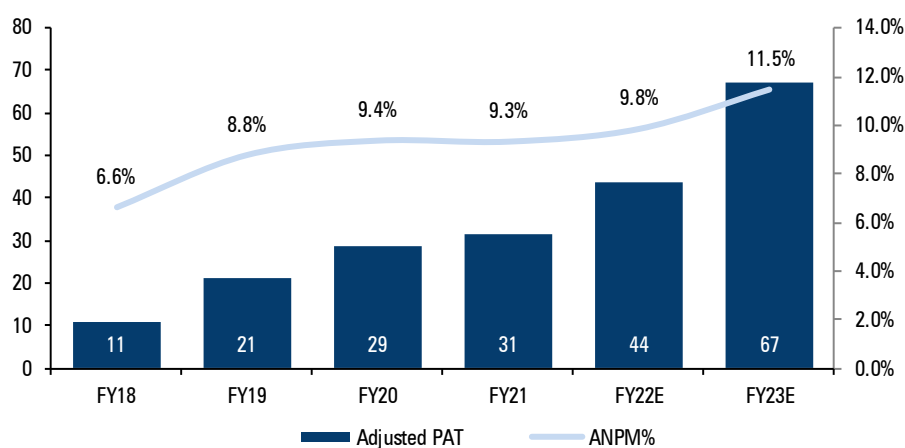
Source: Company, ICICI Direct Research

**Exhibit 2: EBITDA (₹ crore) and OPM (%) trend**



Source: Company, ICICI Direct Research

**Exhibit 3: PAT growth trend (₹ crore)**



Source: Company, ICICI Direct Research

## Financial summary

Exhibit 4: Profit and loss statement ₹ crore					
Year end March	FY19	FY20	FY21	FY22E	FY23E
<b>Total Operating Income</b>	<b>239.1</b>	<b>306.1</b>	<b>336.4</b>	<b>446.3</b>	<b>585.9</b>
Growth (%)	48.3	28.1	9.9	32.7	31.3
Raw Material Expenses	140.7	184.1	197.6	258.9	336.9
<b>Gross Profit</b>	<b>98.4</b>	<b>122.0</b>	<b>138.8</b>	<b>187.5</b>	<b>249.0</b>
Employee Cost	11.2	17.3	20.1	26.8	35.2
Other Operating Expenses	43.8	46.7	54.4	73.6	93.7
<b>EBITDA</b>	<b>43.4</b>	<b>58.1</b>	<b>64.4</b>	<b>87.0</b>	<b>120.1</b>
Growth (%)	49.8	33.7	10.9	35.2	38.0
Other Income	0.6	0.2	0.5	0.7	0.8
<b>EBITDA, including OI</b>	<b>44.0</b>	<b>58.3</b>	<b>64.9</b>	<b>87.7</b>	<b>120.9</b>
Depreciation	2.8	5.2	6.9	9.7	12.2
Net Interest Exp.	11.9	11.9	13.8	17.0	19.1
Other exceptional items	0.0	0.0	0.0	0.0	0.0
<b>PBT</b>	<b>29.3</b>	<b>41.1</b>	<b>44.2</b>	<b>61.0</b>	<b>89.6</b>
Total Tax	8.3	12.5	12.9	17.1	22.4
Tax Rate	28.4%	30.3%	29.1%	28.0%	25.0%
<b>PAT</b>	<b>21.0</b>	<b>28.6</b>	<b>31.3</b>	<b>43.9</b>	<b>67.2</b>
Adj. PAT after Minority interest	21.0	28.6	31.3	43.9	67.2
Adj. EPS (₹)	10.4	12.3	13.4	18.8	28.8
Shares Outstanding	2.0	2.3	2.3	2.3	2.3

