Navin Fluorine International Ltd (NFIL)

- Business with good visibility

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15-05-2020

Recommendation	:	Buy
CMP	:	Rs 1511
Sector	:	Chemicals
NSE Code	:	Navinfluor
BSE Code	:	532504

Financial break up

Market Cap (Rs. Cr)	:	7238
EPS (FY23)	:	91.00
PE	:	**16.60**
Face Value	:	**Rs.2/-**

Share Holding Pattern:

Promoters	:	**30.52**
Others	:	**69.48**

Background: NFIL was established in 1967 in Surat to produce HF, refrigerant gases and a range of inorganic fluorides. NFIL has been engaged in refrigerants and inorganic fluoride businesses during the years 1967-2000 which were largely volume-driven. During this period, the company increased its expertise by single-minded focus on fluorination. NFIL entered into the high value-added specialty chemicals business in 2000, catering to industries like global life science, crop science and industrials. The company has been continuously able to rise up the fluorination value chain and entered the CRAMS segment in 2011. Today, the company has emerged as one of the largest integrated specialty fluorochemicals companies in India.

Expertise in Fluorides

According to industry experts fluorine is a niche and difficult chemistry, implying players already with technology and experience are likely to succeed more. Entry barriers for end-user industry like agrochemicals and pharmaceuticals are also high as most large pharma and agrochemical innovators have stringent quality appraisal processes for their vendors. NFIL, being a fluoro specialist, is ahead of the curve compared to many of its peers and has technology to meet global standards.

HPP Contract

NFIL announced an Rs. 29bn contract which is the largest ever with a global company for manufacturing a new product, High Performance Product (HPP), in fluorochemicals. NFIL will form a new subsidiary Navin Fluorine Advanced Sciences Limited (NFASL) to execute the project. This contract shows the capabilities of the company in complex and high-performance products, growing specialty product portfolio of NFIL and the potential to change the size of the business given that CRAMS and Specialty Chemicals together generated revenues of ~Rs.5bn in FY19.

Strong client relationship

NFIL has pharma relationships with global innovator pharma companies like Roche, Novartis, and Bayer. This along with differentiated R&D capabilities, cGMP certified manufacturing facilities and a high quality management team mean that CRAMS for NFIL would be highly scalable.

Outlook & Valuation

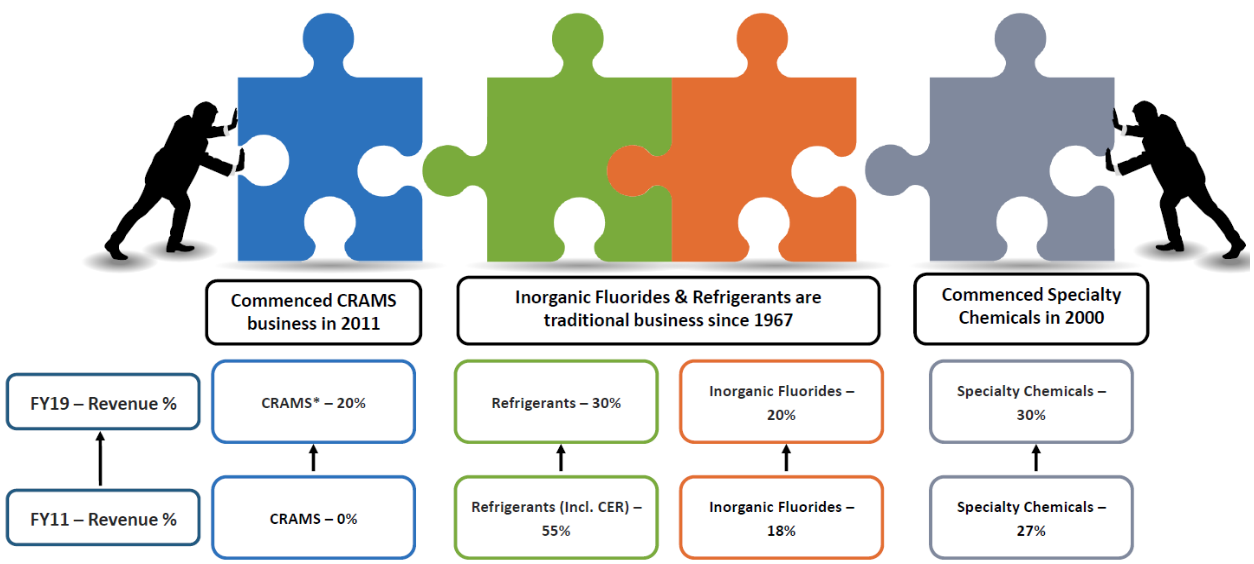
We recommend a **Buy** on NFIL for long term investors. Given the expertise in Fluorides, New high performance product, Marque clientele, Increasing CRAMS business Strong distribution network and Increasing complexity are key positives for the stock. At the CMP of INR 1511, the stock trades at 16.60x Consolidated EPS of FY23.The key risks to the business include Steep increase in raw Material cost, Client Risk and Replacement of Fluorides the key risks of the company.

