

## National Peroxide Ltd.

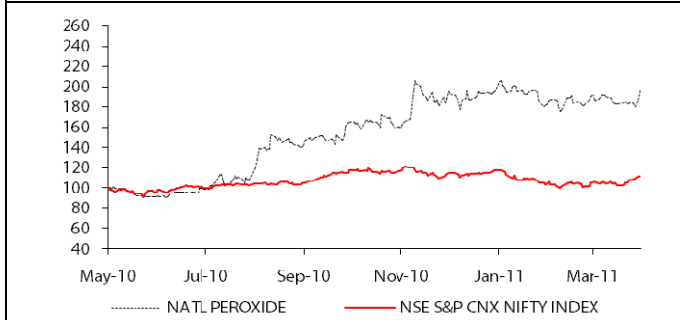


**Initiating Coverage**
**National Peroxide Ltd.**

|                |            |
|----------------|------------|
| Recommendation | <b>BUY</b> |
| CMP            | Rs. 560    |
| Sector         | Chemicals  |

| <b>Stock Details</b>      |         |
|---------------------------|---------|
| BSE Code                  | 500298  |
| Bloomberg Code            | NPL IN  |
| Market Cap (Rs. cr)       | 322     |
| Free Float (%)            | 29.91   |
| 52- wk HI/Lo              | 688/235 |
| Avg. Volume BSE (Monthly) | 21,355  |
| Face Value (Rs)           | 10.0    |
| Dividend (FY 11)          | 120%    |
| Shares o/s (Cr)           | 0.575   |

| Relative Performance | 1Mth | 3Mth | 1Yr  |
|----------------------|------|------|------|
| NPL                  | 1.6  | 10.9 | 87.1 |
| Sensex               | -6.2 | 2.5  | 7.8  |



| <b>Shareholding Pattern as of 31 March 2011</b> |       |
|---|-------|
| Promoters Holding                               | 70.1% |
| Institutional (Incl. FII)                       | 0.3%  |
| Corporate Bodies                                | 4.5%  |
| Public & others                                 | 25.1% |

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**Snapshot**

Incorporated in the year 1956, National Peroxide Limited(NPL) is a Wadia group company. The company is the largest single-location hydrogen peroxide manufacturer in India. NPL derived close to 92% of its revenues from the sale of hydrogen peroxide during FY'10 and is the leader with 38% market-share.

**Investment Rationale**

- **Robust demand for Hydrogen Peroxide:** The demand for Hydrogen Peroxide is on a robust growth trajectory across the globe due the environment-friendly nature of the product. This coupled with a strong demand in the end-user industries, mainly paper and textile is expected to lead to firm trend in the price of Hydrogen Peroxide globally.
- **Expansion plans to expand market-share further:** NPL has commenced the process of expanding its capacity from the present levels of 68,000 tonnes per annum to 84,000 tonnes per annum. The company management has chalked out plans to expand the same to 1,50,000 tonnes per annum over the next five years. The financial performance is set to improve further from the present levels on the back of expanded capacities.
- **Robust performance, set to improve further:** NPL has clocked EBITDA margins in excess of 50% for FY'11. We expect the company to post robust set of numbers on the back of firm trend in Hydrogen Peroxide prices and expanded capacity utilization levels.
- **Deep "Value Buy":** NPL has a clean debt-free Balance Sheet. The company has the largest single-location manufacturing facility at Kalyan. The book-value of the land on which the plant is located is reflected at Rs.5 lakhs which does not capture the present realizable value.

