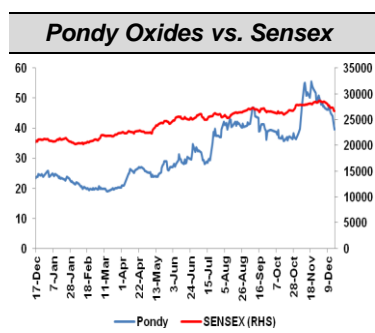


Target Price ₹88
CMP ₹47
FY17E PE 3x

Index Details	
Sensex	27,372
Nifty	8,225
BSE 100	8,281
Industry	Chemicals

Scrip Details	
MktCap (₹ cr)	50.4
BVPS (₹)	35.5
O/s Shares (Cr)	1.1
AvVol (Lacs)	0.01
52 Week H/L	58/19
Div Yield (%)	2.4
FVPS (₹)	10.0

Shareholding Pattern	
Shareholders	%
Promoters	51.9
DII's	0.0
FII's	0.0
Public	48.0
Total	100.0



Pondy Oxides & Chemicals Ltd (POCL), a manufacturer of lead metals, oxides and plastic additives, is undertaking a restructuring exercise by demerging its oxides and plastic additives segments, which account for 30% of FY14 revenues, to a separate entity - POCL Enterprises Ltd (PEL). We believe that a concentrated focus on each business unit will drive operational efficiencies going forward. Also, we are optimistic about the future prospects of the company given that:

- The demand for industrial batteries will remain strong given the world-wide impetus on solar energy. Also, the back-up power demand in India could grow on power supply bottlenecks and increasing industrialization.
- India clocks 3 mn vehicle sales annually which are expected to grow at a 9-10% CAGR. Also, around 70 mn units are sold globally at a CAGR of 6%. Replacement demand is expected to remain robust as automotive batteries are replaced every 2-3 years depending on usage.
- Doubling of capacities to ~57,000 TPA will provide a fillip to revenue growth. Further the greenfield plant is being set up in Andhra Pradesh, close to Amara Raja Batteries' unit, which is its largest domestic customer.
- POCL has moved to sourcing based on flexible pricing thereby cushioning itself from volatility in lead prices leading to stable margins.
- POCL's operations are fuel intensive and the drop in crude oil prices could help margin expansion.

We expect POCL (combined entity) to report a 20% CAGR in revenues to ₹791 crore by FY17. The EBITDA margin will remain stable at ~4.5% and the PAT is expected to grow at a CAGR of 77% to ₹16 crore by FY17. We initiate coverage on POCL as a BUY with a Price Objective of ₹88 which represents a potential upside of 87% over a period of 24 months.

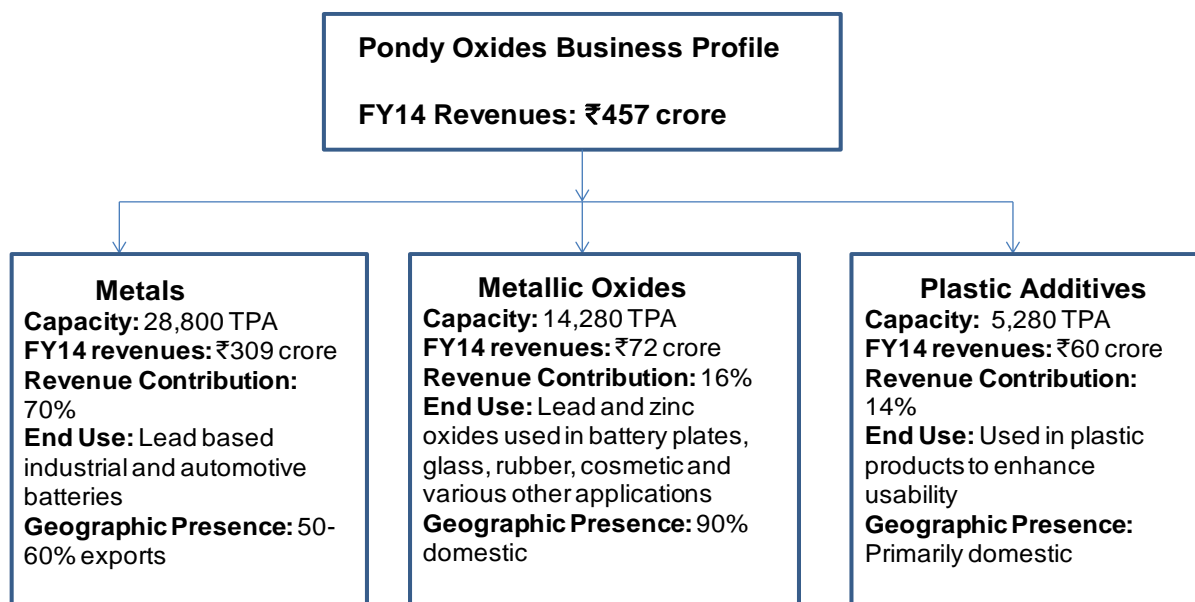
Key Financials (₹ in Cr)

Y/E Mar	Net Sales	EBITDA	PAT	EPS (₹)	EPS Growth (%)	RONW (%)	ROCE (%)	P/E (x)	EV/EBITDA (x)
2014	457.4	13.9	2.9	2.6	-10.6	7.3	15.7	18	8.6
2015E	532.9	24.7	10.8	9.7	269.7	21.8	30.1	4.9	4.8
2016E	702.8	32.3	15.3	13.7	42.2	24.1	32.0	3.4	4.4
2017E	790.9	34.6	16.3	14.6	6.3	20.7	34.4	3.2	4.1

➤ Company Background

Incorporated in 1995, POCL is engaged in the manufacturing of metals, primarily lead and zinc, metallic oxides and plastic additives. Its manufacturing units are located in Tamil Nadu and Pondicherry, with one greenfield unit under construction in Andhra Pradesh. POCL is a secondary smelter, i.e. it manufactures/recycles lead from metal scrap and ores.

