Century Enka

RISK/REWARD RATING: DOG

We feel that the company justifies the rating of a Dog stock—this means high risk to low return.

Reward \ Risk	Low	High
High	Star	UFO
Low	Safe	Dog

Rs m	3/95	3/96	3/97	% CAGR
Sales	3,881	6,039	5,346	17
EBIT	261	639	576	49
Net	76	247	311	102
EPS (Rs)	32.69	106.21	133.63	102
PER (x)	–	–	8.4	–

Warning

JiFi Notes are a first screening of the vast number of unresearched Asian small caps in an attempt to filter out quality companies. It is not designed as an exhaustive research report and will require further work before a major commitment is made by a risk-averse investor. Small caps are inherently volatile and understanding the sensitivity and drivers of the business and its environment is more important than a one-shot forecast of next year's numbers. Hence, there is no forecast; this note is a business rather than financial analysis of the company. A JiFi Note does not imply that the stock will be covered on an ongoing basis.

It is ...

Primarily involved in manufacturing polyester filament yarn (PFY) and nylon tyre cord fabric (NTCF).

It is not interesting because ...

- International prices of Century Enka's major business, PFY, are falling, while domestically overcapacity reigns. Besides, small capacities have meant uneconomical scale of operations. Its once-dominant position in the PFY business has given way to declining market share. Additional capacities from a merger with Rajashree Polyfils will only add to its woes.

- Squeezed margins are reflected in an already-low RoE which is expected to decline further in the next two years.

- Although Century Enka's management, the B. K. Birla management, well respected, it quotes at unjustifiably high PER. Moreover, it will have a negative profit growth in FY98 and FY99.

Key external drivers

- Polyester vs cotton: Inasmuch as cotton is a substitute for polyester, it poses a threat to polyester demand. However, polyester is making a come back (especially in countries with large populations) as declining prices make it a more attractive buy to cotton.

MARKET CAP
Rs 2.6 bn (US$72 m)

12-M HIGH/LOW
Rs 1,800/Rs 845

SHARE PRICE
Rs 100

TRADED SHARES/PAST 6 MONTHS
0.9%

TRADED VALUE/PAST 6 MONTHS
Rs 24 m (US$0.65 m)

REUTERS
CNTE.BO

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Business analysis

Overall	Small			Big	
Market growth			x		Demand for polyester filament yarn is growing at 13%–15% p.a.
Market size				x	

Comment: Polyester filament yarn (PFY) demand grew mainly on the back of a sharp cut in prices. However, prices of Enka's raw materials outpaced produc[t price] growth, making PFY a non-profitable venture.

Market	Low			High	
Customers			x		Fabric manufacturers.
Consumers			x		Polyester fabric sold to final consumers.
Marketing approach			x		Value-added yarn (PFY is better than POY in terms of quality and price realisation).
Repeat business					NA
Cyclicality				x	Polyester cycle is quite notorious. Product price growth is slower than raw material gr[owth].
Price sensitivity				x	Linked to international prices.
Product portfolio			x		PFY (60%), NTCF (33%), NFY (8%).
Geographical distribution	x				Mainly domestic.
Growth prospects	x				Slow, as product price growth is slower than raw material price growth.
Order book					NA
Expansion			x		Merger of Rajashree Polyfils will increase Century's PFY capacity.
Market share					It has declining market share in a growing market. Share declined from 7.3% in FY95 [to] around 4% in FY97.
Margins	x				Squeezed margins in polyester business while nylon tyre cord fabric saves the day.

Comment: Additional capacities from the merger with Rajashree Polyfils will only add to the woes of a falling product cycle. We think the polyester business wi[ll] continue to face squeezed margins while NTCF will save the day because of lower caprolactum prices.