**Valuation & Recommendation**

We expect NPL to post net sales of Rs.230.5 crore in FY'12E. The PAT for the year should be around Rs.66 crore translating into an EPS of Rs.114.8 per share. After assigning a P/E multiple of 6x FY'12E earnings and adding the value of holding in group companies, we arrive at target price of Rs.712 over the next 6 to 9 months, providing an upside of 27% from the present levels.

| Year   | Net Sales<br>(Rs cr) | Growth<br>(%) | EBITDA<br>(Rs cr) | Margin<br>(%) | PAT<br>(Rs cr) | Margin %<br>(%) | EPS<br>(Rs) | PE<br>(x) | P/BV<br>(x) |
|--------|----------------------|---------------|-------------------|---------------|----------------|-----------------|-------------|-----------|-------------|
| FY09A  | 135.0                | 23.4%         | 42.3              | 31.3%         | 20.7           | 15.3%           | 36.0        | 15.6      | 4.7         |
| FY10A  | 121.9                | -9.7%         | 33.6              | 27.6%         | 16.2           | 13.3%           | 28.2        | 19.9      | 4.1         |
| FY 11A | 181.6                | 49.0%         | 93.2              | 51.3%         | 31.9           | 17.6%           | 100.6       | 5.6       | 2.5         |
| FY12E  | 230.5                | 26.9%         | 111.0             | 48.2%         | 66.0           | 28.6%           | 114.8       | 4.9       | 1.7         |

## INVESTMENT RATIONALE

### Demand for hydrogen peroxide on a growth trajectory

The demand for hydrogen peroxide is set to grow across the world on account of environmental concerns. Hydrogen peroxide is widely used as a bleaching chemical finding extensive application in the textile and paper industry. Chlorine, another chemical is equally used in the bleaching industry. However, usage of chlorine leads to depletion of the ozone layer and is therefore, hazardous to the environment. The usage of hydrogen peroxide is not engulfed with any such issue and is very much safe with regard to the issues related to the environment.

The usage of hydrogen peroxide has gained importance over the recent years as a substitute for hypochlorite and other bleaching agents. This chemical acts by creating active oxygen. Hydrogen peroxide needs higher temperatures and high pH levels to oxidise.

Hydrogen reacts very willingly with many chemical substances but creates no harmful by-products. Hence, it can be considered harmless with respect to the environment unlike many other chemicals.

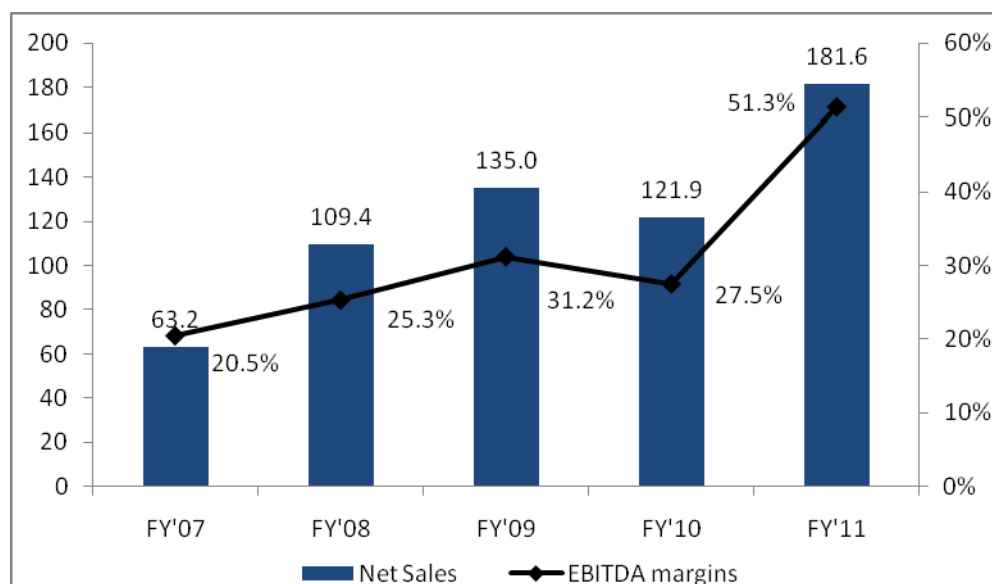
### Hydrogen peroxide prices have almost doubled over the last one year

Hydrogen peroxide prices have been constant at Rs.35 per kg over the last two months. Off late, the prices have improved to Rs.43 per kg levels. There is a 100% y-o-y increase in hydrogen peroxide prices at Rs.41.9 per kg during the quarter compared to Rs.21.9 per kg during the corresponding quarter last year. We expect the company to be a key beneficiary of the upturn in hydrogen peroxide prices.