POCL Business Profile



Source: POCL, Ventura Research

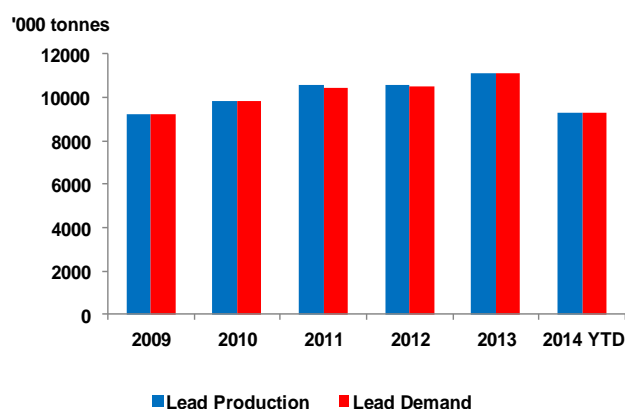
❖ Key Investment Highlights

➤ Capacity expansion to propel revenue growth

POCL is doubling its lead metals smelting capacity to ~57,000 TPA through a greenfield expansion in Andhra Pradesh at a cost of ₹8 crore. The plant, with a capacity of 28,000 TPA is expected to be commissioned in April 2015. The capex has been funded through ₹5 crore in debt, with the remaining being met through internal accruals. We expect the new plant to average at 50% utilizations in the first year of operations and gradually ramp up to 70-75% from the second year onwards. The expansion comes after a period of five years and its timing could not have been better given that macro economic factors have turned favorable. Further, the plant is located near Amara Raja Batteries' unit which is POCL's largest domestic consumer.

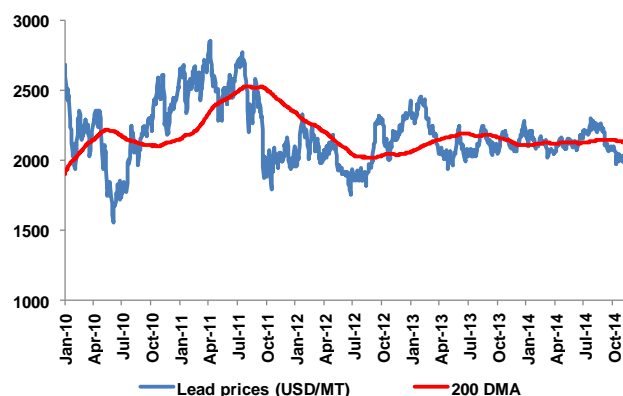
Lead prices have remained stable at an average of \$2200-\$2250 per tonne in the past one year. Unlike ferrous metals which have witnessed a sell-off in 2014, non-ferrous metals have held ground on improving demand. We have built in a marginal 1% rise in lead prices over FY15-17E as the demand supply is in a near equilibrium situation. In fact lead prices could firm up as the Indian Lead Zinc Development Association has forecasted a gradual deficit in lead supply over the coming years.

Global lead demand-supply at equilibrium...



Source: International lead and Zinc Study Group

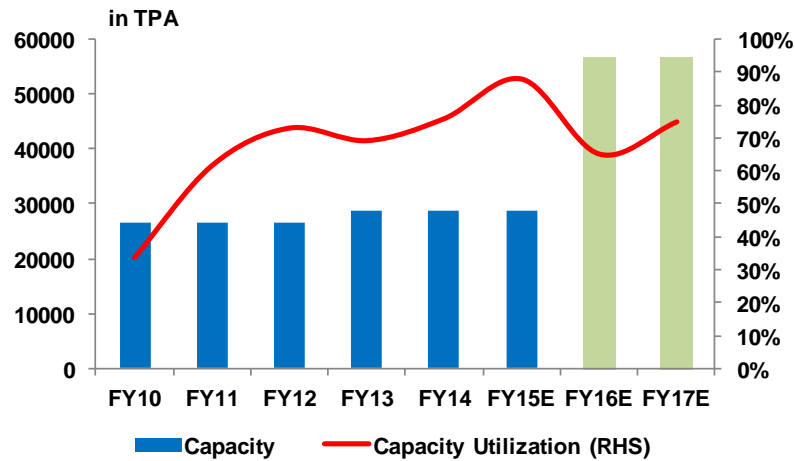
...have lead to stable lead prices since 2010



Source: POCL, Ventura Research

Accordingly, we expect POCL's revenues to grow at a three year CAGR of 20% to ₹791 crore in FY17 primarily driven by volume growth post the capacity expansion.

Revenue growth to be driven by capacity expansion

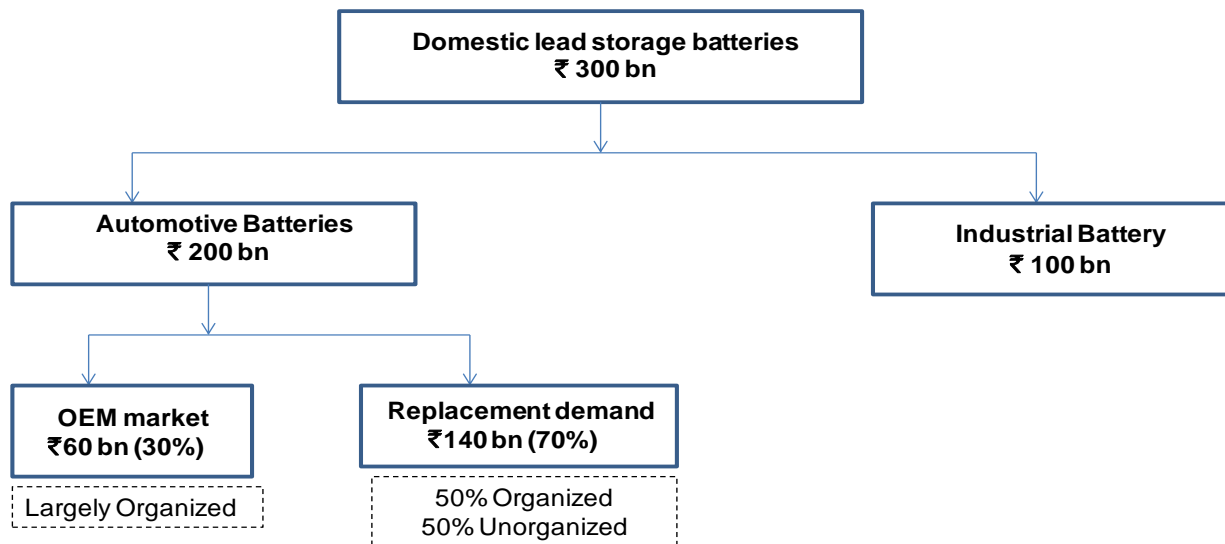


Source: POCL, Ventura Research

➤ Macro economic factors turning favorable

POCL's products - lead and zinc ingots - are primarily used in the manufacture of lead acid batteries i.e. automotive and industrial batteries.

