

Target Price ₹ 539
CMP ₹ 279
FY18E PE 9.5X
Index Details

Sensex	25,807
Nifty	7,908
Industry	Industrial Machinery

Ion Exchange, despite having a tepid performance over the last few years, is up for exciting times. Execution of the Sri Lanka project is expected to take its revenue growth trajectory higher along with a hefty improvement in margins from the Engineering segment. The US FDA nod for pharma resins is a shot in the arm as it is expected to be the next lever of growth in the chemicals segment.

Scrp Details

MktCap (₹ cr)	408.6
BVPS (₹)	115
O/s Shares (Cr)	1.5
AvVol	2,006
52 Week H/L	394/249
Div Yield (%)	1.0
FVPS (₹)	10.0

As a result, we expect overall revenues to grow at a CAGR of 16% over FY16-19, from Rs 869.5 crores in FY16 to Rs 1,371 crores in FY19. Higher EBITDA margins from the Sri Lanka order is expected to help consolidated net earnings to grow at a healthy CAGR of 50% from Rs 16.9 crores in FY16 to Rs 57.2 cr in FY19. Return ratios- RoE and RoCE- are also expected to improve sharply to 23.4% and 30% respectively.

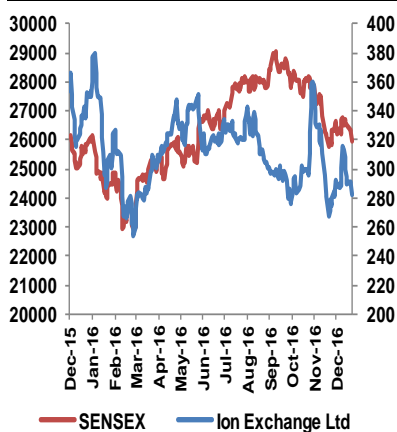
Shareholding Pattern

Shareholders	%
Promoters	67.3
Public	32.7
Total	100.0

We initiate coverage on Ion Exchange (India) Ltd as a BUY with a price objective of Rs 539, which represents a potential upside of 93% from the CMP of Rs 279. At the CMP of Rs 279 the stock is trading at 7.3X its estimated earnings for FY19. We have assigned a PE multiple of 14X on FY19 EPS of Rs 38.5 to arrive at the target price.

We are optimistic about the company's prospects given that:

- Ion Exchange has a health order book of ~Rs 2,040 crores (including the desalination order of \$200 mn from Sri Lanka) executable over FY17-19.
- Waste water management is projected to grow at a CAGR of 8-10% through 2015-2020 while the capital expenditure on water and wastewater infrastructure in India is set to increase by 83% over the next five years. Ion exchange, being one of the largest incumbents, is expected to be its biggest beneficiary.
- The EBITDA margin from the engineering segment is expected to take an upturn led by higher margins from the Srilanka contract from 2.8% reported in FY16 to 6.1% in FY19.

Ion Exchange vs. Sensex

Key Financials (₹ in Cr)

Y/E Mar	Net Sales	EBITDA	PAT	EPS (₹)	EPS Growth (%)	RONW (%)	ROCE (%)	P/E (x)	EV/EBITDA (x)
2016	869.5	58.8	15.3	10.8	56.6	9.4	21.0	25.7	8.0
2017E	881.0	67.5	19.4	13.0	20.0	11.0	20.0	21.4	7.5
2018E	1,117.2	103.6	43.7	29.4	125.7	21.7	28.5	9.5	5.0
2019E	1371.0	125.4	57.2	38.5	30.9	23.4	30.0	7.3	3.9

- **The water chemicals market in India is expected to grow at a CAGR of 15% over FY15-19 from \$0.4 bn in FY14 to \$0.8bn in FY19**
- **US FDA approval for the manufacturing facilities of Ion Exchange opens up huge market potential in the US and Europe for Drug Active resins**

❖ Company Background

Ion Exchange offers a wide range of solutions across the water cycle from pretreatment to process water treatment, waste water treatment, recycling, zero liquid discharge, sewage treatment, packaged drinking water, sea water desalination etc. The company has six manufacturing & assembly facilities across India, and one each in Bangladesh and UAE. The company is also engaged in manufacturing ion exchange resins, speciality chemicals for water and waste water treatment as well as non-water applications.

