

GALAXY SURFACTANTS

Margins getting healthier

India Equity Research | Midcap Chemicals



We believe the 4% YoY drop in Q4FY20 revenue reported by Galaxy Surfactants (GSL) is mainly due to lower realisation coupled with business challenges posed by Covid-19. EBITDA margin expansion by 160bps YoY to 15.6% (highest ever) driven by a better product mix protected bottom line, thereby beating our estimates. As Egypt is back on track (22% YoY growth in FY20), we see that GSL's hygiene-products-heavy business model would gradually gain due to the circumstances set in motion by Covid-19. Risks related to supply-side challenges and down-trading cannot be ruled out though. We remain bullish on GSL's FMCG-linked business model given the strong structural growth opportunity. Maintain 'BUY' with a target price of INR1,628 based on 22x FY22E EPS.

Margins get a boost; revenue dips

Revenue dipped (4% YoY) led by a sharp fall in raw material prices (fatty alcohol prices down by ~12%) leading to 10% YoY drop in performance surfactant. Volume growth was also muted at 3% YoY due to impact of Covid-19 in the last week of the quarter. Specialty chemicals revenue, however, grew by 5% YoY with growth in average realisation. Despite the fall in overall revenue, a healthy product mix led to improvement in EBITDA/MT by 6% to INR17,636/mt and EBITDA margins improved by 160bps YoY to 15.6%, the highest in the company's history.

Egypt recovers strongly, Covid-19 fails to hold together India sales

In FY20, Egypt reported strong growth of 22% YoY as MNCs recouped their lost market share in the region. However, the lockdown in India with effect from 25th March dislocated the business, affected sales. The company, thus, reported flat growth for FY20. ROW markets in FY20 reported growth of 3% YoY.

Outlook and valuation: Resilient under Covid-19; maintain 'BUY'

We believe GSL's FMCG-led business model with exposure to hygiene stands to gain from the structural push for health in a post-Covid-19 world. Sustainable margin expansion driven by speciality chemicals will further drive margin expansion. We maintain 'BUY' with a target price of INR1,628 based on 22x FY22E EPS.

EDELWEISS RATINGS

Absolute Rating BUY

Investment Characteristics Growth

MARKET DATA (R: GALX NS, B: GALSURF IN)

CMP	: INR 1479
Target Price	: INR 1628
52-week range (INR)	: 1,781 / 975
Share in issue (mn)	: 35.5
M cap (INR bn/USD mn)	: 51 / 0
Avg. Daily Vol. BSE/NSE ('000)	: 19.3

SHARE HOLDING PATTERN (%)

	Current	Q3FY20	Q2FY20
Promoters *	70.9	70.9	70.9
MF's, FI's & BKs	13.6	13.2	12.8
FII's	3.3	3.2	3.0
Others	12.2	12.6	13.2
* Promoters pledged shares (% of share in issue)	:		NIL

PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	(2.0)	(6.1)	(4.0)
3 months	(24.4)	(17.6)	6.8
12 months	(24.6)	24.4	49.0

Financials (Consolidated)

(INR mn)

Year to March	Q4FY20	Q4FY19	% change	Q3FY20	% change	FY20	FY21E	FY22E
Net rev. (INR mn)	6,566	6,820	(3.7)	6,259	4.9	25,964	27,944	30,778
EBITDA (INR mn)	1,025	953	7.6	821	24.8	3,689	3,805	4,448
Adj. PAT (INR mn)	627	571	9.8	480	30.7	2,304	2,199	2,624
Adj. Dil. EPS (INR)	17.7	16.1	9.9	13.5	30.8	65.0	62.0	74.0
Diluted P/E (x)						22.8	23.8	20.0
EV/EBITDA (x)						14.9	13.8	11.5
ROAE (%)						23.7	19.0	19.4

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Q4FY20 conference call: Key highlights

COVID-19

- Galaxy's products are part of essentials and thus there will still be the need of the hour.
- These are not easy times as the company is facing unavailability of labour, transportation, etc., but management expects normalcy to return sooner than later.
- The lockdown in March completely wiped out sales in last week of March; however, major impact will be visible in Q1FY21
- The company expects down trading in certain categories as there is likely to be cut in spending on premium products which may impact performance of specialty surfactants going ahead while sales of performance surfactants is likely to remain stable.
- Further, the company expects normalcy to return in the next three-six months.