### Leadership status, expansion plans to improve performance further

National Peroxide is the market-leader with 38% share of the domestic market. Considering the improvement in demand for its product, the company has commenced the expansion process of its facilities from 68,000 tonnes to 84,000 tonnes in this quarter itself. As a result, the company has undertaken maintenance shut down for a period of about six weeks commencing from April 11, 2011. The company plans to expand the capacity further to 1,50,000 tonnes over the next five years. The capacity expansion expected to be around Rs.50 crore would be entirely funded through internal accruals only.

The increase in capacity should not only lead to a surge in volumes but also in margins on the back of apportionment of fixed costs. During FY'11, the company has clocked an EBITDA margin of +50%. We expect high margins to sustain going forward as well on the back of buoyancy in hydrogen peroxide prices, capacity expansion plans and reduction in cost-structure.



(Source: Company, NB Research)

#### Debt-free Balance Sheet

The company has a debt-free Balance Sheet. NPL plans to fund the expansion facilities through internal accruals itself. The market-value of the company's stake in two group companies, Bombay Dyeing and Bombay Burmah is equivalent to ~7% of the present market-cap of the company. The single-location manufacturing facility of the company is located at Kalyan. The book-value of the land on which the plant is located stands at Rs.5 lakhs which does not reflect the present realizable value.

| Company       | Quantity | Present Price(Rs.) | Value       |
|---------------|----------|--------------------|-------------|
| Bombay Dyeing | 297940   | 360                | 10.7        |
| Bombay Burmah | 250440   | 415                | 10.4        |
| Others        | 9.5      | -                  | 0.1         |
| <b>Total</b>  |          |                    | <b>21.2</b> |

(Source: Capitaline)

#### Long-term gas agreement tie-up to reduce the cost of production

Until December 2009, NPL did not have long-term supply agreements for natural gas earlier and so the company used to purchase natural gas on spot basis. However, in January 2010, NPL entered into a long-term gas supply agreement with GAIL in January 2010 which ensures steady supply of feedstock at a pre-defined structure and bring down NPL's cost considerably.

#### Excellent return ratios

NPL operates in a high margin environment. The EBITDA margin posted by the company stood in excess of 50% for FY'11. The RoE and RoCE of the company for FY'10 stood at

## Initiating Coverage

## National Peroxide Ltd.

21.9% and 30.6% respectively. We expect the company to post a RoE of 44.9% and 35.5% respectively for FY'11 and FY'12E respectively on the back of buoyancy in hydrogen peroxide prices.

### Increase in promoter holding

The promoter holding in the company has increased from 66% to 70.09% over the last 15 months. This increase in holding by the promoter group re-instates the confidence of the promoters in the business model of the company.

### Strong growth in the end-user industry

The prospect of Hydrogen Peroxide is dependent on performance of the textile and paper industry since it finds significant application as a bleaching agent in both these sectors. Both, paper and textile, are doing extremely well and are on track with their expansion plans. The acquisition of AP Paper Mills by International Paper and that of Subburaj Papers by Seshasayee Paper Mills clearly states that the paper industry is on the verge of consolidation.

The client list of the company in the textile sector and the Paper sector have been mentioned below:

- BILT
- Andhra Pradesh Paper Mills
- West Coast Paper Mills

Some of the prominent names in the textile sector who source Hydrogen Peroxide from the company are:

- Bombay Dyeing
- Arvind Mills

## Risks & Concerns

### Volatility in the price of hydrogen peroxide

Volatility in the price of hydrogen peroxide is a significant risk to our earnings estimate. However, on account of environmental issues associated with the usage of its nearest competing product, chlorine, the demand is expected to be robust.

