

S H Kelkar and Company

IPO Note – Valuation expensive

S H Kelkar & Company Ltd (SHKCL) is the largest fragrance and flavour company in India by revenue, with a market share of approximately 12.0%. The company has four manufacturing facilities, three of which are located in India and one in The Netherlands, with a total installed manufacturing capacity of over 19,819 tonne annually.

Established Market Leadership: The company has established brands like SHK, Cobra and Keva, which enjoy leadership positions in their respective categories and draw substantial brand equity in India. For the year ended December 31, 2013, SHKCL had a market share of 12.0% in the Indian fragrance and flavour (F&F) industry. On bifurcating, the company's market share stood at 20.5% in the fragrance industry and 2.0% in the flavour industry.

Comprehensive Product Offering and Diverse Customer Base: SHKCL has a wide portfolio of offerings with over 9,700 fragrances, ingredients and flavour products and a large library of product formulations created over the past 90 years. The company enjoys a competitive advantage over its peers on the back of its wide product portfolio. It has a deep understanding of its customers' requirements and preferences and has over 4,100 customers, including leading national and multi-national FMCG companies, blenders of fragrances and flavours, and fragrance and flavour producers.

Outlook and Valuation: SHKCL is valued at a P/E multiple of 40.4x its FY2015 EPS. In terms of P/BV, the company is valued at 5.1x its pre-IPO and 3.2x its post-IPO at the upper end of the price band. In our view, the valuation is expensive, considering its low ROE numbers (around 12-13%) and considering that they are expected to continue to remain in the same range. Further, the domestic F&F industry is not a high growth industry, expected to grow at a subtle rate of 9-10% going forward.

The company's global peers Givaudan S.A. and International Flavors & Fragrances Inc trade at 28.1x and 20.1x their CY2014 earnings, respectively. Givaudan S.A. and International Flavors & Fragrances Inc have strong market shares in the global market of ~21% and ~12%, respectively, and deliver higher RoEs. On the other hand, SHKCL has negligible market share at the global level. Thus, SHKCL's valuation looks expensive vis-a-vis these companies.

Hence, **we recommend an "Avoid" on the issue.** Investors having conviction in the long term growth prospects of the company and the emerging consumption story in India, and wanting to enter the stock to tap this perceived opportunity, could consider waiting for a possible correction in the stock price post the listing of the IPO.

Key Financials

Y/E March (₹ cr)	FY2013	FY2014	FY2015E	1QFY16E
Net Sales	666	761	837	222
% chg	16.9	14.3	9.9	-
Net Profit	58	79	64	21
% chg	31.0	46.6	(18.6)	-
OPM (%)	17.7	18.0	14.3	17.3
EPS (₹)	4.1	6.0	4.8	1.6
P/E (x)	44.3	30.2	37.2	-
P/BV (x)	5.0	5.0	4.7	-
RoE (%)	12.3	16.4	12.6	-
EV/Sales (x)	3.7	3.3	3.0	-
EV/EBITDA (x)	20.8	18.5	21.2	-

Source: Company, Angel Research; Note: *EPS and other valuation parameters is based on Pre IPO outstanding shares at upper price band

AVOID

Issue Open: October 28, 2015
 Issue Close: October 30, 2015

Issue Details

Face Value: ₹10

Present Eq. Paid up Capital: ₹133.0cr

Offer Sale: 1.7cr Shares

Post Eq. Paid up Capital: ₹144.6cr

Market Lot: 80 Shares

Fresh Issue (amount): ₹210cr

Price Band: ₹173-180

Post-issue implied mkt. cap ₹2,502cr* - 2,603cr**

Note: *at Lower price band and **Upper price band

Book Building

QIBs	50%
Non-Institutional	15%
Retail	35%

Post Issue Shareholding Pattern(%)