Break-down of battery demand



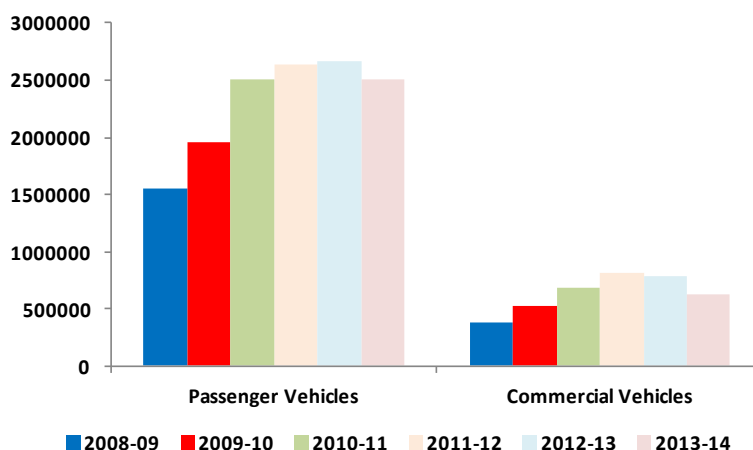
Source: Ventura Research

Favorable macro-economic factors are expected to support POCL's revenue growth.

- **Battery replacement demand to grow at a robust pace**

The automobile sector is the major consumer of lead ingots and oxides, which is the key raw material for its batteries. A large part of the demand for automotive batteries stems from replacement demand, since the typical life of a battery is 2-3 years depending on the extent of usage. Given that 3-3.5 mn vehicles are sold annually in India, the replacement demand will remain robust.

Around 3-3.5 mn vehicles sold annually in India



Source: SIAM

Automobile sales of both passenger and commercial vehicles fell 5% and 19% respectively in FY14 owing to

- i) slowdown in economy
- ii) halt in capex cycle following policy logjam and
- iii) high inflation which lowered consumer discretionary spending.

However, the situation has started to improve since the beginning of FY15 as inflation has softened and economic activity is witnessing a revival post reforms initiated by the newly elected government. In the first 7 months of the current fiscal, passenger vehicle sales stood at 58% of FY14 sales, while commercial vehicle sales are marginally lower at 56%.

According to the "India Automotive Battery Market Forecast & Opportunities, 2018", the Indian automotive battery market is projected to grow at a CAGR of approximately 13% during 2013-18, in value terms. The key reason being the recent launches of Medium Utility Vehicles and Sports Utility Vehicles (SUV) such as Renault's Duster, Mahindra's XUV, Maruti's Ertiga and Ford's Eco Sports. As a result, the utility vehicles battery market segment is expected to witness the fastest growth in automobile battery market, followed by two wheeler batteries and light commercial vehicle battery market segments, over the next five years. The demand for automotive battery has largely emerged from northern region of India due to increasing automobile sales in various states such as Uttar Pradesh, Delhi, Rajasthan, etc., and presence of large automobile manufacturers like Honda and Tata.

According to industry sources, passenger vehicle sales are expected to clock a 9-10% growth in FY15 led by general improvement in sentiments, falling petrol and diesel prices, discounts offered on various car models by manufacturers to pep up sales and slew of new launches bundled with attractive schemes such as a complementary insurance and maintenance contracts.

After three consecutive years of declining sales, commercial vehicles are expected to grow at a rate of 3% in FY15 given the gradual improvement in economic activity, lifting up the ban on mining by Supreme Court and increase in freight rates. Further, decline in oil prices is expected to drive auto sales higher in POCL's key exports markets, which have been growing at a 6% CAGR.

- **Revival in economy and impetus on solar energy to drive growth**

Demand prospects of industrial batteries hinge on the overall macro economic situation. The specific applications of industrial batteries include batteries for back-up power, telecom and solar energy.

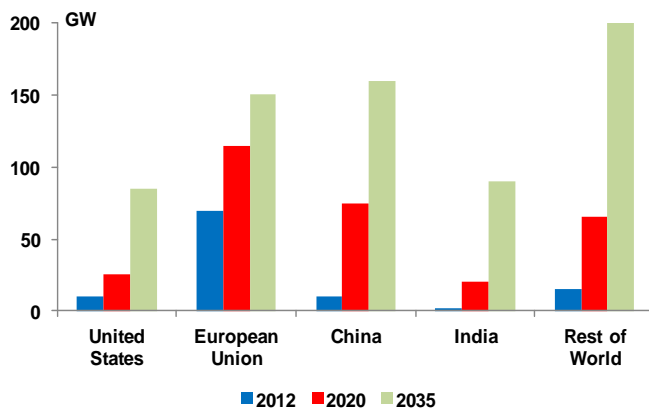
With the election of a reform oriented government, India's GDP growth is expected to revive in the coming years. Further, a majority of the export markets of POCL i.e. Indonesia, Japan, Korea, Malaysia, Sri Lanka and Vietnam are expected to report higher GDP growth in 2014 and 2015. Given the revival in capex cycle coupled with the on-going power supply issues in large parts of India, the requirement for back-up power is bound to increase. The other major driver of industrial batteries is the growing emphasis on the energy efficient solar energy. Historically, the market for industrial batteries has grown at a CAGR of 20% and is expected to clock a similar growth rate in the coming years.