### COMPANY BACKGROUND

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### VALUATION AND RECOMMENDATION

We expect NPL to post an EPS of Rs.114.8 in FY'12E on the back of expansion in capacity and robust trend in the price of Hydrogen Peroxide. The performance in Q1FY'12 is expected to be muted on account of the shutdown undertaken by the company to expand the capacity. We remain upbeat about the future prospects of the company on the back of robust demand for hydrogen peroxide from the end-user industries. We value the core business at 6x FY'12E earnings of Rs.115 per share to arrive at a figure of Rs.690. The value of the investment in group companies stands at Rs.22 per share (after assigning a

Initiating Coverage

National Peroxide Ltd.

40% holding company discount). Investors looking out for strong and steady business model, having high return ratios can expect a price of Rs.712 over the next 6 to 9 months providing an appreciation of 27% from the present levels.

## Initiating Coverage

## National Peroxide Ltd.

| P&L (Rs. Cr)     | FY09A | FY10A | FY11A | FY12E |
|------------------|-------|-------|-------|-------|
| Net Sales        | 135.0 | 121.9 | 181.6 | 230.5 |
| % change         | 23.4% | -9.7% | 49.0% | 26.9% |
| Other Op Income  | 0.8   | 0.6   | 1.3   | 0.0   |
| EBITDA           | 42.3  | 33.6  | 93.2  | 111.0 |
| EBITDA margin    | 31.3% | 27.6% | 51.3% | 48.2% |
| Depn & Amort     | 8.2   | 8.3   | 8.4   | 11.4  |
| Operating income | 34.1  | 25.3  | 84.8  | 99.6  |
| Interest         | 3.0   | 1.3   | 0.8   | 1.2   |
| Other Income     | 0.2   | 0.1   | 1.9   | 0.1   |
| PBT              | 31.2  | 24.1  | 85.9  | 98.5  |
| Tax              | 10.5  | 7.9   | 28.1  | 32.5  |
| EO               | 0.0   | 0.0   | 0.0   | 0.0   |
| PAT              | 20.7  | 16.2  | 57.8  | 66.0  |
| Sh o/s - Diluted | 0.6   | 0.6   | 0.6   | 0.6   |
| Adj EPS          | 36.0  | 28.2  | 100.6 | 114.8 |

| Quarterly   | Jun. 10 | Sep. 10 | Dec. 10 | Mar. 10 |
|-------------|---------|---------|---------|---------|
| Revenue     | 37.1    | 43.2    | 49.4    | 51.9    |
| EBITDA      | 17.0    | 21.0    | 27.9    | 29.2    |
| Dep & Amorz | 2.1     | 2.1     | 2.1     | 2.1     |
| Op Income   | 14.9    | 18.9    | 25.8    | 27.1    |
| Interest    | 0.1     | 0.1     | 0.1     | 0.4     |
| Other Inc.  | 1.4     | 0.5     | 0.4     | -0.3    |
| PBT         | 14.8    | 18.8    | 25.6    | 26.7    |
| Tax         | 4.3     | 5.4     | 7.4     | 11.0    |
| MI & EO     | 1.0     | 0.0     | 0.1     | 0.0     |
| PAT         | 10.5    | 13.4    | 18.2    | 15.7    |
| EPS (Rs.)   | 18.3    | 23.3    | 31.7    | 27.3    |

| Performance Ratio | FY09A | FY10A | FY11A | FY12E |
|-------------------|-------|-------|-------|-------|
| EBITDA margin (%) | 31.3% | 27.6% | 51.3% | 48.2% |
| EBIT margin (%)   | 25.3% | 20.8% | 46.7% | 43.2% |
| PAT margin (%)    | 15.3% | 13.3% | 31.9% | 28.6% |
| ROE (%)           | 29.9% | 20.6% | 44.9% | 35.5% |