Geographical footprints of Ion Exchange



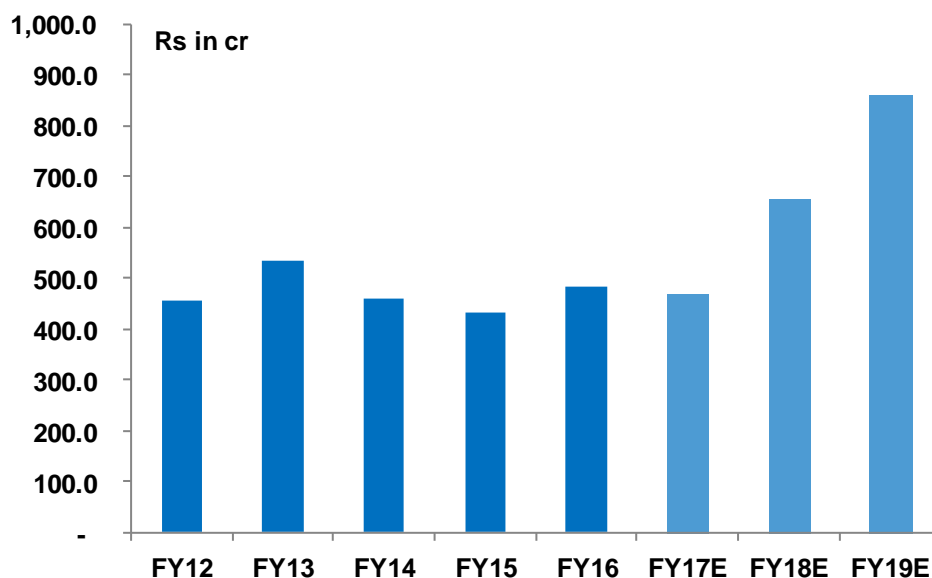
Source: Ion Exchange, Ventura Research

❖ Key Investment Highlights

➤ Revenues from Engineering division to accelerate led by Srilankan order worth Rs.~13bn

For quite some time the engineering division has been underperforming, given the slower recovery in the infrastructure spending and delays in execution of key projects. For the period FY12-16, revenues from the engineering division have grown at a paltry CAGR of 1.5% from Rs 456.6 crores in FY12 to Rs 484.2 crores in FY16. However, over the same period, the EBITDA degrew from Rs 21.4 crores in FY12 to Rs 13.7 crores in FY16 due to cost escalation and write-offs.

Revenue from the engineering division



Source: Ion Exchange, Ventura Research

However the encouraging order book suggests strong traction in revenues going forth

Ion Exchange has a health order book of ~Rs 2,040 crores (including the desalination order of \$200 mn from Sri Lanka) out of which orders worth Rs ~680 crores are executable over a period of 18-36 months. The order from Sri Lanka (Rs ~1,350 cr) is expected to be executed over a period of 3 years and the billing for the same will be milestone driven.

On the back of continued order inflows and timely execution of the Srilanka order, we expect revenues from the engineering division to grow at a CAGR of 21% from Rs 484.2 crores in FY16 to Rs 858.7 crores by FY19.

Sri Lanka order to be executed over next 3 years

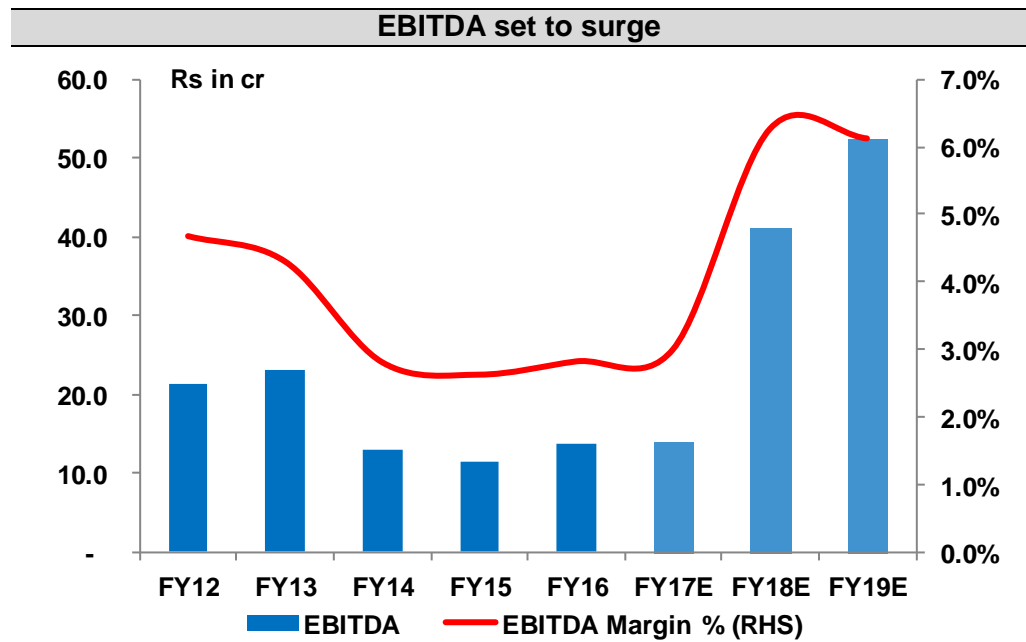
Ion Exchange was awarded a project by Sri Lanka Water Board and funded by the World Bank to execute a water supply project worth Rs 1.2 bn in Sept 2014. The Sri Lanka order revenue booking is expected to start from Q1FY18. We have assumed revenue booking of this order over the next 3 years (26%, 33% and 41%).

Bright industry outlook suggests favorable conditions for order book pick up

The waste water management is projected to grow at a CAGR of 8-10% through 2015-2020 while the capital expenditure on water and wastewater infrastructure in India is set to increase by 83% over the next five years, hitting an annual run rate of \$ 16 bn by 2020. Given the strong industry outlook, Ion Exchange, being one of the leading players, should emerge as a big beneficiary.

