

7th September, 2023

Neogen Chemicals Ltd. – BUY

CMP : Rs. 1,729
Target Price : Rs. 2,166
Upside : 25%+
Stop Loss : Rs. 1,473 (Closing basis)

Investment Thesis

- Neogen Chemicals Ltd. (NEOGEN) recently signed a landmark agreement with MU Ionic Solutions Corporation (MUIS), Japan, to acquire manufacturing technology license for electrolytes in India, making it the only manufacturer of Lithium electrolytes in the India with license to manufacture electrolyte materials using globally acclaimed technology and Plant Design. Effectively this will present NEOGEN with a first mover advantage and build a strong brand. Under the agreement, a capacity of up to 30,000 MTPA is expected to start commercial production in 2025. Its products would be substitutes for imports and qualify under the Advance Chemical Chemistry – Battery PLI scheme of the government.
- The management of NEOGEN has heavily invested in capacity expansion:
 - A brownfield speciality chemicals project was announced having capacity of 60,000 Litres (60 m³), of which 31m³ was commissioned in Q4FY23. The balance 29 m³ will be operational by Q4FY24.
 - Capacity expansion for the inorganic chemical segment to 2,400 MT (30 m³) was completed in Q4FY23.
 - NEOGEN incorporated a wholly owned subsidiary Neogen Ionics for the battery chemicals business to distinguish capex and showcase new business. Further, 400 MT (92 m³) for manufacturing lithium electrolyte salts and additives is expected to be commissioned by Q2FY24.
 - A plant for manufacturing 1,000 MT of electrolytes (under the MUIS agreement) at Dahej facility is expected to be ready before Q3FY24.
 - Capacity expansion has enabled it to achieve backward integration which would boost margins.
- During FY23, NEOGEN Completed acquisition of BuLi Chemicals India Pvt. Ltd., which enables it to manufacture key complex value accretive advanced intermediates and custom synthesis manufacturing (CSM) for customers. In Q1FY24, it has commenced commercial production and sales under NEOGEN.
- Management of NEOGEN has given a revenue guidance for FY25E / FY26E to be Rs. 900 crs / 1,050 crs for the existing businesses. Revenue guidance for the battery chemicals business is set at Rs. 1,200 crs by FY27E with possible revisions based on the MUIS agreement.

Financials

- Q1FY24 saw a muted increase in revenue of 15% Y-o-Y to Rs. 170 crs, due to seasonality effects. Another factor which led to slow growth was the fall in lithium prices, causing an underperformance in the inorganic segment which saw a 25% Y-o-Y decline.

Particulars	FY20	FY21	FY22	FY23	FY24E
Revenue (Rs. in Crs)	306.22	336.55	488.32	690.63	768.52
EBITDA (Rs. in Crs)	58.15	64.50	87.66	116.07	146.02
Adj. PAT (Rs. in Crs)	28.66	31.33	44.63	49.97	67.52
Adj. EPS (Rs.)	12.28	13.43	17.89	20.04	27.08
PE Multiple (x)	28.59	64.36	97.51	64.03	80.00
RoE (%)	25.31	18.47	14.34	10.84	12.13

Stock Data

Market Cap (Rs. Crs)	4,312
Market Cap (\$ Mn)	518.20
Shares O/S (in Crs)	2.49
Avg. Volume (3 month)	44,990
52-Week Range (Rs.)	1,780 / 1,128

Shareholding Pattern

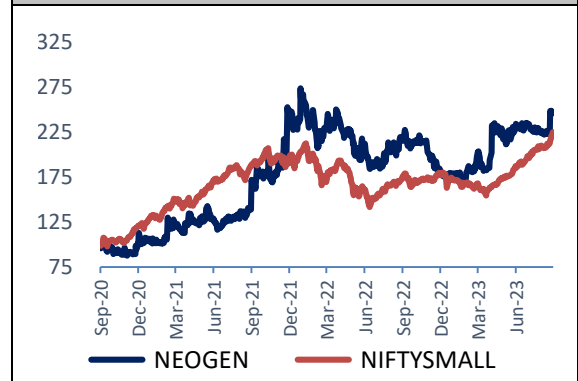
Promoters	60.18
FII's	4.30
Institutions	19.87
Others (incl. body corporate)	15.63

Key Ratios

Div Yield (%)	0.17
TTM PE (x)	85.8
ROE (%)	10.84
TTM EPS (Rs.)	20.20

Stock Performance

Performance (%)	1M	6M	1Yr
ABSOLUTE	9.7	20.9	14.0
RELATIVE	1.9	-15.0	-15.9



- EBITDA Margin for Q1FY24, saw a jump of 133 bps Q-o-Q and 64 bps Y-o-Y to 17.31%, which is the highest since Q3FY22. The expansion in margin was on account of higher contribution from the high margin CSM business and as BuLi Chem ramps up production, there is ample headroom for EBITDA margin to expand in the range of 19-20% over the coming quarters.
- PAT for the quarter witnessed a contraction of 12% Y-o-Y coming in at Rs. 9.73 crs on account of higher finance costs and depreciation associated with the on-going expansion activities. There were also initial one-time expenditures associated with BuLi Chem and Neogen Ionics.