IMF estimates of GDP growth

Country	2012	2013	2014	2015
India	4.7	5.0	5.6	6.4
Exports				
Indonesia	6.3	5.8	5.2	5.5
Japan	1.5	1.5	0.9	0.8
Korea	2.3	3.0	3.7	4.0
Malaysia	5.6	4.7	5.9	5.2
Sri Lanka	6.3	7.3	7.0	6.5
Vietnam	5.2	5.4	5.5	5.6

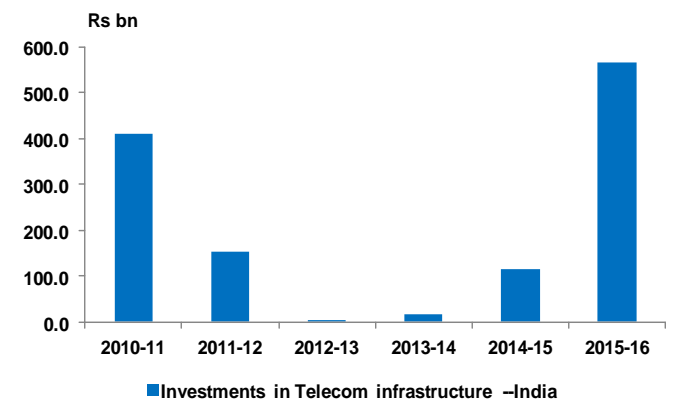
Source: IMF

Solar power capacities to grow substantially



Source: World Energy Report, Ventura Research

Growth in telecom infra driven by mobile phone penetration



Source: CMIE, Ventura Research

StatPlan Energy estimates there are 4 million telecom towers installed in the world, growing at a CAGR of 4.1% to 2020. In 2014, the market for tower construction is estimated at \$20.3 billion globally. By 2020, the total installed base will have risen to 5 million towers.

• Amara Raja Batteries on a growth trajectory

POCL's major domestic customers include Amara Raja Batteries and TATA Batteries, with Amara Raja Batteries accounting for ~30%-40% of POCL's domestic sales. Amara Raja Batteries has clocked a 23% YoY growth in H1FY15, and according to street estimates is expected to clock revenue CAGR of 21%

over FY15-FY16E. Further, Amara Raja has the following capacity expansion plans:

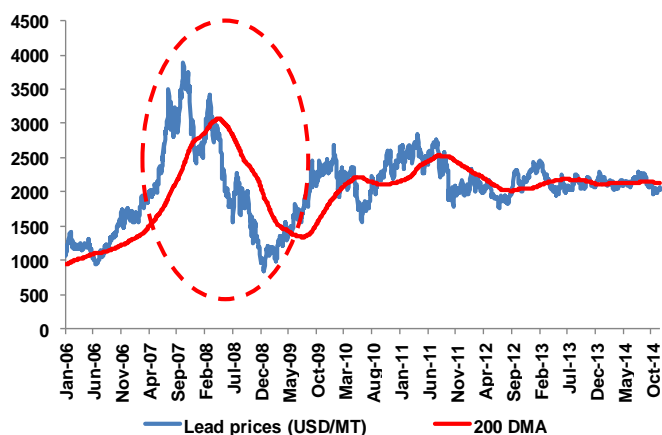
- Capacity of 2.4mn batteries commissioning operations by Dec'14 and capacity of 1.2mn batteries commissioning operations by Mar-15, and it is also
- Setting-up a tubular battery plant (outsourced currently) of ~1.4mn batteries which would start operations in Dec-15 (1mn) and Dec-16 (0.4mn)

With a combination of favorable macro factors and expansion in capacity, POCL is expected to clock a healthy revenue growth going forward.

➤ **Change in sourcing strategy provides stability**

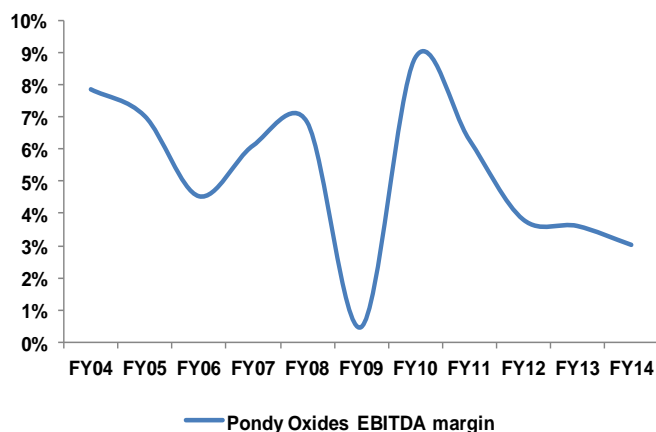
Earlier, the company's raw material prices i.e. battery scrap was fixed at the time of raw material purchase. This exposed POCL to volatility in lead prices from the time the raw material was purchased till the time of sale. For instance in FY09, when lead prices dropped drastically, POCL reported a consolidated EBITDA margin of 0.44% and a loss of ₹7 crore at the PAT level.

Sharp volatility in lead prices...



Source: POCL, Ventura Research

...led to steep drop in EBITDA margins



Source :POCL, Ventura Research

Consequently, the company changed its sourcing strategy and moved to flexible pricing. The pricing is determined anytime between placing the supply order and arrival at the port based on the prevailing LME pricing and previous month's average lead contract price. This provides a cushion to the operating margins as the spreads, which are in the range of \$400-\$500 remain fixed irrespective of the fluctuations in raw material costs. EBITDA margins have remained in the range of 3-3.5% from FY12-FY14. Accordingly, the company is unlikely to make abnormal

gains or losses and the EBITDA margins will remain stable in the long run. However, this stability has come at a cost as EBITDA margin at 3.5% are much lower than 9.8% they reported in FY10, when lead prices recovered from the fall in 2009.

➤ **Fall in crude oil prices to aid margin expansion**

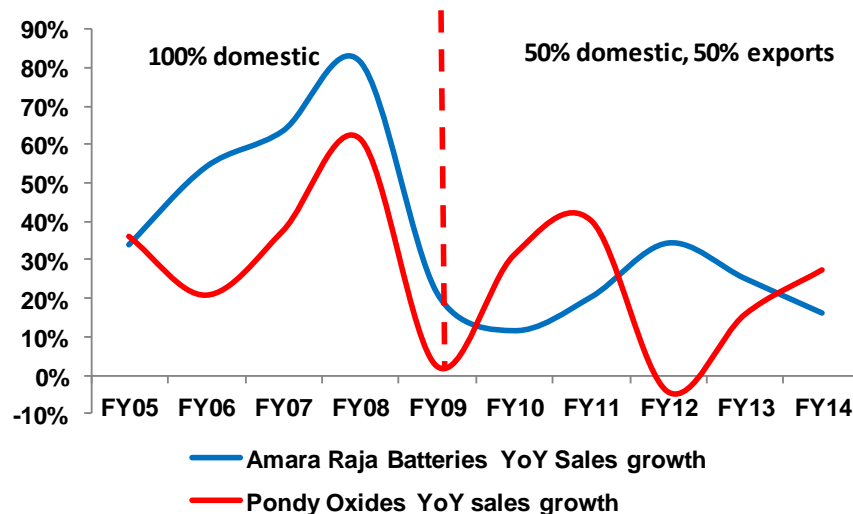
POCL's manufacturing processes i.e. smelting, meting and refining are not power intensive. The major requirement is fuel required to keep the smelters burning. Of the total power and fuel cost of ₹12.4 crore in FY14 (2.7% of revenues), ₹9.6 crore was spent on diesel and furnace oil. With crude oil prices falling as much as 44% YTD to \$59 a barrel, we expect substantial fuel savings to accrue to POCL in the coming quarters.