➤ EBITDA from engineering division set to surge on the back of high margin Srilankan order

Historically, the EBITDA margin from the engineering division has been meager due to cost overruns and escalations. However we expect the EBITDA margin to take an upturn led by higher margins from the Srilankan contract. EBITDA margins are expected to improve from 2.8% reported in FY16 to 6.1% by FY19.



Source: Ion Exchange, Ventura Research

➤ **Secular growth in the global water chemicals industry**

Revenue from the chemical segment has grown at a CAGR of 14.1% to Rs 297.7 crores in FY16 from Rs 175.8 crores in FY12.

Going forth, revenue from the Chemical business is expected to grow at a CAGR of 15% from Rs 342.4 crores in FY16 to Rs 452.8 crores in FY19, driven by robust growth prospects of the global and domestic chemical market and USFDA approvals for resins used in the pharma industry.

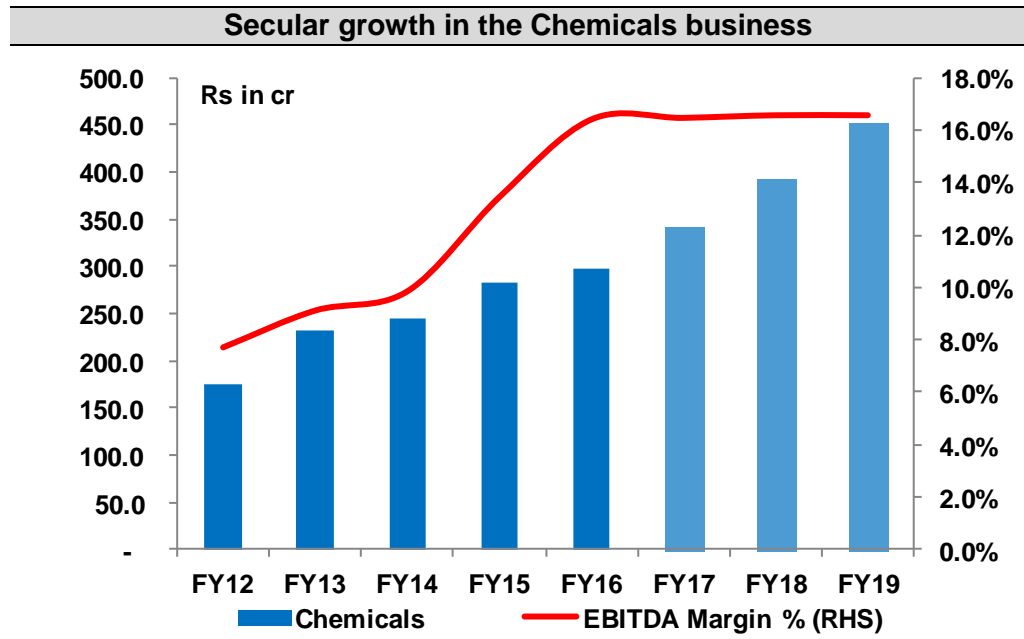
Strong growth outlook for the global water chemical industry

Over the period FY09-14, the water chemicals industry has grown at a CAGR of 5.6%. This brisk pace of growth is expected to continue over the period FY14-19 (5.8% CAGR).

In India, the market has grown at a CAGR of 12% from \$200 mn in 2009 to \$400 mn in 2014. By FY19 the market size is expected to increase to \$ 800 mn by 2019. (15% CAGR).

USFDA approval for resins to help sustain revenues growth in the Chemicals segment

Ion Exchange has successfully renewed the WHO-GMP certification for its Pharma facility at Ankleshwar. It has also received US FDA nod for the manufacturing of resins for the pharma industry from this facility. Ion Exchange plans to tap the large potential markets in US and Europe for Drug Active resins, which has strong growth potential with very good margins.