Key Business Highlights

- NEOGEN is a specialty chemical manufacturing company, founded by Mr. Haridas Kanani, a chemical engineer from Indian Institute of Technology (IIT), Mumbai, having over 3 decades of experience in Bromine based compounds, Grignard Reagents and Inorganic Lithium Salts. Specialty chemicals product offerings are used in pharmaceutical and agrochemical intermediates aroma chemicals, flavours and fragrances in India.
- Neogen Ionic made its first commercial sale of trial quantities of electrolyte.
- There are active discussion with 3-4 Indian cell manufacturers where commercial terms including discussion around memorandum of understanding (MOU) are being considered by NEOGEN.
- Further, NEOGEN is engaged with more than 10 internationals potential customers for Lithium Salts.

Valuation

As the effects of the dumping of cheap chemical by China has begun receding, prices of key chemicals is expected to stabilize for NEOGEN. Further, H2 is a historically strong earning period and we expect earnings to pickup momentum. Currently, NEOGEN is trading at a TTM PE / EBITDA multiple of 85.8x / 38.5x against a 5-year median PE / EBITDA multiple of 65.1x / 33.3x. When compared to Industry PE / EBITDA multiple of 37x / 18.7x, there appears a significant premium.

Our understanding is, a recovery in the agrochemical business will add to the growth in FY24. The primary drivers for growth marked by the management is, 1) growth capex, 2) incremental contribution from BuLi Chem, 3) commercialization of the battery business and sound execution capabilities. Therefore, this valuation premium is justified.

Therefore, we assign a **BUY** rating to **NEOGEN** with a target price of **Rs. 2,166**, implying a **upside of 25%+**.

Risk & Concern

- Management has been unable to improve the working capital cycle, which hinders its ability to generate Free Cash Flow.
- Shift of the government's focus to promote other green mobility technologies.
- Lower realization due to extended dumping of cheaper chemical by China.
- Volatility in the prices of Lithium.

Graphs & Charts

Figure 1: Total Revenue (Rs. in Crs) (FY23)

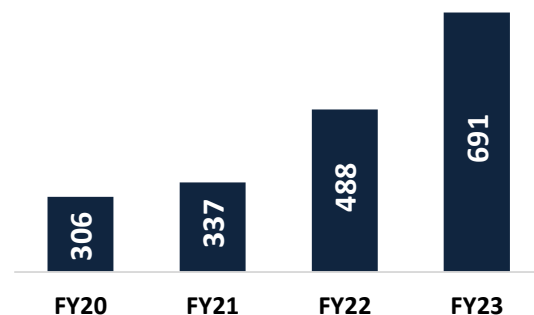


Figure 2: EBITDA & Margins Trend (FY23)

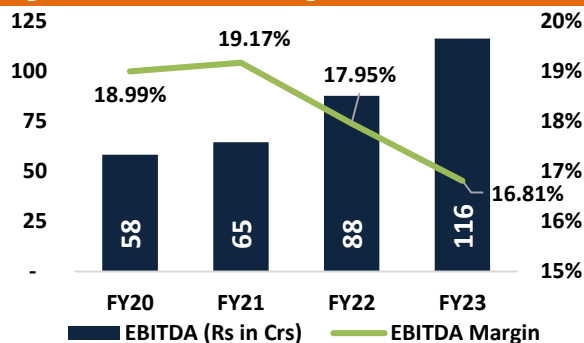


Figure 3: Segment-wise Revenue (Q1FY24)

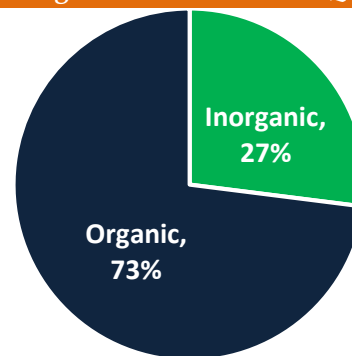
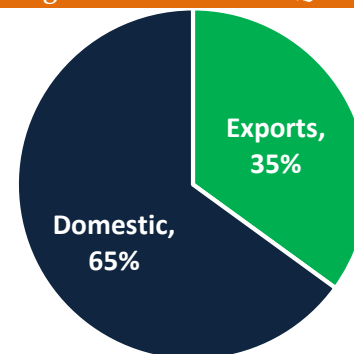


Figure 4: Region-wise Revenue (Q1FY24)



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