

08 November 2019

## GMM Pfaudler

*Strong prospects, surging profitability; maintaining a Buy*

Rating: **Buy**

Target Price: ₹1,845

Share Price: ₹1,450

Its stellar execution capability and ~45% y/y order-book growth assures us of GMM's strong FY20 revenue growth. With higher realisations, greater operating leverage and more export orders in Q2 FY20, margins expanded ~340bps to 19.6%. We expect realisations holding at current levels, lower commodity prices and savings in power (from the new gas furnace) would sustain the high margins. The debt-free status, healthy operating cash-flow, with strong prospects and profitability would lead us to retain our Buy rating at a higher target of ₹1,849, 25x FY21e EPS.

**Strong visibility.** With capacity addition in specialty chemicals and agro in full swing, demand for Pfaudler equipment will surge. The current OB offers revenue assurance for FY20. Though there are issues regarding environmental clearances for greenfield projects of specialty and agro chemicals, the major source of GMM's demand comes from companies' brownfield expansions. With pharma picking up in southern regions like Hyderabad, traction for GLE will be good. User industries such as pharma, specialty chemicals and agro chemicals are expected to clock a 15% CAGR over the next five years.

**Strong non-GLE business.** Its focus on heavy engineering (orders of ₹100m-150m where competition from giants is less) has increased. Also, the proprietary division is likely to see strong growth, since much of its demand stems from the GLE division (complementary demand).

**Better margins.** With more than 90% capacity utilisation, higher operating leverage will help margins expand. The demand-supply imbalance in GLE gives suppliers great bargaining power. Hence, prices have been increased in the last two quarters; management expects this to stabilise at the current high levels. Also, large margin-accretive export orders would improve margins.

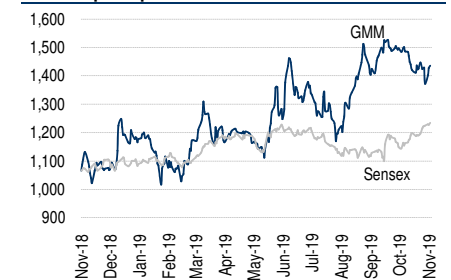
**Valuation.** Due to its sharper focus on diversifying and expanding capacity while keeping balance-sheet fundamentals strong, we retain our Buy. **Risks:** Slowdown in pace of capacity addition; Chinese manufacturers' revival.

Key data	GMM IN/ GMMP.BO
52-week high / low	₹1,560 / 995
Sensex / Nifty	40616 / 11994
3-m average volume	\$0.1m
Market cap	₹21bn / \$301.4m
Shares outstanding	15m

Shareholding pattern (%)	Sep '19	Jun '19	Mar '19
Promoters	75.0	75.0	75.0
- of which, Pledged	-	-	-
Free float	25.0	25.0	25.0
- Foreign institutions	0.3	0.3	0.3
- Domestic institutions	1.7	1.4	1.4
- Public	23.0	23.6	23.6

Estimates revision (%)	FY20e	FY21e
Sales	-3.2	-1.3
EBITDA	7.3	-0.9
Adj. PAT	12.5	4.5

### Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY17	FY18	FY19	FY20e	FY21e
Sales (₹ m)	3,530	4,057	5,026	6,320	8,337
Net profit (₹ m)	333	427	506	801	1,078
EPS (₹)	22.8	29.2	34.6	54.8	73.8
PE (x)	22.9	23.5	41.9	26.5	19.7
EVEBITDA (x)	14.4	14.3	25.9	16.6	12.2
PBV (x)	3.9	4.4	7.9	6.2	4.9
RoE (%)	18.4	20.2	20.4	26.3	27.8
RoCE (%)	24.0	26.1	27.9	34.0	35.3
Dividend yield (%)	0.6	0.6	0.3	0.4	0.4
Net debt/equity (x)	-0.4	-0.5	-0.5	-0.6	-0.6

Source: Company, Anand Rathi Research

Riya Mehta  
Research Analyst

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## Quick Glance – Financials and Valuations (consolidated)

