



ARIHANT capital markets Ltd.

4th -06- 2007

Meghmani Organics Ltd.

Recommendation: **Subscribe**



Issue Summary	
Price Band	Rs. 17-19 (Floor)-(Cap)
Bid Lot	350*
Face Value	Rs. 1
Opens on	4 th June'07
Closes on	7 th June'07

* Minimum investment 350

Pre-issue share capital	Rs. 20.06 cr
Post- issue share capital	Rs.26.06*
Issue Size	Rs. 102 cr
Post Issue Market Cap	Rs. 122.06 cr
P/E on FY 07	13.82 x

* Assuming that the bid will close at lower price band

Net issue	
QIBs*	60% of net issue size
Non-institutions	10% of net issue size
Retail individuals	30% of net issue size

*5% of allocation for mutual funds

* QIB – Qualified Institutional Buyers

Book Running Lead Managers

- IL&FS Investsmart
- Edelweiss Capital

Meghmani Organics – AT A GLANCE

- Engaged in the manufacturing of pigments and agrochemicals. Company has 4 manufacturing facilities
- Issue size Rs. 102 cr with a price band of Rs.17-19. Plans to sell 53.7 million to 60 million new shares with a face value of Rs. 1.
- Primary objective of the issue is to finance setting up of its new high performance pigment plant at Vatva, Ahmedabad and a multi-purpose agrochemicals plant at Panoli.

Company Profile

Meghmani Organics Ltd. was established in 1986 in the name of Gujarat Industries to manufacture pigments. In 1995 Gujarat Industries transformed to a joint stock company, under the name of Meghmani Organics Limited. Currently, Meghmani is in the business of manufacturing pigments and agrochemicals in India.

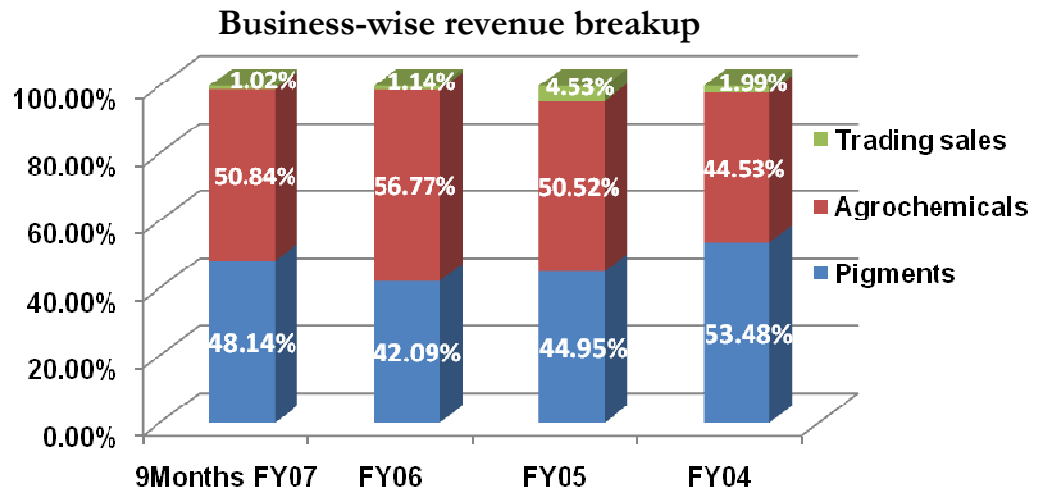
The company is a quality-oriented and research-focused organization with a diversified presence in pigments and agrochemicals, and offers a range of products catering to a diversified customer base.

Business Profile

At present, Meghmani is primarily in two lines of business: Agrochemicals and Pigments. It has 4 manufacturing facilities located in the chemical belt of India and enjoys several benefits owing to its integrated multi-functional plants.

In **agrochemicals** line of business, Meghmani manufactures three broad categories of Agrochemical products, namely, pesticide intermediates, technical grade pesticides and pesticide formulations, all of which fall under the range of pesticides.

The agrochemical products find primary application in crop protection and non crop applications such as public health, termite and insect control and veterinary applications. The agrochemical products are manufactured at two multifunctional manufacturing facilities situated in Chharodi and Ankleshwar, of which Chharodi manufacturing facility is ISO 9001-2000 certified. Exports constituted about 66% of our revenues of company's agrochemical revenues for FY06.



Within **Pigments**, the company specializes in green and blue pigments, which have varied end-use applications including, amongst others, printing inks, plastics, rubber, paints, textiles, leather and paper. The pigments are manufactured in two pigment manufacturing facilities at Vatva and Panoli both of which are ISO 9001-2000 certified. The company has a capacity of manufacturing 15,000 tonne of blue and 1,800 tonne for green pigments, respectively. A majority of the pigments are exported with exports constituting about 85% of the company's pigment revenues in FY06.

Meghmani has established and recognized brands such as Megastar, Megacyper, Courage and Proven under which it sells its pesticide formulations. The Meghafast brand is a recognized brand name with multinational pigment consumers.