Investment Arguments

Company Profile:

NFIL was established in 1967 in Surat to produce HF, refrigerant gases and a range of inorganic fluorides. NFIL has been engaged in refrigerants and inorganic fluoride businesses during the years 1967-2000 which were largely volume-driven. During this period, the company increased its expertise by single-minded focus on fluorination. NFIL entered into the high value-added specialty chemicals business in 2000, catering to industries like global life science, crop science and industrials. The company has been continuously able to rise up the fluorination value chain and entered the CRAMS segment in 2011. Today, the company has emerged as one of the largest integrated specialty fluorochemicals companies in India. The company believes that they are at the cusp of next phase of growth driven by new segment (HPP) and ramp-up in its high-margin Specialty Chemicals business and CRAMS.

Over the last five decades, the Company has emerged as a preferred player. The Company's Mafron brand is a reputed refrigerant gas brand in India. The Company is increasing its presence in the non-emissive feedstock segment catering to the pharmaceutical and agrochemical industries. The non-emissive segment contributed to 12% of the segment's sales in FY19 and this segment is expected to grow.



Inorganic Fluorides

NFIL's inorganic portfolio caters to downstream sectors like steel, glass, oil & gas, abrasives, electronic products, life science drugs and crop science, among others. The Chinese supply impacted raw material prices. However, owing to strong relationships with customers, it could pass price increases to customers. Though demand from domestic steel manufacturers remained subdued, strong demand emerged from the stainless steel and glass industry.

The Company started building exports this segment, generating a positive response from customers in East Asia. The exports business could be a key revenue driver for this business in the coming years.

Speciality Chemicals

NFIL's specialty chemicals business is engaged in manufacturing niche fluorine-based molecules for downstream use in the life science, crop science and chemicals industries. In the last few years, there was steep competition from China owing to an overcapacity eroding margins and making products unviable. However, with impending environment issues forcing the closure of manufacturing plants, prices of specialty chemicals increased globally.

NFIL's new launches attracted positive traction. The Company's strong relationships with customers helped generate longer contracts, enhancing revenue visibility. Going ahead, the Company expects the market to remain favourable and expand its presence in new markets.

Crams Business

The Company entered the CRAMs business in 2011. It offers services in critical fluorination processes to major global life science and crop science innovators. The year FY2019 was challenging, with a number of campaigns being postponed. During the last year, the Board approved the capex for creating additional cGMP capacity and associated infrastructure. The capex is underway and the plant is expected to be operational by the second half of FY 2019-20. The Company has already started building a customer pipeline for the new plant. Though the year witnessed a decline in revenues, the Company selected products and molecules judiciously and did not market me-too products that could have eroded margins.

Despite the revenue challenges, the Company was audited by several pharma clients. The Company is exploring different fluorination processes that could enhance offerings. Going ahead, the Company intends to strengthen the business through the effective interface of project management and delivery framework, deepening customer relationships and enhanced capacity utilisation.

NFIL offers custom services for route development, process and analytical development and scale-up to tonne production of fluorinated compounds in pharmaceuticals, agro chemicals and specialty chemicals industries. Over the years, NFIL has advanced into more complex chemistry capabilities and is doing a higher number of steps varying from Phase-1 to Phase-3 in drug commercialization process. NFIL has the highest margins in CRAMS among the four segments. Although it is a new entrant in CRAMS (vs. other players like Divis and PI), it has the advantage of fluorine expertise. Divis (pharma) and PI (Agri) are more end-to-end API manufacturers while NFIL is a specialized intermediate provider.

