

**Company Update**

September 13, 2012

| HDFC Sec Scrip ID | Industry | CMP | Recommended action | Averaging Band | Target | Time horizon |
|-------------------|-------------------|------------|--------------------------------|--------------------|---------|--------------|
| NATPEREQNR | Hydrogen Peroxide | Rs. 486.35 | Buy at CMP and add on declines | Rs. 433 to Rs. 454 | Rs. 577 | 2-3 quarters |

Company Background

National Peroxide Ltd (NPL) is jointly promoted by The Bombay Dyeing & Manufacturing Company and Solvay, Belgium. It was originally promoted by Bombay Dyeing and Laporte Industries, UK. At that point in time, the company had 2 divisions. The peroxygens division of the company that manufactured hydrogen peroxide and persalts and the plastic additives division, which produced litharge and PVC stabilizers. However, the plastic additives division was later sold out to M/s Barlocher India Additives Pvt. Ltd., an Indian arm of M/s Barlocher GmbH in June 2000. In 1970, Laporte joined hands with Solvay, Belgium, and formed a joint venture known as Interlox Coordination. In 1992, Solvay took over Interlox Coordination and became a shareholder of NPL and today has a stake of 25.1%. Earlier, Solvay and NPL had a technology agreement. However, as of today, NPL has its own in house R&D and technology support team while Solvay is merely a shareholder. The last two expansions carried out by NPL were done independently.

NPL is the largest manufacturer of hydrogen peroxide in India, with an installed capacity of 84,000 MTPA (expanded in FY12 from 68,000 MTPA) on 50% w/w basis (50% w/w means 50% Hydrogen Peroxide by weight; balance 50% of weight is water). It's fully integrated manufacturing site for hydrogen peroxide is located at Kalyan in Maharashtra (India). Other products sold by the company include hydrogen gas and sodium perborate.

Business

NPL derives 90-95% of its revenue from sale of hydrogen peroxide, 2-3% from hydrogen gas and the balance from sodium perborate.

| Split in Sales | FY09 | FY10 | FY11 | FY12 |
|-------------------------------------|--------|--------|--------|--------|
| Hydrogen Peroxide-50% (liquid form) | 90.5% | 91.3% | 94.8% | 94.5% |
| Hydrogen Gas (liquid form) | 8.0% | 6.3% | 3.7% | 3.8% |
| Sodium Perborate (powder form) | 1.5% | 2.4% | 1.5% | 1.6% |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |

(Source: Company, HDFC Sec)

Hydrogen Peroxide is a highly versatile chemical used in various industries for bleaching, chemical synthesis, environmental control/effluent treatment, sterilization etc. The single most important constituent of hydrogen peroxide is the 'active oxygen' that it provides in the aforementioned end-uses. The active oxygen is obtained by the controlled decomposition of hydrogen peroxide, with water as the by-product. Hence, whether it is bleaching, or chemical synthesis, the use of hydrogen peroxide provides a very clean process without the production of any harmful or environmentally unsafe products.

NPL's hydrogen peroxide is a concentrated aqueous solution containing 50% hydrogen peroxide by weight and is commonly referred to as hydrogen peroxide 50% w/w. It is specially stabilized for Indian climatic conditions. The company also produces hydrogen peroxide in 35%, 60% and 70% concentration. Hydrogen Peroxide is most commonly sold in the 50% w/w form, sometimes sold as 35%, 60% and 70% w/w and never sold in the 100% w/w form. NPL has pan-India presence and transports hydrogen peroxide via aluminum tankers or plastic jerry cans. The chemical is usually ordered in bulk quantities as one can save on packaging and transportation cost. End users have storage tanks at their facilities where the chemical is offloaded and stored. NPL sells largely to textile companies (~40% of sales) and paper companies (~40-45% of sales) with the balance going to chemical companies and for effluent treatment to refineries. A major part (~60-70%) of NPL's sales are directly to its customers while a small part (~30-40%) is done via dealers. Customers include companies like BILT, AP Paper, West Coast Paper, Tamil Nadu Newsprint and Papers, Bombay Dyeing, Arvind Ltd etc. Exports of Hydrogen Peroxide are currently low as domestic prices are more attractive to manufacturers.

NPL converts gas or naphtha into hydrogen and then processes it to form hydrogen peroxide. NPL has excess capacity to manufacture hydrogen and hence sells excess hydrogen in the market.

Sodium perborate (by-product of process) has applications in the detergent industry as bleach activator for stain removal. It is also used in denture cleaner, hair dye as fixer, oxidation of vat dyes as well as in laundry.

Subsidiary company

NPL has one wholly owned subsidiary called Naperol Investments Limited. The subsidiary made a profit of Rs. 63.3 lacs in FY12 vs Rs. 33.3 lacs in FY11. The subsidiary has a total number of 25,500 shares outstanding of Rs. 100 each. The company mainly deals in investments within India. Naperol holds small quantities of shares in companies like Bombay Dyeing & Manufacturing Company Limited, Bombay Burmah Trading Corporation Limited, ABB Ltd, Tata Chemicals, ACC Ltd, Colgate Palmolive India Ltd, Finolx Cables, Technojet Consultants Limited, J. K. Synthetics Limited, ICICI Bank Limited etc. The current market value of these investments is about Rs. 46 cr as compared to the book value of Rs. 1.14 cr. However, the main holding is in group companies and hence there are limited chances of value unlocking. Naperol declared a dividend of Rs. 150 per share of Rs. 100 in FY12. In addition to Naperol's investments, NPL has long-term investments with current market value ~Rs. 26 cr as compared to a book value of Rs. 1.0 cr.

