

# Independent Equity Research

Enhancing investment decisions



In-depth analysis of the fundamentals and valuation

**Navin Fluorine Intl  
Limited**

## Explanation of CRISIL Fundamental and Valuation (CFV) matrix

The CFV Matrix (CRISIL Fundamental and Valuation Matrix) addresses the two important analysis of an investment making process – Analysis of Fundamentals (addressed through Fundamental Grade) and Analysis of Returns (Valuation Grade)

### Fundamental Grade

CRISIL's Fundamental Grade represents an overall assessment of the fundamentals of the company graded in relation to other listed equity securities in India. The grade facilitates easy comparison of fundamentals between companies, irrespective of the size or the industry they operate in. The grading factors in the following:

- Business Prospects: Business prospects factors in Industry prospects and company's future financial performance
- Management Evaluation: Factors such as track record of the management, strategy are taken into consideration
- Corporate Governance: Assessment of adequacy of corporate governance structure and disclosure norms

The grade is assigned on a five-point scale from grade 5 (indicating Excellent fundamentals) to grade 1 (Poor fundamentals)

CRISIL Fundamental Grade	Assessment
5/5	Excellent fundamentals
4/5	Superior fundamentals
3/5	Good fundamentals
2/5	Moderate fundamentals
1/5	Poor fundamentals

### Valuation Grade

CRISIL's Valuation Grade represents an assessment of the potential value in the company stock for an equity investor over a 12 month period. The grade is assigned on a five-point scale from grade 5 (indicating strong upside from the current market price (CMP)) to grade 1 (strong downside from the CMP).

CRISIL Valuation Grade	Assessment
5/5	Strong upside (>25% from CMP)
4/5	Upside (10-25% from CMP)
3/5	Align (+-10% from CMP)
2/5	Downside (negative 10-25% from CMP)
1/5	Strong downside (<-25% from CMP)

### Analyst Disclosure

Each member of the team involved in the preparation of the grading report, hereby affirms that there exists no conflict of interest that can bias the grading recommendation of the company.

### Additional Disclosure

This report has been sponsored by NSE - Investor Protection Fund Trust (NSEIPFT).

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Mumbai-based Navin Fluorine International Ltd (Navin), belonging to the Arvind Mafatlal Group of companies, manufactures fluorine-based chemicals. It has two plants - Surat (Gujarat) and Dewas (Madhya Pradesh). We assign Navin a fundamental grade of '2/5' indicating that its fundamentals are 'moderate' relative to other listed securities in India.

### Navin is one of the four major fluorine players in India

Navin is one of the four large fluorochemical companies in India with 22,000 tonnes of nameplate hydrogen fluoride (HF) capacity. HF is combined with various other chemicals to manufacture refrigerants, specialty fluorine chemicals and bulk fluorides.

### Existing businesses have stagnated - CERs to the rescue

**Refrigerants** - The production of Navin's flagship refrigerant HCFC 22 is facing an accelerated phase-out under the Montreal Protocol due to its ozone-depleting nature. At the same time, exports, which form a substantial portion of Navin's sale volumes have been facing lower realizations than the domestic market. However, Navin is entitled to a CER (Certified Emission Reduction) income of around Rs 1.4-1.5 bn each year, which ensures sustainability of this segment.

**Bulk fluorides** - All of Navin's sales are largely low-margin and volume-driven, and some products are under pressure due to competition from China.

### Focus on specialty chemicals – benefits to accrue gradually

Navin has identified the specialty chemicals segment as the next rung for growth. To this end it is investing in R&D and in recruiting qualified personnel. Despite an existing presence in the specialties vertical, the full benefits of successfully acquiring and leveraging R&D capability are expected to be visible only after FY12.

### Uncertainty of CER income, potential threat to profitability

The sustained issuance and saleability of CERs is under question since the Kyoto Protocol is expected to be reviewed in FY12. In case the CER incentives are withdrawn, thereby reducing the issue or saleability of CERs, the company's sales will be adversely affected.

### Funding of group companies' liabilities by Navin is history

Navin was born out of the demerger of the loss-making Mafatlal Industries Ltd (MIL) in 2002. As part of the scheme of rehabilitation of the BIFR, Navin was mandated to settle the secured liabilities of MIL. Navin has also advanced money from time to time to settle working capital and other secured liabilities of MIL. However, as of March 2010, all the secured liabilities have been settled by Navin, inter-company advances to group companies are decreasing and we believe they are likely to be discontinued.

### Revenues to grow at 16% till FY12, propped by CER income

We expect revenues to grow by 16% from FY10-12 to Rs 5,011 mn in FY12, primarily supported by an estimated CER income of Rs 1.4-1.5 bn, partial recovery in demand for bulk fluorides and increase in revenue from the specialties vertical. PAT margins are expected to be at 21.5% in FY11 and 23.4% in FY12 vis-à-vis 19.1% in FY10.

### Valuation – Current market price is 'aligned'

A valuation grade of '3/5' indicates that the fair value of the stock is 'aligned' with the current market price. We have arrived at a one-year fair value of Rs 300 per share based on the SOTP (Sum-Of-The-Parts) method.

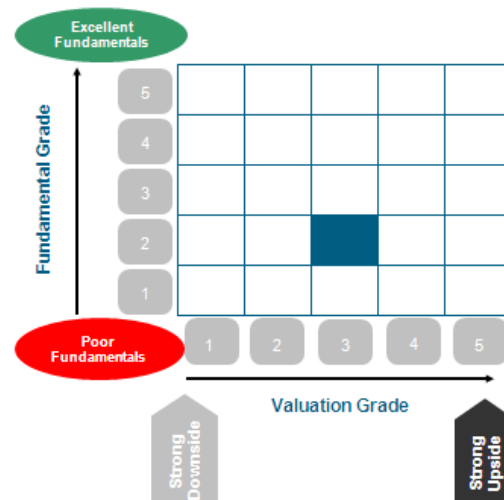
### Key forecast(consolidated financials)

(Rs Mn)	FY08	FY09	FY10	FY11E	FY12E
Operating income	2,950	4,209	4,318	4,639	5,011
EBITDA	374	1,026	1,464	1,529	1,714
Adj Net income	57	570	824	999	1,174
EPS-Rs	5.6	56.5	81.6	98.9	116.3
EPS growth (%)	(96.3)	n.m.	89.7	21.1	17.6
PE (x)	39.4	1.5	3.7	3.0	2.5
P/BV (x)	1.1	0.4	1.0	0.8	0.6
RoCE(%)	8.7	31.2	45.8	40.7	36.4
RoE(%)	2.8	26.5	31.3	29.4	27.2
EV/EBITDA (x)	7.8	1.2	1.6	0.9	0.4

n.m.: not meaningful

Source: Company, CRISIL Forecast

### CFV matrix



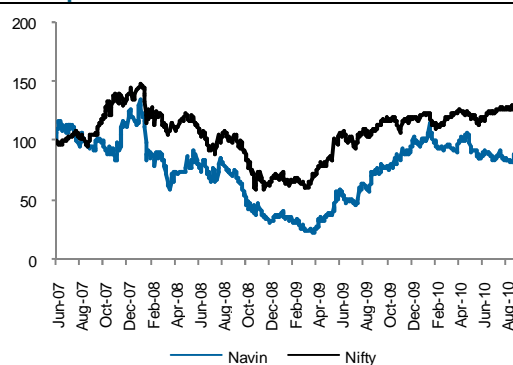
- Fundamental grade of '2/5' indicates moderate fundamentals
- Valuation grade of '3/5' indicates aligned market price