Increasing Fluorine usage

Globally, fluorine has become a leading choice to carry active ingredients in pharma and agrochemical applications, leading to rising interest in fluorine research. However, three of 10 blockbuster drugs contain fluorine and therefore, the use of fluorine in pharma and agrochemical has attracted interest. Some 40%-50% of new molecules being researched (for use in agrochemicals/pharma) contain some form of fluorine, since fluorine is inert and much more lipophilic (fat soluble) than hydrogen. NFIL is well poised to tap the opportunity from the increased demand for Fluorine.

Expertise in Fluorine

According to industry experts fluorine is a niche and difficult chemistry, implying players already with technology and experience are likely to succeed more. Entry barriers for end-user industry like agrochemicals and pharmaceuticals are also high as most large pharma and agrochemical innovators have stringent quality appraisal processes for their vendors. NFIL, being a fluoro specialist, is ahead of the curve compared to many of its peers and has technology to meet global standards. Globally only a few companies have capabilities to do complex fluorination including some Chinese and European players. NFIL is likely to gain here as some Chinese and European players are in the phase of shutting down and moving away from manufacturing due to environmental concerns.

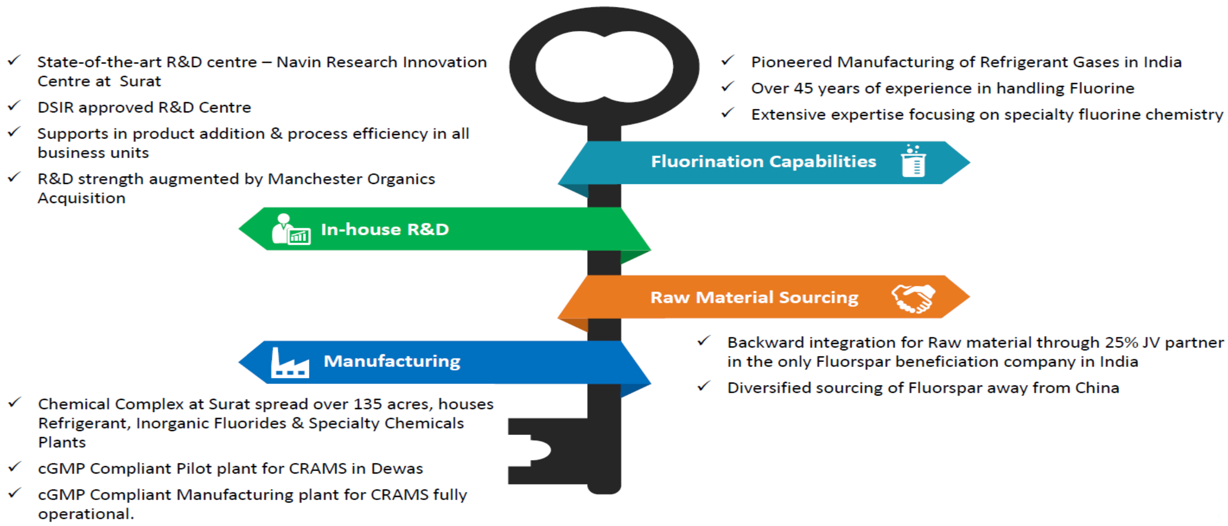
Huge opportunity size in fluorinated pharma products

The agrochemical business of the Company is seasonal NFIL is among the very few CRAMS companies in India with expertise in fluorine. Fluorine is increasingly getting used in life and crop sciences. Currently three of 10 blockbuster drugs contain fluorine. Moreover, 40-50% of all new molecules being researched (for use in crop sciences/life sciences) contain some form of fluorine. NFIL has leveraged on its fluorine capabilities and doing more number of chemical synthesis steps for global innovators (fluorination remains the key step).

The opportunity for contract research/manufacturing to get boosted by the increasing rate of outsourcing from global innovators and desire to diversify away from China. With strict quality appraisal processes already in place from global innovators, existing players like NFIL are likely to be the key beneficiaries.