Promoters Group	56.7
MF/Banks/Indian Fls/FIs/Public & Others	43.3

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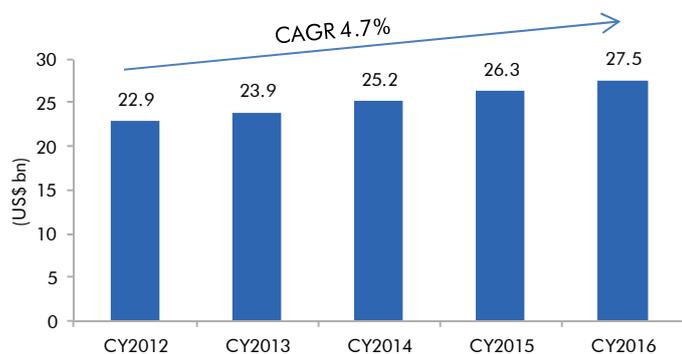
Company background

SHKCL is the largest F&F company in India by revenue, with a market share of approximately 12.0%. The company initiated business in 1922 as a manufacturer of industrial perfumes in British India. It now has four manufacturing facilities, three of which are located in India and one in The Netherlands, with a total installed manufacturing capacity of over 19,819 tonne annually.

Last year, the company manufactured and supplied over 6,300 fragrances. The offerings included fragrance ingredients and flavours for the personal and home care products industry and the food and beverage industry, either in the form of compounds or individual ingredients. The company has a large and diverse mix of over 3,500 customers, including leading national and multi-national FMCG companies, blenders of F&F, and F&F producers.

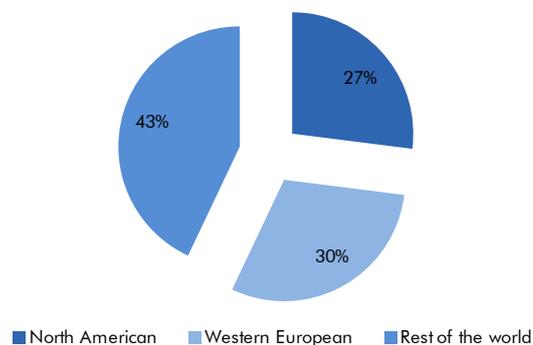
The flavour products produced by the company are used as a raw material by producers of baked goods, dairy products, beverages and pharmaceutical products. The company has over 300 customers for its flavour products and a dedicated research team of 18 scientists. The research team has developed 12 molecules over the last three years, of which, the company has filed patent applications for three.

Exhibit 1: Global fragrance and flavour industry



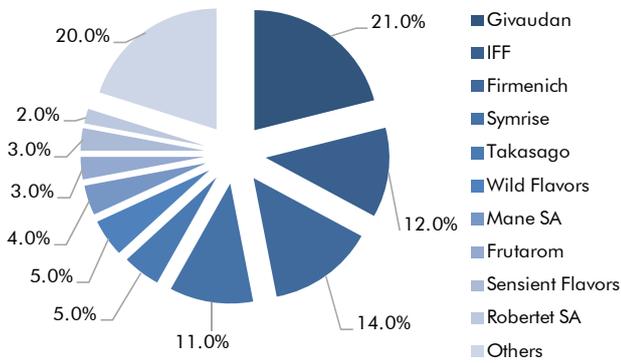
Source: RHP

Exhibit 2: Geographic revenue break-up for FY13



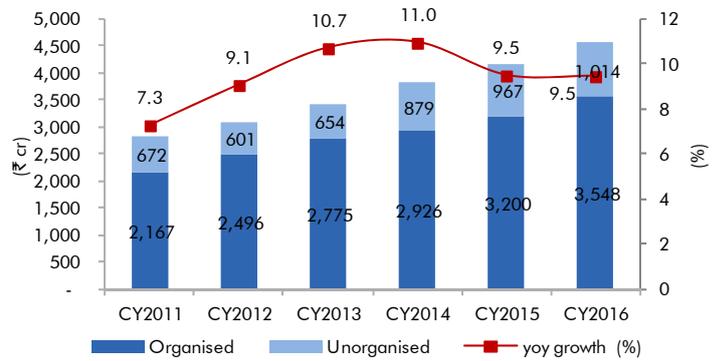
Source: RHP

Exhibit 3: Market shares of the top 10 players in the global fragrance and flavour industry