### Key stock statistics

	NAVINFLUOR
NSE Ticker	NAVINFLUOR
Fair Value (Rs per share)	300
Current market price (Rs per share)*	293
Shares outstanding (Mn)	10.1
Market cap (Rs Mn)	2,958
Enterprise value (Rs Mn)	2,264
52-week range (Rs) (H/L)	397/213
P/E on EPS estimate (FY11E)	3.0
Free float (%)	62.8%
Average daily volumes	15037.0

\* as on September 09, 2010

### Share price movement



-Indexed to 100

### Analytical contact

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Table 1: Business Environment

Parameter	Refrigerant gases	Specialty chemicals	Bulk Fluorides
Revenue contribution (FY10) - including CER income	62%	21%	14%
Revenue contribution (FY12) - including CER income	52%	29%	15%
Applications	M22 - residential air conditioning M134a - car air-conditioners and household refrigerators	Pharmaceutical, agrochemical and petrochemical industries	Metal industry, mainly the aluminum and steel industries
Geographic presence (revenue share in FY10)	Domestic 48%, exports 52%	Domestic 52%, exports 48%	Domestic 96%
Key export destinations	South-East Asia, Middle East, South Africa, Europe	Europe, USA, Asia	-
Client mix	Domestic – 50% sales to OEMs, 50% to exclusive stockists Exports – 40% to OEMs 60% to re-sellers	Domestic – Pharmaceutical and Agrochemical companies Exports – Agro and finechem companies, sold through resellers	Sold to traders and re-rollers for steel surface treatment
Raw materials used	Fluorspar, chloroform, sulphur		
Raw materials sourced from	Fluorspar - China, Mexico. South Africa Chloroform – Procured from domestic or international market depending on pricing Sulphur – Domestic and international sources		
Sales growth (FY07 to FY10 – 3-yr CAGR)	32%	5%	3%
Sales forecast (FY10 to FY12) – (organic growth)	-6%	58%	23%
Sales drivers	<ul style="list-style-type: none"> <li>Volumes to remain constant due to cap on production of M22 under the Montreal Protocol despite growing demand from developing countries</li> </ul>	<ul style="list-style-type: none"> <li>Increasing application in the pharmaceutical industry</li> <li>Established relationships with global pharmaceutical companies</li> </ul>	<ul style="list-style-type: none"> <li>Recovery in production of metals such as aluminium and steel</li> </ul>
Key competitors	<ul style="list-style-type: none"> <li>Chinese refrigerant players</li> <li>Domestic - SRF Ltd, Gujarat Fluorochemicals Ltd</li> </ul>	<ul style="list-style-type: none"> <li>International - Honeywell, BASF, Arkema, Rhodia, Saltigo and Chinese imports</li> <li>Domestic – SRF Ltd, Aarti Industries</li> </ul>	<ul style="list-style-type: none"> <li>International - Chinese imports</li> <li>Domestic - Tanfac Industries</li> </ul>
Key risks	<ul style="list-style-type: none"> <li>Impact on export realisations due to cheaper Chinese imports</li> <li>Uncertainty of regulatory environment under Montreal Protocol</li> <li>Uncertainty of cash flows from CER sales</li> <li>Exchange rate fluctuations</li> </ul>	<ul style="list-style-type: none"> <li>Threat of obsolescence due to short life cycle</li> <li>Competition from Chinese players</li> <li>Exchange rate fluctuations</li> </ul>	<ul style="list-style-type: none"> <li>Cyclicality in demand for aluminum and steel</li> <li>Exchange rate fluctuations</li> </ul>

Source: Company, CRISIL Equities

## Grading Rationale

### Navin is one of the four major fluorine players in India

There are four major players in the domestic fluorine market: Gujarat Fluorochemicals Ltd (GFL), SRF Ltd, Tanfac Industries and Navin. Navin has a nameplate hydrogen fluoride (HF) capacity of 22,000 tonnes. HF forms the base of the fluorochemicals industry. It is combined with chloromethane to make refrigerants, with boric acid or bromine or other organic chemicals to make specialty chemicals and with aluminium or ammonium compounds to make bulk fluorides. The company has two operational units – one each in Bhestan in Surat and Dewas in Madhya Pradesh.

**Table 2: Domestic fluorochemicals industry**

Company	HF Capacity	Key focus area in fluorochemicals	Other business segments
Navin	22,000	<ul style="list-style-type: none"> <li>Refrigerants</li> <li>Bulk fluorides</li> <li>Specialty chemicals</li> </ul>	<ul style="list-style-type: none"> <li>None</li> </ul>
Tanfac	15,600	<ul style="list-style-type: none"> <li>Mainly produces bulk fluorides for the aluminium industry</li> </ul>	<ul style="list-style-type: none"> <li>None</li> </ul>
SRF	12,000	<ul style="list-style-type: none"> <li>The only player in India to have successfully commercialised HFC 134a, an ozone-friendly refrigerant</li> </ul>	<ul style="list-style-type: none"> <li>Technical textiles</li> <li>Packaging films</li> </ul>
GFL	10,000	<ul style="list-style-type: none"> <li>Backward integration into chloroform (which is combined with HF to produce refrigerants)</li> <li>Forward integration into PTFE (in which refrigerants are an input)</li> <li>Buys HF from Navin</li> </ul>	<ul style="list-style-type: none"> <li>PTFE</li> <li>Chemicals</li> <li>Multiplexes</li> <li>Power</li> </ul>

Source – CRISIL Equities

### Growth of existing businesses constrained

#### Refrigerants: Dependent on CERs for profitability

#### Production capped under Montreal Protocol

The ozone-depleting refrigerant HCFC-22 is on an accelerated phase-out under the Montreal Protocol. Navin's refrigerants division derives 75% of its sales from M-22. As per the protocol, by FY13, no player can produce HCFC-22 beyond the average production attained during FY09 and FY10. Accordingly, Navin's refrigerants division sales are expected to be stagnant at around 10,000 tonnes.

#### HCFC market limited to developing nations

While the developed countries have already switched to non-polluting blends of HCFCs, the Montreal Protocol has currently permitted the use of HCFC-22 until FY30. However, it is to be noted that most of the incremental refrigeration units are being produced to use 134A and other chemicals, which are not as polluting as HCFCs. Hence, the market for HCFC is expected to decline in the longer term with complete phase-out by 2030.

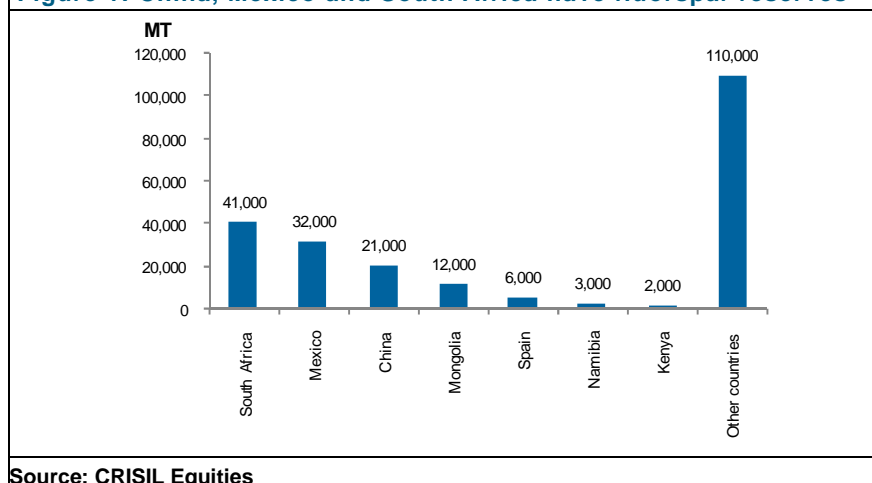
*Navin's flagship refrigerant is on an accelerated phase-out*

*A flood of Chinese refrigerants makes the segment barely profitable*

### China – largest producer of HCFC-22

By virtue of being an early signatory to the Montreal Protocol, India is disadvantaged in HCFC vis-à-vis China. Between 2000 and 2005, China increased its HCFC production capacity seven-fold and is now the market leader. Also, China has large reserves of fluorspar (key raw material for fluorine-based chemicals), while India currently imports most of its fluorspar requirements.