Increasing Complexity

NFIL has witnessed much less complexity molecules vs. SRF in the past which is also reflected in the margin profiles of these businesses. So far large part of the revenues comes from Boron TriFluoride. However, NFIL has been working on more complex products of late and is now competing in the same space as SRF for fluorinated specialty molecules. We note NFIL's CEO also carries many global agro innovator relationships from his previous job. Augmentation in leadership and sales capabilities is also likely to strengthen the business here. Growing preference for agrochemical players in favor of Indian suppliers is also likely to benefit NFIL. NFIL's agri business fluorination revenues are ~Rs.1bn while for SRF it is ~`16bn which would gradually get bridged.



Inorganic fluorides - Steady cash generator

NFIL since its inception has been manufacturing various inorganic fluorides. This segment caters to downstream sectors like steel, glass, oil & gas, abrasives, electronic products, life science products and crop science among others. The business is driven by the domestic steel and glass industry. The key products are anhydrous hydrofluoric acid, aqueous hydrofluoric acid, ammonium bifluoride, potassium fluoride, sodium fluoride, boron trifluoride, etc.

NFIL has been focusing on growing its exports market for its inorganic fluorides (currently 10% of sales). Management indicated that of late it has been able to get a positive response from customers in East Asia. This has been aided by customers who were earlier procuring from Chinese/European players but now shifting to the company.

HPP Contract - Future Potential

NFIL announced an Rs. 29bn contract which is the largest ever with a global company for manufacturing a new product, High Performance Product (HPP), in fluorochemicals. NFIL will form a new subsidiary Navin Fluorine Advanced Sciences Limited (NFASL) to execute the project. This contract shows the capabilities of the company in complex and high-performance products, growing specialty product portfolio of NFIL and the potential to change the size of the business given that CRAMS and Specialty Chemicals together generated revenues of ~Rs.5bn in FY19. The Company believes this could turn out to be an inflection point for NFIL given the company has the necessary levers in place to bag similar contracts in future along with growing opportunities for India as an outsourcing destination and increasing applications for fluorine.

The company will incur a total capex of Rs.4,350mn i.e Rs.3,650mn for infrastructure and Rs.710mn for captive power plant. The plant will be a dedicated one with continuous production facility. NFIL has the required land (in Dahej) and most necessary approvals like environmental clearances etc. The contract is for seven years and revenues are expected to be evenly staggered across the years (~Rs.4,000mn per year). This new product is expected to contribute to revenue from 4QFY22E.

R&D Expenditure

NFIL has been ramping up its R&D capabilities, as evident from the R&D expenses incurred by the company in the last few years. NFIL has established two R&D centers in Dewas and Surat. The research center in Surat focuses in fluorination and chemistries related to organic and inorganic specialty chemicals space while the Dewas center is focused on development of intermediates for life science applications. Also Manchester Organics acquisition is helping NFIL to leverage its competencies to synthesize and manufacture of value-added chemicals in future. Management is willing to build a distributed R&D across the world.

Strong Client relationship

Being among only a few players in CRAMS with fluorine expertise, NFIL can gain scale as use of fluorination in life and crop sciences continues to rise. Given growing use of fluorine as both excipient and intermediate in active ingredients, it is being used in ~40% of new pharma drugs vs 20% a few years ago and almost none 1-2 decades back, as per industry experts. Further fluorinated compounds are also used as excipients in biosimilars as well.

NFIL has pharma relationships with global innovator pharma companies like Roche, Novartis, and Bayer. This along with differentiated R&D capabilities, cGMP certified manufacturing facilities and a high quality management team mean that CRAMS for NFIL would be highly scalable. The street that believe one of the CRAMS molecules is now being launched commercially and has a good scalability. This can meaningfully ramp up overall revenues for the segment.

Marquee Client Portfolio

Key Risks

Raw Material Risk

NFIL's margin has been impacted in the past due to wide price fluctuations in key raw material like fluorspar, chloroform, sulphur, etc. Failure to control volatility and exposure to China are key risks which can compress margins. While NFIL has been successful in eliminating dependence on China for some key raw materials, any disruption in China can still impact the prices of the raw materials.

Client Risk

NFIL is dependent on its customers' success in commercialization of molecules in order to scale up its CRAMS business. Also, CRAMS business is concentrated and loss of clients can impact the revenues as was seen during FY19.

