

Initiating Coverage

S H Kelkar and Company Ltd.

January 03, 2022





Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Chemicals	Rs 155	Buy in the Rs 155-158 band & add more on dips at Rs 137	Rs 172.5	Rs 184	2 quarters

HDFC Scrip Code	SHKELKEQNR
BSE Code	539450
NSE Code	SHK
Bloomberg	SHKL IN
CMP Dec 31, 2021	155
Equity Capital (Rs cr)	141
Face Value (Rs)	10
Equity Share O/S (cr)	14.1
Market Cap (Rs cr)	2188
Book Value (Rs)	67
Avg. 52 Wk Volumes	1309192
52 Week High	207
52 Week Low	104

Share holding Pattern % (Sep, 2021)	
Promoters	60.9
Institutions	22.4
Non Institutions	16.7
Total	100.0



HDFCsec Retail research
stock rating meter

for details about the ratings, refer at the end of the report

* Refer at the end for explanation on Risk Ratings

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Our Take:

S H Kelkar (SHK) is one of the largest domestic players with around 10-12% market share in Flavour and Fragrance market and with ~20% market share in the domestic fragrances market. The company along with Givaudan and Firmenich control more than 60% of the market. The fragrance market is highly consolidated with the top-5 players controlling 60-70% of the total market. F&F constitutes key components of a variety of consumer products and hence are critical raw material for FMCG companies. It is a key ingredient behind developing different variants of consumer products and suppliers of particular ingredients are usually not changed during the lifecycle of the product. On account of the significance of this raw material, consumer companies largely deal with only established suppliers and this acts as a barrier for new entrants to break in. The sticky nature of the business thus acts as a moat for the company. Currently, the company has product basket of over 9,000 products, which they supply to > 4,500 customers in the fragrance and flavours segment including long-term relationships with global MNCs (~5% of client base), as well as with domestic players. In Nov-2021, Swiss firm Firmenich Aromatics acquired 10 percent stake in the company at Rs 173 per share by investing around Rs 242cr in a secondary market transaction. We believe, due to intensifying competition among FMCG companies, product innovation is expected to gain traction. The company's products, which are used as raw materials in many FMCG companies, thus will be a critical component of product success.

In line with its strategy to grow through the inorganic route, S H Kelkar has done several acquisitions in the last 2-3 years. Given F&F industry is characterized by high level of customer stickiness, inorganic growth is the quickest way to not only increase market share, but also gain access to new clients. To expand its global presence, the company had acquired 51% stake in Italy-based Creative Flavours & Fragrances (CFF) in Jan-2018 and in Jul-2020, SHK concluded the acquisition of the balance 49% equity stake in CFF at Euros 16 million (~Rs. 126cr). Total investment towards the CFF acquisition stood at Euros 28 million (~Rs. 223cr). The acquisition helped strengthen SHK's global product offering (particularly in fine fragrances and fabric care segments) and would help in gaining access to the European markets. SHK caters to major geographies such as Asia, Africa and the Middle East. The acquisition has enabled SHK to expand presence into newer markets in Europe within the categories of fine fragrances, air care, and fabric care segments. It has also assisted expanding the Company's international footprint and building additional R&D capability in fabric care & air care. Company derives over 80% of its revenue from India EM (including Asia ex-Japan and MENA regions) as against MNC players which derive slightly over 40% from developing countries. We believe SHK is well placed in terms of geographical exposure, which have high growth potential.



Valuation & Recommendation:

We believe SHK would be a major beneficiary of increasing demand from FMCG companies specifically present in personal care, packaged foods & dairy products. Management guided for 12-13% CAGR in revenue over the next 3-4 years. Company said that gross margin would be sustainable at 42-43% area in the medium term. We expect 12.5% revenue CAGR over FY21-24E largely led by strong volume growth in the end user industry. We believe margin should remain around 15-16.5% over the same period largely due to pressure in gross margin and higher expenses. We estimate ~9% PAT CAGR on the back of strong revenue and steady margin. Recently global giant Firmenich Aromatics took 10% stake in the company. This would help SHK in technological & R&D newer product development. Management said that the company will maintain distribution policy of 30-40% via dividend/buybacks as no major capex is planned in the medium term. At CMP of Rs 155, the stock trades at 15.5x/12.4x of FY23E/FY24E EPS. We feel that investors' can buy the stock at in the band of Rs 155-158 and add on dips at Rs 137 for base case target price of Rs 172.5 (14.5x Dec-2023E EPS) and bull case target price of Rs 184 (15.5x Dec-2023E EPS) over the next two quarters.