Raw material prices

- Input costs have softened – both petrochemicals and oleo chemicals.
- Prices of oleochemicals depend on yields and demand and supply scenario; however, are likely to remain stable for the next three months.

Trends

- The company supplies to most players making hand washes in India and has also seen increase in stocking.
- Sanitizer involves 70% alcohol and thus the company is not catering to that segment.
- Customers are washing surfaces, hands, clothes, multiple times leading to higher demand for its products.
- Hygiene consciousness has increased, but the company is unable to highlight any structural changes as of now.
- New categories such as veggie wash, etc., are also emerging post COVID-19.

Egypt

- Egypt saw 22% growth in FY20 driving growth of performance surfactants division and market in Egypt has come back to previous level with 62% market share being held by MNCs with top players market share at original level.
- AMET saw 9% growth during the year led by strong growth in Egypt.
- Growth rate of home care in Egypt has been 13.8%.
- The company has not seen shutdowns in Egypt and thus momentum of Q4 is likely to continue in Q1FY21 as well. Other countries in AMET had seen negative impact of COVID-19 on performance in Q4FY20.

Indian operations

- April sales was severely impacted as the company had hardly worked on number of days as lockdown was all of a sudden and the company had to wait for all permissions to restart operations.
- In June, the company operated at much better utilization.

Volume growth region wise in FY20

- Africa – 9%
- India – flat
- Row – 3%

New products/Geography/customers

- Products made and sold outside India and India's exports are 65% of sales.
- Exports from India is 50-55% of sales and has been trending upwards for the company.
- The company is trying to grow business with its customers in other geographies also.
- It would like to increase share with existing customers and work with them for entire product portfolios.
- New products – must have contributed 5-6% of total turnover.
- New customers – less than 5% of total sales in FY20.

Ind-AS

- Depreciation is higher is on account of Ind-As accounting.

Gross margin

- Gross margin was led by lower raw material cost and as the company was able to take price advantage in both specialty and performance surfactants business
- Although specialty had only 2% volume growth, pricing was in favour of the company.
- If demand remains robust, the company will be able to maintain margin at current level

Tarapur

- Tarapur incident will impact Q1FY21 results as the plant contributes 8-10% of turnover and makes majority of the specialty surfactants products
- The plant is fully covered for insurance

Specialty surfactants

- The company expects down trading in certain categories which may impact sales of specialty products. However, the impact is going to be only short term as people will return to normalcy sooner than later
- On the other hand, specialty surfactants should find good usage in mild hand washes.
- The company's aim is to grow both Specialty and performance surfactants division wherein share of its Specialty division can increase from 30-32% to 40%

Tier 3 players

- The company's focus in this segment continues to be high
- Tier 3 segment has seen more impact because of lockdown not only in India but also anywhere else

Capex

- FY20 capex stood at INR2.3bn of which INR800mn was for land acquisition at Jagadia for future use. Although the company has got the land, it will take 18 months to get all approvals in place
- The company expects to spend INR1bn per year for FY21 and FY22 with investments both in performance and specialty surfactants
- In case of performance surfactants the company invests from 3-5 years perspective whereas for specialty surfactants the company invests from 7-8 years perspective
- Innovation is a continuous process and last year the company added two new products in the market
- In terms of space utilisation, the Taloja plant is full, while the company is doing some amount of capex at its Tarapur and there is scope for some expansion at Jagadia plant as well
- Capacity utilization FY20 stood at 61%. As soon as it starts trending towards full utilization, the company is ready with new capex

Market share

- We company became market leaders in domestic market in 1986 and since then holds significant market share in domestic market. In certain product, the company holds good market share globally too

Financial snapshot

(INR mn)