**Figure 1: China, Mexico and South Africa have fluorspar reserves**



Source: CRISIL Equities

### Domestic market is a small but assured market for refrigerants

The import of HCFC-22 is discouraged in India, providing an assured market for the Indian manufacturers. The total Indian market of HCFC-22 is estimated at around 9,000 tonnes (inclusive of PTFE demand) of which Navin enjoys about 25% market share. Navin derives about 19% of revenues from India and balance from other developing countries, mainly South-East Asia and Africa. In the highly competitive exports market, the additional revenues from CERs enable Indian players to make profits in the refrigerants segment.

### CERs – lifeline for Navin

Following the installation of a Clean Development Mechanism (CDM) in FY08 in collaboration with Ineos Flour (a global fluorochemicals major), the company has successfully stopped the release of HFC-23, a harmful by-product, into the atmosphere. According to CRISIL Equities estimates, this entitles Navin to around 2 mn saleable CERs or an average income of Rs 1,400-1500 mn each year till FY12 from the sale of the same. In the absence of this support, the profitability of the company would have been under severe stress.

*Low margins and uncertain demand make sales uncertain*

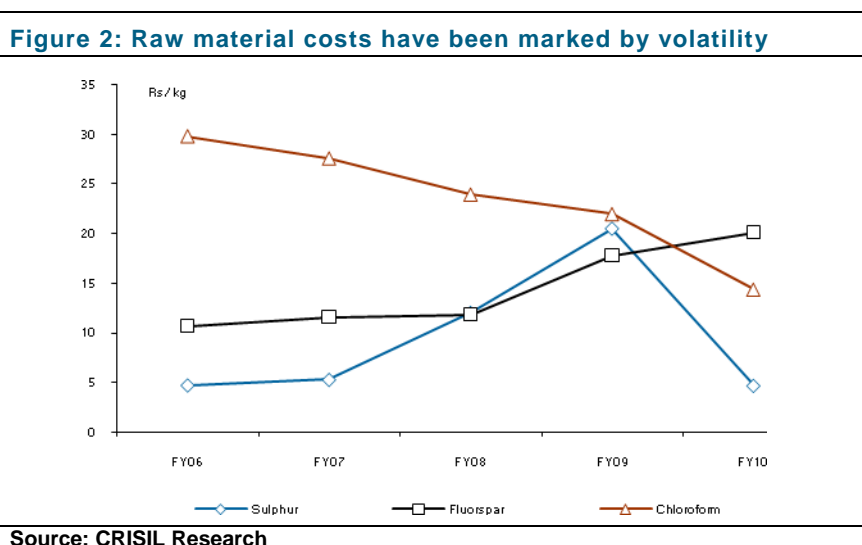
### Bulk fluorides: Demand slump hit volumes in the past two years

Bulk fluorides primarily comprise sale of HF, cryolite and ammonium bifluoride. In HF, the company sells only 40% of its production, while the balance is internally consumed for manufacturing refrigerants (40%) and specialty chemicals (20%). Sale of HF is primarily to domestic refrigerant makers for PTFE production and to re-rollers as well as smaller steel players to be used in processes such as surface treatment of steel.

### Bulk fluorides - low margin, volume-driven sales

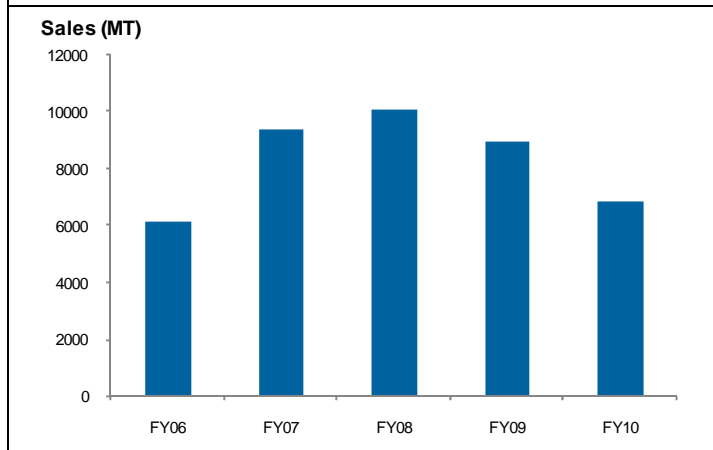
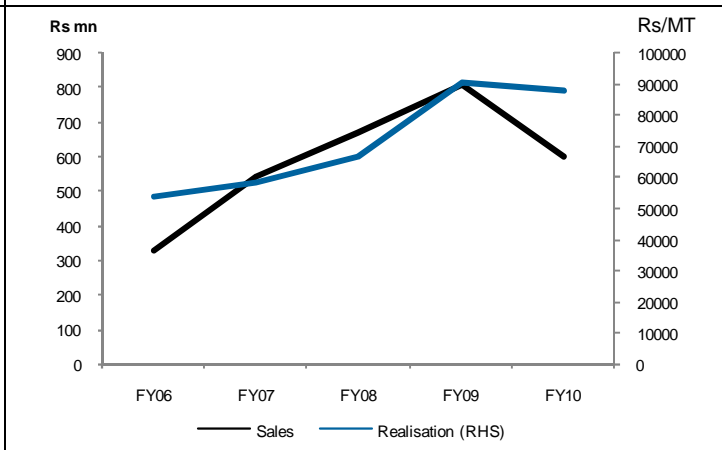
During the past five years, bulk fluorides registered average contribution margins of 16-18%, which is significantly lower than those enjoyed by the specialty chemicals. Bulk fluorides are characterised by:

- Domestic sales of high-volume and low-margin products
- Difficulty in raw material price management due to tremendous volatility
- Limited bargaining power with end-users
- Limited market size is due to difficulty in transportation of HF due to its hazardous nature



### Volumes have declined over the past two years

Volumes have declined for two consecutive years (by 11% in FY09, 24% in FY10) in the bulk fluoride segment due to the slump in aluminium and steel production. Revenues grew in FY09 due to a 50% realisation growth as Navin was partially able to pass on the rise in raw material prices. However, in FY10, sales declined due to continued slump in volumes with a 3% fall in average realisations.

<p><b>Figure 3: Sales across bulk products took a beating in FY09 and FY10</b></p>	<p><b>Figure 4: Double impact of realisations and volumes cause sales to slump in FY10</b></p>																														
 <table border="1"> <caption>Sales (MT) Data</caption> <thead> <tr> <th>Fiscal Year</th> <th>Sales (MT)</th> </tr> </thead> <tbody> <tr> <td>FY06</td> <td>6,000</td> </tr> <tr> <td>FY07</td> <td>9,500</td> </tr> <tr> <td>FY08</td> <td>10,000</td> </tr> <tr> <td>FY09</td> <td>9,000</td> </tr> <tr> <td>FY10</td> <td>7,000</td> </tr> </tbody> </table>	Fiscal Year	Sales (MT)	FY06	6,000	FY07	9,500	FY08	10,000	FY09	9,000	FY10	7,000	 <table border="1"> <caption>Sales and Realisation Data</caption> <thead> <tr> <th>Fiscal Year</th> <th>Sales (Rs mn)</th> <th>Realisation (Rs/MT)</th> </tr> </thead> <tbody> <tr> <td>FY06</td> <td>350</td> <td>50,000</td> </tr> <tr> <td>FY07</td> <td>550</td> <td>60,000</td> </tr> <tr> <td>FY08</td> <td>750</td> <td>80,000</td> </tr> <tr> <td>FY09</td> <td>800</td> <td>90,000</td> </tr> <tr> <td>FY10</td> <td>600</td> <td>80,000</td> </tr> </tbody> </table>	Fiscal Year	Sales (Rs mn)	Realisation (Rs/MT)	FY06	350	50,000	FY07	550	60,000	FY08	750	80,000	FY09	800	90,000	FY10	600	80,000
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### Recovery in volumes expected, to remain stagnant thereafter

The company has lost some clients to cheaper Chinese vendors during the FY09-10 period for non-HF bulk fluorides. Accordingly, we remain conservative on the volume growth in this segment. Over FY10-12, we project a 23% growth in sales, a partial recovery from FY10 levels, driven by increase in volumes to 8,300 tonnes, 17% lower than the 10,064 tonnes achieved in FY08.