**Fig 1 – Income statement (₹ m)**

Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
GLE sales	1,954	2,186	2,850	3,600	4,800
Net revenues	3,530	4,057	5,026	6,320	8,337
Growth (%)	20.9	14.9	23.9	25.7	31.9
Material cost	1,493	1,685	2,329	2,591	3,585
Employee & Other expense	1,560	1,751	1,928	2,568	3,213
<b>EBITDA</b>	<b>477</b>	<b>621</b>	<b>770</b>	<b>1,161</b>	<b>1,539</b>
EBITDA margins (%)	13.5	15.3	15.3	18.4	18.5
- Depreciation	82	98	110	128	158
Other income	82	94	85	75	88
Interest expenses	9	10	12	12	12
PBT	469	607	733	1,097	1,457
Effective tax rate (%)	29.0	29.6	31.0	27.0	26.0
+ Associates / (Minorities)	-	-	-	-	-
Net income	333	427	506	801	1,078
Adjusted income	333	427	506	801	1,078
WANS	15	14.62	15	15	15
FDEPS (₹ / sh)	22.8	29.2	34.6	54.8	73.8
EPS growth (%)	65.4	28.3	18.5	58.3	34.6

**Fig 3 – Cash-flow statement (₹ m)**

Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
PBT	469	607	733	1,097	1,457
+ Non-cash items	9	14	37	64	82
Oper. prof. before WC	477	621	770	1,161	1,539
- Incr. / (decr.) in WC	-121	222	-284	191	-143
Others incl. taxes	-131	-166	-215	-289	-371
Operating cash-flow	225	677	270	1,062	1,025
- Capex (tang. + intang.)	-144	-239	-159	-339	-398
Free cash-flow	80	438	111	724	627
Acquisitions	-	-	-	-	-
- Div. (incl. buyback & taxes)	53	70	79	97	114
+ Equity raised	-	-	-	-	-
+ Debt raised	-	-	-	-	-
- Fin investments	309	59	-29	-	-
- Misc. (CFI + CFF)	-61	-43	-28	-54	-62
Net cash-flow	-220	352	90	681	575

Source: Company, Anand Rathi Research

**Fig 5 – Price movement**


Source: Bloomberg

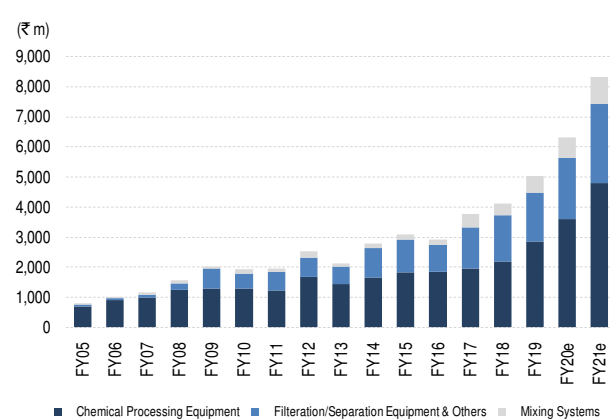
**Fig 2 – Balance sheet (₹ m)**

Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
Share capital	29	29	29	29	29
Net worth	1,948	2,278	2,689	3,393	4,357
Debt	-	-	-	-	-
Minority interest	-	-	-	-	-
DTL / (Assets)	23	45	45	52	60
<b>Capital employed</b>	<b>1,972</b>	<b>2,323</b>	<b>2,735</b>	<b>3,445</b>	<b>4,417</b>
Net tangible assets	612	627	598	798	1,048
Net intangible assets	-	121	178	178	178
Goodwill	-	-	-	-	-
CWIP (tang. & intang.)	20	28	49	60	50
Investments (strategic)	6	9	5	5	5
Investments (financial)	440	497	472	472	472
Current assets (ex cash)	2,335	1,971	2,275	2,836	3,740
Cash	316	668	758	1,439	2,014
Current liabilities	1,759	1,598	1,601	2,343	3,091
Working capital	577	373	675	493	650
<b>Capital deployed</b>	<b>1,972</b>	<b>2,323</b>	<b>2,735</b>	<b>3,445</b>	<b>4,417</b>
Contingent liabilities	384	452	634	-	-