Products in pipeline

Stage of development	Pigments Division	Agrochemicals Division
	No. of products*	No. of products**
In lab scale	5	4
In Pilot Scale	5	1
Ready for commercial production	2	2
Total	12	7

* Product Category: High performance ** Product Category: Crop Protection

The company holds about 90 registrations worldwide for its agrochemicals business and has 415 pending registrations in 56 countries. Clients of the company include multinationals such as Sun Chemicals, the Flint Group, and Valent USA Corporation.

Issue Objectives

One of the main objectives of Meghmani's IPO is to finance the setting up of a new high performance pigment plant at Vatva, Ahmedabad and a multi-purpose agro-chemicals plant at Panoli.

Other objectives:

- To invest in its subsidiary Meghmani Energy Ltd. to finance the 3 MW Captive Power Plant to be located at Chharodi.
- To finance the requirements of funds for inorganic growth opportunities, diversification opportunities, general corporate purposes.
- To finance the working capital requirements of the Company.
- To meet issue related expenses.
- achieve the benefits of listing on the Stock Exchanges.

Deployment of Funds

Proposed Expenditure Program	Means of Finance (Rs. In millions)
New HPP plant at Valva	145.20
New Technical grade Pesticide /Formulation plant at Panoli	114.20
3 MW Captive Power Plant at Chharodi	144.10
Financing working capital needs	349.00

Shareholding Pattern

	Pre-issue		Post Issue	
	No. of shares	% holding	No. of shares	% holding*
Promoters group	92,734,930	46.22	92,734,930	35.58
Promoter Group	31,312,420	15.61	31,312,420	12.01
Public	0	0.00	60,000,000*	23.02
Investors	76,582,650	38.17	76,582,650	29.38
Total	200,630,000	100.00	260,630,000	100.00

*Assuming the bid closes at the lower price band of Rs. 17.

Investment Positive

High growth in user industry:

- **Pigment:** The global market of dyes and organic pigment industry is estimated to be at US\$ 8.4 billion, out of which the organic pigment market would be around US\$ 5.5

billion. The global demand for organic pigments is expected to grow at the rate of 4.9% annually through 2008. **The outlook for the pigments business appears strong in the light of the improving growth prospects for the paints and inks industry in the domestic as well as the global context.** The domestic printing ink industry is seen augmenting its turnover on the back of a strong growth in the user industries such as newspapers, flexible packaging, and publishing, with the present market size of Rs 1,200 crore. Further, the Indian paint industry has grown at an annual growth rate of around 6% over last 4 - 5 years, making the market size of the paint industry to around Rs. 5,000cr.

▪ **Agrochemicals:** Indian pesticides market is the thirteenth largest in the world with a value of approximately US\$ 650 million in 2004, which is 2.12 percent of the global agrochemical market size. However, per hectare consumption of pesticides in India is very low at 0.57 Kilograms when compared to developed countries. Since the population in India is growing at a steady rate and the availability of cultivable land is limited, consumption in pesticides is expected to increase in the future.

Diversified customer base: Meghmani has a diversified base of customers from a wide range of industries. Its pigments customers range from industries such as printing inks, plastics, rubber, paints, textiles, leather and paper. While the pigment segment serves more than 300 customers, the agrochemicals business has more than 90 customers. These customers are based in various countries in North America , Europe , Central and Latin America , Africa , Asia , as well as end users in the domestic markets. We believe the company has reduced the risk of being affected by a downturn in any particular product, customer or industry by diversifying its customers.

Registered products to leverage market share: For the year ended 31st March, 2006, exports accounted for half its agrochemical sales. Agrochemical products are regulated products and require prior registration with the relevant governing authorities in respective countries before they can be sold. The company has 90 products that have been registered worldwide and 415 registrations pending in 56 countries. The registration process is important, as the cost of registration and time involved to obtain necessary approvals are very high. We consider registration as crucial and considerable investment as these will help the company to move ahead of competition and garner greater market share.

High-margin products through vertical integration: Meghmani is one of the few that manufacture both CPC Blue crude (an upstream product), and the finished pigments, the blue and green pigment products. It is moving up the value chain by shifting focus from being a bulk supplier of CPC Blue crude to high-margin and technology-oriented pigments. Further, the company is increasing its thrust on expanding its range of high performance pigments and additives. The company is now planning to commercialize additional range of pigments like pigment red, pigment yellow and pigment orange, which are under development in various stages. We believe that with its existing portfolio and products under development, the company is well placed to take advantage of these trends.

Concerns

Forex risk: The company is susceptible to foreign currency fluctuations. The company earned almost 74% of its revenues in foreign currency in FY06, 73% in FY05 and 71% in FY04. Any significant adverse fluctuation in foreign currency against Indian rupees may result in foreign exchange losses and adversely impact the company's performance.

Delay in regulatory approvals: Company has not sorted approvals for the proposed expansion. Any delay/non-receipt of the licenses and/or approvals that may be required for the proposed additional facilities could result in a cost and time over run, and accordingly adversely affect its operations and profitability.