**Shareholding pattern**

| Particulars | No of Shares (In Lakhs) | % Holding | | | | |
|------------------------------------|-------------------------|--------------|--------------|--------------|--------------|--------------|
| | | 30/06/2012 | 30/06/2012 | 31/03/2012 | 31/03/2012 | 31/12/2011 |
| Promoters | 40.3 | 70.1 | 70.1 | 70.1 | 70.1 | 70.1 |
| Foreign Institutions & Individuals | 0.2 | 0.4 | 0.5 | 0.4 | 0.4 | 0.4 |
| Indian Institutions | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Non Promoter Corporate Holding | 2.6 | 4.6 | 4.5 | 4.3 | 4.7 | 4.8 |
| Public & Others | 14.3 | 24.9 | 24.9 | 25.2 | 24.8 | 24.8 |
| Total | 57.5 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

(Source: Company, HDFC Sec)

Within the promoters' holding, 26.1% is held by foreign promoters while Indian promoters hold 44.0%. Solvay SA is the largest foreign promoter with a holding of 25.1%.

Triggers[NPL is a large-scale, focused player of hydrogen peroxide](#)

NPL is the largest producer of hydrogen peroxide in the country and commands a market share of 40-42%. In addition to being well known in the industry as a pioneer, its product commands a strong brand image. It has been in the forefront in the development of technology for manufacture of hydrogen peroxide, as well as new applications development. NPL is no longer dependent on Solvay for technology, but instead has its own in-house technology and R&D team.

Being a leader and due to the very wide versatility of hydrogen peroxide, NPL's technical services extends to almost all spheres of industrial activity in the country today. Laboratory trials and development work are invariably followed up with extended plant trials at the customer's premises. This has resulted in various new processes being developed in the processing of textile, both for the mill sector and the non-power hand-processing sector. Similarly, NPL's technical services personnel have been successful in optimizing the use of hydrogen peroxide in the bleaching of pulp for the paper industry. Very useful work has also been done in collaboration with various industries and civic authorities in the treatment of effluent waters. NPL, thus, offers its customers a complete range of technical services on all matters related to hydrogen peroxide application, storage, handling and usage. Any special problems, arising out of the circumstances of use, are also attended to.

The hydrogen peroxide industry mainly consists of four organized players (there are no unorganized players in this space). Key entry barriers include access to technology and a large initial capital investment. An 80,000 MT Greenfield plant of hydrogen peroxide could cost over Rs. 200 cr. Technology is available only from a few global developers but NPL is no longer dependant on other companies for technology. The key players in the hydrogen peroxide industry other than NPL include Gujarat Alkali (capacity of 39,080 MT on 100% w/w basis and market share of ~39%), Asian Peroxide (capacity of 13,000 MT on 10% w/w basis and market share of ~13%) and Hind Org Chemicals (capacity of 5,525 MT on 10% w/w basis and market share of ~6%). Of these Gujarat Alkali is of significance as the cost of production of hydrogen peroxide is slightly lower than NPL (as hydrogen is produced in-house as a by product of its other chemical manufacturing processes) and it is the only company with comparable capacity. Gujarat Alkali manufactures hydrogen peroxide by the auto oxidation process with technology of UHDE (Germany) and Chematur Engineering (Sweden). However, we would like to highlight that while competition from Gujarat Alkali is real, hydrogen peroxide is manufactured, as a value added by product while the main focus of the business is alkali. Hydrogen peroxide contributes a small % to Gujarat Alkalies topline. In FY12, it contributed 6.7% of sales of Rs. 1,862.6 cr. Hence, Gujarat Alkali's focus is not hydrogen peroxide while NPL is a dedicated hydrogen peroxide manufacturer with years of experience backing it.

In FY10, NPL de-bottlenecked its operations to increase its installed capacity to 65,000 MT from 54,000 MT. Additionally, NPL increased its capacity to 84,000 MT at a cost of ~Rs. 40 cr in FY12. The total production capacity in the country after accounting for added capacities in FY12 is 2 lakh MTPA (on a 50% w/w basis). As a result, the demand supply gap was bridged significantly and imports declined to very low levels. The domestic demand is expected to grow by ~5% p.a. during FY13, resulting in good supply demand balance. Prices of Hydrogen Peroxide could correct marginally from currently high levels on account of surplus capacities in Thailand, Pakistan and Bangladesh. However, currently they remain firm. Solvay commissioned a 330,000 MTPA 100% w/w plant in Thailand in FY12. The plant serves mainly as a captive raw material source for the manufacture of propylene oxide (PO) by Dow and Siam Cement Group (SCG). However, any excess production could result in exports to Indian markets. Hence prices are expected to remain under pressure in the near future. The Free Trade Agreement with ASEAN countries mainly Thailand, Malaysia and Singapore came into effect from 1 January 2010. As a result, the customs duty on imports of hydrogen peroxide from these countries was reduced from 7.5% to 5%. This is likely to have an impact on realizations. Additionally, there is no import duty on Hydrogen Peroxide imported from Pakistan and Bangladesh.

[Ability to run plant on naphtha or natural gas enables NPL to derive maximum benefits](#)

NPL's key raw materials include Naphtha or Natural Gas. The company has the ability to operate its plant on either Naphtha or Natural Gas. This flexibility in operation is an advantage for the company, as it can interchange the raw material based on price considerations. This has significantly contributed to the bottom line. For eg, until March 2008, NPL was running the plant on Naphtha. It thereafter switched over to natural gas due to certain cost benefits. In Aug-Sept 08, it switched back to Naphtha till March 2009 as natural gas prices had risen considerably. Once again, the company switched back to gas as it was the cheaper option and till date has been

running the plant on gas. From 1 January 2010, the company's long term supply agreement of gas with GAIL started and now the company has a steady, assured supply of gas for the next 16 years (vs short term contracts entered into earlier). While there are few differences in the quality of hydrogen peroxide manufactured via gas, the main difference is that the process using gas is a cleaner, more environmentally friendly process. It is assured supply while the price is linked via some formula to the price of Japanese crude cocktail as well as exchange rates. Overall, this augurs well for NPL as the price volatility is reduced (in comparison to naphtha as well as spot gas contracts) and the company is assured of steady supply. NPL also switched the fuel of its boilers from furnace oil to natural gas and this too has led to substantial cost savings for the company. With large-scale availability of natural gas, which is a vital input for hydrogen peroxide on a long-term contract basis, there is no concern in the supply situation. The volatility in the price of natural gas is also expected to reduce. However, natural gas prices have been increasing in the recent times and Rupee has been depreciating.