**Fig 4 – Ratio analysis**

Year-end: Mar	FY17	FY18	FY19	FY20e	FY20e
P/E (x)	22.9	23.5	41.9	26.5	19.7
EV / EBITDA (x)	14.4	14.3	25.9	16.6	12.2
EV / Sales (x)	1.9	2.2	4.0	3.1	2.2
P/B (x)	3.9	4.4	7.9	6.2	4.9
RoE (%)	18.4	20.2	20.4	26.3	27.8
RoCE (%) - after tax	24.0	26.1	27.9	34.0	35.3
RoIC (%) - after tax	26.6	31.2	35.1	47.9	55.6
DPS (₹ / sh)	3.0	4.0	4.5	5.5	6.5
Dividend yield (%)	0.6	0.6	0.3	0.4	0.4
Dividend payout (%) –incl. DDT	15.9	16.5	15.7	12.1	10.6
Net debt / equity (x)	-0.4	-0.5	-0.5	-0.6	-0.6
Receivables (days)	72	45	49	49	49
Inventory (days)	85	86	84	84	84
Payables (days)	65	65	55	57	57
CFO : PAT %	67.6	158.6	53.5	132.7	95.1

Source: Company, Anand Rathi Research

**Fig 6 – Segment-wise revenue break-up**


Source: Company

## Result Highlights

**Fig 7 – Segment-wise results**

₹ m	Q4 FY17	Q1 FY18	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	%Y/Y
<b>Revenue</b>												
Glass-lined equipment	490	529	535	481	640	659	670	757	762	963	839	25.2
Heavy engineering	243	94	92	85	99	104	136	98	214	62	202	48.0
Proprietary products	134	118	136	226	139	168	184	200	230	276	318	73.0
<b>EBIT</b>												
Glass-lined equipment	87	81	116	95	137	131	120	140	165	187	188	56.6
Heavy engineering	39	8	9	8	15	23	23	14	5	2	24	5.1
Proprietary products	10	6	6	20	15	12	22	23	22	40	56	154.2
<b>EBIT margins %</b>												
Glass-lined equipment	17.7	15.3	21.6	19.8	21.4	19.9	17.9	18.4	21.6	19.5		
Heavy engineering	15.9	8.3	9.9	9.7	15.2	22.1	16.9	13.7	2.1	2.8		
Proprietary products	7.6	5.0	4.5	8.8	10.4	6.9	12.0	11.2	9.4	14.4		

Source: Company

**Fig 8 – Quarterly trend (standalone)**

₹ m	Q1 FY18	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	%Y/Y
Revenue	689	764	792	879	932	992	1056	1207	1,303	1,361	37.2
EBIDTA	79	116	123	144	153	161	172	170	239	267	65.9
EBIDTA margins %	11.4	15.2	15.5	16.4	16.4	16.2	16.3	14.1	18.4	19.6	
Depreciation	20	20	21	22	25	26	28	24	41	49	85.5
Other income	29	13	9	21	13	19	21	20	12	7.2	-61.3
PBT	83	107	109	140	139	150	162	162	205	215	43.4
Tax rate	28	37	35	56	48	52	53	54	58	35	-33.3
PAT	56	70	74	84	91	98	110	108	147	180	83.8

Source: Company

## Concall Highlights

### General information

- At end-Q2 FY20, GMM's order book had grown 40-45% y/y, offering revenue assurance for FY20. It is equally split between GLE, filtration/mixing equipment and heavy engineering. Management is now focusing on building a backlog for FY21.

### Glass-lined equipment

- The company has a more than 60% market share in glass-lined equipment (GLE).
- It has lowered its guidance for equivalent units (EU, from 3,000 to 2,400) on account of changes in their composition (larger and higher value). Average realisation per EU is ₹1.5m.
- Till H1 FY20 the company had achieved 1,000 EU (900 a year ago). Q2 is usually a weak quarter for the GLE business due to the monsoon, since greater care has to be taken to maintain moisture content.
- In GLE, spare parts and services brought ₹150m-200m to revenue. Besides, they fetch higher margins. Exports formed 12% of revenue.
- Because of mounting demand and more orders, management will keep both furnaces (electric and gas) operational.
- User industries of glass-lined equipment (agriculture, specialty chemicals) are likely to record a ~15% CAGR.
- Pharma is seeing a pick-up in the south, mainly Hyderabad and Vishakhapatnam (brown-field expansions of Aurobindo, Hetro, Divis, etc.).
- 70% of overall demand is fresh demand; 30%, replacement demand.