### Focus on specialty chemicals: A step in the right direction

#### Specialty business currently dependent on limited range of products

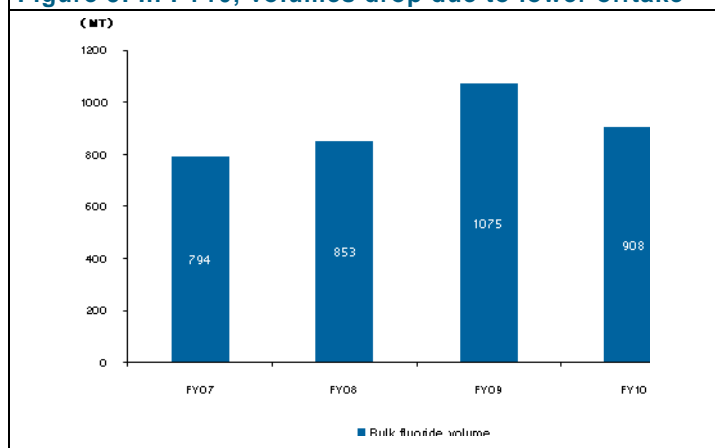
*Specialty segment needs to be a more diversified portfolio*

Navin's specialties segment comprises of sale of fluorine-based molecules finding niche applications in the pharma and agrochemicals industry. More than half of Navin's revenues from the specialty segment come from a limited product range, which has been well accepted by the pharmaceutical, agrochemical and petrochemical companies. This product range is currently supplied to domestic pharmaceutical and agrochemical companies. Navin is the only Indian player to have commercialised this particular product range— the American and European markets being serviced by players such as Honeywell, BASF and Arkema.

#### Sales of other specialty products have been under pressure

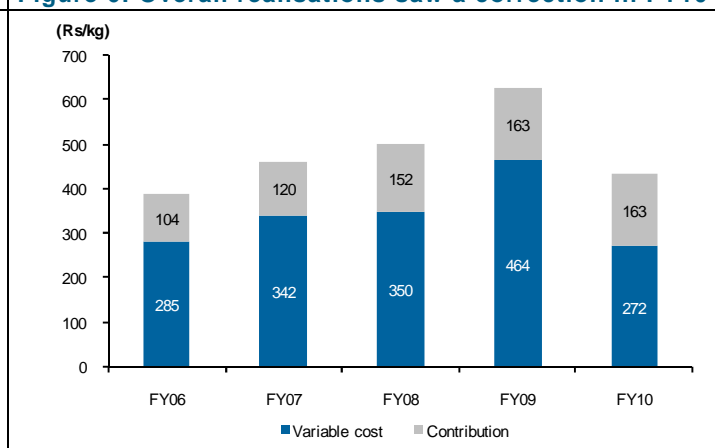
Other products in Navin's specialty chemicals basket include fluorobenzene and its derivatives which are mainly exported to global agrochemicals companies. Exports of the same were impacted in FY10 due to lower offtake, pulling down volumes. Sale of other specialty products were also impacted by lower offtake in FY10.

**Figure 5: In FY10, volumes drop due to lower offtake**



Source – Company

**Figure 6: Overall realisations saw a correction in FY10**



\* The bar represents total realization

Source – Company

**Investments in processes and people to augment revenue growth from specialties**

**Navin is strengthening R&D capability to ensure growth from specialty**

So far, the company has not been able to replicate the success of its main product range with other specialty products. It has identified strengthening its R&D capability to tap its expertise in fluorine chemistry. To this end

- In FY10, the company's R&D and pilot plant at Surat was commissioned at an investment of Rs 130 mn.
- The first multi-purpose plant was commissioned in Surat in July 2010, configured to manufacture about 15 variants of fluorochemicals.
- A US FDA compliant CGMP (Current Good Manufacturing Practices) pilot plant is expected to be commissioned by Q4FY11 at Dewas. CGMP facilities are pre-requisites for many of Navin's potential pharmaceutical clients.
- It is in the process of recruiting various senior-level R&D personnel to increase focus on new chemical development.

With the aforementioned initiatives, we expect revenues from specialties to grow at 58% from FY10-12, including revenues from the multi-purpose plant.

**Entry into CRAMS to open more opportunities**

Navin is the first domestic fluorochemicals player to have invested in CRAMS (Contract Research and Manufacturing Services). The company is in the process of setting up a full-fledged CRAMS centre, equipped with a CGMP pilot plant at Dewas in Madhya Pradesh. The CRAMS model works in two ways:

- The company is mandated to find a suitable application for fluorine molecules and payment is received if the company is successful; or
- The company is mandated to provide a process or chemistry from a catalog of processes currently followed by the pharma company (outsourcing).

Navin intends to follow both these models.

### Navin expects to move up the pharma value chain

In the pharmaceutical industry, molecules such as bromine and chlorine are being replaced by fluorine since it is considered more bio-effective. Currently, Navin's inputs to APIs are at the N-3 (read as N minus 3 steps, where N is the API stage) or N-4 stage. With the new CRAMS centre, the company intends to move to the N-2 and N-1 stages by a) Building R&D capability and b) leveraging its existing client relationships. Since this is a gradual time-consuming process, the benefits of this initiative are expected to be visible post FY12.

### Recruitment of experienced professionals to strengthen capabilities

In order to gear up for the growth opportunities in specialties, the company has made many senior level recruits. Recent senior recruits include Mr Shekhar Khanolkar, President - Specialties in FY08. A new R&D head, Mr Ashish Mukherjee, was recruited in FY09 to spearhead the CRAMS initiative. Mr Mukherjee brings 20-years of experience in CRAMS. Also, recruitment of business development executives in the US and Germany is currently underway. We believe that the recruitment of these personnel is a step in the right direction, benefits of which are expected to accrue over the next two-three years, initially through Multi-Purpose Plant, then through CRAMS.

*Navin has recruited qualified personnel to ensure success in specialties*

### Exploring inorganic growth opportunities

Navin has adequate cash balance of Rs 808 mn in FY10; combined with incremental CER income of around Rs 1.4-1.5 bn each year, cash reserves are expected to increase significantly. Hence, the company is looking at acquiring smaller specialty companies in Europe or the USA. These acquisitions are expected to improve the technology and processes of Navin. The company is trading cautiously, given the challenges of successfully acquiring and assimilating a foreign company. We have not factored in the income or capex from such an acquisition in our forecast.

### Concerns cloud over issuance and saleability of CERs

Navin would have made losses in FY10 if CER revenues were not factored in. This dependence on CER income makes the company's cash flows vulnerable to changes in the policy governing the CDM mechanism.