Overall, the ability to switch its raw material gives NPL a unique advantage and ensures that the company enjoys decent operating margins in most environments.

[Hydrogen Peroxide demand to remain strong given its versatile uses](#)

The most important chemical property of hydrogen peroxide is its ability to provide active oxygen to the process concerned. In most inorganic and organic compounds, which contain oxygen (e.g. water, metal oxides, alcohols, carbonates, etc.), the oxygen atom is bound to another type of atom and cannot be easily split off. Hydrogen Peroxide, on the other hand, contains the group -O-O- (oxygen atom) in which the two oxygen atoms are directly coupled to each other. The oxygen-oxygen link in such compounds can be broken, liberating one atom as active oxygen. Hydrogen Peroxide thus reacts (1) as an oxidant, (2) as a reductant, (3) to form other inorganic and (4) organic peroxy compounds, to form addition compounds. Its versatility is further enhanced by the following properties: (1) effective over whole pH range (2) high oxidation potential (3) non-contaminating by-product and (4) is a liquid and so, easy to use.

The properties described have given rise to a large and growing number of applications. Hydrogen Peroxide is used in following areas: **Chemical Synthesis, Textile Bleaching, Paper Pulp Bleaching, Sugar Bleaching, Non-Edible Oil Bleaching, Water and effluent treatment, Metallurgy and other applications.** In case of NPL, ~40-45% of its sales are to the paper industry, ~40% to the textile industry and the balance to chemical companies and for effluent treatment.

Textile Industry

Hydrogen Peroxide is undoubtedly the most versatile bleaching agent available to the textile industry. It offers advantages, namely ease of application, potential for reducing process times, minimization of effluent problems, preservation of textile fibre quality, a high and extremely stable degree of whiteness and harmless decomposition products (water & oxygen). Natural cellulosic fibres contain varying quantities of impurities, e.g. cottonseed, fats, waxes and pectins. Early bleaching processes required that most impurities be removed by alkaline or acid treatments. Hydrogen Peroxide bleaching in an alkaline medium often enables those pretreatments to be less severe or even eliminated whilst retaining the intrinsic qualities of the cellulose. Of special significance is the single stage bleaching process developed by NPL, wherein scouring and bleaching have been combined into a single step. Hydrogen Peroxide has also been successfully used in the cold bleaching of textile fabrics both in the organized sector as also in the urban/rural based hand-processing sector. Cold bleaching of hand-spun yarn with hydrogen peroxide prior to dyeing greatly increases the absorbency thereby reducing the consumption of expensive dyes. Hydrogen Peroxide is also used for bleaching of coir, jute fibres.

Next, wool and silk are also bleached easily with hydrogen peroxide. After scouring, wool may be bleached by immersion or pad and dry techniques, using alkaline or acid solutions. Prior to bleaching, silk is usually degummed. Hydrogen Peroxide addition assists this process and it is universally used as the bleaching agent for natural silk, usually in an alkaline solution. NPL has also developed single stage combined degumming and bleaching of silk especially for Tussah silk. Moving on, rayon and spun rayon, can also be bleached using hydrogen peroxide under mild conditions.

The Indian textile industry estimated to expand significantly from ~\$89 bn in 2012 to ~\$221 bn by 2021. The textile industry accounts for around 4% of the GDP, 14% of Industrial production and over 17% of the country's total export earnings. The textile industry is capital intensive and in recent years it has invested significantly on capital assets by acquiring sophisticated new machinery. This has gone a long way towards upgrading products to international standards and massive investment is expected further. All this has enabled the industry to entrench itself firmly and make an entry into the society of top fashion, formal and leisurewear garments. The textile industry is dependent on exports to a large extent. Given the global slowdown, the Indian Government has announced a number of measures to boost exports. Despite a challenging economic environment in its major markets of the US and Europe, India crossed the export target of \$300 billion for 2011-12. Total imports last fiscal also grew to \$485 billion, primarily because of high petroleum prices. Trade deficit, which grew to \$185 billion, is a big challenge for the current fiscal. However, the pace of export growth is slowing as the base effect wears out and demand from developed markets remains sluggish. India's exports in July contracted 14.8%, the steepest fall in three years, to \$22.4 billion, mainly due to the demand slowdown in the US and Europe. India has a target to achieve exports of \$350 billion for the current fiscal year, but the government needs to be watchful of uncertainty in the global environment. Exports had been consistently growing at a break-neck pace of close to 30%. The growth rate is now slowing as the wide gap with the previous year's levels steadily fades.

We believe that the Government's focus on the export sector augurs well for offtake of NPL's products as hydrogen peroxide is used by the textile industry. Further, India will have to be vigilant about its increasing trade deficit and hence an increase / maintaining growth in exports is paramount. Hence, continued support to the export oriented sectors until the US and Europe are not out of the woods could be expected in the medium term.



Paper Industry

Hydrogen Peroxide is used to bleach mechanical pulp, chemical pulp as well as waste paper pulp. Different types of paper require different amounts of hydrogen peroxide. For eg. recycled paper requires more hydrogen peroxide for bleaching than other forms. The brightness is more stable with Hydrogen Peroxide than with any other commercial bleaching agent. CMP, CSRMP of eucalyptus, CMP bagasse, Cold Soda Semi Chemical Pulp of hardwood and SGW of hardwood can be bleached to high degree of brightness using hydrogen peroxide. Hydrogen Peroxide is an environmentally safe oxidizing agent, which does not generate chlorine derivatives in the pulp suspension. Recirculation of bleaching effluents therefore becomes possible. For these reasons and its cost effectiveness, the use of Hydrogen Peroxide has good potential in chemical pulp bleaching as a partial replacement for chlorine, chlorine dioxide and sodium/calcium hypochlorite. Hydrogen Peroxide is used in all types of deinking processes, whether flotation or washing deinking. It is also used in recycling processes where ink is dispersed rather than removed.