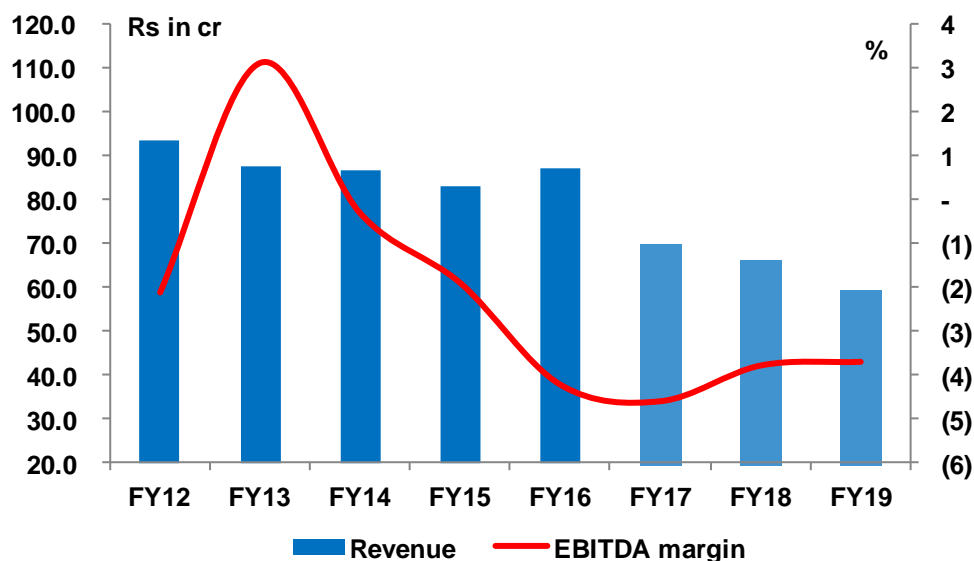


Source: Ion Exchange, Ventura Research

➤ **Consumer product business scarred by fierce competition**

In 1986, Ion Exchange launched its first consumer product under the brand Zero B, gaining strong initial demand. However, due to heightened competition and aggressive investment from large national and multi-national players, the consumer product has lost ground over the last few years. Going forth, the focus will be on expansion of ground water treatment solutions by designing products to meet the requirements of specific markets.

Dismal performance of the consumer product division



Source: Ion Exchange, Ventura Research

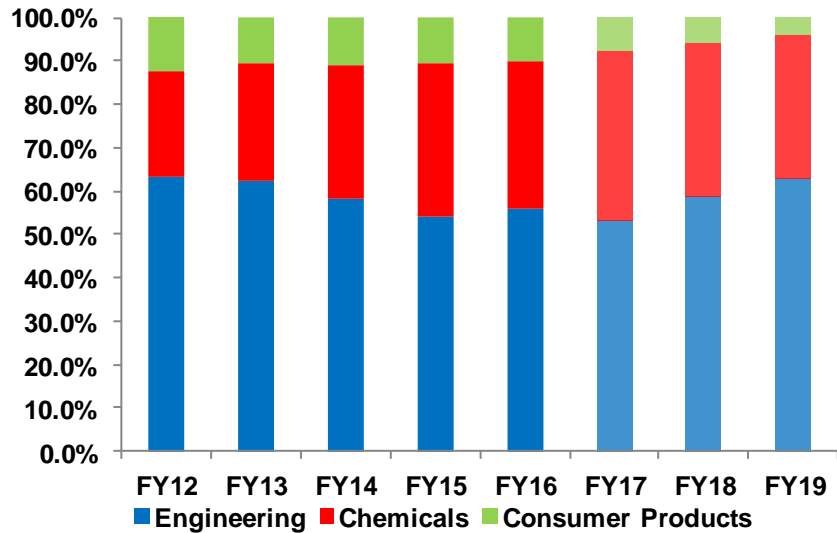
Revenue from the consumer product business is expected to fall to Rs 59.6 crores by FY19 from Rs 87 crores reported in FY16.

➤ **Lion's share of Engineering division to total revenues expected to continue**

The Engineering division contributes ~56% of the overall revenues for Ion Exchange, even after declining from a high of ~63% reported in FY12, on account of a slowdown in private capex and delays in project offtake. However, this trend is expected to reverse as Ion Exchange will start booking revenues from the Srilankan order from FY18. We expect the share of the Engineering division to reach to 63% by FY19.

The Share of the Chemicals division has grown steadily from ~24% reported in FY12 to ~34% in FY16. Going forth, we expect the share of the Chemicals business in the overall revenues to stay at the same levels.

Revenue mix expected to be in favor of Engineering segment



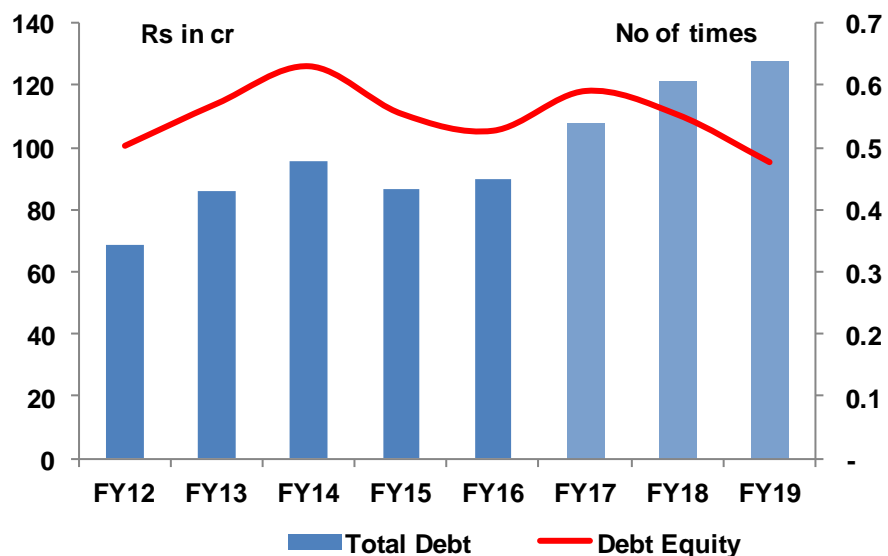
Source: Ion Exchange, Ventura Research

Overall revenues are expected to grow at a CAGR of 16.4% to Rs 1,371 crores by FY19 from Rs 869.5 crores reported in FY16.