In H1FY15, the company has reported an EBITDA margin of 4.1% as the company managed to increase spreads through higher sales of specialized lead products. The company plans to increase the proportion of specialized lead products to 60% from 40% in the current year. Further, coupled with lower fuel costs, we believe the company will be able to sustain EBITDA margins at ~4.5% from FY15-FY17.

➤ **Export focus to reap long term benefits**

POCL commenced exports in FY09 in order to diversify and cater to large players globally instead of catering to only domestic organized and unorganized players. Further, since a majority of the raw materials are imported, exports provide a natural hedge. Also, export sales are secured against a Letter of Credit thereby minimizing credit risks. Consequently, POCL's dependence on Amara Raja Batteries has greatly reduced. Further, POCL's strategy of supplying to large customers provides comfort as these players have the financial strength to withstand a downturn.

Export focus has de-risked business model

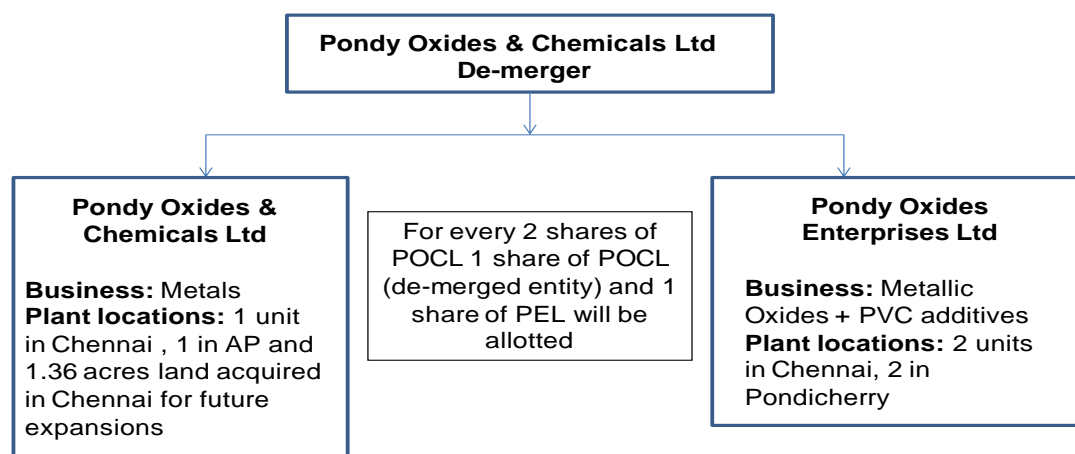


Source: Ventura Research

➤ De-merging to unlock value

In March 2013, POCL had applied for de-merging its metallic oxides and plastic additives segments into a different entity, PEL. The management has indicated that they should receive the necessary court approvals by end December 2014. Post the de-merger, for every 2 shares of POCL, 1 share of POCL (de-merged entity) and 1 share of PEL will be allotted.

POCL post de-merger



Source: Ventura Research

❖ Key Risks

- **Cyclicality in end-user industries:**

As the demand for lead ingots and oxides stems primarily from automotive and industrial batteries, POCL's growth prospects are heavily linked to the overall macro economic situation. A slow-down in the economy will result in idle capacities and hurt POCL's financial performance; especially post the doubling of capacities in April 2015.

- **Client concentration:**

Amara Raja Batteries accounts for 30-40% of domestic sales, which is effectively 17-18% of POCL's total sales. Any company specific issues will adversely impact 20% of revenues exposed to Amara Raja Batteries.

- **Thin margins:**

The company has reported an average EBITDA margin of 3.2% and average PAT margin of 0.8% from FY12-FY14 given the commoditized nature of POCL's products. While the company has cushioned itself with a flexible raw material sourcing strategy, any increase in employee or fuel costs will hit the company's profitability.

- **Stricter pollution control norms:**

Lead being a highly hazardous metal can cause significant environmental damage. Accordingly, all recyclers have to adhere to pollution control norms set out by the Central Pollution Control Board at the manufacturing facilities. According to the management, nearly 15% of the capex requirements are towards meeting the pollution control norms. Any changes in these norms could mean higher funds requirements for future capacity expansion. However, the strict pollution control norms also act like an entry barrier, thereby preventing an influx of small unorganized players into the industry.

❖ Financial Performance

In Q2FY15, POCL reported a 16% YoY increase in revenues to ₹153.8 crore led by volume growth as demand scenario has improved considerably over the past one year. EBITDA grew 37% YoY to ₹6.3 crore in Q2FY15; EBITDA margin expanded 60 bps YoY to 4.1% with increase in sales proportion of high margin specialized lead products. PAT grew 85% YoY to ₹2.3 crore; PAT margin expanded 60 bps to 1.5% owing to improvement in operational performance.

Quarterly Financial Performance (₹ in crore)