Year to March	Q4FY20	Q4FY19	% change	Q3FY20	% change	FY20	FY21E	FY22E
Net revenues	6,566	6,820	(3.7)	6,259	4.9	25,964	27,944	30,778
Raw material	4,178	4,662	(10.4)	4,216	(0.9)	17,153	19,281	21,083
Staff costs	465	438	6.1	432	7.7	1,781	1,923	2,077
Other expenses	897	767	17.0	789	13.6	3,341	2,934	3,170
Total expenditure	5,540	5,867	(5.6)	5,438	1.9	22,275	24,139	26,331
EBITDA	1,025	953	7.6	821	24.8	3,689	3,805	4,448
Depreciation	155	129	20.0	164	(5.7)	622	822	897
EBIT	870	824	5.7	657	32.5	3,067	2,983	3,550
Interest	56	79	(29.2)	58	(4.8)	238	151	151
Other income	-	35	(99.7)	34	(99.7)	59	100	100
Add: Prior period items								
Profit before tax	815	780	4.5	632	28.9	2,888	2,932	3,499
Provision for taxes	188	209	(10.1)	152	23.2	584	733	875
Reported net profit	627	571	9.8	480	30.7	2,304	2,199	2,624
Adjusted Profit	627	571	9.8	480	30.7	2,304	2,199	2,624
Adjusted Diluted EPS	17.7	16.1	9.9	13.5	30.8	65.0	62.0	74.0
Raw material	63.6	68.4		67.4		66.1	69.0	68.5
Employee cost	7.1	6.4		6.9		6.9	6.9	6.7
Other expenses	13.7	11.2		12.6		12.9	10.5	10.3
EBITDA	15.6	14.0		13.1		14.2	13.6	14.5
Reported net profit	9.5	8.4		7.7		8.9	7.9	8.5

Company Description

Galaxy Surfactants (GSL) is India's leading manufacturer of surfactants and other specialty ingredients for home & personal care (HPC). The company's products find application in a host of consumer-centric personal & home care products including skin care, oral care, hair care, cosmetic, toiletries and detergents. Since incorporation in 1986, GSL has expanded and diversified its product portfolio, client base and geographical footprint. The company's customers include some of the leading MNC, regional and local players in home & personal care industries. GSL's product portfolio comprises over 200 product grades, which are marketed to more than 1,750 customers in over 75 countries. Its products are organised in the following two groups:

- Performance surfactants
- Specialty care products

Investment Theme

Galaxy Surfactants (GSL) is India's leading manufacturer of surfactants and other specialty ingredients for home & personal care (HPC). We believe: 1) a 200 plus product portfolio in fast-growing oleochemicals; 2) diversified geographical footprint & clientele including MNCs and regional players (creating strong entry barriers); and 3) leading presence in high growth potential markets of India & Africa, Middle East and Turkey (AMET), place GSL ideally to benefit from structural growth opportunity. Moreover, we envisage healthy return ratios (ROCE of 25% plus) coupled with robust earnings growth (13% CAGR over FY19-21E) to keep the valuation multiple high.

Key Risks

- Absence of long-term raw material supply contracts
- Significant dependence on top customers
- Over dependence on single supplier
- Foreign currency fluctuation
- Discontinuation of export promotion scheme

Financial Statements

Key Assumptions

Year to March	FY19	FY20	FY21E	FY22E
Macro				
GDP(Y-o-Y %)	6.1	4.8	(4.0)	7.0
Inflation (Avg)	3.4	4.3	3.5	4.0
Repo rate (exit rate)	6.3	4.4	3.0	4.0
USD/INR (Avg)	70.0	70.7	75.0	73.0
Company				
Total sales volume (tonnes)	214,711.0	224,237.0	241,368.8	265,815.7
Total volume growth (%)	8.8	4.4	7.6	10.1
Performance volume (tonnes)	135,337.0	143,521.0	155,002.7	170,813.0
Performance volume growth (%)	3.6	6.0	8.0	10.2
Specialty volume (tonnes)	79,374.0	80,716.0	86,366.1	95,002.7
Specialty volume growth (%)	18.8	1.7	7.0	10.0
Gross margins (%)	29.5	33.9	31.0	31.5
Employee (% of net rev)	6.0	6.9	6.9	6.7
Other expenses as (% of net rev)	10.7	12.9	10.5	10.3
Depreciation (% of Avg GFA)	5.1	4.8	6.1	6.2
Int (% of avg G.debt)	11.0	8.3	10.0	10.0
Tax rate as % of PBT	31.0	20.2	25.0	25.0

Income statement

(INR mn)