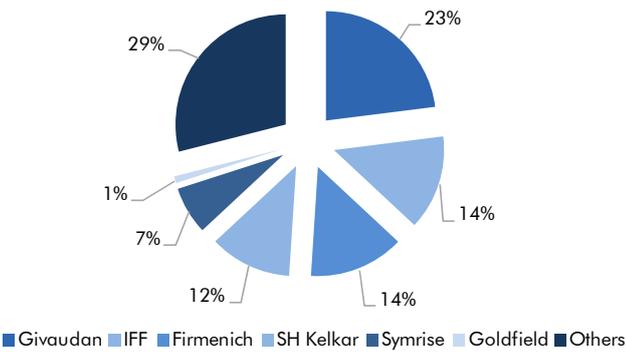
Source: RHP

Exhibit 4: Organised and unorganised Indian fragrance and flavour industry trend.



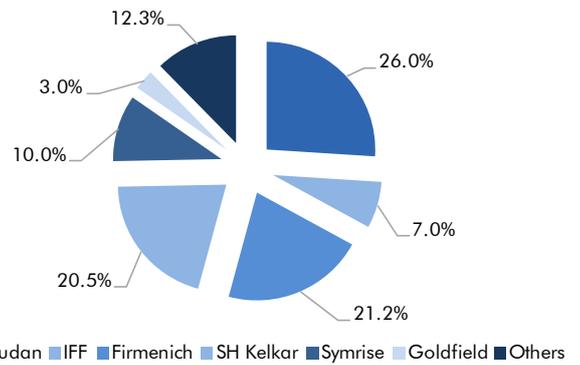
Source: RHP

Exhibit 5: Market share in Indian F&F industry ₹34.29bn



Source: RHP

Exhibit 6: Market share in Indian Fragrance industry ₹18.8bn



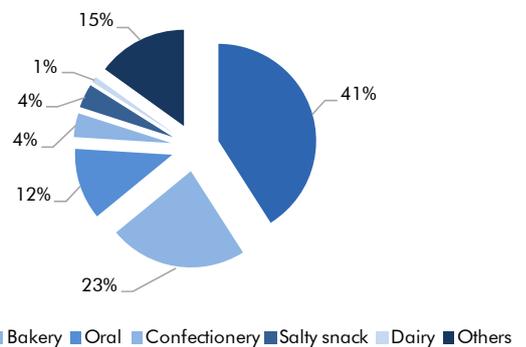
Source: RHP

Exhibit 7: End user industry for fragrances



Source: Company, Angel Research

Exhibit 8: End user industry for Flavours



Source: Company, Angel Research

Issue details

The company's ₹210cr IPO comprises of a fresh issue/Offer for Sale of upto 1.66cr shares, in which Blackstone PE Fund is selling ~10% share and the promoter is selling ~2.5% share of the total pre-IPO outstanding shares. Shares could be subscribed to in the price band of ₹173-180 (face value of shares: ₹10/- each) via the book building route. The fresh issue of shares will constitute ~8% (at the upper end of the price band) of the post-issue paid-up equity share capital of the company.

Exhibit 9: Shareholding pattern

Particulars	Pre-Issue		Post-Issue	
	No. of shares	(%)	No. of shares	(%)
Promoter group	853,52,000	64.2	820,14,414	56.7
Others	476,02,135	35.8	626,06,388	43.3
Total	1329,54,135	100.0	1446,20,802	100.0

Source: Company, Angel Research Note: calculation is based on upper price band

Objects of the Fresh Issue are as below

- Repayment/pre-payment in full or in part of certain loans availed by the company - ₹126cr
- Investment in its subsidiary K.V. Arochem Pvt Ltd (KVA) and for repayment/prepayment of certain loans availed by KVA in full or in part - ₹32cr.
- The balance would be utilized towards general corporate purposes.

