5 MINUTE STOCK IDEA

BY SMART SYNC INVESTMENT ADVISORY SERVICES

ANDHRA PETROCHEMICALS LTD

WHAT WE LIKE

STRONG MARKET POSITIONING:

- **Duopoly market-** The company is one of the only 2 domestic manufacturers of Oxo-alcohols like 2EH, NBA, and isobutanol (IBA) which are primarily used as a raw material to manufacture PVC plasticizers. Its current capacity stands at 73,000 MTPA & the only other domestic competitor is BPCL which commercialised its plant in 2021.
- **Strategic location advantage-** The company owing to its plant's proximity to HPCL can procure its raw material i.e. Propylene easily without incurring high freight costs.

HEALTHY GROWTH PROSPECTS:

- **Import substitution opportunities:** The Estimated demand for Oxo-Alcohols is about 3,30,000 MTs per annum, which is growing at a healthy growth rate of 8% to 10% per annum. Therefore, the demand is far greater than the domestic capacity, however, the company faces major competition from imports. Hence Government's favourable measures like Anti-dumping duty can help the company in clocking high capacity utilization despite competition from BPCL.
- **Mammoth capex plans:** The company is planning a **sizeable capex of 500 crs** to set up facilities for the production of value-added products in the medium term. This can help in changing the company's business profile from a commodity producer & derisking the business model going forward.

BUYING THE PESSIMISM?

At the current Mcap of 700 Crs with a cash balance of around 280 Crs & mutual fund investments of around 40 Crs, **the company is trading at an Entreprise value (EV) of appx. 400 Crs.** After a series of poor quarterly performances led by margin deterioration, the company's share price has been down by more than 50% in the past 2 years.

However, based on P/B analysis, it is trading at its lowest levels in the past decade.

Therefore, the company is a **strong candidate for re-rating provided its OPM% rebounds in the coming years.**

ANDHRA PETROCHEMICALS LTD										
Rs Cr	Mar-14	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23
Sales	259	140	334	329	520	666	456	566	965	683
EBITDA Margin	*-6%*	*-21%*	*-3%*	*4%*	*13%*	*16%*	*7%*	*24%*	*32%*	*5%*

STRONG BALANCE SHEET & MANAGEMENT SUPPORT:

The company has negligible debt & high cash in the balance sheet which will ensure its ability to incur huge capex through internal accruals. Further, support from the parent company- Andhra sugars, also improves its credibility.

WHAT WE DON'T LIKE

RAW MATERIAL VOLATILITY RISK:

The major raw material- propylene, is a crude oil derivative that is very volatile in nature & can hurt OPM%. This risk is big considering the company enters into a few fixed-priced contracts & carries an inventory of 45 days leading to potential inventory losses.

HIGH MARGIN FLUCTUATIONS+ POOR DEMAND:

The company's profitability is dependent on the spread between oxo-alcohols and feedstock. The operating margins sharply declined in FY2023 owing to the reduction in the spreads (from Rs.58,518/MT to . 26,356/MT) after product prices dropped **because of subdued global demand.**

SUPPLIER CONCENTRATION RISK:

The company's dependence on a single supplier (HPCL) for the key raw material, propylene is a major risk. This risk came to light when there was an insufficient supply of Propylene from HPCL in FY23 leading to lower production of 12,789 MTs However, the company has started procuring raw materials from BPCL & GAIL(though at a higher cost) which provides some diversification.

HIGH COMPETITIVE INTENSITY:

The company is not backward integrated & dependent on other sources for raw materials. Further, the entry of a larger player like BPCL coupled with other factors like intense competition from imports, changes in duty structure/trade protection measures such as ADD, the import pattern of the end-user segments, and substitute products are some glaring risks.

OTHER RISKS:

- **Project execution risks-** Especially considering its recent troubles in getting a lease extension agreement for its current capacity. This is a major concern as the agreement issue is yet to be settled despite court interference in the past 3-4 years.

Further, delay in its pipeline laying work with GAIL due to internal/finance issues also hints at some internal inefficiencies.

- **Lack of succession planning-** The company has reappointed its 75-year-old MD for a further tenure of 5 years. Now although, the promoter's son has joined the business, however, his erstwhile experience is in textile.