Financial Summary

Particulars (Rs cr)	Q2 FY22	Q2 FY21	YoY (%)	Q1 FY22	QoQ (%)	FY19	FY20	FY21	FY22E	FY23E	FY24E
Total Revenues	359	355	1.2	356	0.8	1048	1114	1322	1507	1683	1888
EBITDA	54	71	-24.3	41	31.2	137	158	236	219	260	307
Depreciation	17	15	16.8	17	3.6	31	52	62	70	76	83
Other Income	1	6	-82.3	3	-63.3	23	8	24	20	19	22
Interest Cost	4	4	-6.8	3	28.1	14	25	17	20	17	14
Tax	5	17	-68.9	-57	-109.1	27	19	50	-28	49	59
PAT	22	54	-58.8	81	-72.7	88	63	135	113	138	172
EPS (Rs)						6.1	4.4	9.5	8.2	10.0	12.5
RoE (%)						10.2	7.4	15.2	11.2	12.3	13.9
P/E (x)						25.5	34.9	16.2	19.0	15.5	12.4
EV/EBITDA (x)						18.3	15.9	10.6	11.4	9.7	8.2

(Source: Company, HDFC sec)

Q2 FY22 result update

Revenues declined 13% yoy, adjusted for CFF and Nova acquisitions. Reported revenues grew 1% yoy to Rs 359cr. Fragrance segment grew 1.5% yoy (down 1% qoq) to Rs 326cr. Fragrances EBIT margin was down 660bps yoy and up 225bps qoq. Flavors segment grew 6% yoy to Rs 32cr. EBIT margin declined 650 bps yoy. Reported Gross Margin stood at 40.7%, down 330 bps yoy and 150 bps qoq. It was impacted by significant raw material inflation. Reported EBITDA declined 24% yoy to Rs 54cr. Adjusted EBITDA (ex-CFF, Nova) declined



36% yoy. PAT for the quarter stood at Rs 22cr. Q1FY22 included the reversal of additional tax provisioning aggregating to Rs. 64.5 crore consequent to the ITAT order. Adjusting for this, PAT stood at Rs. 45.2 crore in the first half.

Board has approved the buyback of 29 lakh equity shares of at Rs 210 per share through tender offer route. The total amount of buyback size will be a maximum of Rs. 61cr. Promoter/promoter group of the company would participate in the said offer.

Key Highlights

- Overall gross margin is expected to be around 42-43%. Should improve to 45-46% in the next 4-5 years.
- Company guides for 19-20% EBITDA margin in the next 4-5 years. Higher gross margin would not flow to EBITDA due to more investments in R&D and higher other expenses. Guides for 12-13% CAGR in revenue over the next 3 years.
- SHK is not facing any raw material availability issues and has procured raw materials for coming two quarters.
- Company has no major capex programme in the medium term. Net debt stood at Rs. 347 crore as on Sep-2021, compared with Rs. 334 crore as on Jun-2021. This increase in debt was primarily due to higher working capital on inventory in the current environment.
- Fragrance capacity utilization is around the 55% mark. Flavours utilization is also around 50% mark. Company has capacity at China, which is also available for further expansion. And the company continues to invest incremental investments to enhance the capacity. It will not need any large fund for increasing the capacity, so with around Rs 5-10cr investments, company can increase capacity by 20-30%.
- Company launched immunity boosters for the online retail market based on its newly developed Ayurvedic (immunity-boosting flavour) extracts following the Ayush guidelines formulation.
- Good traction seen in nutraceuticals and health supplements like protein powders and protein bars launched in the health and wellness segment.
- SHK launched natural flavours on Amazon and Flipkart under Keva brand name witnessing strong monthly orders.
- SHK started own e-commerce portal, kevaflavours.com which received good initial consumer response
- It has started separate B2B e-commerce portal on the website and increasing awareness through social media and digital marketing.
- Company witnessed wins in new categories and in key accounts in granules in bakery and milkshake markets.
- SHK booked Rs 6.2 cr exceptional loss on account of flooding in the Mahad unit. The company expects to offset the loss against insurance claim. Given disruption in Mahad, the company used its China unit to fulfill customer orders, which resulted in some drag on gross margin.



Swiss firm Firmenich bought 10% stake in S H Kelkar for Rs 242cr

Swiss firm Firmenich Aromatics acquired private equity (PE) major Blackstone's 10 percent stake in S H Kelkar. The stake was acquired at Rs 173 per share for a total consideration of Rs 242 crore.

Firmenich is the world's largest privately-owned perfume and taste company, founded in Geneva, Switzerland, in 1895 and has been family-owned for 125 years. Firmenich is a leading B2B company operating primarily in the fragrance and taste market, specialized in the research, creation, manufacturing and sale of perfumes, flavors and ingredients.

Firmenich had recorded revenue of CHF 4,272 million in FY21, up 10.2% YoY on a reported basis, and +4.7% on an organic basis at constant currency. Adjusted EBITDA came in at CHF 816 million, down 5% year-over-year. Excluding the impact of acquisitions and foreign exchange, adjusted EBITDA would have decreased by 1.1% compared to the previous year. Adjusted EBITDA margin came in 300bps lower at 19.1%. This was driven by the impact of acquisitions, negative foreign exchange impact as well as the temporary impact of the pandemic on costs and mix. Excluding the impact of acquisitions and foreign exchange, adjusted EBITDA margin would have slipped by 120 bps.