Key investment rational

Established Market Leadership

The company has established brands like SHK, Cobra and Keva which enjoy leadership positions in their respective categories, and have substantial brand equity in India. For the year ended December 31, 2013, SHKCL had a market share of 12.0% in the Indian F&F industry. For the same period, the company had a market share of 20.5% in the Indian fragrance industry and 2.0% in the Indian flavour industry. (Source: "Market Study on Fragrances and Flavours" by Nielsen, March 22, 2015). The company is the largest domestic fragrance producer in India, while it also exports fragrance products to over 52 countries.

Comprehensive Product Offering and Diverse Customer Base

SHKCL has a wide product portfolio with over 9,700 fragrances, ingredients and flavour products and a large library of product formulations created over 90 years. The company enjoys a competitive advantage over its peers on the back of its wide product portfolio. It has a deep understanding of its customers' requirements and preferences and has over 4,100 customers, including leading national and multi-national FMCG companies, blenders of fragrances and flavours, and fragrance and flavour producers. The company enjoys long term relationships with several customers for its F&F products spanning over 15 years. Its diversified and comprehensive product portfolio and large customer base, spread across several countries and customer categories, mitigates concentration risk.

Research and development skills

SHKCL has a strong research & development (R&D) team, which has contributed to the company's growth over the past several years. The company currently employs 18 scientists; over the last three years the R&D team has developed 12 molecules, of which, patent applications have been filed for three molecules by the company. As in FY2015, the company had 12 perfumers and 2 flavourists in its 5 creation and development centres. The company developed over 502 new fragrance and flavour compounds during the year, which it sold commercially.

Experienced Promoters and Management Team

SHKCL is led by a qualified and experienced management team that has the expertise and vision to manage and grow business. Its Promoters have an experience of over 50 years in the fragrance industry and of over 15 years in the flavour industry. Its senior and mid-level management teams are also very experienced, having worked in large multi-national companies, in the F&F and FMCG industries, with an average experience of over 20 years. The knowledge and experience of its Promoters, senior and middle-management, and its team of R&D personnel and perfumers provides the company a significant competitive advantage as it seeks to expand in its existing markets and enter new geographic markets.

Valuation

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Exhibit 10: Valuation table

	Year	Currency	Net Sales	EBITDA	Margin (%)	PAT	PE	ROE
*S H Kelkar & Company	FY2015	₹ cr	837	119	14.3	64	40.4	12.6
Givaudan S.A.	CY2014	CHF mn	4,404	760	17.3	563	28.1	16.5
International Flavors & Fragrances Inc	CY2014	US\$ mn	3,089	601	19.5	449	20.1	29.5

Source: Company, Angel Research, Note: * EPS and other valuation parameters is based on Post IPO outstanding shares at upper price band

Risks to upside

- Higher than expected growth in the FMCG industry and launches of strong brands by the company would be a risk to our recommendation.
- Decline in input costs for the company could increase the profitability of the company.

Consolidated Profit & Loss Statement

Y/E March (₹ cr)	FY2013	FY2014	FY2015	1QFY16
Total operating income	666	761	837	222
% chg	16.9	14.3	9.9	
Total Expenditure	548	624	718	184
Raw Materials Costs	351	399	466	125
Personnel Expenses	89	103	115	26
Others Expenses	108	122	137	33
EBITDA	118	137	119	39
% chg	13.1	16.1	(12.9)	-
(% of Net Sales)	17.7	18.0	14.3	17.3
Depreciation & Amortisation	17	19	29	7
EBIT	101	118	90	31
% chg	15.7	17.4	(23.9)	
(% of Net Sales)	15.1	15.5	10.8	14.1
Interest & other Charges	22	18	19	5
Other Income	2	8	23	2
(% of PBT)	1.9	7.2	24.6	6.4
Share in profit of Associates	-	-	-	-
Recurring PBT	80	109	95	28
% chg	(74.0)	34.8	(12.7)	
Prior Period & Extraordinary Exp./ (Inc.)	(2)	-	-	-
PBT (reported)	83	109	95	28
Tax	24	29	30	8
(% of PBT)	29.3	27.1	32.1	26.7
PAT (reported)	58	79	64	21
Less: Minority interest (MI)	-	-	0	-
PAT after MI (reported)	58	79	64	21
% chg	31.0	46.6	(18.6)	-
(% of Net Sales)	8.8	10.4	7.7	9.3
Basic EPS (₹)	4.1	6.0	4.8	1.6