➤ **Debt comfortably placed**

Over the period FY17-19, the company is envisaging a capex of Rs 130 crores to increase its capacity in the Chemicals division and help in executing the Sri Lanka order. A sizable portion of the capex is expected to be funded by internal accruals. However, the debt is expected to rise to Rs ~128 cr by FY19 from Rs 90 crores in FY16.

Comfortable debt levels going forth

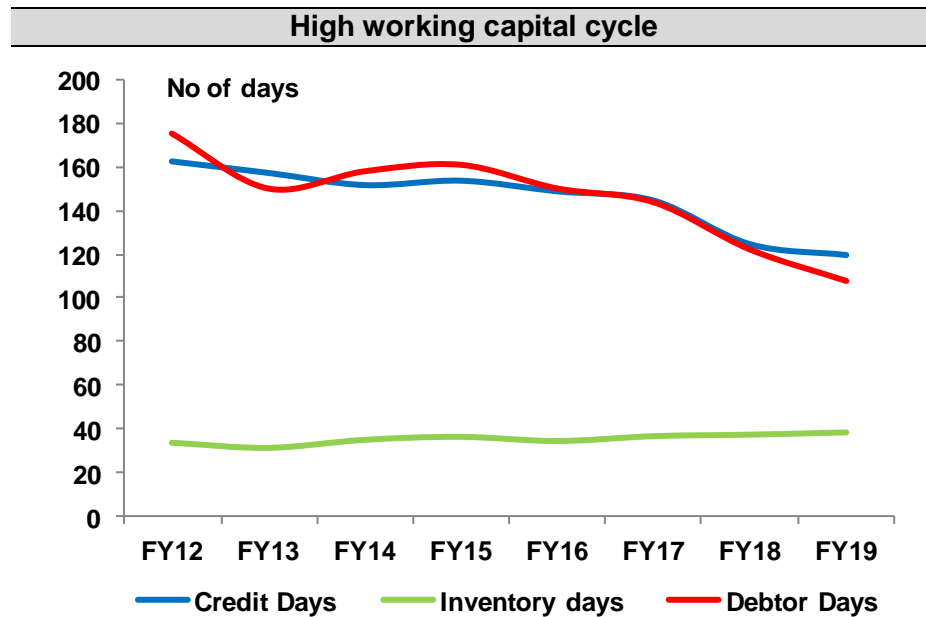


Source: Ion Exchange, Ventura Research

❖ Key Risk

➤ Working capital intensive model – Debtor days are quite high

Total receivable for Ion exchange stand at Rs 363 cr as on 31st march 2016 resulting into a debtor days of 150 days. Given the high amount of receivables, the company is exposed to default risk from its clients, which can have a adverse impact on the company's profitability and cash flows.



Source: Ion Exchange, Ventura Research

➤ Future growth of the company is dependent on economic growth and infra spend across geographies

Despite having a decent order book, the company is directly exposed to stress in the infrastructure industry globally. Slowdown in the infra spends can lead to delay in order execution resulting into poor cash flows and revenue.

- **Forex fluctuations could have negative impact on margins**
- **Consumer product business is a drag on the performance given the stiff competition from large players including Eureka Forbes, HUL, Tata**

❖ Financial Performance

The company reported muted numbers for Q2FY17 with net sales growing 3.2% to Rs 201.4 crores from Rs 195.1 crores reported in Q2FY16. EBITDA gained 29% YoY to Rs 13.3 crores from Rs 10.3 crores in Q2 FY16 led by a higher share of chemical business revenue. EBITDA margins improved 130 bps from 5.3% in Q2 FY16 to 6.6% in Q2 FY17. PAT gained 12.8% YoY to Rs 6.9 crores on the back of higher operating margins.

For FY16, Ion Exchange's net sales stood at Rs 869.5 crores registering a growth of 8.6% YoY. However EBITDA rose 14.2% YoY to Rs 58.8 crores on the back of an uptick in the Chemicals segment margins. PAT jumped 48.1% YoY to Rs 16.9 crores in FY16 from Rs 11.4 crores in FY15.

