Galaxy Surfactants Ltd. (GSL) – IPO Note: "AVOID for listing gains/Long term subscribe" **13th May, 2011**

GSL is one of the leading manufacturers and marketers of surfactants and specialty chemicals in India for the Personal and Home Care ("PHC") industry. It produces a range of vital cosmetic ingredients including active ingredients, UV protection and functionalproducts catering to some of the largest global brands in the FMCG sector and find applications in skin care, hair care, oral care, body wash, sun care, household cleaners and fabric care segments. Its product portfolio comprises of 66 products across 70 countries. The company is a certified supplier and preferred vendor for leading companies in the field of Personal and Home Care. Few of its global customers are Beiersdorf, Ecolab, Henkel, Diversey, L'Oreal, Reckitt Benckiser and Unilever. GSL has dominant share of 60% in the domestic market. Its key domestic customers include Ayur, CavinKare, Dabur, Emami, ITC, Marico, Procter & Gamble Home Products Limited to name a few. The company has to its credit 18 patents in India and 10 patents in the US and has applied for 12 patents in India and one in Europe.

The company's consolidated revenues have grown at a healthy CAGR of 29.8% over the period FY08-10 to Rs.6.4 bn. The company witnessed improvement in EBITDA margins by 250 bps to 12.3% in FY10 on account of lower raw material costs. On the other hand, PAT margins improved by 110 bps on a yoy basis to touch 5.9% in FY10. This led to increase in ROE by 250 bps to touch 28.5% in FY10.

At the upper end of the price band of the issue price, the stock is valued at 14x its 9MFY11 annualized EPS.

We believe the prospects of the company are bright on account of the company promoted and managed by technocrats, strong product portfolio with marquee clients, dominant presence in its domain, positive operating cashflows, and capacity expansion to drive growth However, there are concerns like GSL having no prior experience of setting up an overseas project, high client concentration risk and competition from large global players.. The valuations too, are bit expensive considering the secondary market conditions. With due consideration to the fact of recent dismal performance of IPOs on listing, the stock may be available at a discount to the issue price post listing. Investors looking for short term listing gains may avoid the issue. However, higher risk appetite investors with a horizon of two to three years can consider applying the issue.

Financial summary (Consolidated)

Y/e 31 Mar (Rs. mn)	FY08	FY09	FY10	9MFY11
Total sales	3,821	5,560	6,442	6,480
OPM (%)	12.4	9.8	12.3	7.8
PBT	335.5	321.4	523.44	546.27
Reported PAT	262.8	267.7	378.8	427.9
PAT (%)	6.9	4.8	5.9	6.6
Equity Capital	85.64	85.64	177.27	177.27
Networth	920.62	1,142.3	1,508.1	1,865.3
EPS(Rs)	15.35	15.63	22.12	24.14
RoE (%)	32.3	26.0	28.5	22.9

Source: RHP, Ajcon Research

Issue date	13th May, 2011- 18th May, 2011
Issue size	Rs.2.01bn at upper end of the price band
FV	Rs.10
Price Band	Rs. 325-340 per share
Fresh issue	5.93 mn equity shares
Issue structure	50% - QIBs 35% - Retail 15% - Non Institutional Bidders
Lot size	20 shares
Equity shares prior to issue	17.72 mn
Equity shares post issue	23.65 mn
Post issue market capitalization	Rs. 8 bn at upper price band
Promoters	Mr. Unnathan Shekhar – Chairman Mr. Gopalkrishnan Ramkrishnan - Director
IPO Grading	Grade 4 by CRISIL, indicating above average fundamentals
Book Running Lead Managers	Motilal Oswal Investment Advisors, Centrum
Registrar to the issue	Link Intime India Pvt. Ltd.

Shareholding (%)	Pre Issue	Post Issue
Promoters	75.9	56.3
Others	24.1	43.7
Total	100	100

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OBJECTS OF THE ISSUE

Particulars	Amount (Rs. in mn)
To fund capital expenditure of the company's subsidiary in Egypt	2,123
To set up a new manufacturing facility at Jhagadia, Gujarat	701
Expansion of capacities at the existing manufacturing units in Tarapur	470
Expansion of capacities at the existing manufacturing units in Taloja	135
Total	**3,429**

Source: RHP

MEANS OF FINANCE

Particulars	Amount (Rs. in mn)
Proceeds from IPO	1,927-2,016
Project loan from IFC	576
External Commercial Borrowing (ECB) from Standard Chartered Bank, London	336
Term loans from domestic banks	600

Source: RHP

KEY POSITIVES

FMCG segment to drive growth: Globally, the personal care market is valued at US$ 145 bn in 2007. As per Acmite Market Intelligence report 2008, the sector is expected to grow at an eight – year CAGR of ~5% to US$ 218 bn. In 2007, the global market for surfactants in personal care was estimated at US$3.9 bn. On the other hand, home care was estimated at US$8.9 bn.