Note: *EPS calculation is based on Pre IPO outstanding shares

Consolidated Balance Sheet

Y/E March (₹ cr)	FY2013	FY2014	FY2015	1QFY16
SOURCES OF FUNDS				
Equity Share Capital	12	14	141	141
Reserves & Surplus	412	467	369	397
Equity Application Money	52	-	-	-
Shareholders Funds	477	481	510	538
Minority Interest	-	-	-	-
Total Loans	133	184	214	176
Deferred Tax Liability	6	6	5	5
Total Liabilities	616	671	728	719
APPLICATION OF FUNDS				
Net Block	140	169	196	192
Capital Work-in-Progress	43	50	10	15
Goodwill	71	83	78	83
Investments	41	0	0	0
Current Assets	480	557	650	629
Inventories	225	279	318	308
Sundry Debtors	172	179	195	215
Cash	33	42	76	40
Loans & Advances	47	56	56	60
Other Assets	2	2	5	7
Current liabilities	164	196	216	212
Net Current Assets	316	361	434	417
Deferred Tax Asset	5	8	10	12
Mis. Exp. not written off	-	-	-	-
Total Assets	616	671	728	719

Consolidated Cash Flow Statement

Y/E March (₹ cr)	FY2013	FY2014	FY2015	1QFY16
Profit before tax	78	109	95	28
Depreciation	17	19	29	7
Change in Working Capital	11	(73)	(38)	(13)
Interest / Dividend (Net)	0	(1)	(0)	(0)
Direct taxes paid	(26)	(34)	(28)	(12)
Others	23	13	5	6
Cash Flow from Operations	103	32	62	16
(Inc.)/ Dec. in Fixed Assets	(26)	(105)	(18)	(6)
(Inc.)/ Dec. in Investments	(8)	41	0	-
Cash Flow from Investing	(33)	(64)	(17)	(6)
Issue of Equity	1	-	-	-
Inc./ (Dec.) in loans	(79)	52	32	(41)
Dividend Paid (Incl. Tax)	(11)	-	(18)	-
Interest / Dividend (Net)	28	(16)	(22)	(7)
Cash Flow from Financing	(61)	36	(7)	(48)
Inc./ (Dec.) in Cash	9	4	37	(38)
Opening Cash balances	19	29	35	72
Effect of exch. rate changes on cash & bank bal.	0	2	1	1
Closing Cash balances	29	35	72	36

Key Ratios

Y/E March	FY2013E	FY2014	FY2015
Valuation Ratio (x)			
P/E (on FDEPS)	44.3	30.2	37.2
P/CEPS	33.6	24.4	25.6
P/BV	5.0	5.0	4.7
EV/Sales	3.7	3.3	3.0
EV/EBITDA	20.8	18.5	21.2
EV / Total Assets	3.1	2.9	2.7
Per Share Data (₹)			
EPS (Basic)	4.1	6.0	4.8
EPS (fully diluted)	4.1	6.0	4.8
Cash EPS	5.4	7.4	7.0
Book Value	35.9	36.2	38.4
Returns (%)			
ROCE	16.5	17.8	12.4
Angel ROIC (Pre-tax)	18.8	19.0	13.9
ROE	12.3	16.4	12.6
Turnover ratios (x)			
Inventory / Sales (days)	123	134	138
Receivables (days)	94	86	85
Payables (days)	40	42	15
WC cycle (ex-cash) (days)	177	178	208

Note: *EPS and other valuation parameters is based on Pre IPO outstanding shares at upper price band

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