Year to March	FY19	FY20	FY21E	FY22E
Net revenue	27,630	25,964	27,944	30,778
Materials costs	19,481	17,153	19,281	21,083
Employee costs	1,646	1,781	1,923	2,077
Other Expenses	2,969	3,341	2,934	3,170
Total operating expenses	24,096	22,275	24,139	26,331
EBITDA	3,534	3,689	3,805	4,448
Depreciation	512	622	822	897
EBIT	3,022	3,067	2,983	3,550
Less: Interest Expense	300	238	151	151
Add: Other income	46.8	59.2	100.00	100.00
Profit Before Tax	2,769	2,888	2,932	3,499
Less: Provision for Tax	859	584	733	875
Reported Profit	1,910	2,304	2,199	2,624
Adjusted Profit	1,910	2,304	2,199	2,624
Shares o/s (mn)	35	35	35	35
Adjusted Basic EPS	53.9	65.0	62.0	74.0
Diluted shares o/s (mn)	35	35	35	35
Adjusted Diluted EPS	53.9	65.0	62.0	74.0
Adjusted Cash EPS	68.3	82.5	85.2	99.3
Dividend per share (DPS)	14.5	11.7	11.2	13.4
Dividend Payout Ratio(%)	0.3	0.2	0.2	0.2

Common size metrics

Year to March	FY19	FY20	FY21E	FY22E
Materials costs	70.5	66.1	69.0	68.5
Staff costs	6.0	6.9	6.9	6.7
S G & A expenses	10.7	12.9	10.5	10.3
Depreciation	1.9	2.4	2.9	2.9
Interest Expense	1.1	0.9	0.5	0.5
EBITDA margins	12.8	14.2	13.6	14.5
Net Profit margins	6.9	8.9	7.9	8.5

Growth ratios (%)

Year to March	FY19	FY20	FY21E	FY22E
Revenues	13.5	(6.0)	7.6	10.1
EBITDA	22.8	4.4	3.1	16.9
PBT	26.5	4.3	1.5	19.3
Adj. net profit	20.9	20.6	(4.6)	19.3
EPS	20.9	20.6	(4.6)	19.3

Balance sheet		(INR mn)			
As on 31st March	FY19	FY20	FY21E	FY22E	
Share capital	355	355	355	355	
Reserves & Surplus	8,413	10,323	12,125	14,275	
Shareholders' funds	8,767	10,678	12,479	14,629	
Long term borrowings	892	1,166	1,166	1,166	
Short term borrowings	1,640	2,030	2,030	2,030	
Total Borrowings	2,532	3,196	3,196	3,196	
Long Term Liabilities	110	342	342	342	
Deferred tax (net)	321	241	242	241	
Sources of funds	11,730	14,457	16,260	18,409	
Gross Block	10,068	12,974	13,974	14,974	
Net Block	5,112	7,396	7,574	7,677	
Capital work in progress	826	660	-	-	
Intangible Assets	75	82	82	82	
Total Fixed Assets	6,013	8,138	7,656	7,759	
Cash and Equivalents	257	545	3,003	4,574	
Inventories	3,513	3,250	3,698	4,043	
Sundry Debtors	4,268	4,394	4,211	4,638	
Loans & Advances	37	4	4	4	
Other Current Assets	1,592	1,788	1,788	1,788	
Current Assets (ex cash)	9,410	9,436	9,700	10,473	
Trade payable	3,059	2,731	3,170	3,466	
Other Current Liab	892	931	931	931	
Total Current Liab	3,950	3,663	4,101	4,397	
Net Curr Assets-ex cash	5,460	5,774	5,601	6,076	
Uses of funds	11,730	14,457	16,260	18,409	
BVPS (INR)	247.3	301.2	352.0	412.7	

Free cash flow		(INR mn)			
Year to March	FY19	FY20	FY21E	FY22E	
Reported Profit	1,910	2,304	2,199	2,624	
Add: Depreciation	512	622	822	897	
Interest (Net of Tax)	207	190	113	113	
Others	72	350	38	38	
Less: Changes in WC	(129)	304	(174)	476	
Operating cash flow	2,829	3,162	3,346	3,196	
Less: Capex	1,689	1,416	340	1,000	
Free Cash Flow	1,140	1,746	3,006	2,196	

Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		EV / EBITDA (X)		EV / Sales (X)	
		CY20E	CY21E	CY20E	CY21E	CY20E	CY21E
Galaxy Surfactants Ltd	694.3	22.0	23.1	14.5	13.4	1.8	1.6
Aarti Industries	2133.3	31.2	22.3	17.2	12.7	4.0	3.1
Fine Organic Industries Ltd	767	32.4	25.0	20.3	15.9	4.4	3.6
SRF	2742.6	30.2	22.5	15.2	12.3	3.1	2.7
Median	-	30.7	22.8	16.2	13.0	3.6	2.9
AVERAGE	-	29.0	23.2	16.8	13.6	3.4	2.8

Source: Edelweiss research

Cash flow metrics		FY19	FY20	FY21E	FY22E
Year to March					
Cash flow from ops		2,829	3,162	3,346	3,196
Financing cash flow		(1,192)	(1,438)	(548)	(625)
Investing cash flow		(1,673)	(1,511)	(340)	(1,000)
Net cash Flow		(36)	213	2,457	1,571
Capex		(1,689)	(1,416)	(340)	(1,000)
Dividend paid		2	3	3	3

Profitability and efficiency ratios

Year to March	FY19	FY20	FY21E	FY22E
ROAE (%)	23.9	23.7	19.0	19.4
ROACE (%)	28.7	24.8	20.9	21.8
Inventory Days	65	72	66	67
Debtors Days	56	61	56	52
Payable Days	59	62	56	57
Cash Conversion Cycle	62	71	66	62
Current Ratio	2.4	2.7	3.1	3.4
Gross Debt/EBITDA	0.7	0.9	0.8	0.7
Gross Debt/Equity	0.3	0.3	0.3	0.2
Adjusted Debt/Equity	0.3	0.3	0.3	0.2
Net Debt/Equity	0.3	0.2	-	(0.1)
Interest Coverage Ratio	10.1	12.9	19.8	23.5

Operating ratios

Year to March	FY19	FY20	FY21E	FY22E
Total Asset Turnover	2.5	2.0	1.8	1.8
Fixed Asset Turnover	5.7	4.1	3.7	4.0
Equity Turnover	3.5	2.7	2.4	2.3

Valuation parameters

Year to March	FY19	FY20	FY21E	FY22E
Adj. Diluted EPS (INR)	53.9	65.0	62.0	74.0
Y-o-Y growth (%)	20.9	20.6	(4.6)	19.3
Adjusted Cash EPS (INR)	68.3	82.5	85.2	99.3
Diluted P/E (x)	27.5	22.8	23.8	20.0
P/B (x)	6.0	4.9	4.1	3.5
EV / Sales (x)	2.0	2.1	1.9	1.7
EV / EBITDA (x)	15.5	14.9	13.8	11.5
Dividend Yield (%)	1.0	0.8	0.8	0.9

Additional Data

Directors Data

Mr. S Ravindranath	Chairman, Non-Executive Independent Director	Mr. U Shekhar	Managing Director
Mr. K Ganesh Kamath	Executive Director (Finance) & CFO	Mr. K Natarajan	Executive Director & COO
Mr. G Ramakrishnan	Non-Executive Director	Mr. Sudhir Patil	Non-Executive Director
Mr. Nirmal Koshti	Non-Executive Director	Mr. Vaijanath Kulkarni	Non-Executive Director
Mr. Subodh Nadkarni	Non-Executive Independent Director	Mr. M G Parameswaran	Non-Executive Independent Director
Ms. Nandita Gurjar	Non-Executive Independent Director	Mr. Uday K Kamat	Non-Executive Director
Mr. Ravi Venkateswar	Executive Director		

Auditors - Deloitte Haskins & Sells LLP

**as per last available data*

Holding Top -10

	Perc. Holding		Perc. Holding
SBI Mutual Funds	6.80	Reliance Capital Trustee	0.84
Axis Asset Management	3.49	Matthews International	0.40
Abu Dhabi Investment Authority	1.62	Daiwa Asset Management	0.31
ICICI Prudential Life Insurance Co	1.29	Canara Robeco Asset Management	0.21
Kotak Mahindra Asset Management	1.08	ICICI Pru Asset Management	0.14

**as per last available data*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
No Data Available				

**as per last available data*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
No Data Available			

**as per last available data*