### Mavag

- No significant demand improvement would be seen as Europe's economy has slowed down.
- However, some improvement (single digit) in profitability can be seen.

### Non-GLE business

- In the proprietary business, production capacity has been increased. Fresh prospects in the niche sub-segment of acid recovery have arisen. Current capacity is enough to generate ₹750m-1,000m. Growth in this segment is a shadowed demand from the GLE business. For every 3-4 reactors, one D-F-S is used.
- In heavy engineering, despite the loss of orders in Q1, orders in the next few quarters look good (more inquiries and the pipeline in the industry). Also, orders to be executed in Q1 FY21 have been received. Keen competition arises from domestic and international operators such as L&T. Yet, GMM (having equivalent credentials and quality), is gaining market share, since it is taking up smaller orders (of ₹100m-150m). Huge prospects are seen in this segment, which is expected to enjoy 12% margins.

**Other points**

- On the subdued performance of its debt-mutual-funds investments, other income was lower. WC is expected to be intact.
- Carbon steel prices have decreased. Peak margins: 22%

## Valuation

Being the leader, with a commanding 60% market share, GMM Pfaudler will be a major beneficiary as vast prospects in agro and specialty chemicals are opening up. Its diversification into heavy engineering and drying and mixing would add to its revenue.

Its strong fundamentals are substantiated by its record of positive operating cash-flows, even in economic crises. On its robust revenue prospects, expanding margins and continuing sturdy balance sheet, we maintain a Buy, at a higher target price of ₹1,849, at 25x FY21 earnings.

### Change in estimates

Due to the change in management guidance in terms of EU, revenue has been fine-tuned accordingly. Also, with the higher realisations, lower raw material costs, greater operating leverage and more export orders in pipeline, we revise our operational profit expectation for FY20 by 7%. Also, the shift to the new tax regime would lead to our FY20e and FY21e EPS rising respectively 13% and 5%.

**Fig 9 – Change in estimates**

(₹ m)	Old		Revised		% Change	
	FY20e	FY21e	FY20e	FY21e	FY20e	FY21e
Revenue	6,532	8,445	6,320	8,337	-3.2	-1.3
EBITDA	1,082	1,553	1,161	1,539	7.3	-0.9
EPS (₹)	48.7	70.6	54.8	73.8	12.5	4.5

Source: Anand Rathi Research

**Fig 10 – One-year-forward PER**



Source: Anand Rathi Research

### Risks

- Slowdown in pace of capacity addition.
- Revival of Chinese manufacturers.

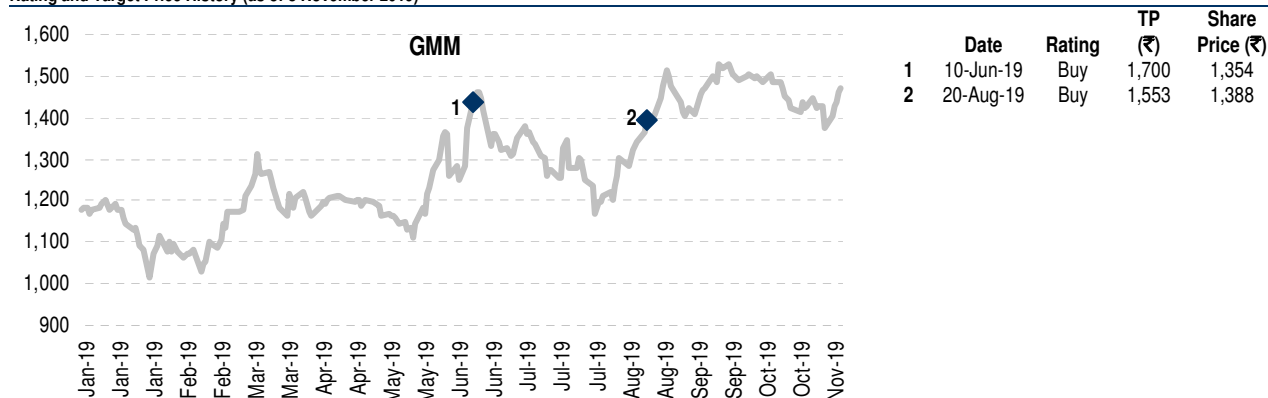
## Appendix

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