



5 MINUTE STOCK IDEA

BY SMART SYNC INVESTMENT ADVISORY SERVICES

DYNEMIC PRODUCTS LTD

WHAT WE LIKE

BACKWARD INTEGRATED PLAYER

After the commissioning of the intermediates (raw materials) plant in FY21, the company's dependence on raw materials from China has reduced substantially, leading to better margins owing to lower volatility in raw material prices. This is a major advantage considering its peer-Vidhi Specialities which is also engaged in the production of dyes & food colors doesn't have backward integration (yet)

MARQUE CLIENTELE & DIVERSIFIED REVENUE PROFILE

The company has a presence in over 74 countries with marquee customers like Mondelez India Foods and Nestle & no customer contributing more than 10% of total revenues leading to low client concentration risk.

STRONG ENTRY BARRIERS

Owing to the high regulatory approvals requirements, the commissioning of a plant takes around 2-4 years leading to a high gestation period. Further, different approvals by different countries, the task of maintaining various approvals (BIS, FDA, EU & WHO), and certifications (Kosher & Halal) backed by an appropriate lab with testing facilities creates entry barriers.



BUYING THE PESSIMISM?

The company had a tough financial year where it recorded its lowest EBITDA margins of the past decade. This was due to several reasons like high raw material costs, power & fuel, and stiff competition from China for dye intermediates. Further, 3X capacity in FY21-22 ~ high depreciation & finance costs (while operating profits already suppressed)-poor PAT.

WHAT WE DON'T LIKE

REDUCING PROMOTER OWNERSHIP

Promoter holding has reduced from 35 % to 30.27% in the past owing to the sale of one promoter for personal reasons. Irrespective of the sale, the company's shareholding has remained on the lower end Vs its listed peer which has a 64% holding.

VALUATION GAP VS VIDHI AN INDICATION OF QUALITY?

While both have performed exceedingly well in the past decade (in terms of stock price), Vidhi has 2X the CAGR vs the company. This might be due to factors like higher asset turnover, better balance sheet strength & quality clientele, operational efficiency (like lower employee expenses), and high promoter ownership & ultimately the 10-year ROE (25% Vs 14% for the company). The idea for sharing this is rather than focusing on lower multiples, investors should carefully evaluate the reasons for higher valuations of their peers & see if the gap is likely to persist.

HIGH DEBT

The company's ambitious debt-funded capex for the Dahej plant has led to borrowings swelling to 150 Crs currently which has led to very high interest costs during these tough times.

RISKS OF REPLACEMENT FROM NATURAL FOOD COLOUR

Although synthetic food colors have been approved for human consumption, the need to replace these ingredients with natural alternatives, such as carmine, has increased. Thus, end manufacturers are launching various products with natural ingredients, owing to a surge in demand for nutritious and natural ingredients. We at SSS believe that due to its qualities, synthetic ingredients will continue to thrive, however, this is a major source of fragility to its business model, & hence needs to be tracked properly.

- Dropping low-calorie sweetener aspartame from Diet Pepsi due to consumer's preference for soft drinks that are free of artificial sweeteners.
- Nestle USA removing artificial flavors and FDA certified colors from all Nestle chocolate candy by end of 2015.
- Nestle UK removing all artificial ingredients from all its confectionary in the UK.
- Removing artificial flavors from most products and replacing them with natural alternatives, as of this year.
- Removing artificial colors by end of July 2015.
- Replacing artificial preservatives and additives by end of 2017.
- Replacing synthetic colors and artificial preservatives from best selling classic: Macaroni & Cheese starting 2016.
- Collaborating with Evolution Fresh to Let Simple ingredients Shine in New Smoothies and Greek Yogurts, as customers are looking for foods with fewer ingredients that are minimally processed and taste great.
- Transforming to cleaner labels across all brands to meet consumer trends for food made with genuine, simple ingredients.
- aiming to stop using artificial colors and flavors in its cereals and snack bars by the end of 2018.
- growing pressure to remove synthetic ingredients from products due to health concerns.

FOREX & ENVIRONMENTAL RISK

Due to the high share of exports to other countries, volatility in forex currency remains a huge risk. Further, issues related to environmental clearances for its Dahej plant & any subsequent stoppages can be a major risk.

'DIWORSIFYING' INTO DYE INTERMEDIATE CAPACITY

Around 60% of the dye intermediate capacity will be sold in the markets. Now, given the cyclical clientele (mainly textiles) coupled with stiff competition from China, coupled with low existing utilization levels in India, we believe that this apparent backward-integration effort can cause more harm than benefit to the company.

DYNEMIC PRODUCTS LTD										
Rs Cr	Mar-14	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23
Sales	117	129	130	129	164	167	182	206	252	296
% Growth YOY		10%	0%	0%	27%	1%	9%	13%	23%	17%
EBITDA	19	18	17	25	31	30	36	43	43	29
EBITDA Margin	16%	14%	13%	20%	19%	18%	20%	21%	17%	10%

However, given the strong tailwinds for the industry, improved demand for dye intermediates & its competitive positioning owing to the Dahej plant, the company can be a beneficiary of the operating & financial leverage in the coming time once the business rebounds.