Inability to widen refrigerant portfolio

In the long term, if NFIL fails to expand its refrigerant portfolio beyond R22, it could lead to loss of revenues as R22 gets phased out. Currently, NFIL has total R22 capacity of 10,000 tons, of which 8,400 tons can be used for emissive purpose and is stated to be cut by 25%. NFIL is increasing non- emissive usage and will also benefit from price increase due to supply cut.

Replacement of Fluorine

NFIL's core value proposition is centered on fluorine. Any replacement of fluorine, especially in the latest new generation refrigerants, can impact earnings. However the company takes comfort from the fact that fluorine usage is only increasing across industries and probability of any substitute coming out is low given it's the lightest halogen.

Financials

P&L

P&L (Rs Mn)	FY19	FY20E	FY21E	FY22E	FY23E
Net Sales	9959	10587	12454	15870	22384
Gross Profit	5194	5801	6887	8776	12379
Employee Expenses	1155	1275	1445	1724	2000
Power & Fuel Expenses	567	602	704	897	1265
Other Expenses	1283	1403	1538	1941	2697
EBITDA	2190	2521	3200	4215	6417
Depreciation	275	339	405	533	731
EBIT	1915	2182	2795	3682	5686
Interest	-8	-5	-39	-104	-90
Non Recurring Income	169	-76	0	0	0
Tax	770	812	778	978	1343
PAT Reported	1474	1648	2262	2842	4495
PAT Adjusted	1306	1724	2262	2842	4495
EPS	30	33	46	58	91

Balance Sheet

Balance Sheet (Rs Mn)	FY19	FY20E	FY21E	FY22E	FY23E
Share Capital	99	99	99	99	99
Reserves & Surplus	9736	10626	11779	13362	15353
Networth	9835	10725	11878	13461	15452
Debt	42	0	0	0	0
Deferred Tax Liability (Net)	308	348	348	348	348
Total Liabilities	10185	11073	12226	13809	15800
Net Block	2818	2850	3377	4142	5233
Capital Work in progress	201	393	1093	2143	2543
Investments	1892	2058	2058	2058	2058
Cash & Bank Balances	374	370	331	457	445
Sundry Debtors	1556	1727	1764	2076	2645
Inventories	1138	1119	1259	1465	1867
Loans & Advances	118	48	48	48	48
Net Current Assets	3536	3839	3769	3543	4047
Other long term Assets	1994	2163	2159	2154	2148
Net long term Assets	1737	1932	1928	1923	1917
Total Assets	10185	11073	12226	13809	15800

Cash Flow Statement

Cash Flow Statement (Rs Mn)	FY19	FY20E	FY21E	FY22E	FY23E
PBT	2244	2460	3040	3820	5837
Depreciation	275	339	405	533	731
Interest Paid net	-4	-354	-245	-138	-151
CFO before working capital changes	2235	2445	3200	4215	6417
Change in working capital	-615	72	-347	-516	-1080
Direct Taxes Paid	-719	-812	-778	-978	-1343
CFO	902	1705	2075	2720	3995
Net Capex	-616	-1562	-2215	-2018	-2220
Net Investments	-243	-1203	-1931	-1776	-1979
CFI	-683	-541	-18	-957	-1863
Proceeds from Borrowings	-85	-41	700	0	-200
Change in share capital	21	0	0	0	0
Interest & finance charges	-8	-5	-39	-104	-90
Dividend paid	-611	-494	-678	-853	-1573
CFF	-683	-541	-18	-957	-1863
Net increase in cash	-465	-623	2039	807	268
FCF	286	143	-140	702	1775

Key Financial ratio’s

Ratio's	FY19	FY20E	FY21E	FY22E	FY23E
EBITDA Margins (%)	22	23.8	25.7	26.6	28.7
EBIT (%)	19.2	20.6	22.4	23.2	25.4
PBT Margin (%)	20.8	24	24.4	24.1	26.1
Net Profit Margin(%)	14.8	15.6	18.2	17.9	20.1
Dividend payout Ratio (%)	41.9	30	30	30	35
Working Capital Turnover	4.7	5.1	5.2	5.4	5.6
Gross Block Turnover	2.7	2.1	1.8	1.8	2
ROCE (%)	17.6	18.4	21.1	24.5	32.5
ROE (%)	14.3	14.6	17.9	19.7	26.6

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