Business and its outlook

S H Kelkar and Company is a Fragrance and Flavour manufacturer in India. Company operates in two segments: Fragrances, where it manufactures/trades in Fragrances and aroma ingredients for Fragrances, and Flavours, where it manufactures/trades in Flavors. Company derived 92% of revenue from fragrance and the balance from flavors in FY21. It offers fragrances in various categories, such as personal care, hair care, skincare and cosmetics, fabric care, household products and fine fragrances. Over the years, SHK has developed a vast product portfolio of fragrances and flavor products for the FMCG, personal care, pharmaceutical and food & beverages industry.

The global fragrance and flavour market is largely oligopolistic with a few aroma formulators. These include Givaudan, Firmenich, American firm International Flavors & Fragrances Inc., Germany's Symrise AG and Japan's Takasago International Corp. This group controls the market and supplies to consumer and personal care industries. SH Kelkar is India's largest aroma chemicals company. The company produces aroma chemicals while manufacturing a small portion of its raw materials in-house for captive consumption and sale.

Fragrance segment is witnessing good traction of new product development with a slew of new launches seen around health soaps, sanitisers, and specific health-benefit products. The company is working with existing and new clients to cater to these growing needs. The Company has an edge over competitors, given its strong leadership in the FMCG category. With a strong domestic portfolio, robust manufacturing capabilities, good inventory management and strong supply chain, the company is well poised to capture new growth levers. For its bio-technology innovation in the ingredients portfolio, the company's R&D efforts are progressing in the right direction and



the Company is establishing supply chain links for effective production. Company is constantly working on prototype development and exploring new applications as well.

Major raw material supply disruptions caused an unprecedented rise in raw material prices and that had resulted into sharp contraction in margin and profitability in FY19 and FY20. Chinese government shutdown of chemical factories on environmental grounds, floods in the US and blast in BASF plant in Germany had caused supply side disruptions for F&F players such as SHK. Sourcing of raw materials such as orange oil, citral, and Isoprenol has been challenging.

FY21 result update

In FY21, total income stood at Rs 1,345 crore, up 19.9% led by healthy demand and enquiries with normalization in business activities across both domestic and international markets. Robust business of the mid and large-sized FMCG customers amidst COVID-19 pandemic resulted in continued steady demand flow. In addition, Creative Flavours & Fragrances SpA (CFF), the Company's wholly-owned subsidiary, also delivered an encouraging performance supported by robust demand and volume off-take in the European markets. Excluding CFF contribution, on a like-to-like basis, revenue grew 3% YoY, without adjusting for the period of disruption. Primary segment fragrance contributed ~90% to total revenue registering 5% growth in India and 198% growth in Europe. The fragrance business in rest of the world degrew marginally by 0.4%. Flavours segment grew by 7% in India and by 319% in Europe and de-grew by 8.6% in rest of the world. In FY21, EBITDA came in at Rs 259.35cr as compared to Rs 166cr in FY20 reflecting higher operating leverage led by prudent inventory management combined with sustainable cost optimisation measures. PAT stood at Rs 144cr in FY21 as compared to Rs 35.8cr in FY20.

Creating value through inorganic route

In line with its strategy to grow through the inorganic route, SHK has done around 10 acquisitions in last 3 years. As the F&F industry is characterized by high level of customer stickiness, we believe growing inorganically is the quickest way to not only increase market share, but also gain access to new clients.

To expand its global presence, the company acquired 51% stake in Italy-based Creative Flavours & Fragrances (CFF) in Jan-18 and in the second and final tranche, on July 28, 2020, SHK through its Italian subsidiary - Keva Italy Srl, concluded the acquisition of the balance 49% equity stake in CFF at a consideration of Euros 16 Million (~Rs. 126cr). The Company financed this investment through local debt raised in Europe in order to avail the benefit of lower interest costs. Total investment towards the CFF acquisition stands at Euros 28 million (~Rs. 223cr). The acquisition was to strengthen SHK's global product offering (particularly in fine fragrances and fabric care segments) and would help in gaining access to the European markets. SHK caters to major geographies such as Asia, Africa and the Middle East. The acquisition has enabled SHK to expand presence into newer markets in Europe within the categories of fine fragrances, air care, and fabric



care segments. It has also assisted expanding the Company's international footprint and building additional R&D capability in fabric care & air care. The company had gross margin of around 30-32% in 2019.

Revenue contribution is dominated by Italy (75%) catered to by local sales team and some regional agents. European countries and Middle East contribute 20% and 5% respectively, serviced through a network of agents. The fragrances are mainly used in homecare products (42%) like air fresheners or cleaners, in fabric care products (22%) like laundry fragrance boosters or softeners, in beauty care products (22%) like shampoos or personal wash and in fine fragrance (5%).