*Uncertainties around CDM make for uncertain cash flows*

Greenhouse gasses are covered by the Kyoto Protocol. Under this treaty, which recognises the greenhouse potential of HFCs (by products in HCFC production), companies capture and incinerate HFC by-products they produce, thereby becoming eligible for CERs. The Kyoto Protocol is expected to be reviewed in FY12, creating an uncertainty around the continuation, modification or replacement of the CDM mechanism post FY12. If the CDM is modified before or post FY12, Navin's sales could get adversely affected.

*Navin was demerged from MIL in 2002*

### **Funding of MIL's liabilities by Navin is history**

**Demerger from Mafatlal Industries Ltd:** Navin belongs to the Arvind Mafatlal Group of companies. It was demerged from the loss-making Mafatlal Industries Ltd (MIL) in 2002 under the sanctioned scheme of rehabilitation of the BIFR. It was also mandated to settle secured liabilities of MIL amounting to Rs 1490 mn. Further, as part of the promoters' contribution in the rehabilitation of MIL, Rs 900 mn was infused into MIL by Navin by way of investment in preference shares. The investment was written down to the extent of Rs 600 mn and the balance was sold.

**Navin is not expected to fund MIL's liabilities any longer:** After the settlement of secured liabilities of MIL, Navin continued to advance money from time to time to settle working capital and other secured liabilities of MIL through inter-company advances. However, the incidence of advances has been declining over the past few years. As of March FY10, advances amounting to Rs 558.5 mn were on the books of Navin. With the proceeds from an impending land sale by MIL (expected to be complete by Q3FY11), we believe these advances will be fully settled. Further, based on our interaction with the Chairman Mr. Hrishikesh Mafatlal, we believe MIL is no longer in need of funds from Navin and no amount from Navin is expected to be advanced to MIL in the future.

**Investment in MDL likely to be written back:** As of FY10, Navin held equity shares of Rs 155.3 mn in an unlisted group company, Mafatlal Denim Ltd (MDL). The entire amount of investment in MDL has been provided for diminution in value in FY10 since MDL is facing net worth erosion. However, MDL is witnessing a revival in operations and profitability, so we expect these to be written back.

Sale of residual assets in SSL (after repayment of all liabilities) amounting to around Rs 300 mn will also provide a potential upside to cash flows.

*Navin's investments in net worth-eroded MDL are likely to be written back*

## Financial Outlook

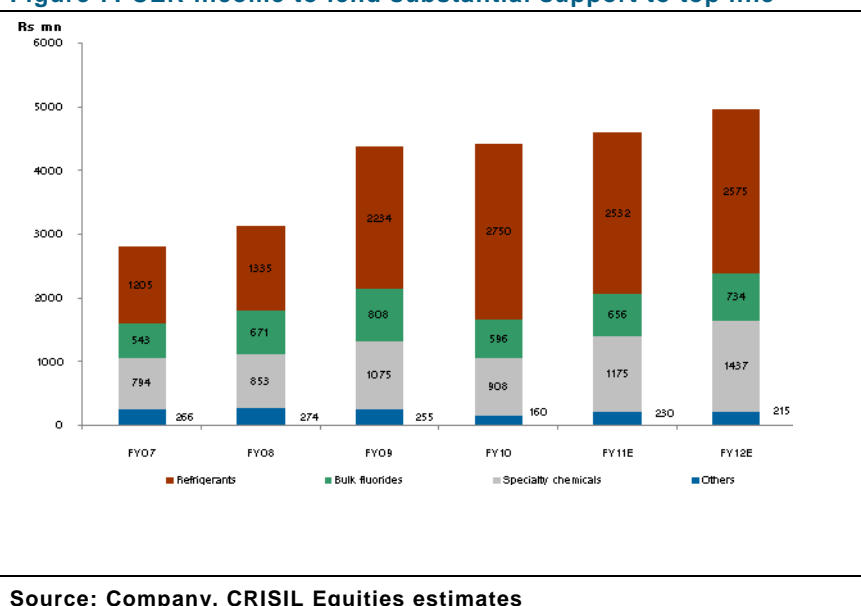
### Revenues to grow at 16% propped by CER income

We expect revenues to grow at a CAGR of 16% to Rs 5011 mn in FY12, driven by

- Refrigerants - Continuing issuance and sale of CERs amounting to Rs 1400-1500 mn each year (at the current market prices)
- Bulk fluorides – Revenue growth of 23% due to recovery demand
- Specialty chemicals – Revenue growth of 58% expected due to the commissioning of the new multi-purpose plant in FY12.

*Lower CER income to outweigh business growth in FY11*

**Figure 7: CER income to lend substantial support to top line**



Source: Company, CRISIL Equities estimates

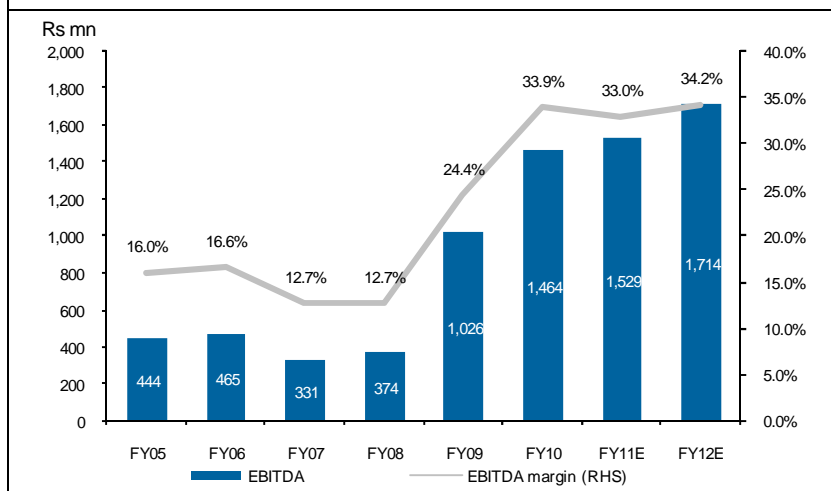
### EBITDA to improve, EBITDA margins to decline marginally

*EBITDA margin to be lower in FY11, to rise in FY12*

CER income is expected to be lower in FY11 due to contractual obligations under the CDM mechanism. This is expected to outweigh business growth and raw material price reduction for other segments. Hence, EBITDA is expected to grow at 4.4% in FY11. EBITDA margins are expected to be lower - to drop from 33.9% in FY10 to 33.0% in FY11. In FY12, EBITDA margins are expected to be higher at 34.2% due to:

- Higher revenues from all segments.
- Continued easing of raw material prices.
- Higher contribution from high-margin specialty products.