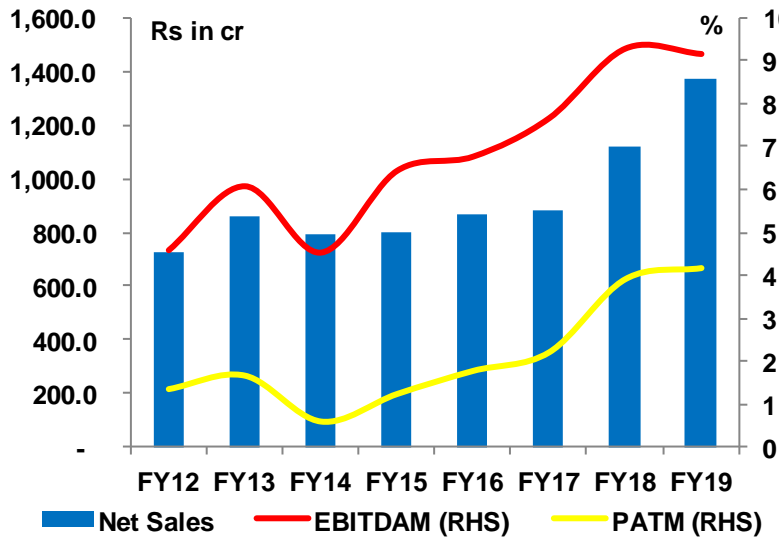
Standalone Quarterly Financial Performance (Rs crores)				
Particulars	Q2FY17#	Q2FY16#	FY2016*	FY2015*
Net Sales	201.4	195.1	869.5	800.5
<i>Growth (%)</i>	<i>3.2</i>		<i>8.6</i>	
Total expenditure	188.5	185.4	810.6	748.9
Operating Profit	13.3	10.3	58.9	51.6
<i>Margin (%)</i>	<i>6.6</i>	<i>5.3</i>	<i>6.8</i>	<i>6.4</i>
Depreciation	2.6	2.5	12.6	12.1
EBIT (Ex. OI)	10.6	7.8	46.3	39.5
Non-Operating Income	2.8	4.1	6.5	4.4
EBIT	13.4	11.8	52.8	43.9
<i>Margin (%)</i>	<i>6.7</i>	<i>6.1</i>	<i>6.1</i>	<i>5.5</i>
Finance Cost	3.2	2.6	18.1	20.0
Exceptional Items	-	-	-	-
PBT	10.2	9.3	34.6	23.8
<i>Margin (%)</i>	<i>5.1</i>	<i>4.7</i>	<i>6.4</i>	<i>5.2</i>
Prov. for Tax	3.4	3.2	17.7	12.4
Profit after Tax	6.9	6.1	16.9	11.4
<i>Margin (%)</i>	<i>3.4</i>	<i>3.1</i>	<i>4.3</i>	<i>3.6</i>

Source: Ion Exchange, Ventura Research (# represents standalone, * represents consolidated)

❖ Financial Outlook

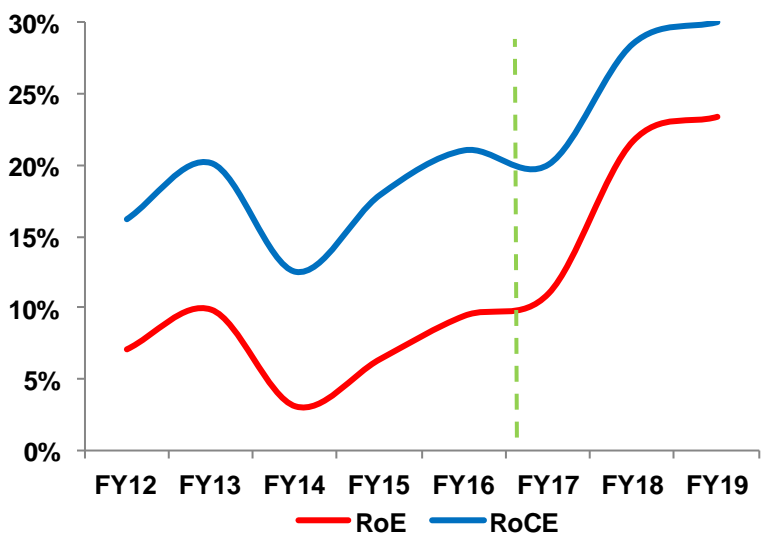
Revenue growth trajectory is expected to improve going forward as Ion Exchange will start generating revenues from the Sri Lankan order. We expect overall revenues to grow at a CAGR of 16% over FY16-19 from Rs 869.5 crores in FY16 to Rs 1,371 crores in FY19. Consolidated net earnings are expected to grow at a healthy CAGR of 50% from Rs 16.9 crores in FY16 to Rs 57.2 cr in FY19. The EBITDA and PAT margin are expected to reach to 9.1% and 4.2% respectively.