Volatility in raw material cost: Crude is the source of many raw materials used for manufacturing pigment. The company has no supply agreements for raw materials required. Volatility in prices and non-availability of the raw material may have an adverse impact on its operations.

Agro-chemical business unstable: The agrochemical business is vulnerable to seasonal and weather fluctuations, which make its operations really unpredictable. This could result in fluctuations in demand for the agrochemical products, which will adversely affect the financials. Furthermore, sales pattern of the pigment products is difficult to predict and company's revenues and profit may fluctuate from quarter to quarter and may cause volatility in share prices.

Financials

Meghmani is a profitable company since inception. Its revenues have grown from Rs 1,772.70 mn in FY2002 to Rs 3,891.61 million in FY2006 at a CAGR of 17.03 % and net profits have increased from Rs 235.19 mn in FY2002 to Rs 383.38 mn in FY2006 at a CAGR of 10.26 %. The revenues for the nine months ending December 2006 are Rs 3,553.4 million and net profit after tax is Rs 320.77 million.

Income Statement

(Rs. In millions)

Particulars	9Months FY2007	FY2006	FY2005	FY2004	*Annualised FY07
Operating Income	3553.40	3891.61	3362.79	2419.32	4737.87
Other Income	19.94	55.34	68.51	66.30	26.59
Total Income	3573.34	3946.95	3431.30	2485.62	4764.45
Interest Expense	84.26	79.20	45.22	57.48	112.35
Depreciation	100.46	114.84	111.86	94.39	133.95
Other Expenditure	3032.67	3282.79	2863.68	1961.17	4043.56
Total Expenditure	3217.39	3476.83	3020.76	2113.04	4289.85
Profits/(Losses) Before Tax	355.95	470.12	410.54	372.57	474.60
Deferred Tax Expense	-6.03	15.68	-0.44	15.98	-8.04
Current Tax Expense	41.21	71.06	100.20	58.68	54.95
Net Profits / (Losses)	320.77	383.38	307.88	296.99	427.69

*Annualised on basis of 9 months figures of 2007

Valuation

On the valuation front, Meghmani quotes a P/E of 10.35 (x) at the lower band of Rs. 17 and P/E of 11.29 (x) at the higher band of Rs. 19, based on the FY2007 EPS.

The issue looks expensive compared to peers like Rallis India which is currently trading at a lower P/E to its FY07 EPS. But then Meghmani ranks better in terms of the volume and sales growth the company has maintained over the past three years (sales have grown at a CAGR of 23%) and the good profit margins company maintains, hovering at a healthy 15-20% levels.

At lower band of Rs. 17, we think that the issue is priced well, looking the company's healthy financials and the growth prospective.

Recommendation

Investors with an appetite for risk can subscribe to the IPO from Meghmani Organics Ltd. at the lower band of Rs. 17. At the lower band of Rs. 17, the number of equity shares would rise to 26 crore resulting in EPS of Rs 1.23 and the P/E at 10.35x.

A consistent track record of financial performance and a well-diversified client base for pigments and agrochemicals suggest that the company can deliver good earnings growth over the next few years. Also compared to its peers the company has better operating profit margins and has sustained profitability. The company's ability to sustain high revenue growth amidst rather sluggish market conditions and fairly intense competition in its businesses, suggests cost competitiveness.

From here, the company appears well-placed to deliver strong earnings growth over the next couple of years, with the help of new manufacturing facilities, an improved product mix, a strong new product pipeline and reduced tax incidence.

Despite reasonable earnings prospects, the lack of market fancy for stocks in this sector may curtail the scope for listing gains on this offer. Therefore we reiterate that *investment in this scrip is only recommended for investors with an appetite for high risk and who have a long-term perspective.*

Disclaimer: This document has been prepared by **ARIHANT** capital markets ltd (hereinafter referred to as **ARIHANT**). The views and opinions expressed in this document may or may not match or may be contrary with the views, estimates, rating and target price of the Affiliates research report of **ARIHANT**. This document has been prepared and issued on the basis of publicly available information, internally developed data and other sources believed to be reliable. Whilst meticulous care has been taken to ensure that the facts stated are accurate and opinions given are fair and reasonable, neither the analyst nor any employee of **ARIHANT** is in any way is responsible for its contents. **ARIHANT** may trade in investments, which are the subject of this document or in related investments and may have acted upon or used the information contained in this document or the research or the analysis on which it is based, before its publication. **ARIHANT** or its owners may have a position or be otherwise interested in the investment referred to in this document. This is just a suggestion and **ARIHANT** will not be responsible for any profit or loss arising out of the decision taken by the reader of this document. No matter contained in this document may be reproduced or copied without the consent of the firm.

ARIHANT capital markets ltd.

3rd Floor Krishna Bhuvan, 67, Nehru Road, Vile Parle (E) Mumbai - 400057. Tel. 022-67664800

www.arihantcapital.com