Surfactant market in personal care in US$ bn

Geography	2007	2015E	% CAGR (2007 – 2015)
Western Europe	0.86	1.17	3.9
North America	1.05	1.45	4.1
Japan	0.26	0.35	3.8
Asia Pacific	0.96	1.6	6.6
Rest of the world	0.74	1.16	5.8
Total	**3.88**	**5.73**	**5.0**

Surfactant market in home care in US$ bn

Geography	2007	2015E	% CAGR (2007 – 2015)
Western Europe	2.26	2.53	1.4
North America	2.52	2.79	1.3
Japan	0.7	0.77	1.2
Asia Pacific	1.85	2.57	4.2
Rest of the world	1.54	1.99	3.3
Total	**8.87**	**10.65**	**2.3**

Dominant position in the Indian market, marquee clients: The company garners 60% market share in its range of personal care performance chemicals (Source: Euromonitor International). Its customers include Ayur, Cavinkare, Dabur, Emami, Hindustan Unilever, Henkel, ITC, L'Oreal, Marico, Procter and Gamble Home Products Ltd. to name a few. It has the largest continuous process plant in India for manufacturing surfactants used in personal care application.

Setting up manufacturing facilities at strategic locations: The company is setting up manufacturing units in Jhagadia, Gujarat and Suez, Egypt. The installed capacity in Jhagadia will be 77,000 MTPA which will be operational by August 2011, whereas in Phase I of Suez, the installed capacity will be 50,000 MTPA which will be operational by August 2011. In Phase II of Suez, additional installed capacity will be 40,000 MTPA which will be operational by August 2012. It would look for more geographic locations suitable for catering to different markets and product ranges. As it is a supplier of key personal care and home care ingredients in growing markets of Africa, Middle East and Turkey (AMET), its upcoming unit at Suez, Egypt will enable it to serve the AMET region efficiently and drive its growth in the region. Further, proximity to Europe and East Coast of North America of this facility will enable GSL to tap new markets that are difficult to be catered from India. This will also allow it to manage its supply chain effectively, both in terms of time and cost. The upcoming domestic facility at Jhagadia, Gujarat will ensure logistical efficiencies due to its proximity to key raw material supplies and to the port.

Locational advantage:All of its manufacturing units are strategically located in terms of proximity to customers and access to key raw materials. The company's existing facilities at Tarapur and Taloja have an easy access to Jawaharlal Nehru Port Trust (JNPT), Navi Mumbai. During FY10, GSL acquired TRI-K in USA, which in addition to increasing its product portfolio, also expands its reach to American markets to help us in tapping new business opportunities. Presently, it is setting up manufacturing facilities at Jhagadia, Gujarat and Suez, Egypt. Jhagadia is in close proximity to the source of ethylene oxide which is an important raw material. GSL's upcoming facility in Suez, Egypt located in a public free zone will enhance its presence in markets such as Europe, Middle East, Africa and East Coast of North America.

Thrust on other specialty chemicals: Specialty chemicals are higher margin products which require multi stage processing and unique technical competencies. These products are characterized by their functionality like mildness, sun protection, etc. to the end products. Innovation in product and application development will be the key to success in this category. GSL has set up an application laboratory exclusively to analyze benefits and build the required functionality in the products. Its current portfolio of specialty chemicals comprises of sunscreen actives, mild surfactants, formulated mixtures, conditioners, cosmetic preservatives, syndet and transparent bar soap base, etc.

Key negatives

High client concentration risk: GSL's top ten customers accounted for 70% of revenues in FY09 and 67% in FY10, while the company has done substantial business with these customers in the past, it doesn't have any legally binding agreements or commitments for long-term supply. We believe, loss of major customers can impact the sales and profitability.

Project execution risk: The company plans to double its total capacity from ~155,440 MTPA to 348,460 MTPA. The company is implanting its first overseas Greenfield project in Egypt. The capex required over the two phases of the project is estimated to be Rs 2,123 mn. Commercial production from the first phase of the plant is likely to start in August 2011. Considering the political tensions in Egypt, timely completion of the facility and ability to initiate commercial production without any delays will be a key monitorable as delays could impact revenue growth and profitability.

Competition from global players: GSL faces competition from some large global players. Global peers like Huntsman Corporation, Rhodia, Stepan Company, BASF Corporation, Croda International Plc, The Dow Chemical Company, Clariant Limited, Sasol Limited would lead competitive intensity in global markets for the company. GSL would be to some extent would be mitigated from this risk as these global peers have a diversified product portfolio in chemicals and are not restricted just to surfactants. In the surfactants space too, they provide a variety of surfactants for various end-use markets like agrochemicals, textiles, paints and adhesives besides personal and home care. Their lack of focus specifically for the end-use market of personal care works in favour of the company.

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