The Indian paper industry has a long history with the first mill being commissioned in 1867, using rags and waste papers for raw materials. The industry got a major shot in the arm of early 1970s when the acute shortage of paper forced the Govt to grant excise concessions and subsidies on imports of cheap technology. Consequently, a large number of small players entered the sector, with the number of paper mills jumping from ~57 in 1971 to 135 in 1981. Industry capacity more than doubled from 0.77m mt to 1.65m mt during the same period. Presently, the industry has ~700 mills, with a significant amount of capacity concentrated amongst the smaller players with capacities of less than 7,500mt pa. The sector is expected to grow 7% per annum from the current about Rs 30,000 cr size to ~Rs. 60,000 cr by 2025. Currently, the Indian industry accounts for ~2.5% of the global production of paper. India imports 1.6 million tonne of paper per year, in which 1 MT comes under newsprint. The paper and paperboard industry is expected to cross 20 mn tones by 2020.

The demand for paper in India is expected to be strong. Paper is used for diverse purposes viz. writing, printing, decorating, tissues, etc. Additionally, it enjoys a wide consumer base i.e. across age groups and socio-economic strata. Paper has a short lifecycle. The consumable nature of paper results in short lifespan of paper thereby generating immediate replacement demand. Lastly there is no substitute for paper. Although polymeric and alternative replacements have been designed to substitute paper, the same are prohibitively expensive. With regards to India, specific factors contributing to the increasing demand for paper are as follows (1) The ongoing phase of economic growth is a major factor boosting consumption of paper and paperboard. This is most evident from growth of the FMCG and print sectors, which are end users for this product. (2) Increasing government spend on education and rising levels of literacy are spurring paper consumption in the form of demand for textbooks, newspapers, magazines, etc. (3) Lastly, the historically low levels of per capita consumption in the country coupled with the growth in population are also resulting in an upward trend in paper demand.

Other end users of Hydrogen Peroxide

Hydrogen Peroxide has a number of other uses. For eg, it is used for sugar and syrup bleaching, non-edible oil bleaching, water and effluent treatment, hydrogen sulphide control, detoxification of industrial wastewater, cleaning of waste gases etc. **We believe that the use of hydrogen peroxide for effluent treatment could gain traction going ahead as in the developed economies.**

There are several areas in which Hydrogen Peroxide can assist environmental protection. Since its own ultimate decomposition products are water and oxygen, it is not itself a source of pollution. Sewage frequently has to be pumped over long distances. Anaerobic conditions can then develop in the sewer system leading to the production of hydrogen sulphide with consequent odor and corrosion problems. Injection of Hydrogen Peroxide into the sewer can both eliminate any sulphide already developed and maintain aerobic conditions, thus preventing further sulphide formation. Sludges and leachate from municipal and industrial refuse tips are frequently subject to the same problems, which Hydrogen Peroxide can cure.

Next, hydrogen peroxide provides an effective means of treating certain toxic industrial pollutants such as cyanides, phenols, nitrites and sulphides. For example, wastewater encountered in refinery, chemical or pharmaceutical operations can be treated with hydrogen peroxide. In fact, many refineries have now started purchasing Hydrogen Peroxide from NPL. Oxidation processes have been developed in which hydrogen peroxide is catalyzed in various ways according to the nature of the pollutant present, thus achieving detoxification in the most effective manner. As a potential source of oxygen, hydrogen peroxide is used in biological treatment, particularly at times of overload, for the treatment of bulking sludges, and for the prevention of denitrification in settling tanks.

Hydrogen Peroxide is also used in other applications such as metallurgy, electronics industry (etching of printed circuit boards and in other cleaning and etching process throughout the industry), polymer manufacture, cosmetics, pharmaceutical antiseptic, sterilization, dye oxidation, starch modification, antichlor, manufacture of foams, source of oxygen and energy and bleaching of naturally occurring products.

In summary, given the healthy demand from the textile and paper industry as well as the diverse applications of hydrogen peroxide, we believe the demand for hydrogen peroxide could remain healthy. NPL, being a market leader, is ready to capitalize on this demand leading to robust growth in profit for the company. NPL could benefit from its expansion leading to volume growth.

[Increase in capacity to lead to volume growth](#)

NPL completed a ~Rs. 40 cr expansion in FY12. Capacity increased from 68,000 MT to 84,000 MT. The estimated shutdown of the plant to incorporate the new capacities took longer than estimated. The plant was shut from 11th April 2011 to 21st June 2011 while commercial production only started on 1st September 2011. NPL had inventory of 5,422 MT of Hydrogen Peroxide (H₂O₂) for the shutdown period. However, due to the extension of shutdown and the prevailing market conditions, there was a loss of ~1,500 MT of Hydrogen Peroxide by way of sales. In FY12, NPL produced 57,624 MT of Hydrogen Peroxide, as compared to 71,826 MT in FY11.

NPL sold 61,240 MT of Hydrogen Peroxide in FY12, as against 66,806 MT in FY11. The lower demand in the market led to a decrease in prices, resulting in lower profit for the year. The company, however, continues to maintain its prime position in the market and held ~40% market share during the year. NPL is now running at ~90% utilization levels (manufactured 19,178 MT in Q1FY13) and we expect the plant to continue running at a similar rate for the rest of the year. Next year we expect volumes to increase further as NPL ramps up production above 95% utilization levels. While NPL was unable to leverage the advantage of added capacities in FY12, we believe the company can now ramp up production as long as realizations remain good.