Competition	Low			High	
Competitive edge		x			PFY has higher value addition than POY.
Cost competitiveness		x			Synergy to manufacture other value-added yarn has helped Century to keep its marg[ins] reasonable.
Differentiation			x		A manufacturer with quality foreign collaboration.
Uniqueness			x		Higher value addition in PFY. A quality NTCF manufacturer with foreign collaboration.
Critical success factor		x			Maintaining prices through higher value addition.
Competitors				x	Reliance, Indo Rama Synthetics and others.
Barriers to entry				x	High replacement cost. A 4,000 tpa expansion costs around Rs 1 bn.
New entrants		x			Not many.
Substitute products				x	Cotton yarn.
New technology	x				No new technology. Existing manufacturing process to continue.

Comment: Higher value addition in PFY and lower caprolactum prices helped Century maintain reasonable margins. However, the slump in the tyre business w[ill take] its toll from FY98 onwards.

Operations	Bad	Poor	Good	Great	
Quality of plant			x		Quality maintained through foreign collaboration and constant willingness to moderni[se].
Capacity			x		After the merger (Rajashree Polyfils with Century Enka) PFY capacity will increase sh[are].
R&D			x		Technology supplied by Akzo of Netherlands.
Suppliers			x		Reliance, Bombay Dyeing.
Bottlenecks					NA
Throughput efficiency					NA
Inventory control					NA
Distribution method					Ex-factory.

Comment: Technological back-up from Akzo helps maintain higher value addition.

Century Enka

Management	Bad	Poor	Good	Great	
Management style			x		Family-managed company. Belongs to the well-respected B.K. Birla group.
Layers of management					NA
Key people			x		Executives given powers.
Management (% of equity)			x		Promoters hold 80%. Rest with public.
Family members			x		

Comment: Family-managed company but well respected in industrial circles.

Financial control	Low			High	
Subsidiary information					No subsidiary...
Consolidation			x		...hence no consolidation.
Timeliness			x		Reported FY97 results after one month of the close of the year.

Drivers	--	-	+	++	
Political			x		No political risk foreseen.
Technological	x				Existing manufacturing process continues.
Social		x			Social tastes have shifted to polyester as it caters to a relatively lower per capita income. Rich class prefers cotton fabrics to polyesters.
Environmental	x				No environmental problems.

Inputs	Low	Medium	High	V High	Value added by inputs
Raw materials and fuel				x	70% of net sales (FY96).

Comment: Higher raw materials price growth has added to existing woes coupled with rising power costs.

Classification	Dog	Safe	Star	UFO	Comment
Beta box	x				Low beta and a declining next two-year EPS growth.
Cash box		x			Modest RoCE and RoE.
Sentiment	x				Few brokers' visits and way above the 12-month low.
Valuation	x				High price-to-cash flow and a premium to SCI PER.

Comment: We think the stock justifies the rating of a Dog stock based on a declining EPS growth in the next two years despite a modest RoCE and RoE.

Economic effects	US	Japan	China	HK	Indon	Mal	Phil	Sing	Taiw	Thai	S Korea	India	Pak	Sri
Foreign exchange														
Consumption												x		
Investment (government)												x		
Political change												x		
Interest rates												x		

Comment: Falling interest rates will help reduce interest costs. However, normally fixed costs are quite high in petrochemical companies, and this will also take its toll on Century's bottom line.