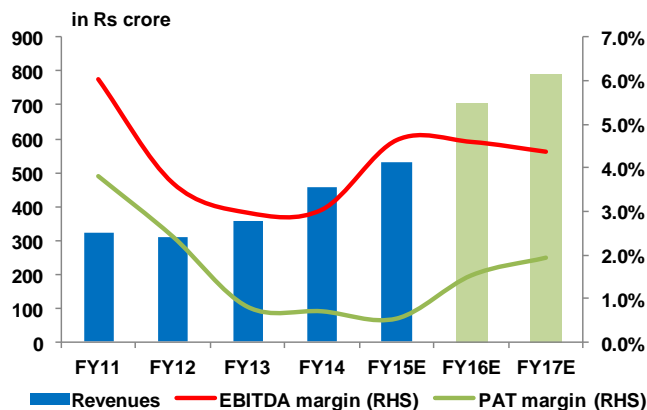
Particulars	Q2FY15	Q2FY14	FY14	FY13
Net Sales	153.4	132.5	448.2	342.4
<i>Growth %</i>	<i>15.8</i>		<i>30.9</i>	
<i>Total Expenditure</i>	147.1	127.9	434.9	332.9
EBIDTA	6.3	4.6	13.3	9.5
<i>EBDITA Margin %</i>	<i>4.1</i>	<i>3.5</i>	<i>3.0</i>	<i>2.8</i>
Depreciation	0.6	0.6	2.1	2.2
EBIT (EX OI)	5.7	4.0	11.2	7.3
Other Income	0.2	0.02	1.4	3.8
EBIT	6.0	4.0	12.6	11.1
<i>Margin %</i>	<i>3.9</i>	<i>3.0</i>	<i>2.8</i>	<i>3.2</i>
Interest	2.6	2.2	8.3	7.6
Exceptional items	0	0	0.0	0.6
PBT	3.3	1.8	4.2	4.0
<i>Margin %</i>	<i>2.2</i>	<i>1.4</i>	<i>0.9</i>	<i>1.2</i>
Provision for Tax	1.1	0.6	1.4	1.3
PAT	2.3	1.2	2.8	2.8
<i>PAT Margin (%)</i>	<i>1.5</i>	<i>0.9</i>	<i>0.6</i>	<i>0.8</i>

Source: POCL, Ventura Research

❖ Financial Outlook

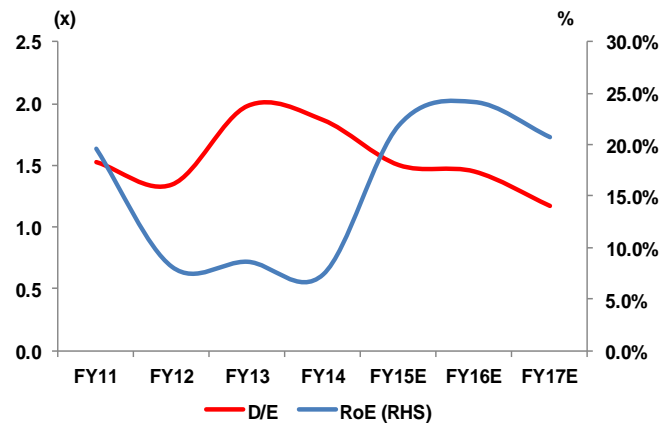
We expect POCL to report a three year CAGR of 20% in revenues to ₹791 crore by FY17 driven by doubling of metals smelting capacity which is slated to commission at the start of FY16. We expect EBITDA to grow at a three year CAGR of 36% to ₹34.6 crore; EBITDA margin is expected to consolidate at 4.5% for the coming years as the company sells higher proportion of specialized lead products. We expect the company to clock a PAT growth of 77% to ₹16 crore owing to expansion in operating margins. We expect POCL to report a PAT margin of 2.1% and an EPS of ₹14.6 in FY17.