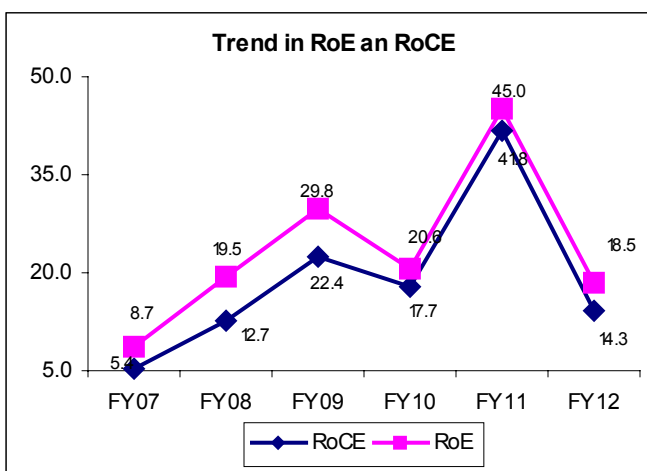
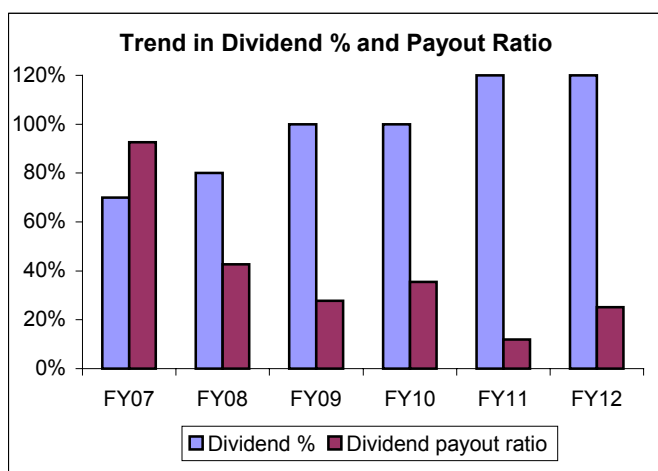
The capex was mainly funded via internal accruals. NPL has also set up infrastructure to take its capacity of hydrogen peroxide upto 95,000 MT. It has the necessary land as well as hydrogen gas capacity. The company is currently studying the feasibility of this expansion. In the future, the company could further increase capacity within a short time frame.

Healthy Financials & Dividend Yield

NPL has been paying dividend consistently for the past few years. Dividend % increased from 100% in FY10 to 120% in FY11 and FY12. At the current market price, a dividend of Rs. 12 gives a yield of 2.5%.

Next, in FY10, NPL prepaid the balance term loans and thereafter the company does not have any long-term borrowings. At this point in time, NPL is a debt free company (in terms of long-term borrowing) and going ahead as well the company plans to keep debt levels low. Healthy cash generation permits the company to incur all expenses via internal accruals.

In terms of return ratio, NPL's RoE and RoCE are expected to rise in FY13 and FY14 after a sharp drop in FY12. We expect ROE and ROCE to increase to FY10 levels by the end of FY13 and then increase even further.



(Source: Company, HDFC Sec)

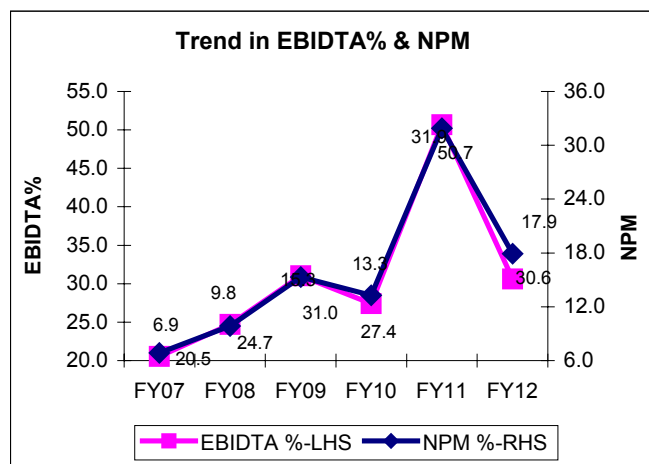
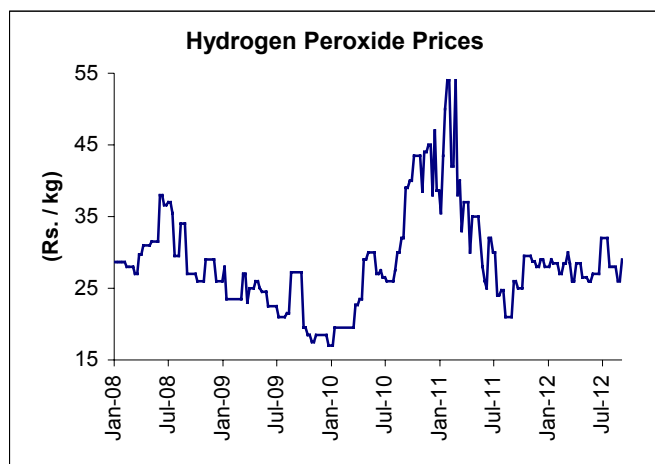
Lastly, NPL also has hidden assets in the form of investments in group companies like Bombay Dyeing & Manufacturing Company Limited and Bombay Burmah Trading Corporation Limited in its own books and in the books of its subsidiaries. The total market value of these investments is to the tune of ~Rs. 72 cr (~Rs. 126 per share) and hence provides an additional layer of comfort.