| Valuation Ratio    | FY09A | FY10A | FY11A | FY12E |
|--------------------|-------|-------|-------|-------|
| Price Earnings (x) | 15.6  | 19.9  | 5.6   | 4.9   |
| Price/BV (x)       | 4.7   | 4.1   | 2.5   | 1.7   |

| Balance Sheet (Rs Cr)    | FY09A       | FY10A       | FY11A        | FY12E        |
|--------------------------|-------------|-------------|--------------|--------------|
| Share Capital            | 5.8         | 5.8         | 5.8          | 5.8          |
| Reserves & Surplus       | 63.4        | 72.9        | 123.0        | 180.4        |
| Minority                 | 0.0         | 0.0         | 0.0          | 0.0          |
| Eq app money             | 0.0         | 0.0         | 0.0          | 0.0          |
| Net Worth                | 69.2        | 78.7        | 128.7        | 186.1        |
| Total Loans              | 16.5        | 1.5         | 8.9          | 13.5         |
| <b>Total Liabilities</b> | <b>85.7</b> | <b>80.1</b> | <b>137.6</b> | <b>199.6</b> |
| Net Fixed Assets         | 87.1        | 82.1        | 102.8        | 147.0        |
| Capital WIP              | 1.1         | 2.1         | 0.0          | 0.0          |
| Investments              | 1.3         | 1.3         | 21.8         | 32.8         |
| Cash & Bank              | 0.2         | 0.9         | 1.0          | 1.5          |
| Debtors & Other CA       | 29.1        | 30.5        | 61.1         | 80.0         |
| CA                       | 29.2        | 31.4        | 62.1         | 81.5         |
| CL & P                   | 33.0        | 36.8        | 49.0         | 61.1         |
| Net CA                   | -3.8        | -5.4        | 13.1         | 20.4         |
| <b>Total Assets</b>      | <b>85.7</b> | <b>80.1</b> | <b>137.6</b> | <b>200.2</b> |

| Cash Flow (Rs. Cr)    | FY09A | FY10A | FY11E | FY12E |
|-----------------------|-------|-------|-------|-------|
| Operating Cash Flow   | 31.2  | 24.1  | 85.9  | 98.5  |
| Adjustments           | 11.1  | 8.8   | 9.1   | 12.5  |
| Change in WC          | -1.4  | 3.3   | 18.5  | 7.3   |
| Tax                   | -10.5 | -8.4  | -28.1 | -32.5 |
| CF from Operation     | 30.3  | 27.8  | 85.5  | 85.8  |
| Investing Activities  |       |       |       |       |
| Capex                 | -3.9  | -4.1  | -20.7 | -44.2 |
| Oth Inc & Investments | 0.2   | 0.1   | -20.5 | -11.0 |
| CF from Investing     | -3.7  | -4.0  | -41.2 | -55.2 |
| Financing             |       |       |       |       |
| Dividend paid         | -5.4  | -5.8  | -6.9  | -8.6  |
| Share Capital         | 0.0   | 0.0   | 0.0   | 0.0   |
| Loans & Others        | -21.0 | 23.2  | -37.3 | -22.5 |
| CF from Financing     | -26.4 | -17.5 | -44.2 | -31.1 |
| Net Chg. in Cash      | 0.0   | 6.3   | -0.1  | -0.5  |
| Cash at beginning     | 0.2   | 0.2   | 0.9   | 1.0   |
| Cash at end           | 0.2   | 0.9   | 1.0   | 1.5   |

| Per Share Data     | FY09A | FY10A | FY11A | FY12E |
|--------------------|-------|-------|-------|-------|
| Adj EPS            | 36.0  | 28.2  | 100.6 | 114.8 |
| BV per share       | 120.3 | 136.8 | 223.9 | 323.7 |
| Dividend per share | 10.0  | 10.0  | 12.0  | 15.0  |

Note

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