Keva has unique raw materials, allowing CFF perfumers to create memorable signature fragrances. High standard management processes and software of Keva deployed to CFF will allow better control and efficiency. The strategy is to consolidate CFF market share in Italy and to expand to select targeted areas in Europe.

SHK derives over 80% of its revenue from India & EM (including Asia ex-Japan and MENA regions) as against MNC players which derive 40-50% from developing countries. We believe SHK is well placed in terms of geographical exposure, which have high growth potential.

In Apr-2021, SH Kelkar's wholly-owned subsidiaries, Keva Italy and CFF, entered into an agreement for acquisition of 70% equity stake of Nova Fragranze S.r.l. (Nova). Nova is a Italy-based company specializing in fragrance development and marketing with focus on premium customers in the high-end product segments of hair care and beauty care. In the year 2020, Nova's revenues stood at 2.4 million euros, with a solid gross margin profile of more than 60%. As per the agreement, Keva Italy and CFF shall be acquiring 28% and 42% stake, respectively of Nova. The consideration to be paid for the acquisition of 70% stake is 1.52 million euros (~Rs. 13.4cr).

Acquisition of 62% stake in Holland Aromatics B.V.

In Dec-2021, SH Kelkar, through its wholly owned subsidiary Keva Europe B.V., has entered into an agreement to acquire 100% stake in Holland Aromatics B.V. (Holland Aromatics). The acquisition is being done by acquiring 100% stake of Provier Beheer B.V., holding company of Holland Aromatics in the Netherlands. As per the agreement and subject to customary closing conditions, 62% of the stake will be acquired upon closure of the transaction, and the balance 38% shall be acquired in two tranches of 19% stake each over the next two years. The consideration for the acquisition of 62% stake is Euros 13.02 million.

SHK plans to fund the investment through local debt raised in Europe in order to avail the benefit of lower interest costs. This acquisition being complementary to the CFF business, supports SHK's strategy to deepen presence in a highly penetrated European fragrance market. In addition, it provides further growth dimensions such as broadened product portfolio through cross-engagements, augmented client relations and better reach across diverse customer segments, ranging from local companies to global MNC players.



Holland Aromatics is a leading fragrance company in the Netherlands. It has a strong presence in Europe, Middle East and Asia. In the calendar year 2020, Holland Aromatics' revenues stood at Euros 6.58 million. Their YTD CY2021 unaudited estimated revenues stood at over Euros 6.7 million. The company has a healthy balance sheet profile and is debt-free. Overall, the acquisition is value-accretive and a synergistic business opportunity for SHK over the longer-term.

Acquisition of NuTaste Food and Drink Labs Pvt. Ltd.

In Dec 2021, SHK announced the acquisition of 100% stake in NuTaste Food and Drink Labs Pvt. Ltd (NuTaste) through the wholly owned subsidiary Keva Flavours. Company will acquire 100% stake for a total consideration of Rs. 13.25 crore. The acquisition would help drive growth momentum of flavour business. It will enable SHK to expand further into the high-potential flavour categories such as syrups, sauces, seasonings, fruit preps and other such premium grade products. It brings on-board a solid and reputed customer base across the fast-growing FMCG & QSR space. Overall, the combined capabilities of NuTaste and SHK will add scale, provide cross-selling opportunities, and accelerate growth, going forward. Incorporated in 2006, NuTaste manufactures premium grade ingredients and products, natural ingredients and extracts, nutraceuticals etc. In FY21, NuTaste's revenues stood at Rs. 21.1cr whereas in FY20 and FY19, revenue stood at Rs. 24.5cr and Rs. 25.6cr respectively. In FY22 total revenue is expected to cross Rs. 35cr; the company is profitable and debt-free.

Participation in Global RFPs

SHK had earlier been shortlisted by a large global FMCG MNC as one of the registered suppliers of fragrances. The company is now participating in the global RFP (Request for Proposal) and will engage with the MNC on an interactive pitch for commercial tender submission. The tender has a tender submission fee of ~Rs. 12.5 crore for SHK. Such global tender participation is in line with the Company's strategy of more deeply associating with large global MNCs. SHK has strong competence and such participation sets the stage for SHK to tap upon further global RFP opportunities. In addition, the company's recent acquisition of Holland Aromatics along with the CFF business will augment SHK's ability to strengthen its presence in the high-potential global MNC space over the medium to long term.

In Sep-2021, SHK said that it has won an order in the Home Care segment from a large global MNC player in the domestic FMCG market. SHK highlighted Rs 25-30cr incremental annual sales from the strategic order win from a global MNC in the homecare segment. Driven by robust R&D capabilities and innovation strategies, SHK is the only company of Indian origin to file patents in the field of Fragrance and Novel Aroma Molecules. These patented molecules along with SHK's strong & well known expertise in the Indian fragrance industry paved the way for this order win. This strategic association will enhance the company's competitive advantage in the domestic markets and will enable SHK to build its presence in the high-potential global MNC space in the longer term.



