

SINCE 1986

DALAL STREET
INVESTMENT JOURNAL
DEMOCRATIZING WEALTH CREATION



The Trick Is To **Spot Them** At The **Larval Stage**

TINY
TREASURE

March 2017

BSE Code : 532626

Time Duration : 1 year

CMP : ₹375 (as on 23 March, 2017)

Target Price : ₹502

Pondy Oxides & Chemicals

LEAD THE LEAD

The Tiny Treasure for the month of March is Pondy Oxides and Chemicals Ltd (POCL), a leading secondary lead smelter. The company produces lead, lead alloys and PVC additives which have applications in battery, chemical industry and PVC extruded and moulded products. We recommend a BUY on this stock on the basis of its strong financial performance, expansion into new geographies and improving operational efficiencies. We expect the stock to continue its strong growth with stability in lead prices and to reach target price of Rs.502.

Improving operational performance: We see that in FY16 the company improved its ROA from 5.4 in FY15 to 7.6 in FY16. During the same period, ROCE improved to 22.2x as against 16.5x in FY15. This was primarily led by growth in sales by 24% YoY in FY16. The company has inventory of about 30 days, while the debtors' days are 24.

Automotive segment growth : Growth in automotive segment will directly impact the need for lead and lead alloys. Automotive industry is seeing growth due to 'Make in India' initiative which will help India to become an automobile exporter. Also, we see that there is huge demand for replacement of batteries as the battery life is usually 3-5 years depending on the usage.

In industrial applications, we expect demand to be robust from telecom and railways segments which are seeing growth in sale of handsets and AC coaches, respectively.

Expansion in new geographies : The company exports nearly 50% of its output. It exports a substantial portion to Asia including South Korea, Japan, Indonesia and to the Middle-East. To find new opportunities for growth, it has forayed into geographies of the USA, Thailand and Europe.

Capacity expansion: POCL had invested in FY16 in new smelter in Andhra Pradesh. The company is again expanding its capacity in lead and lead alloys and looking at adding a smelter in South India. We see that the company's fixed assets have increased.

Since the company has not provided balance sheet for the last quarterly results, we will be able to see the addition during the FY17 results.

Hedging the lead prices and building operational efficiencies: The company's major raw material is lead. Due to this, it has set up a hedging desk with a broker in London to manage the risk associated with fluctuations in metal prices. It has been focusing on the growth in revenue and at the same time looking to improve operational efficiencies by improving technical know-how.

Industry overview : Lead acid battery largely caters to automotive and industrial segments. In India, automotive segment constitutes 60% of the total acid battery market in India. This demand emanates from OEMs as well as replacement market. As per IBEF, sales of passenger vehicles, commercial vehicles and two-wheelers grew 9.17 per cent, 3.03 per cent and 8.29 per cent, respectively, during the period April-January 2017. The growth in passenger vehicle is expected to continue at the same momentum. The commercial vehicle sale is expected to pick on the base of replacement demand as the government plans to replace fleet older than year 2005.

Industrial demand emanates from applications as power source in telecom, railways and motive power. With India moving towards digitalisation, there is higher demand for mobiles and laptops and hence there is demand for batteries.

Financial performance : The company's smelter division witnessed 20% increase in revenue from Rs.362.3cr to Rs.433.9cr. Profit before tax (PBT) for the year was Rs.16cr against Rs.9.7cr for the previous year. Profit after tax (PAT) for the year increased by 21% YoY to Rs.10.1cr against Rs.6.7cr for the previous year. Profit after tax has registered an impressive growth of 51%. The company's D/E stands at 2.0x which we think is reasonable considering that the company recently undertook expansion in capacity. The interest coverage ratio of 3.1x provides it room to service interest.

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Valuation : The company's stock is currently trading at TTM P/E of 10.7x while it has grown revenue and net profit at a CAGR of 10% and 68.4% respectively over last three years. However, the growth in the last 12 months has been exceptional. Its return on equity (ROE) improved to 28.2% on TTM basis. We see a substan-

tial upside from this level if the company continues its growth supported by favourable economic tailwinds.

We urge investors to invest in four tranches and **BUY** on dips. We expect the share price to reach the target price of Rs.502 over a period of one year.

Inc/Exp Statement(Standalone) (Rs in Crore)

Description	201603	201503	201403	201303	201203
Net Sales	464.67	372.96	448.24	342.43	304.45
Total Income	465.76	375.03	449.60	346.18	305.89
Total Expenditure	438.50	356.06	434.93	332.94	293.66
PBIDT	27.25	18.97	14.67	13.24	12.24
PAT	10.13	6.71	2.81	2.76	2.88
Dividend %	20.00	20.00	10.00	10.00	10.00
Adj. EPS(Rs)	18.16	12.03	2.52	2.48	2.58

Quarter On Quarter (Standalone) (Rs in Crore)

Particulars	201612	201609	Q on Q Var%	201512	Y on Y Var%
Net Sales	222.59	186.22	19.53	107.81	106.46
Total Expenditure	209.42	174.39	20.08	102.22	104.87
PBIDT (Excl OI)	13.17	11.91	10.62	5.78	128.00
PAT	7.12	6.93	2.73	2.12	236.50
PBIDTM% (Excl OI)	5.52	5.89	-6.28	4.91	12.42
PBIDTM%	6.21	6.11	1.64	5.11	21.53
PATM%	2.99	3.43	-12.83	1.80	66.11
Adj. EPS(Rs)	12.76	12.42	2.74	3.79	236.68