**Figure 8: EBITDA and EBITDA margins to drop in FY11 followed by a rise in FY12**



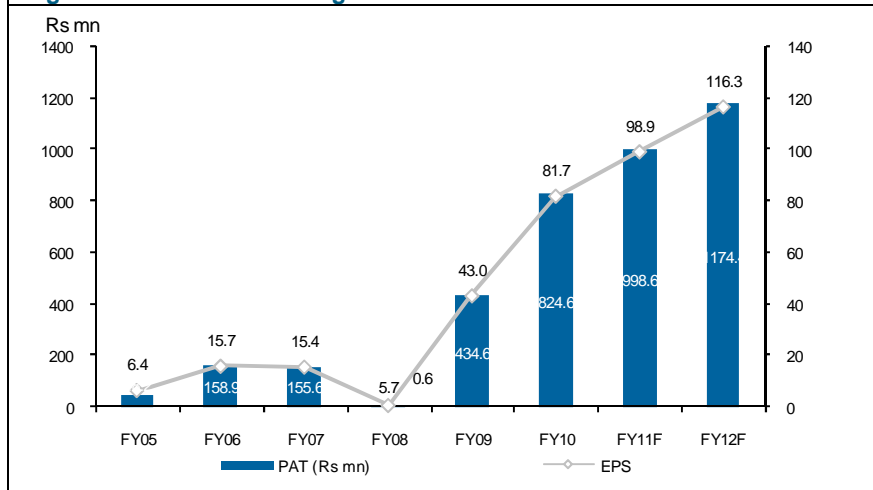
Source: Company, CRISIL Equities

**PAT and PAT margin to be higher – EPS to rise to Rs 116.3 in FY12**

*Growth in EPS driven by top line growth and margin improvement*

Navin’s PAT is expected to grow from Rs 824.6 mn in FY10 to Rs 999 mn in FY11 and further to Rs 1174 mn in FY12, primarily driven by growth in revenues and improvement in EBITDA. The payment of MIL’s liabilities is expected to lower the interest payment as well. The company’s EPS is expected to increase from Rs 81.6 in FY10 to Rs 98.9 in FY11 and further to Rs 116.3 in FY12. RoCE is expected to decline from 45.8% in FY10 to 40.7% in FY11 and to 36.4% in FY12.

**Figure 9: PAT and EPS to grow**



Source: Company, CRISIL Equities

We have assumed a dividend payout of Rs 14 per share, in line with FY10.

## Management Evaluation

*The promoter relies on professionals to run the business*

CRISIL Equities' fundamental grading methodology includes a broad assessment of management quality apart from other key factors such as industry and business prospects, and financial performance. Mr Hrishikesh Mafatlal, the promoter, relies on professionals to run the company.

### Success unproven in new areas

Since the refrigerant and bulk fluoride segments have stagnated, the identification of the specialty chemicals as a strategic focus area is an appropriate move. However, so far the growth in the specialties segment is largely single product-driven; there has been no significant successful commercialisation since then. In the past, an attempt to commercialise the refrigerant 134A in collaboration with Indian Institute of Chemical Technology was also not pursued to fruition.

For success in the specialty segment, the short product life-cycle in the pharma and agrochemicals industries, and the subsequent threat of obsolescence calls for quick and timely response in the form of innovation, something that remains unproven in Navin's case.

### Second line of management

*With the right people in the right place, success in specialty chemicals looks promising*

The second line of management comprises industry professionals with relevant experience in their respective fields, many of whom have been with Navin for a fairly long time. The focus on quality improvement and specialties is supported by the appointment of Mr Shekhar Khanolkar, President – Specialties, in 2007, Mr P.S. Haridas, Vice President, Supply Chain Management in 2008 and Dr. Ashish Mukherjee President, CRO and CRAMS in 2009. Based on our discussions with them, the newly appointed personnel are capable.

## Corporate Governance

CRISIL Equities' fundamental grading methodology includes a broad assessment of corporate governance and management quality, apart from other key factors such as industry and business prospects, and financial performance. In this context, CRISIL Equities analyses shareholding structure, board composition, typical board processes, disclosure standards and related-party transactions. Qualifications by regulators or auditors, if any, also serve as useful inputs while assessing a company's corporate governance.

### Board composition

Navin's board comprises ten members, five of whom are independent directors. This meets the minimum requirements stipulated in Clause 49 of the Securities and Exchange Board of India's (SEBI's) listing guidelines. The board includes industrialists and professionals with diverse backgrounds.

A majority of the independent directors have been on the board since 2003, and their suggestions and feedback are well-received by the promoters.

### Board processes

Our discussions with independent directors indicate that the board processes appear to be well structured, and audit committees and other committees, including grievance committee, are in place. The audit committee is chaired by an independent director, Mr T.M.M. Nambiar. The board meetings are conducted professionally with the detailed agenda reaching the board of directors on time. The attendance of independent directors for each of the meetings was hundred per cent in FY10.

### Significant related party transactions

In the past, Navin has provided support to its group companies by way of loans and advances, and investments in Inter Corporate Deposits (ICDs). Apart from the amount mentioned under the sanctioned scheme of rehabilitation, Navin also continues to take over the secured liabilities of MIL, which it currently accounts for under "advances". Based on our interactions with the management, we are confident of the amount being recovered from MIL. An investment in Mafatlal Denim Ltd (amounting to Rs 155.3 mn), has been written down completely since the net worth of the company was eroded. With a turnaround in MDL's operations in Q2FY11, we expect the amount to be written back.

*Fairly diversified board with well-structured processes*

*High level of related party transactions in the past – expected to be significantly lower from FY11 onwards*

**Valuation Grading**
**Grade: 3/5**

Navin's valuations are currently driven by the windfall income from CERs, the sustainability of which is under question beyond FY12. While the CERs are generating significant cash reserves which will be deployed by the company into the business through acquisitions, no progress has been made on this account yet.

Also, Navin has significant non-operating assets in the form of cash (from CERs), real estate, balances with group companies (cash equivalent) and investments in group companies through equity and preference shares. Accordingly, we prefer using the SOTP method, valuing the core business by way of PE method, and valuing the non-operating assets as per the following:

**Table 3: Sum of the parts valuation**

Nature of non-operating asset	Amount in Rs mn (Rs/share)	Discount for valuation	Reason for discount	Valuation – Rs per share
Cash (excluding core business) - FY12	Rs1624 mn (Rs162/share)	16%	Cash and bank at end of FY12, less business EBITDA discounted at cost of equity	136
Residual real estate assets in Sulakshana	Rs 300 mn (Rs 30 / share)	20%	Holding company discount	24
Interest bearing Advances to group companies	Rs559 mn (Rs56/share)	25%	Group companies are currently making losses at the PAT level. However, these companies are expected to pay interest (market rates) to Navin. Promoters are confident of recoveries to Navin.	42
Equity Investments in MDL	Rs155 mn (Rs 16/ share)	20%	While the probability of write back of MDL investments is high, we remain conservative on the timing of the cash flows	13
Preference shares in MIL	Rs 600 mn (Rs 60/ share)	25%	The company has turned net worth positive and accordingly has approached the BIFR for de-registration of its reference. Sale of MIL's real estate assets in prime areas of Mumbai are also expected to lead to cash flows	45
<b>Total without core business</b>				<b>260</b>
Core Business valuation	Rs 40	0%	Core business EPS for FY12 is estimated at Rs10 without considering CER income. We have valued this at a P/E multiple of 4x, the average valuations for chemicals industry.	40
<b>Total value of core business + non-operating assets</b>				<b>300</b>

Source: Company, CRISIL Equities

Should CERs continue beyond FY12, the company could generate cash of Rs 1.4-1.5 bn per year (pre-tax). Valuing the cash through DCF (using cost of equity of 16%, tax 33%), we arrive at Rs 236 per share. This is purely event driven and difficult to assess whether CERs will be continued beyond FY12. Accordingly, we prefer not to include this in our valuations.

At the current market price of Rs 293 per share, the stock is trading at 3.0x and 2.5x its estimated EPS of Rs 98.9 (FY11) and Rs 116.3 (FY12) respectively. Based on the above SOTP, we arrive at a fair value of Rs 300/share. Consequently, we initiate coverage on Navin with a valuation grade of '**3/5**', indicating that the current market price is '**aligned**' with our fair value.