Exclusive distributor of Santalol in India

S H Kelkar has become the exclusive distributor for Isobionics' product Santalol in India. The new fragrance ingredient is the first joint product from BASF and Isobionics and is available for the Indian market through SHK. The new fragrance ingredient is an alternative to sandalwood oil and is produced by a biotechnological basis from renewable raw materials. Sandalwood oil market is in excess of Rs. 100 crore per year. There is a good opportunity and having a renewable source with a stable supply will encourage the use of sandalwood oil again in perfumery, which has been declining in terms of volumes year-on-year and as the volumes continue to grow, it will help S H Kelkar in helping to grow into the premium and upcoming natural based products that is the new trend. Top-line is expected at around Rs. 25cr from this business and post 1% or 2% marketing costs, 7-8% could be the net margin on that product.

Global flavours and fragrances market

Global flavours and fragrances market reached a value of US\$ 31.7 billion in 2020 as compared to US\$ 29.8bn in 2019. The growth was driven by changing food preferences especially of the younger population and the shift towards low-calorie foods and beverages. Fast-paced growth in the processed food and beverage industry catalysed by a rising global population and rapid urbanisation has been the major driving force for the global flavours and fragrances market.

Further, rising incomes, changing lifestyles and increasing consciousness towards physical appearance boosted the market for personal care products and that has created a strong demand for flavours and fragrances market. Other growth drivers include rapidly-growing emerging markets, rising demand for organic and natural products, growing young population, rising need for convenience etc. Rising demand for packaged foods, beverages, home care, personal care, cosmetics, toiletries, pharmaceuticals, and nutraceuticals has been leading to the growth in demand as well.

Global flavours and fragrances market is poised to grow by US\$ 10.98 billion during 2020-2024, approximately at 6% CAGR, according to Technavio. The rising demand for personal care products and food-related products, growing dietary supplements and nutraceuticals market and rising demand for natural flavours and fragrances are likely to drive growth of the global flavours and fragrances market. The changing taste and preferences of consumers and their willingness to try and experience new varieties are some of the factors that will increase the demand for fragrance and flavors.

Rapid rise of online sales and exponential growth in the pharmaceutical industry led by the COVID-19 pandemic further contribute to the rise in demand of flavours and fragrances. The market growth is driven by the increasing launch of new products by vendors. Successful new product launches help in increasing revenue inflow of vendors and also provide multiple options to buyers driving overall growth of the market. Asia-Pacific (APAC) region is expected to offer several growth opportunities mainly due to the presence of a huge consumer base, rising working women population, growing demand for international cuisines and penetration of key vendors.



Owing to the sheer size of the population, India and China are the fastest growing consumption as well as production markets in the fragrance and flavour industry. This is an ancillary industry to fast moving consumer goods, food processing and pharmaceutical industries. Despite constituting less than 1% of product's volume and under average of 5% of its total cost of production, fragrances and flavours are instrumental in creating distinct product association with the consumers. Even though natural fragrances are perceived to be safe, healthier and therapeutic, synthetic ingredients continue to dominate the Indian market as they are cheaper, long-lasting, emit strong fragrance and offer greater freedom of creativity to manufacturers.

There are over 1,000 small, medium and large size enterprises operating in this industry, both in organised and unorganized sector. An estimated 70% of the organised market in India comprises international players while the remaining market is catered by domestic players. The market is fairly consolidated with the top 5 players accounting for 65% of the total market share. The market is dominated by MNC players, with 4 global majors featuring in the Top 5 along with Keva. Keva holds the position of being the largest Indian origin player which is most adaptable to evolving consumer needs. India is approximately 3% of the global fragrances and flavour market despite having 20% of the world population. The Indian F&F industry is valued at approximately US\$ 1.4 billion in 2019 with exports forming around 12% of total production. The growing demand for foods, cosmetics, personal care and household care products is expected to be the major driving factor for the growth of aroma chemicals market. The Indian fragrance and flavour market is estimated to grow at 15% CAGR to reach US\$ 3.3 billion during 2019-2025. Low rural penetration of FMCG products, growing aspirations of the middle class Indians, excessive and growing demand for personal care and processed foods, easy access to internet, growing young population which demands options and a rapidly evolving pharmaceutical market present tremendous growth opportunities for the fragrance and flavour industry.

There has been a tremendous rise in derived demand for fragrances with the increasing demand for fragranced personal care, laundry care and household care products. The consumer preference, too, has been towards more powerful and long-lasting fragrances. All these factors together bode well for fragrance industry.