Stellar Q1FY13 & Positive Outlook

Q1FY13 results are not directly comparable to those of Q1FY12 as the plant was not operational for most of Q1FY12. In Q1FY13, NPL reported a healthy jump in topline to Rs. 49.3 cr, up 102% y-o-y and 3.0% q-o-q. The y-o-y increase was largely on account of higher volumes as the plant was shut in Q1FY12 to incorporate expanded capacities. Street prices of Hydrogen Peroxide currently are ~Rs. 29/kg, down ~45% from their highs of Rs. 50+ in FY11 but still fairly strong. Prices were at similar levels in FY09. Margins have bounced from lower levels last year however, they remain below the all time high margins of FY11. FY11 and FY12 were both unusual years (however on good and bad extremes). In FY11, NPL is got the advantage of high realizations and volumes due to a large supply-demand deficit and high utilizations. At the time, NPL and Gujarat Alkali had both announced shutdowns to expand their capacities, which created concern among the consumers, who started stocking up on Hydrogen Peroxide at even exorbitant rates. India imports less than 10% of consumption of Hydrogen Peroxide each year to bridge the supply-demand gap. However, now with added capacities by domestic players, this could get reduced. The local manufacturers could maintain production in such a way so as to not allow the prices to dip significantly. The Government had in the past imposed anti dumping duty on Hydrogen Peroxide originating in, or exported from, the People's Republic of China, European Union, Indonesia, Korea ROK and Turkey.

EBIDTA margins during the quarter expanded to 36.5% from 19.2% in Q1FY12 and 31.3% in Q4FY12 due to lower price of gas (long term supply agreement), higher realization of hydrogen peroxide and low staff cost and other expenses. Interest and depreciation costs were in line with those of previous quarters after expanded capacities came into play. NPL reported a bottomline of Rs. 11.0 cr, up 411.6% y-o-y and 14.0% q-o-q. This translates into an EPS of Rs. 19.2 for the quarter.

In FY13, we expect NPL to ramp up production fast however utilization could be ~90%. The company could sell ~75,000 MT of hydrogen peroxide (volume growth of ~22% y-o-y). Additionally, we expect realizations to inch up marginally for the year based on current price trends. In FY14, we expect the plant to run at ~95% utilization and expect sales volume growth of ~8%. We expect realizations to improve marginally in FY14. Cash generation for both years is expected remain strong.



(Source: Company, HDFC Sec)

Concerns

Competition could lead to decrease in realizations of hydrogen peroxide and impact profitability

NPL faces competition from imports from Asia and domestic players like Gujarat Alkali, Asian Peroxide and Hind Org Chemicals. India signed a Free Trade Agreement (FTA) with ASEAN countries on August 13, 2009 after 6 years of negotiation on sideline of meeting of Economic Ministers of ASEAN. India's trade with ASEAN countries is mainly with Singapore, Malaysia and Thailand. As a result of the FTA, the customs duty of imports from Thailand has been reduced from 7.5% to 5%. This is likely to put pressure on domestic prices. Solvay has setup a mega plant in Thailand for Hydrogen Peroxide from which a large quantity is available for their domestic and export markets in 2012. India imports less than 10% of consumption of Hydrogen Peroxide each year. Increase in capacity by players like Guj Alkali along with increase in supply overseas could result in an oversupply in the domestic market leading to a fall in realizations.

Volatility in exchange rate & slowdown in textile sector

The volatility of the exchange rate of Rupee vis-à-vis USD has a dual impact on NPL. Depreciation of the INR could have a positive impact on export of textiles. This could lead to increased consumption of Hydrogen Peroxide. However, NPL is a net importer of raw material and LNG (linked to JCC) (Net forex used in FY12 was to the tune of Rs. 10 cr) so INR depreciation is detrimental. However, depreciation of Rupee gives NPL the flexibility to raise prices as the landed cost of imported goods become higher.

Slowdown in economies overseas to impact textile sector

The textile sector is export oriented and hence depends on the US, UK and Europe for demand. Adverse economic conditions in these geographies could impact offtake for hydrogen peroxide negatively.

Slowdown in use of paper

There is a significant change in the way in which the Publishing industry is evolving. Many books are now available on electronic devices such as the Kindle and iPad. Similarly there is a trend to go paperless by making use of a system or a set of systems that work entirely online and without the need of paper. The other aspect of paperless office philosophy is the conversion of paper documents, photos, engineering plans, microfiche and all the other paper based systems to Digital documents. These over a period of time could reduce the demand for paper, which is a major consumer of Hydrogen Peroxide.

Single product, single location company

NPL carries the risk of business failure in the long run due to high dependency on single product as well as the risk of obsolescence of technology for manufacturing Hydrogen Peroxide. Further, any prolonged shutdown of its plant at Kalyan or for any reason if operations at Kalyan are disrupted the company could be impacted negatively.

Dependent on gas supply from GAIL and raw material prices

Any disruptions of gas supply could adversely impact NPL. However, the company could switchover to naphtha in the interim. The company has entered into a long-term agreement with GAIL (India) Limited (GAIL) for purchase of Natural Gas. The agreement is valid till 30th April 2028. As per the said agreement, the company under 'Take or Pay obligation' clause has to make payment for a fixed quantity of gas on an annual basis, whether used or not. However the shortfall can also be adjusted against the next year's consumption. GAIL has the discretion to waive off the said Take or Pay charges. NPL even currently does not use the entire amount decided under the contract and till date GAIL has not levied such charges and the company also does not foresee any liability on this account in the near future.

GAIL bills NPL fortnightly, resulting in price adjustment every 2 weeks. However, even with these minor fluctuations, gas obtained from GAIL via the long-term contract is far cheaper than that obtained at the spot gas rate or the price of Naphtha. Natural gas prices are dependant on crude oil prices. In FY12, the price of crude oil and consequently Natural Gas rose significantly, thereby impacting the cost of production.

Low realizations due to poor market conditions and increase in supply:

The decline in the sales volume during FY12 was partially due to the shutdown in NPL's plant and sluggish market conditions. The decline in profit was due to lower sales realization arising from higher imports at lower prices. While realizations and demand have picked up since, the possibility of a recurrence is a major concern.