Strong revenue growth visible



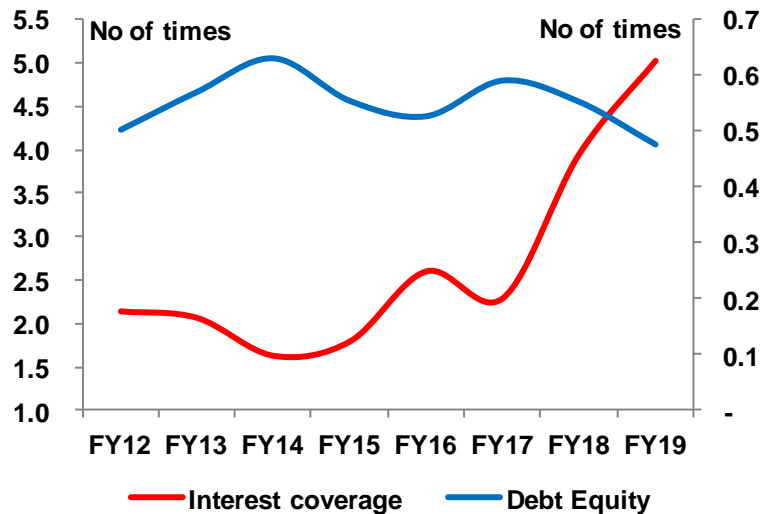
Source: Ion Exchange, Ventura Research

Stable return ratios going forth



Source: Ion Exchange, Ventura Research

Stable solvency ratios

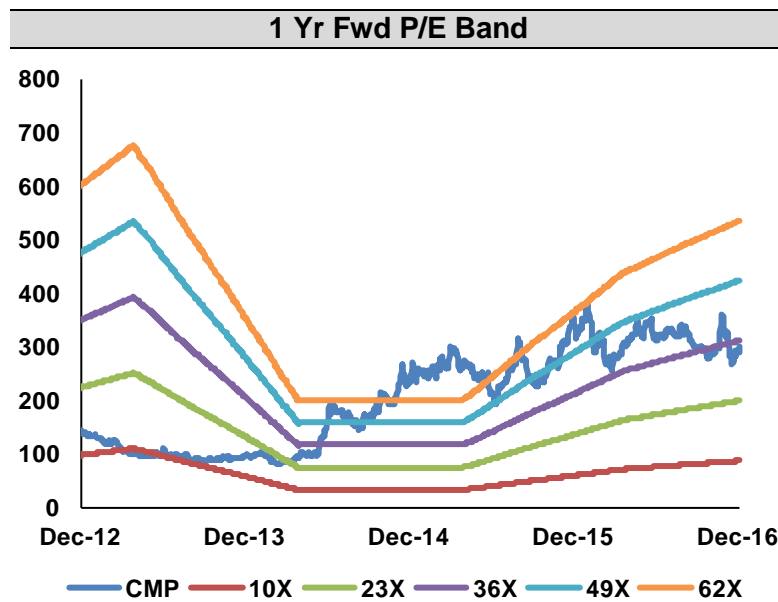


Source: Ion Exchange, Ventura Research

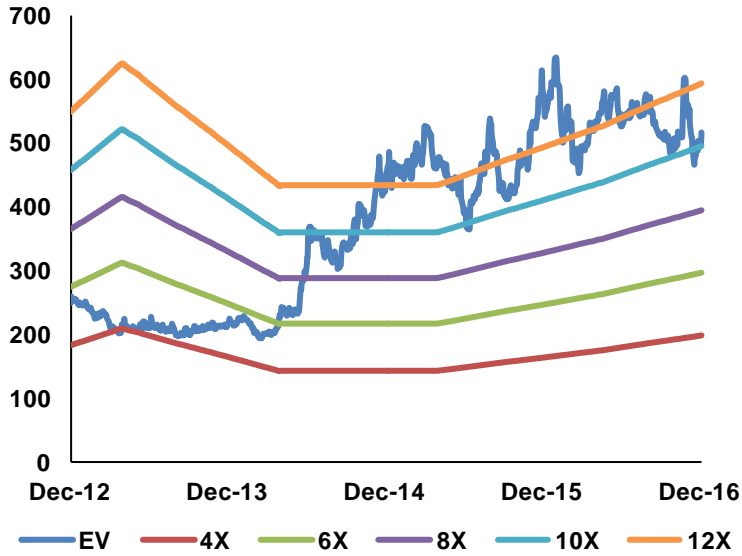
❖ **Valuation**

We initiate coverage on Ion Exchange (India) Ltd as a BUY with a price objective of Rs 539, representing a potential upside of 93% from the CMP of Rs 279. At the CMP of Rs 279 the stock is trading at 7.3X its estimated earnings for FY19. We have assigned a PE multiple of 14X on FY19 EPS of Rs 38.5 to arrive at the target price. We are positive on the company given the:

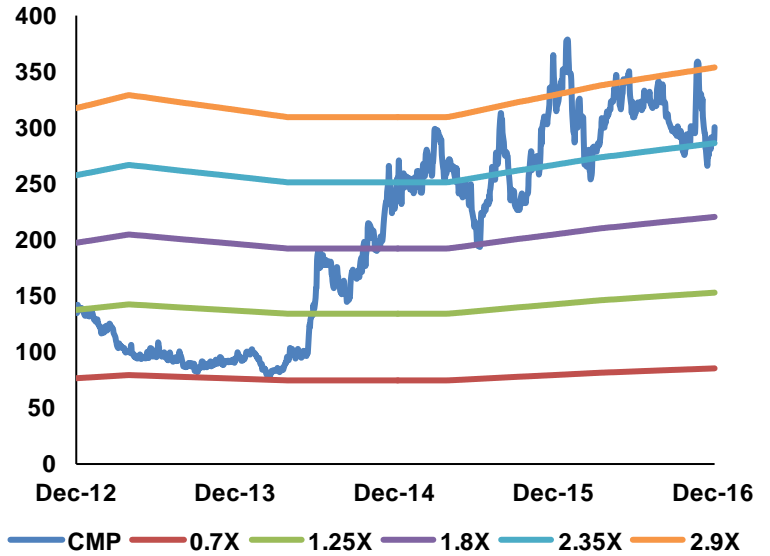
- Robust outlook for the water chemical industry globally (5.8% CAGR over FY14-19)
- Execution of the Srilankan project expected to swing revenues from the engineering division
- US FDA nod for the manufacturing of resins to aid in maintaining growth trajectory in the chemicals segment (15% CAGR over FY17-19) besides improving margins