POCL consolidated revenues and margin trend



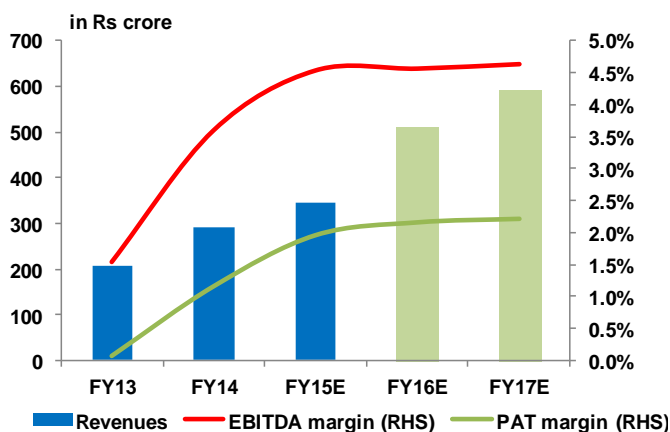
Source: POCL, Ventura Research

RoE on an uptrend; gearing comfortable



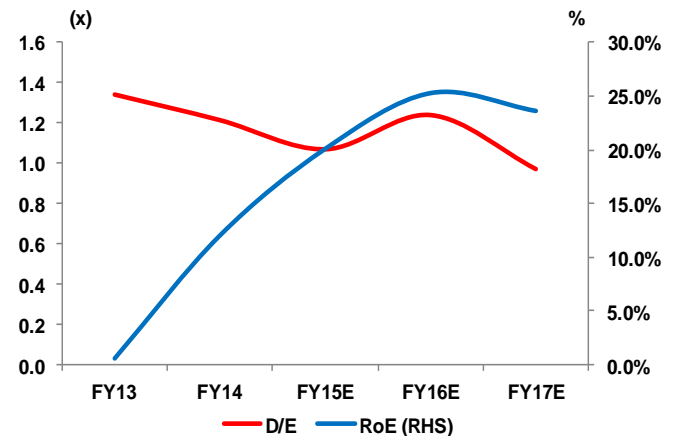
Source: POCL, Ventura Research

POCL (Metals) revenues to jump on expansion



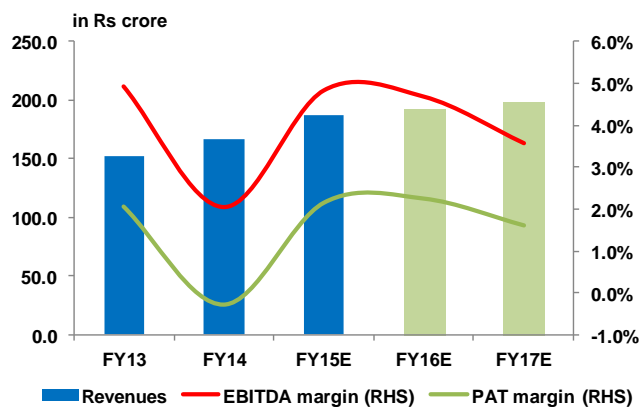
Source: POCL, Ventura Research

RoE to improve substantially



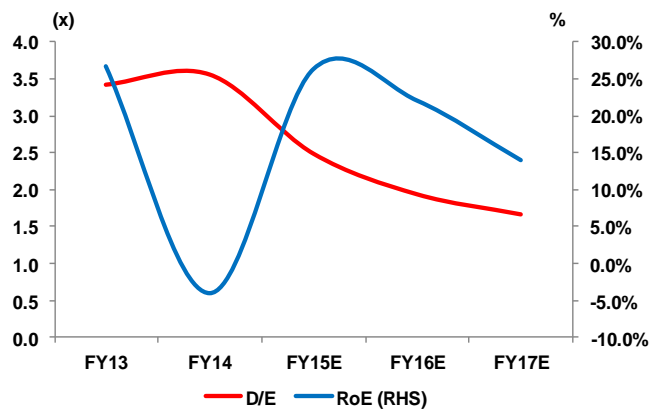
Source: POCL, Ventura Research

PEL revenues to remain stable



Source: POCL, Ventura Research

RoE and leverage will remain range bound

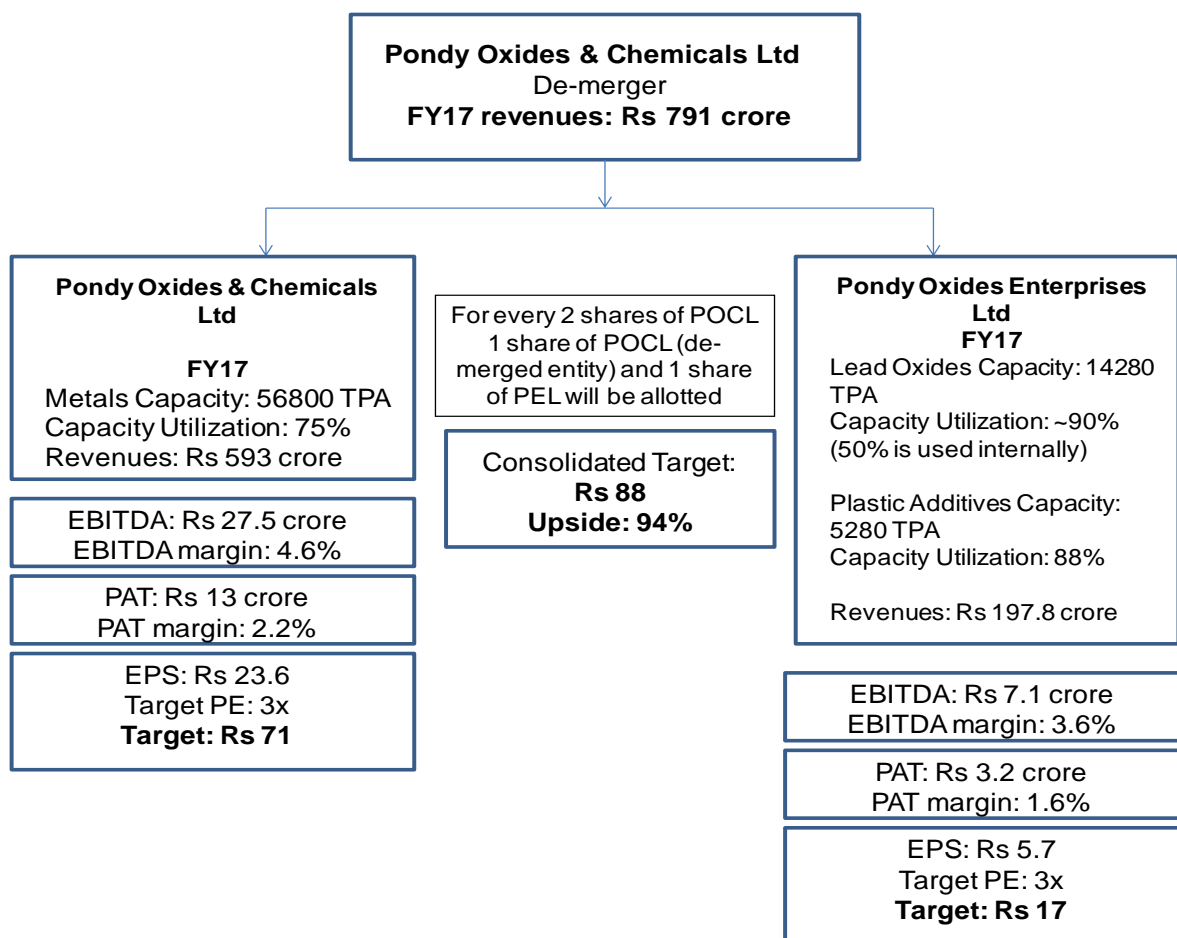


Source: POCL, Ventura Research

Valuation

We initiate coverage on POCL as a **BUY** with a Price Objective of ₹88 representing a potential upside of ~87% over a period of 24 months. The target price is arrived at by assigning a PE multiple of a conservative 3x each on the FY17 EPS of ₹23.6 for POCL (de-merged entity) and ₹5.7 for PEL Enterprises. The company has traded at an average multiple of 6x since 2010.

POCL post de-merger



Source: Ventura Research

At the CMP of ₹47, the stock is trading at a PE multiple of 3.2x FY17 consolidated EPS.

Peer Comparison

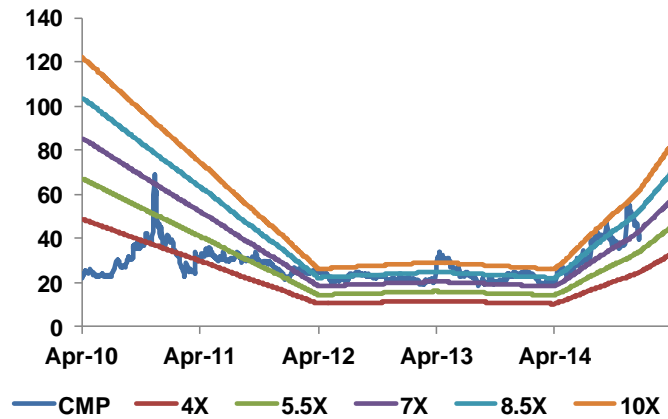
Company	Business	CMP	M Cap	Sales	EBITDA margin	FY14 PAI margin	RoE	Dividend Yield	PE		P/B		EV/EBITDA	
									FY15E	FY16E	FY15E	FY16E	FY15E	FY16E
Hindustan Zinc	Primary Smelter	164	70605	12163.4	52.0%	51.1%	19.4%	2.7%	9.3	8.7	1.6	1.4	5.5	4.4
Pondy Oxides	Secondary Smelter	47.0	53	457.4	3.0%	0.6%	7.3%	2.4%	4.9	3.4	1.1	0.8	4.8	4.4
Nile	Secondary Smelter	289	101	278.2	6.0%	1.9%	9.0%	3.9%	0.0	4.3	NA	NA	0.0	0.0
Gravita	Secondary Smelter	63	505	641.2	6.3%	3.1%	17.6%	2.4%	17.1	14.6	3.7	3.0	5.5	4.4