Financial data

Rs m	3/95	3/96	3/97	% CAGR	Comment
Profit and loss					
Sales	3,881	6,039	5,346	17	Cut in prices led to growth in overall demand.
EBIT	261	639	576	49	Mainly internal efficiencies but sluggish industry conditions.
Net interest	−173	−171	−97	−25	Repayment of loan.
Tax	−12	−220	−169	275	Tax shield on expansion of PFY capacity.
Net earnings	76	247	311	102	Negative growth in future.
EPS (Rs)	32.69	106.21	133.63	102	Best increase over two years in the sector.
DPS (Rs)	30.00	24.00	27.00	−5	To be maintained.
Cash flow					
EBIT	261	639	576	49	
Depreciation	212	194	169	−11	Expansion yet to kick in.
Working capital	−232	−33	18	–	
Operating cash flow	−187	180	358	–	
Capex + other investments	−74	117	74	–	
Free cash flow	−261	297	432	–	
Financing	260	−290	−433	–	
Change in cash	−1	7	−1	0	
Balance sheet					
Cash and equivalent	39	46	45	7	Steady. But going to be lower due to expansion in FY98.
Receivables	665	661	548	−9	
Investments	0	0	0	–	
Inventory	1,212	1,025	907	−13	
Non-current assets	2,542	2,425	2,351	−4	
Others	505	629	611	10	
Total assets	4,963	4,786	4,463	−5	
Short-term debt	0	0	0	–	
Payables	622	492	641	2	
Long-term debt	1,286	996	563	−34	
Miscellaneous	523	687	510	−1	
Shareholders' equity	2,532	2,611	2,749	4	
Total liabilities	4,963	4,786	4,463	−5	
Interest rates (%)	16.50	14.50	14.50	−6	Lowering interest rate to reduce interest cost.
Operating margin (%)	8.89	11.41	11.15	12	NTCF business saves the day.
Non-current assets/sales (%)	65.50	40.15	43.99	−18	
RoCE (%)	9.04	19.11	17.99	41	Moderate.
Net income/sales (x)	0.02	0.08	0.09	99	
Sales/assets (x)	0.78	1.26	1.20	24	
Assets/equity (x)	1.96	1.83	1.62	−9	
RoE, pre-tax (%)	3.48	17.90	17.44	124	Moderate.
Total debt/equity (%)	50.79	38.15	20.49	−36	
Net debt/equity (%)	49.25	36.39	18.86	−38	
RoE/RoA, both after-tax (x)	1.96	1.83	1.62	−9	
Dividend/FCF (x)		0.19	0.15	–	
FCF per share (Rs)		127.74	185.68	–	
P/FCF per share (x)		8.78	6.04	–	
NAV/share (fully diluted)	1,089	1,123	1,182	4	

Denso India

(formerly Nippon Denso India)

RISK/REWARD RATING: SAFE

We feel that the company deserves the rating of defensive stock—this means low risk and low reward.

Reward \ Risk	Low	High
High	Star	UFO
Low	Safe	Dog

Rs m	3/95	3/96	3/97	% CAGR
Sales	957	1,306	1,534	27
EBIT	82	129	154	37
Net	56	103	114	43
EPS (Rs)	3.55	6.49	7.01	41
PER (x)	–	14.6	10.0	–

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It is ...

Primarily a manufacturer of auto electricals for 4-wheelers and 2-wheelers, as well as spare parts. It is the biggest supplier to Maruti Udyog, the largest car manufacturer. New customer, Honda SIEL, will account for 4% of net sales in FY98 and 17% in FY99.

It is interesting because ...

- It has a high market share in auto electricals. It raised its market share (53% vs 47% by Lucas) from volume growth of Maruti Udyog (Esteem and Zen) and Hero Honda's range of 2-wheelers.

- Technical collaboration with Denso, Japan, ensures quality products. Denso, Japan and ASMO have raised their stakes from 45.3% to 51%, showing that the technical collaborator is financially interested.

- Denso India's stock has been quoted at a steep premium to the SCI. But a slowdown in the economy in FY97 will see sales of passenger cars falling in 1H FY98. Maruti Udyog's production capacity will rise in FY99 as it is setting up a new plant. Overall volumes should improve in FY99, and will gain from indigenisation; currently, [illegible]% of raw material and components are imported.

- More indigenisation, volume growth and Maruti Udyog's increased capacity in FY99 will see improved margins. But we feel the share price will soften mid-term because of a possible negative EPS growth in FY98F. With the fluctuating currency rate, the share price could fall even further. Denso India's share price has slipped recently because of lower RoE and RoCE in FY97 over FY96.