Source: Company, ICICI Direct Research

Exhibit 5: Cash flow statement ₹ crore					
Year end March	FY19	FY20	FY21	FY22E	FY23E
PBT & Extraordinary	29.3	41.1	44.2	61.0	89.6
Depreciation	2.8	5.2	6.9	9.7	12.2
After other adjustments					
(Inc) / Dec in Working Capital	-42.4	-85.1	36.6	-64.1	-66.9
Taxes	-5.5	-12.7	-10.4	-17.1	-22.4
Others	12.1	16.9	6.2	17.0	19.1
<b>CF from operating activities</b>	<b>-3.7</b>	<b>-34.5</b>	<b>83.6</b>	<b>6.5</b>	<b>31.6</b>
Purchase of Fixed Assets	-18.4	-26.5	-135.0	-17.3	-15.0
Others	-1.7	-2.1	0.4	0.0	0.0
<b>CF from investing activities</b>	<b>-20.1</b>	<b>-28.6</b>	<b>-134.6</b>	<b>-17.3</b>	<b>-15.0</b>
Proceeds from issue of shares	0.0	70.0	0.0	0.0	0.0
Borrowings (Net)	38.2	16.5	69.6	50.0	5.0
Others	-14.3	-23.9	-18.9	-22.3	-24.3
<b>CF from financing activities</b>	<b>24.0</b>	<b>62.6</b>	<b>50.7</b>	<b>27.7</b>	<b>-19.3</b>
Net cash flow	0.2	-0.5	-0.3	16.8	-2.7
Effects of foreign currency translation	0.0	0.0	0.0	0.0	0.0
Opening Cash	1.8	2.0	1.5	1.2	18.1
<b>Closing Cash</b>	<b>2.0</b>	<b>1.5</b>	<b>1.2</b>	<b>18.1</b>	<b>15.3</b>

Source: Company, ICICI Direct Research

Exhibit 6: Balance sheet ₹ crore					
Year end March	FY19	FY20	FY21	FY22E	FY23E
<b>Liabilities</b>					
Share Capital	20.1	23.3	23.3	23.3	23.3
Reserves	50.1	132.9	159.7	198.3	260.3
<b>Total Shareholders Funds</b>	<b>70.2</b>	<b>156.2</b>	<b>183.0</b>	<b>221.7</b>	<b>283.6</b>
Minority Interest	0.0	0.0	0.0	0.0	0.0
Long Term Borrowings	50.6	30.4	116.1	156.1	166.1
Net Deferred Tax liability	4.9	5.6	8.2	8.2	8.2
Other long term liabilities	2.0	9.2	7.7	8.0	10.5
Long term provisions	2.0	3.6	3.0	4.3	5.7
<b>Current Liabilities and Provisions</b>					
Short term borrowings	65.2	101.9	85.8	95.8	90.8
Trade Payables	42.8	35.9	66.1	85.6	112.4
Other Current Liabilities	7.7	10.6	20.9	27.8	36.4
Short Term Provisions	1.1	1.5	1.1	1.5	1.9
Total Current Liabilities	116.8	149.9	173.9	210.6	241.5
<b>Total Liabilities</b>	<b>246.4</b>	<b>354.9</b>	<b>492.0</b>	<b>608.9</b>	<b>715.6</b>
<b>Assets</b>					
Net Block	82.8	110.6	126.7	204.0	251.8
Capital Work in Progress	0.4	2.7	114.7	45.0	0.0
Intangible assets under devl.	0.0	0.0	0.0	0.0	0.0
Goodwill on Consolidation	0.0	0.0	0.0	0.0	0.0
Non-current investments	0.5	0.6	0.8	0.8	0.8
Deferred tax assets	0.0	0.0	0.0	0.0	0.0
Long term loans and advances	2.5	5.9	7.3	7.9	10.3
Other Non Current Assets	0.4	4.1	2.3	8.8	11.5
<b>Current Assets, Loans &amp; Advances</b>					
Current Investments	0.0	0.0	0.0	0.0	0.0
Inventories	72.4	129.9	114.0	165.1	216.7
Sundry Debtors	60.7	75.2	78.6	97.8	128.4
Cash and Bank	2.0	1.5	1.2	18.1	15.3
Loans and Advances	0.0	0.0	0.0	0.0	0.0
Other Current assets	24.7	24.5	46.4	61.5	80.8
Current Assets	159.8	231.1	240.2	342.5	441.2
<b>Total Assets</b>	<b>246.5</b>	<b>354.9</b>	<b>492.0</b>	<b>608.9</b>	<b>715.6</b>