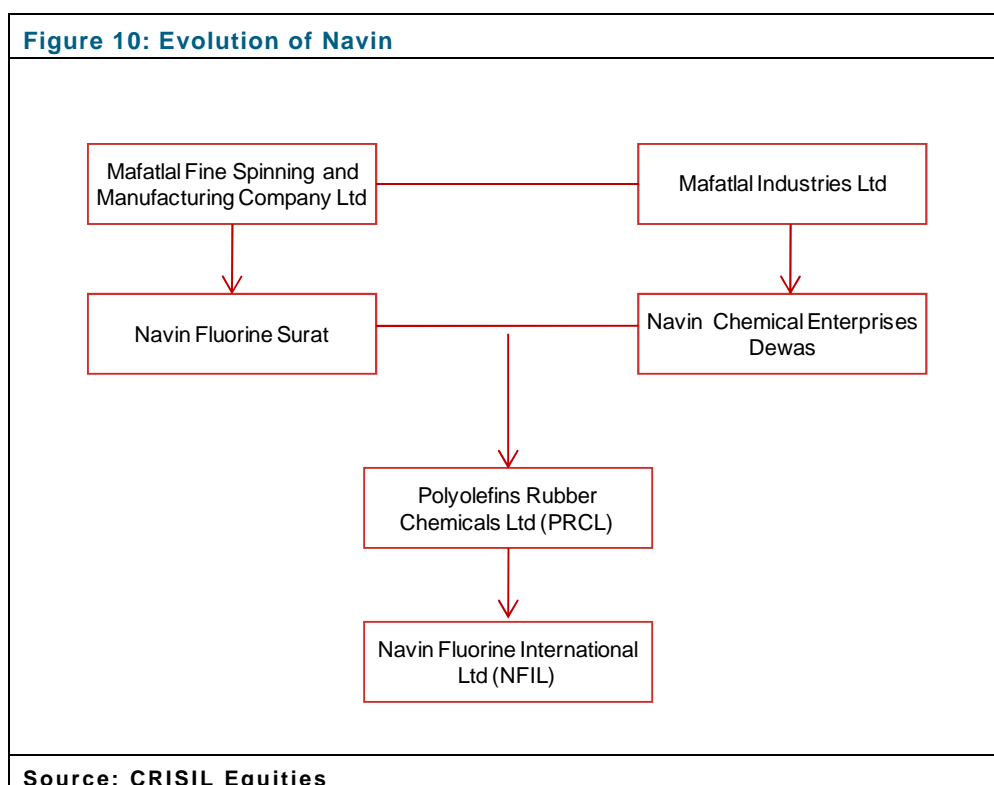
## Company and Business Overview

### Genesis of Navin

- The Surat unit of Navin was set up in 1967 as a division of Mafatlal Fine Spinning and Manufacturing Company Ltd (Mafatlal Fine). The division was then known as Navin Fluorine Industries.
- The Dewas unit of Navin was a division of Mafatlal Industries Ltd (MIL) and manufactured dye intermediates and pharma intermediates. It was then known as Navin Chemical Enterprises.
- Mafatlal Industries Ltd and Mafatlal Fine were merged in 1993 since many functions in the businesses were common. The two units constituted the chemicals business of MIL
- As part of the demerger of MIL's businesses in FY02, the chemicals business of MIL was demerged into what was then called PRCL. (Polyolefins Rubber Chemicals Ltd). PRCL was originally incorporated in 1998 for hiving off the rubber division of NOCIL, but was not engaged in any business activity.
- PRCL was listed in FY03 and it was renamed Navin Fluorine International Ltd in FY04.

*Navin was earlier PRCL*

**Figure 10: Evolution of Navin**



The equipment at Dewas was partly shifted to the Surat unit and a full-fledged CRAMS facility is currently being set up at Dewas.

**Table 4: Milestones**

1967	First fluorochemical plant in South-East Asia to produce HF, CFC and inorganic fluorides
1969	Commercial production of CFC/HCFC
1978	Dewas facility set up
1982	Smelter fluorides ALF3 capacity expanded
1990	CFC113 plant commissioned
1999	Production of organic and inorganic specialty fluoride commenced
2000	Production of fluorobenzene and Benzo - Trifluoride commenced
2001	BF3 commercialised
2003	Capacity expansion of specialty organic fluorides
2006	Capacity expansion of BF3
2008	New R&D centre set up
2009	Pilot plant ready
2010	Multi-purpose plant commissioned at Surat

## Annexure: Financials

### Income Statement

(Rs Mn)	FY08	FY09	FY10	FY11E	FY12E
Net sales	2,908	4,178	4,290	4,593	4,961
<b>Operating Income</b>	<b>2,950</b>	<b>4,209</b>	<b>4,318</b>	<b>4,639</b>	<b>5,011</b>
<b>EBITDA</b>	<b>374</b>	<b>1,026</b>	<b>1,464</b>	<b>1,529</b>	<b>1,714</b>
Depreciation	118	128	114	122	143
Interest	90	86	25	6	1
Other Income	(41)	37	(22)	97	191
<b>PBT</b>	<b>125</b>	<b>848</b>	<b>1,304</b>	<b>1,498</b>	<b>1,761</b>
<b>PAT</b>	<b>57</b>	<b>570</b>	<b>824</b>	<b>999</b>	<b>1,174</b>
No. of shares (mn)	10.1	10.1	10.1	10.1	10.1
<b>Earnings per share (EPS)</b>	<b>5.6</b>	<b>56.5</b>	<b>81.6</b>	<b>98.9</b>	<b>116.3</b>

### Balance Sheet

(Rs Mn)	FY08	FY09	FY10	FY11E	FY12E
Equity capital (FV - Rs 10)	101	101	101	101	101
Reserves and surplus	1,926	2,177	2,878	3,711	4,720
Debt	918	526	114	5	5
Current Liabilities and Provisions	1,456	1,304	1,359	1,438	1,525
Deferred Tax Liability/(Asset)	146	171	210	210	210
Minority Interest	-	-	-	-	-
<b>Capital Employed</b>	<b>4,546</b>	<b>4,281</b>	<b>4,662</b>	<b>5,466</b>	<b>6,562</b>
Net Fixed Assets	1,718	1,633	1,664	1,733	2,063
Capital WIP	290	281	278	140	140
Intangible assets	149	149	158	158	158
Investments	175	79	8	8	8
Loans and advances	593	771	884	950	1,026
Inventory	680	609	472	507	548
Receivables	714	608	390	381	412
Cash & Bank Balance	226	151	808	1,588	2,207
<b>Applications of Funds</b>	<b>4,546</b>	<b>4,281</b>	<b>4,662</b>	<b>5,466</b>	<b>6,562</b>