Rapidly rising incomes and urbanisation is spurring interest in convenient packaged foods and fast food. Packaged goods require high flavour loadings to prevent the loss of taste that occurs during large-scale manufacturing. The growth in food and beverage industry will continue to remain the key driver for flavor industry due to the widespread use of flavours in processed food, snacks, soft drinks, candy & confectioneries, meat and seafood products, sauces, condiments, etc. There has been rising interest in natural, organic food and beverages which is leading to increased demand of essential oils and natural extracts used in these product categories.

Company Background

S H Kelkar and Company (SHK) is the largest Indian-origin F&F company in India with over 90 years of experience. Its fragrance products and ingredients are used as a raw material in personal wash, fabric care, skin & hair care, fine fragrances and household products. Its



flavour products are used as a raw material by producers of baked goods, dairy products, beverages and pharmaceutical products. The company offers products under SHK, Cobra and Keva brands in the small pack segment. It has a strong and dedicated team of scientists, perfumers, flavourists, evaluators and application executives at its facilities and five Creation & Development Centers in Mumbai, Bengaluru, The Netherlands and Indonesia for the development of fragrance and flavour products. Over the years, SHK has developed a vast product portfolio of F&F products for FMCG, pharmaceutical and F&B industries. The company has a diverse client base of over 4,500 customers including leading national and multi-national FMCG companies, blenders of fragrances & flavours and its producers.

Key Risks and Concerns

Sharp rise in raw material prices could adversely impact profitability

In manufacturing of F&F, SHK uses 1500+ raw materials from 4 broad category essential oil fruit extract flowers, wood etc. The prices of these raw materials have been volatile in the recent past and have adversely impacted its operating margin during same period. Similar adverse changes in the raw material prices could have a negative impact on earnings.

Foreign exchange risk

SHK's overseas revenue and a portion of raw material expenditures (~50% of RM) are in foreign currency, mostly USD and Euro. Company derived 25% of its revenue from exports in FY21. Thus, the company is exposed to the risk of fluctuation in foreign exchange rates.

Increasing competitive intensity may erode pricing power

SH Kelkar faces competition from global companies like Givaudan, IFF, Firmenich and Symrise which collectively hold around 60% share in Indian F&F market. The foreign companies have stronger financial strength and larger scale of operations coupled with higher investment in R&D (8-9% vs. 2-3% by SHK).

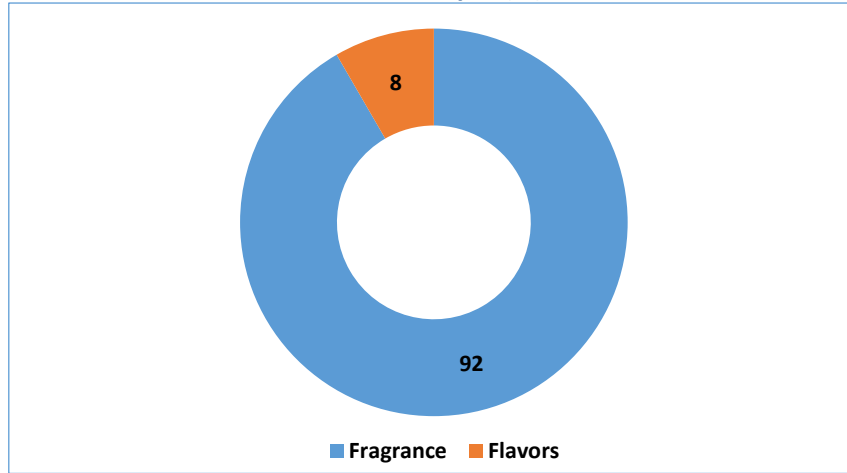
Debt funded capex

Though in the medium term, the company has not planned any major capex, significant debt funded capex may lead to deterioration of B/S and thus profitability.

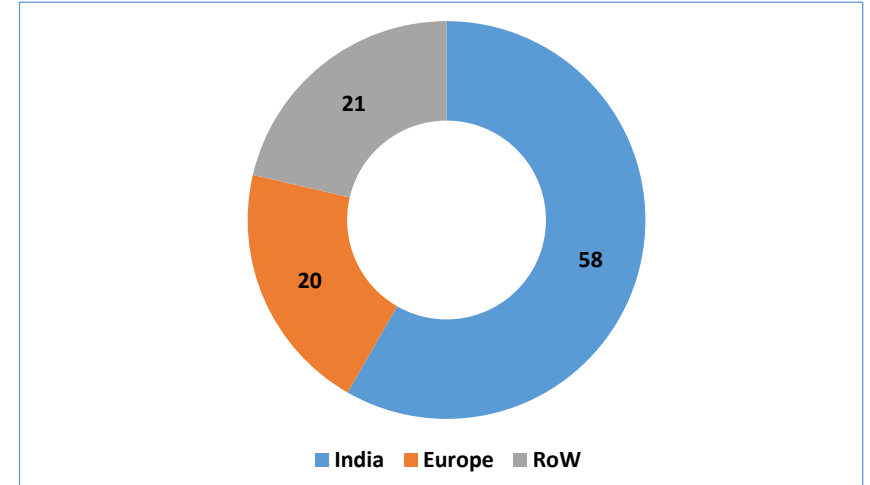
Recent acquisitions may strain the financials of the group unless they are integrated fast and synergies benefits are derived soon. Debt borrowed for these acquisitions may extend the leverage ratios. We have not considered the impact of these acquisitions in our estimates. The stock price may perform once the street becomes more comfortable about these not pulling down the overall ratios beyond a couple of quarters.