Annual maintenance shutdown:

NPL had its last annual maintenance shutdown in April-June 2011 when the plant was shutdown to incorporate new capacities. The next scheduled shutdown is in March or April 2013. The annual shutdown lasts 15 days and could affect the results of the quarter it is taken in.

Royalty to Wadia group:

NPL pays a 0.25% of net sales as royalty to the Wadia group since October 2011 for accessing shared services and group expertise. While this royalty treatment has already been accounted for a few quarters, it does eat into the EPS of NPL.

Low trading volume:

NPL's stock is thinly traded on the bourses. Average trading volume for the past 2 weeks has been ~6,400 shares per day with volumes dropping below 1,000 shares per day on some days as well. Investors taking large positions in NPL should take into consideration the difficulty of entry/exit.

Conclusion

National Peroxide Ltd. is the largest manufacturer of hydrogen peroxide in India with 40-42% market share. It has a strong brand image and diverse clientele. The company was established in 1954 and has a manufacturing facility is at Kalyan in Maharashtra. Other products manufactured by the company include hydrogen gas and sodium perborate. To meet the increasing demand the company expanded capacity of hydrogen peroxide from 68,000 MT to 84,000 MT per annum. Hydrogen Peroxide is widely used in various industries for bleaching, chemical synthesis, environmental control, effluent treatment, sterilization etc. End user industries are mainly Paper, Textiles etc. These industries are doing well and the company expects strong demand in the quarters to come.

NPL also has hidden assets in the form of investments in-group companies like Bombay Dyeing & Manufacturing Company Limited and Bombay Burmah Trading Corporation Limited in its own books and in the books of its subsidiaries. The total market value of these investments is ~Rs. 72 cr, which provides an additional layer of comfort.

Current realizations could come under pressure as competitors (domestic and global) ramp up capacities thereby increasing the supply. Gujarat Alkali's new capacities and Solvay's new plant in Thailand could put pressure on prices as supply increases. Slowdown in user industries due to economic slowdown or the influence of forex fluctuation is another concern for NPL. Lastly, dependence on GAIL for raw material, while giving the comfort of continuous supply, exposes NPL to the risks that govern GAIL's production.

NPL is an operationally and financially efficient commodity player. At the current market price of Rs. 486.35, NPL is available at 6.6x and 5.9x its FY13 (E) and FY14 (E) EPS of Rs. 73.7 and Rs. 82.5 respectively. Based on the Forward P/E of NPL, we expect the stock to trade at ~7x its FY14 (E) EPS. Accounting for the investments of the company (with 50% haircut) and its Core EPS, the sum-of-the-parts value of NPL comes to Rs. 606. We feel investors could buy the stock at the CMP and add on dips to the Rs. 433-454 (5.25-5.5x FY14 (E) EPS) band for a target of Rs. 577 (7x FY14 (E) EPS).

SOTP Working:

| Particulars | FY14 |
|--|--------------|
| EPS Standalone | 82.5 |
| Core EPS (excluding Investment income) | 77.6 |
| P/E multiple | 7 |
| Core value per share | 543 |
| Market value of Standalone investments after 50% haircut | 22.5 |
| Market value of subsidiary investments after 50% haircut | 40.3 |
| Total | 606.0 |



Financials

Quarterly Results

| Particulars (Rs. Cr) | Q1FY13 | Q1FY12 | %YoY | Q4FY12 | % QoQ | Q3FY12 | Q2FY12 |
|-------------------------|-------------|-------------|---------------|-------------|--------------|-------------|-------------|
| Net Sales | 49.3 | 24.4 | 102.0% | 47.9 | 3.0% | 42.1 | 38.9 |
| Other Operating Income | 0.1 | 0.4 | -75.9% | 0.0 | 4278.3% | 0.2 | 0.1 |
| Other Income | 1.1 | 0.6 | 81.7% | 0.8 | 35.7% | 0.2 | 0.6 |
| Total Income | 50.5 | 25.4 | 98.6% | 48.7 | 3.7% | 42.5 | 39.6 |
| Operating Expense | 31.4 | 20.1 | 56.4% | 32.9 | -4.6% | 28.0 | 25.9 |
| Operating Profit | 19.1 | 5.4 | 256.3% | 15.8 | 21.1% | 14.5 | 13.7 |
| OPM (%) | 36.5% | 19.2% | | 31.3% | | 33.9% | 33.6% |
| Interest | 0.1 | 0.1 | -35.1% | 0.1 | -18.3% | 0.1 | 0.1 |
| Depreciation | 2.7 | 2.1 | 29.9% | 2.8 | -2.0% | 2.8 | 2.3 |
| PBT | 16.3 | 3.2 | 417.5% | 12.9 | 26.4% | 11.6 | 11.3 |
| Tax | 5.3 | 1.0 | 430.1% | 3.2 | 63.4% | 3.7 | 3.5 |
| PAT | 11.0 | 2.2 | 411.6% | 9.7 | 14.0% | 7.9 | 7.8 |
| NPM (%) | 22.4% | 8.8% | | 20.2% | | 18.7% | 20.1% |
| EPS (Annualized) | 19.2 | 3.8 | 411.6% | 16.9 | 14.0% | 13.7 | 13.6 |
| P/E | 6.3 | 32.4 | | 7.2 | | 8.9 | 8.9 |

(Source: Company, HDFC Sec)