Source: Company, CRISIL Estimates

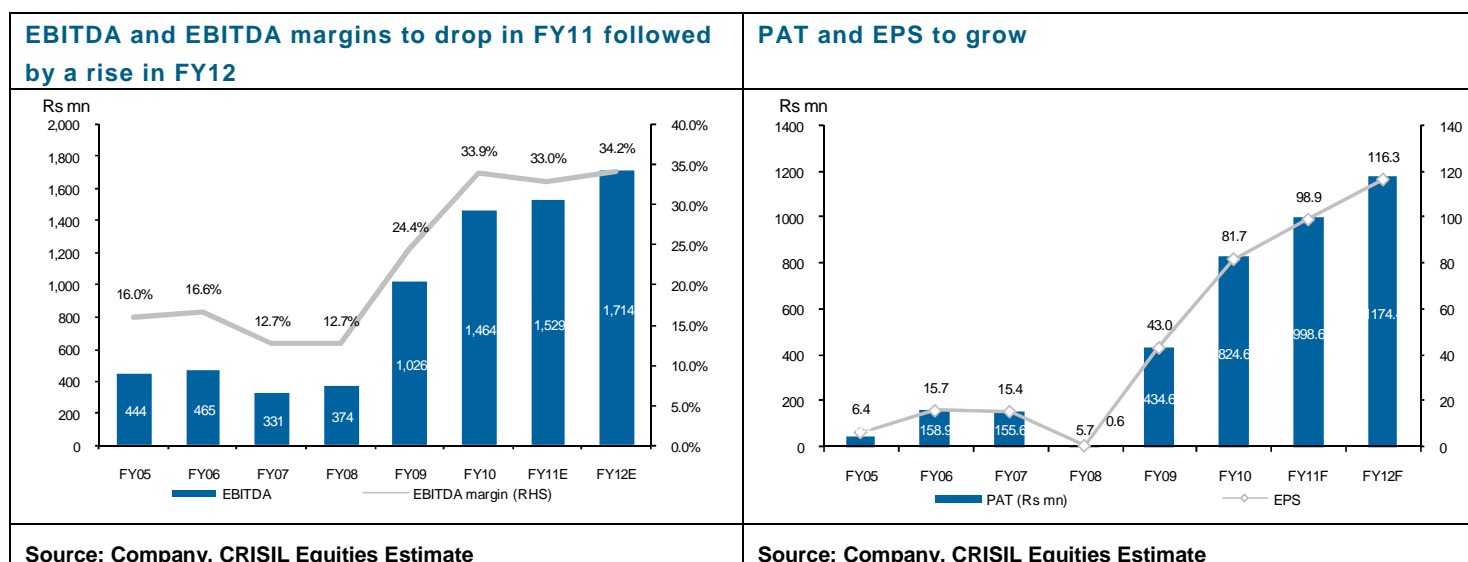
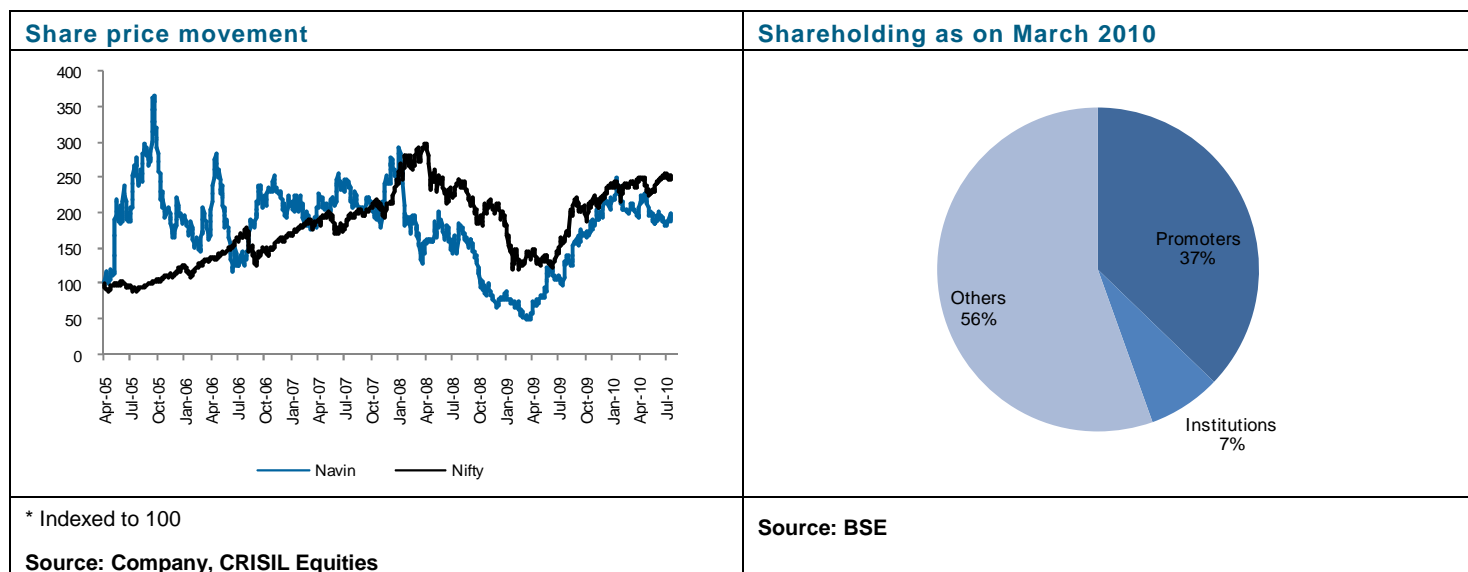
<b>Cash Flow</b>					
<b>(Rs Mn)</b>	<b>FY08</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11E</b>	<b>FY12E</b>
Pre-tax profit	125	848	1,304	1,498	1,761
Total tax paid	(18)	(253)	(441)	(499)	(587)
Depreciation	118	128	114	122	143
Change in working capital	(310)	(151)	288	(14)	(60)
<b>Cash flow from operating activities</b>	<b>(85)</b>	<b>571</b>	<b>1,264</b>	<b>1,107</b>	<b>1,257</b>
Capital expenditure	(221)	(33)	(142)	(53)	(472)
Investments and others	139	96	71	-	-
<b>Cash flow from investing activities</b>	<b>(82)</b>	<b>63</b>	<b>(71)</b>	<b>(53)</b>	<b>(472)</b>
Equity raised/(repaid)	0	0	0	-	-
Debt raised/(repaid)	(7)	(391)	(413)	(108)	-
Dividend (incl. tax)	(47)	(118)	(165)	(165)	(165)
Others (incl extraordinary)	(16)	(200)	42	-	-
<b>Cash flow from financing activities</b>	<b>(70)</b>	<b>(709)</b>	<b>(536)</b>	<b>(273)</b>	<b>(165)</b>
<b>Change in cash position</b>	<b>(237)</b>	<b>(75)</b>	<b>657</b>	<b>780</b>	<b>619</b>
Opening Cash	463	226	151	808	1,588
Closing Cash	226	151	808	1,588	2,207

<b>Ratios</b>					
	<b>FY08</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11E</b>	<b>FY12E</b>
<b>Growth ratios</b>					
Sales growth (%)	13.1	42.6	2.6	7.4	8.0
EBITDA growth (%)	13.0	174.2	42.8	4.4	12.1
EPS growth (%)	(96.3)	n.m.	89.7	21.1	17.6
<b>Profitability Ratios</b>					
EBITDA Margin (%)	12.7	24.4	33.9	33.0	34.2
PAT Margin (%)	1.9	13.5	19.1	21.5	23.4
Return on Capital Employed (RoCE) (%)	8.7	31.2	45.8	40.7	36.4
Return on equity (RoE) (%)	2.8	26.5	31.3	29.4	27.2
<b>Dividend and Earnings</b>					
Dividend per share (Rs)	4.7	11.7	16.4	14.0	14.0
Dividend payout ratio (%)	n.m.	27.2	20.1	14.2	12.0
Dividend yield (%)	2.1	13.7	5.5	4.8	4.8
Earnings Per Share (Rs)	5.6	56.5	81.6	98.9	116.3
<b>Efficiency ratios</b>					
Asset Turnover (Sales/GFA)	1.3x	1.7x	1.7x	1.7x	1.7x
Asset Turnover (Sales/NFA)	1.9x	2.5x	2.6x	2.7x	2.6x
Sales/Working Capital	7.8x	6.9x	8.1x	11.8x	11.6x
<b>Financial stability</b>					
Net Debt-equity	0.3	0.2	-0.2	-0.4	-0.5
Interest Coverage	2.9	10.4	54.1	236.4	n.m.
Current Ratio	1.5	1.6	1.9	2.4	2.7
<b>Valuation Multiples</b>					
Price-earnings	39.4x	1.5x	3.7x	3.0x	2.5x
Price-book	1.1x	0.4x	1.0x	0.8x	0.6x
EV/EBITDA	7.8x	1.2x	1.6x	0.9x	0.4x

n.m.: not meaningful

Source: Company, CRISIL Estimates

### Focus Charts





## About CRISIL Limited

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