Source: Ion Exchange, Ventura Research

1 Yr Fwd EV/EBITDA Band


Source: Ion Exchange, Ventura Research

1 Yr Fwd P/B Band


Source: Ion Exchange, Ventura Research

Financials and Projections

Y/E March, Fig in ₹ Cr	FY16	FY17E	FY18E	FY19E	Y/E March, Fig in ₹ Cr	FY16	FY17E	FY18E	FY19E
Profit & Loss Statement					Per Share Data (Rs)				
Net Sales	869.5	881.0	1117.2	1371.0	Adj. EPS	10.8	13.0	29.4	38.5
% Chg.		1.3	26.8	22.7	Cash EPS	19.9	23.7	41.6	52.1
Total Expenditure	810.6	813.5	1013.6	1245.6	DPS	3.0	4.0	4.4	5.0
% Chg.		0.4	24.6	22.9	Book Value	119.4	126.9	152.6	186.4
EBDITA	58.8	67.5	103.6	125.4	Capital, Liquidity, Returns Ratio				
EBDITA Margin %	6.8	7.7	9.3	9.1	Debt / Equity (x)	0.5	0.6	0.6	0.5
Other Income	6.5	3.5	4.5	5.5	Current Ratio (x)	1.1	1.0	1.1	1.1
PBDIT	65.4	71.0	108.1	130.9	ROE (%)	9.4	11.0	21.7	23.4
Depreciation	12.6	15.9	18.1	20.3	ROCE (%)	21.0	20.0	28.5	30.0
Interest	18.1	21.5	21.8	21.7	Dividend Yield (%)	1.1	1.4	1.6	1.8
Exceptional items	0.0	0.0	0.0	0.0	Valuation Ratio (x)				
PBT	34.6	33.5	68.1	88.9	P/E	25.7	21.4	9.5	7.3
Tax Provisions	17.7	14.2	24.4	31.7	P/BV	2.3	2.2	1.8	1.5
Reported PAT	16.9	19.4	43.7	57.2	EV/Sales	0.5	0.6	0.5	0.4
Minority Interest	1.6	0.0	0.0	0.0	EV/EBIDTA	8.0	7.5	5.0	3.9
PAT	15.3	19.4	43.7	57.2	Efficiency Ratio (x)				
PAT Margin (%)	1.8	2.2	3.9	4.2	Inventory (days)	34.2	36.5	37.2	38.3
Other opr Exp / Sales (%)	0.0	0.0	0.0	0.0	Debtors (days)	150.3	144.0	122.4	108.0
Tax Rate (%)	51.2	42.3	35.9	35.7	Creditors (days)	149.2	145.0	125.0	120.0
Balance Sheet					Cash Flow Statement				
Share Capital	15.6	15.6	15.6	15.6	Profit Before Tax	34.6	33.5	68.1	88.9
Reserves & Surplus	154.5	167.1	204.1	252.8	Depreciation	12.6	15.9	18.1	20.3
Minority Interest	6.2	6.2	6.2	6.2	Working Capital Changes	2.2	-16.1	-32.5	-2.3
Long Term Borrowings	23.0	18.0	12.5	10.0	Others	0.3	8.1	-2.0	-9.4
Deferred Tax Liability	3.6	4.3	4.9	5.5	Operating Cash Flow	49.8	41.5	51.7	97.6
Other Non Current Liabilities	25.7	27.3	28.0	29.2	Capital Expenditure	-25.2	-47.9	-40.0	-40.0
Total Liabilities	228.7	238.6	271.3	319.4	Other Investment Activities	0.0	0.0	0.0	0.0
Gross Block	239.7	289.7	329.7	369.7	Cash Flow from Investing	-25.2	-47.9	-40.0	-40.0
Less: Acc. Depreciation	-136.7	-152.7	-170.8	-191.1	Changes in Share Capital	0.0	0.0	0.0	0.0
Net Block	102.9	137.0	158.9	178.6	Changes in Borrowings	3.4	20.0	14.5	7.5
Capital Work in Progress	2.1	0.0	0.0	0.0	Dividend and Interest	-20.0	-28.3	-28.6	-30.1
Non Current Investments	2.4	2.4	2.4	2.4	Cash Flow from Financing	-16.7	-8.3	-14.1	-22.6
Net Current Assets	40.6	12.3	27.6	46.0	Net Change in Cash	7.9	-14.7	-2.3	34.9
Long term Loans & Advances	80.6	86.9	82.4	92.4	Opening Cash Balance	11.2	19.1	4.4	2.0
Total Assets	228.7	238.6	271.3	319.4	Closing Cash Balance	19.1	4.4	2.0	37.0

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