Profit & Loss A/c

| Particulars (Rs. Cr) | FY09 | FY10 | FY11 | FY12 | %YoY | FY13 (E) | FY14 (E) |
|-------------------------|--------------|--------------|--------------|--------------|---------------|--------------|--------------|
| Net Sales | 135.0 | 121.9 | 181.6 | 153.3 | -15.6% | 195.4 | 221.7 |
| Other Operating Income | 0.8 | 0.5 | 0.3 | 0.7 | 142.8% | 1.0 | 1.2 |
| Other Income | 0.2 | 0.1 | 3.0 | 2.2 | -26.8% | 3.0 | 3.5 |
| Total Income | 136.0 | 122.5 | 184.9 | 156.2 | -15.5% | 199.4 | 226.4 |
| Operating Expense | 93.7 | 88.9 | 89.8 | 106.9 | 19.0% | 125.9 | 145.1 |
| % of sales | 69.4% | 72.9% | 49.4% | 69.7% | | 64.4% | 65.4% |
| Operating Profit | 42.4 | 33.6 | 95.1 | 49.3 | -48.2% | 73.5 | 81.3 |
| OPM % | 31.0% | 27.4% | 50.7% | 30.6% | | 35.9% | 34.9% |
| Interest | 3.0 | 1.3 | 0.8 | 0.4 | -46.3% | 0.3 | 0.4 |
| Depreciation | 8.2 | 8.3 | 8.4 | 10.0 | 19.2% | 11.2 | 11.0 |
| PBT | 31.2 | 24.1 | 85.9 | 38.9 | -54.8% | 62.0 | 69.9 |
| Net Tax | 10.5 | 7.9 | 28.0 | 11.4 | -59.3% | 19.6 | 22.5 |
| Effective Tax Rate % | 33.7% | 32.7% | 32.6% | 29.3% | | 31.6% | 32.2% |
| PAT | 20.6 | 16.2 | 57.9 | 27.5 | -52.6% | 42.4 | 47.4 |
| NPM % | 15.3% | 13.3% | 31.9% | 17.9% | | 21.7% | 21.4% |
| EPS | 35.9 | 28.2 | 100.8 | 47.8 | -52.6% | 73.7 | 82.5 |
| P/E | 13.5 | 17.3 | 4.8 | 10.2 | | 6.6 | 5.9 |

(Source: Company, HDFC Sec)

Balance Sheet

| Particulars (Rs. Cr) | FY11 | FY12 | FY13 (E) | FY14 (E) |
|--------------------------|-------|-------|----------|----------|
| SOURCES OF FUNDS | | | | |
| Shareholders' Funds: | | | | |
| Capital | 5.7 | 5.7 | 5.7 | 5.7 |
| Reserves & Surplus | 123.0 | 142.5 | 175.5 | 213.6 |
| | 128.8 | 148.3 | 181.3 | 219.3 |
| Non-Current Liabilities | | | | |
| Deferred Tax Liabilities | 12.4 | 15.8 | 16.0 | 16.5 |
| | 12.4 | 16.3 | 16.0 | 16.5 |
| Current Liabilities: | | | | |
| ST Borrowings | 8.9 | 5.3 | 5.0 | 4.0 |



| | | | | |
|-----------------------------|--------------|--------------|--------------|--------------|
| Accounts Payable | 22.9 | 20.1 | 26.0 | 28.0 |
| Other Current Liabilities | 4.8 | 2.0 | 3.0 | 4.0 |
| ST Provisions | 9.0 | 9.0 | 9.5 | 9.5 |
| | 45.5 | 36.4 | 43.5 | 45.5 |
| Total | 186.7 | 200.9 | 240.8 | 281.3 |
| APPLICATION OF FUNDS | | | | |
| Non-Current Assets: | | | | |
| Fixed Assets | | | | |
| (i) Tangible Assets | 74.6 | 117.8 | 113.2 | 120.2 |
| (ii) Capital WIP | 21.9 | 2.6 | 3.0 | 5.0 |
| | 96.5 | 120.4 | 116.2 | 125.2 |
| Non-Current Investments | 1.3 | 1.3 | 1.3 | 1.3 |
| LT Loans & Advances | 8.0 | 2.1 | 4.0 | 6.0 |
| | 105.8 | 123.8 | 121.5 | 132.5 |
| Current Assets: | | | | |
| Inventories | 18.4 | 11.0 | 23.0 | 21.0 |
| Sundry Debtors | 27.1 | 24.4 | 29.0 | 47.0 |
| Cash & Bank Balances | 1.0 | 1.0 | 2.0 | 3.0 |
| Other Current Assets | 0.1 | 0.2 | 0.3 | 0.5 |
| Current Investments | 20.5 | 22.7 | 44.5 | 54.3 |
| ST Loans & Advances | 13.8 | 17.9 | 20.5 | 23.0 |
| | 80.8 | 77.1 | 119.3 | 148.8 |
| Total | 186.7 | 200.9 | 240.8 | 281.3 |

(Source: Company, HDFC Sec)

Ratio Analysis

| Particulars | FY09 | FY10 | FY11 | FY12 | FY13 (E) | FY14 (E) |
|------------------|------|------|------|------|----------|----------|
| RoCE | 22.4 | 17.7 | 41.8 | 14.3 | 19.3 | 18.3 |
| RoA | 20.4 | 16.9 | 41.4 | 14.2 | 19.2 | 18.2 |
| RoE | 29.8 | 20.6 | 45.0 | 18.5 | 23.4 | 21.6 |
| P/E | 13.5 | 17.3 | 4.8 | 10.2 | 6.6 | 5.9 |
| Price/BV | 4.0 | 3.6 | 2.2 | 1.9 | 1.5 | 1.3 |
| EV/EBITDA | 2.3 | 4.7 | 2.9 | 4.3 | 3.2 | 2.8 |
| EV/Sales | 0.7 | 1.3 | 1.5 | 1.4 | 1.2 | 1.0 |
| D/E (Total) | 0.2 | 0.0 | 0.1 | 0.0 | 0.0 | 0.0 |
| Inventory (days) | 24.5 | 23.7 | 53.5 | 50.1 | 49.2 | 55.3 |
| Debtors (days) | 40.4 | 52.2 | 44.7 | 61.2 | 49.8 | 62.6 |
| Creditors (days) | 44.8 | 66.7 | 72.7 | 77.7 | 68.4 | 67.9 |

(Source: Company, HDFC Sec)

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