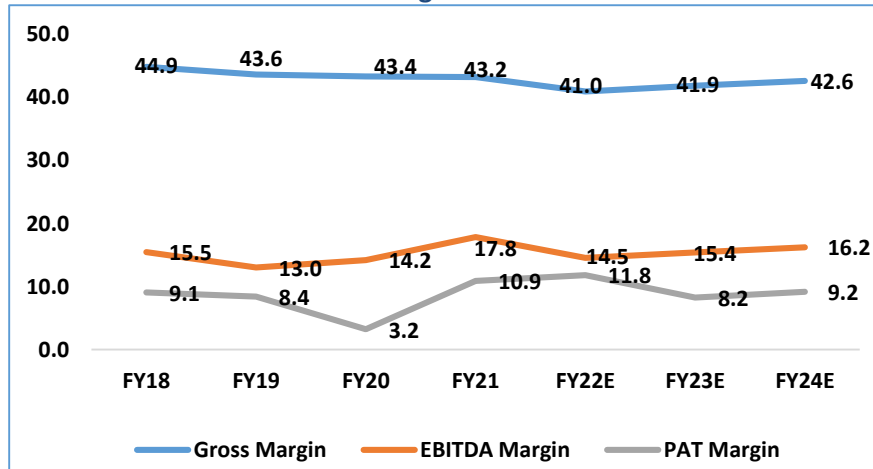
Revenue Split (%)



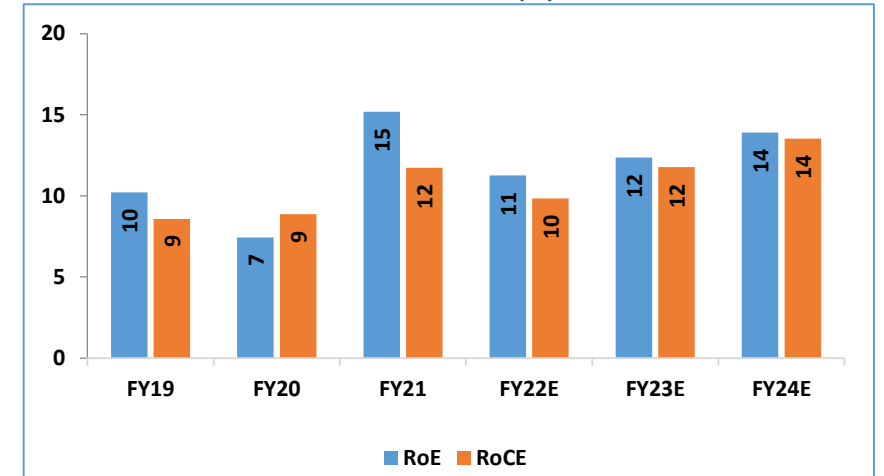
Revenue Mix (%)



Margin Trend



Return Ratios (%)



(Source: Company, HDFC sec)



Financials (Consolidated)

Income Statement

(Rs Cr)	FY20	FY21	FY22E	FY23E	FY24E
Net Revenue	1114	1322	1507	1683	1888
Growth (%)	6.3	18.7	14	11.7	12.2
Operating Expenses	956	1086	1288	1424	1582
EBITDA	158	236	219	260	307
Growth (%)	15.7	49.1	-7.1	18.6	18.2
EBITDA Margin (%)	14.2	17.8	14.5	15.4	16.2
Depreciation	52	62	70	76	83
EBIT	107	174	149	184	224
Other Income	8	24	20	19	22
Exceptional Items	-35	13	0	0	0
Interest	25	17	20	17	14
PBT	54	181	149	186	231
Tax	19	50	-28	48	59
RPAT	36	144	178	138	172
Growth (%)	-59.4	302.8	23.5	-22.3	24.9
APAT	63	135	113	138	172
EPS	4.4	9.5	8.2	10	12.5