Source: POCL, Ventura Research

Key Monitorables:

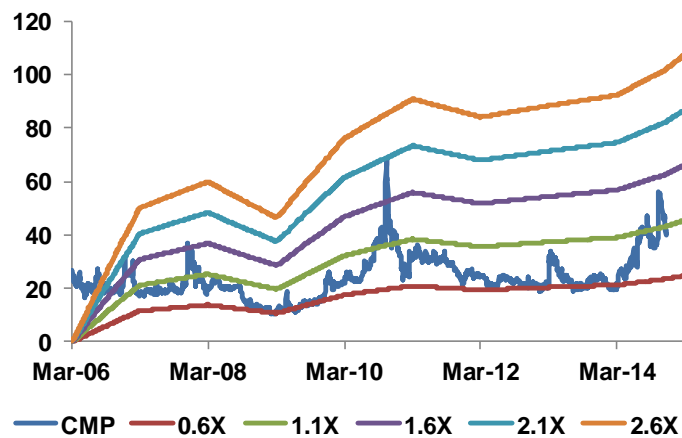
- The listing price of the de-merged entity, PEL is not known as of now; if the valuations at the time of listing are steep, the stock may witness a correction
- Even though the company does not supply to Russia and other oil dominated economies, the spill-over effect of sharp decline in crude oil prices may cause a economic slowdown thereby adversely impacting demand

P/E



Source: POCL, Ventura Research

P/BV



Source: POCL, Ventura Research

Financials and Projections

Y/E Mar, Fig in ₹ Cr	FY 2014	FY 2015E	FY 2016E	FY 2017E	Y/E Mar, Fig in Rs. Cr	FY 2014	FY 2015E	FY 2016E	FY 2017E
Profit & Loss Statement					Per Share Data (Rs)				
Net Sales	457.4	532.9	702.8	790.9	EPS	2.6	9.7	13.7	14.6
% Chg.	27.5	16.5	31.9	12.5	Cash EPS	4.6	11.9	16.3	17.2
Total Expenditure	443.5	508.2	670.5	756.3	DPS	1.0	1.0	1.0	1.0
% Chg.	27.4	14.6	31.9	12.8	Book Value	35.6	44.3	57.0	70.6
EBITDA	13.9	24.7	32.3	34.6	Capital, Liquidity, Returns Ratio				
EBITDA Margin %	3.0	4.6	4.6	4.4	Debt / Equity (x)	1.9	1.5	1.4	1.2
Other Income	1.3	1.6	2.1	2.4	Current Ratio (x)	1.3	1.4	1.6	1.7
Exceptional items	0.0	0.0	0.0	0.0	ROE (%)	7.3	21.8	24.1	20.7
PBDIT	15.1	26.3	34.4	36.9	ROCE (%)	15.7	30.1	32.0	34.4
Depreciation	2.3	2.4	2.8	2.9	Dividend Yield (%)	2.1	2.1	2.1	2.1
Interest	8.5	7.8	8.7	9.7	Valuation Ratio (x)				
PBT	4.4	16.1	22.9	24.3	P/E (x)	18.0	4.9	3.4	3.2
Tax Provisions	1.5	5.3	7.6	8.0	P/BV (x)	1.3	1.1	0.8	0.7
Reported PAT	2.9	10.8	15.3	16.3	EV/Sales (x)	0.3	0.2	0.2	0.2
Minority Interest	0.0	0.0	0.0	0.0	EV/EBITDA (x)	8.6	4.8	4.4	4.1
Share of profit associate	0	0.0	0.0	0.0	Efficiency Ratio (x)				
PAT	2.9	10.8	15.3	16.3	Inventory (days)	33.3	32.0	32.1	32.1
PAT Margin (%)	0.6	2.0	2.2	2.1	Debtors (days)	38.8	40.0	40.0	40.0
RM cost as a % of sales	88.7	86.9	86.9	86.9	Creditors (days)	15.8	17.0	17.0	17.0
Balance Sheet					Cash Flow statement				
Share Capital	11.2	11.2	11.2	11.2	Profit Before Tax	4.4	16.1	22.9	24.3
Reserves & Surplus	28.6	38.2	52.4	67.6	Depreciation & Amortisation	2.3	2.4	2.8	2.9
Minority Interest	0.0	0.0	0.0	0.0	Working Capital Changes	3.7	-5.6	-23.0	-9.3
Long-Term Provisions	4.2	7.9	10.1	10.6	Direct Taxes Paid and Others	-1.3	-5.3	-7.6	-8.0
Long-Term Borrowings	74.1	74.1	92.1	92.1	Operating Cash Flow	9.1	7.7	-4.9	10.0
Other Long-Term Liabilities	23.3	27.2	36.3	39.9	Capital Expenditure	-1.4	-0.5	-8.0	-2.0
Total Liabilities	141	159	202	221	Dividend Received	0.1	1.6	2.1	2.4
Gross Block	22.0	21.6	24.8	23.9	Others	-0.6	0.0	0.0	0.0
Less: Acc. Depreciation	0.0	0.0	0.0	0.0	Cash Flow from Investing	-2.0	1.1	-5.9	0.4
Net Block	22.0	21.6	24.8	23.9	Inc/(Dec) in Loan Fund	1.9	0.0	18.0	0.0
Capital Work in Progress	3.0	1.5	1.5	1.5	Others	-6.8	-1.3	-1.3	-1.3
Goodwill on Consolidation	0	0	0	0	Interest Paid	-8.5	-7.8	-8.7	-9.7
Non-Current Investments	0.4	0.4	0.4	0.4	Cash Flow from Financing	-13.3	-9.1	8.0	-11.0
Net Current Assets	115.3	134.4	172.5	192.6	Net Change in Cash	-6.2	-0.3	-2.8	-0.6
Other Non-Current Assets	0.5	0.5	0.5	0.5	Opening Cash Balance	13.2	7.0	6.7	3.9
Total Assets	141	159	202	221	Closing Cash Balance	7.0	6.7	3.9	3.3

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