Source: Company, ICICI Direct Research

Exhibit 7: Key ratios					
Year end March	FY19	FY20	FY21	FY22E	FY23E
<b>Per share data (₹)</b>					
Adj. EPS	10.4	12.3	13.4	18.8	28.8
Adj. Cash EPS	11.8	14.5	16.4	23.0	34.0
BV	35.0	67.0	78.4	95.0	121.5
DPS	0.0	1.5	2.3	2.3	2.3
<b>Operating Ratios (%)</b>					
Gross Margin (%)	41.1	39.9	41.3	42.0	42.5
EBITDA Margin (%)	18.2	19.0	19.1	19.5	20.5
PAT Margin (%)	8.8	9.4	9.3	9.8	11.5
Debtor Days	93	90	85	80	80
Inventory Days	111	155	124	135	135
Creditor Days	65	43	72	70	70
Cash Conversion Cycle	138	202	137	145	145
<b>Return Ratios (%)</b>					
Return on Assets (%)	8.5	8.1	6.4	7.2	9.4
RoCE (%)	22.2	18.4	15.1	16.5	20.1
Core RoIC (%)	22.1	18.4	15.0	17.0	20.5
RoE (%)	29.8	18.3	17.1	19.8	23.7
<b>Solvency Ratios</b>					
Total Debt / Equity	1.6	0.8	1.1	1.1	0.9
Interest Coverage	3.5	4.4	4.2	4.6	5.7
Current Ratio	1.4	1.5	1.4	1.6	1.8
Quick Ratio	0.7	0.7	0.7	0.8	0.9
<b>Valuation Ratios (x)</b>					
EV/EBITDA	44.1	38.3	35.6	26.7	19.4
P/E	86.0	73.1	66.8	47.7	31.2
P/B	25.7	13.4	11.4	9.4	7.4
EV/Sales	8.0	7.3	6.8	5.2	4.0

Source: Company, ICICI Direct Research

**Exhibit 8: ICICI Direct coverage universe (Chemicals)**

Company	CMP			M Cap (₹ Cr)	EPS (₹)			P/E (x)			EV/EBITDA (x)			RoCE (%)			RoE (%)		
	(₹)	TP(₹)	Rating		FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
PI Industries	3316	3,855	Buy	50,403	48.6	59.2	77.1	68.3	56.0	43.0	47.8	39.2	30.1	17.2	18.6	20.4	13.8	14.6	16.1
Aarti Industries	853	960	Buy	30,927	30.2	72.8	60.0	55.2	22.9	27.8	32.2	23.5	18.0	10.7	12.7	15.3	15.0	16.3	18.7
Sumitomo Chemical	431	505	Buy	21,513	6.9	8.5	10.1	62.3	50.6	42.6	43.1	35.1	29.0	29.8	29.3	28.1	22.4	22.1	21.2
Vinati Organics	1954	2,300	Buy	20,086	26.2	40.2	44.3	74.6	48.6	44.1	56.4	36.2	32.3	21.7	29.4	27.1	17.4	22.1	20.4
Tata Chemical	824	925	Hold	20,997	10.1	39.1	42.6	81.9	21.1	19.3	15.8	10.0	8.3	4.1	7.1	7.7	1.8	6.6	6.9
Navin Fluorine	3720	3,712	Hold	18,413	45.0	53.0	73.1	82.6	70.2	50.9	57.5	49.7	33.9	21.0	19.0	22.6	13.6	14.2	17.0
Rallis India	320	400	Buy	6,215	11.4	12.7	16.0	28.1	25.1	20.0	18.4	16.8	13.0	18.0	17.7	20.0	13.9	13.9	15.3
Sudarshan chemical	752	775	Buy	5,204	20.4	24.4	29.9	36.9	30.8	25.1	19.9	16.5	14.2	15.2	16.3	17.9	19.0	19.5	20.2
Neogen Chemicals	897	1,095	Buy	2,093	13.4	18.8	28.8	66.8	47.7	31.2	35.6	26.7	19.4	15.1	16.5	20.1	17.1	19.8	23.7

Source: Bloomberg, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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