Balance Sheet

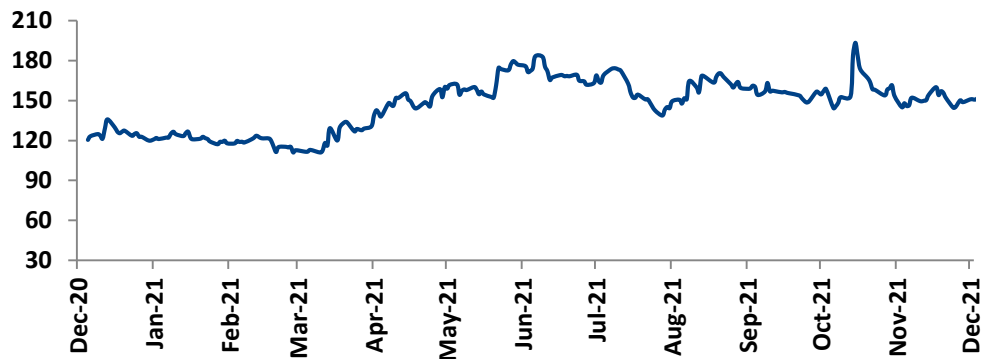
As at March	FY20	FY21	FY22E	FY23E	FY24E
SOURCE OF FUNDS					
Share Capital	141	141	138	138	138
Reserves	683	810	927	1037	1171
Shareholders' Funds	824	952	1065	1176	1309
Long Term Debt	54	332	260	208	160
Net Deferred Liabs	-49	-25	-21	-18	-14
Long Term Provisions & Others	2	2	5	10	17
Minority Interest	11	3	3	3	3
Total Source of Funds	842	1264	1313	1378	1475
APPLICATION OF FUNDS					
Net Block (incl. CWIP)	376	383	430	424	431
Goodwill & Intangibles	101	365	365	365	365
Long Term Loans & Advances	135	45	51	60	66
Total Non-Current Assets	612	794	846	849	863
Inventories	337	429	458	498	585
Trade Receivables	317	375	417	476	533
Short term Loans & Advances	7	8	9	10	10
Cash & Equivalents	66	139	102	69	31
Other Current Assets	54	64	71	81	73
Total Current Assets	805	1045	1030	1107	1205
Short-Term Borrowings	288	161	158	153	145
Trade Payables	173	247	255	274	300
Other Current Liab & Provisions	104	152	132	128	119
Short-Term Provisions	11	13	16	21	27
Total Current Liabilities	576	575	563	577	592
Net Current Assets	230	470	467	529	613
Total Application of Funds	842	1264	1313	1378	1475



Cash Flow Statement

(Rs Cr)	FY20	FY21	FY22E	FY23E	FY24E
Reported PBT	53	194	149	186	231
Non-operating & EO items	-8	-24	-20	-19	-22
Interest Expenses	25	17	20	17	14
Depreciation	52	62	70	76	83
Working Capital Change	111	-41	-90	-95	-121
Tax Paid	-28	-13	28	-48	-59
OPERATING CASH FLOW (a)	205	195	157	116	127
Capex	-45	-31	-60	-70	-90
Free Cash Flow	160	165	97	46	37
Investments	-3	-141	-5	-9	-6
Non-operating income	8	24	20	19	22
INVESTING CASH FLOW (b)	-40	-149	-45	-60	-75
Debt Issuance / (Repaid)	-155	134	-65	-45	-37
Interest Expenses	-25	-17	-20	-17	-14
FCFE	-17	282	12	-15	-14
Share Capital Issuance/MI/Buyback	0	-8	-64	0	0
Dividend	-16	-21	0	-28	-39
FINANCING CASH FLOW (c)	-196	88	-148	-89	-90
NET CASH FLOW (a+b+c)	-31	134	-37	-33	-38

One Year Price Chart



Key Ratios

	FY20	FY21	FY22E	FY23E	FY24E
Profitability					
Gross Margin	43.4	43.2	41	41.9	42.6
EBITDA Margin	14.2	17.8	14.5	15.4	16.2
EBIT Margin	9.6	13.2	9.9	10.9	11.9
APAT Margin	3.2	10.9	11.8	8.2	9.1
RoE	7.4	15.2	11.2	12.3	13.9
RoCE	8.9	11.7	9.7	11.6	13.3
Solvency Ratio					
Net Debt/EBITDA (x)	1.8	1.5	1.4	1.1	0.9
D/E	0.4	0.5	0.4	0.3	0.2
Interest Coverage	4.3	10.2	7.5	11.1	15.6
PER SHARE DATA					
EPS	4.4	9.5	8.2	10	12.5
CEPS	8.1	13.9	13.2	15.4	18.4
BV	58	67	77	85	95
Dividend	1	1.8	0	2	2.8
Turnover Ratios (days)					
Debtor days	104	103	101	103	103
Inventory days	116	106	111	108	113
Creditors days	77	97	82	79	78
VALUATION					
P/E	34.9	16.2	19	15.5	12.4
P/BV	2.7	2.3	2	1.8	1.6
EV/EBITDA	15.9	10.6	11.4	9.7	8.2
EV / Revenues	2.2	1.9	1.7	1.5	1.3
Dividend Payout (%)	21.4	18.3	0	20.1	22.3
Dividend Yield (%)	0.6	1.1	0	1.3	1.8

(Source: Company, HDFC sec)



HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. These stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicity of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

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