Key external drivers

- GDP growth: A slowdown in economic growth will see fewer automobile sales. Hence, a slowdown in auto ancillaries is inevitable. However, car sales are expected to pick up in FY99 after a lag period as GDP growth is expected to be around 7% in FY98F.

- Interest rate: As interest rates ease, auto financing will pick up and this results in volume growth. Interest rates in India have recently slipped.

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MARKET CAP
Rs 1.1 bn
(US$31 m)

12-M HIGH/LOW
Rs 132/Rs 63

SHARE PRICE
Rs 70.50

TRADED SHARES/ PAST 6 MONTHS
1.42%

TRADED VALUE/ PAST 6 MONTHS
Rs 21 m
(US$0.56 m)

REUTERS
DNSO.BO

Business Analysis

Overall	Small			Big	
Market growth			X		Higher GDP growth rate boosted auto volumes by 20%.
Market size					NA

Comment: Higher GDP growth gave fillip to auto volumes which grew by around 20%. However, it seems that a slowdown in passenger car sales due to constra capacities and economic slowdown will affect most auto ancillary stocks which are likely to face lower margins in FY98.

Market	Low			High	
Customers			X		Maruti (63%), Hero Honda (14%), Bajaj (6%), Subros (3%), Eicher (3%). Introducing a ne customer, Honda SIEL, in the current year.
Consumers			X		OEMs such as 4-wheeler and 2-wheeler manufacturers.
Marketing approach			X		Locational advantages. OEMs such as Maruti and Hero Honda pick up from Denso's factory. In fact, Denso India was not affected during the transport strike.
Repeat business			X		70%–80%.
Cyclicality		X			Rides on the economic cycle. GDP growth is going to be higher in FY98 than in FY97.
Price sensitivity		X			Major products freely available, hence very price-sensitive. But removal of subsidies by parent will take its toll on margins in FY98.
Product portfolio			X		Alternators (26%), Starter Motors (14%), Wiper (11%), Fan (12%). New products introdu power windows, fuel pumps and door-locks.
Geographical distribution	X				Mainly in India.
Growth prospects			X		Will reap benefits from indigenisation and economic recovery in FY99.
Order book					NA
Expansion				X	Capex of Rs 700 m in FY98 and FY99, mainly stressing on indigenisation.
Market share			X		Market share of around 53% in the 4-wheeler car market.
Margins		X			Volume growth will improve operating margins in FY99.

Comment: Although we feel that Denso India will continue to be a key player in the auto electrical industry, a slowdown in the passenger car market will see decl net margins in FY98. However, an economic recovery (as is expected) will improve operating margins in FY99.

Competition	Low			High	
Competitive edge			X		A technical tie-up with Denso, Japan, has ensured steady supply to Maruti.
Cost competitiveness		X			The rupee is appreciating against the yen and this has provided increasing margins. But rupee weakening against the US$, and hence against the yen, will reduce margins in FY9
Differentiation			X		Steady supply to largest manufacturer of passenger cars, Maruti.
Uniqueness			X		First, technical tie-up with Denso, Japan. Second, located near to Maruti and Hero Honda.
Critical success factors			X		Technical tie-up with Denso, Japan, gives it a competitive edge in the industry.
Competitors			X		Mainly Lucas; it also supplies Maruti and will supply Mitsubishi when it sets up shop in I
Barriers to entry		X			High technology with skilled labour but limited capital investment (cf petrochemical proj
New entrants	X				Nothing major on the horizon.
Substitute products	X				No substitutes.
New technology			X		Expansion to be technologically backed by technical collaborator, Denso, Japan.

Comment: Stress on indigenisation while technology backed by collaborators will help Denso India to save on cost. However, Denso India will be affected by Mar capacity constraints and lower price realisation because of a cut in import duties and the removal of subsidies by the parent.

Operations	Bad	Poor	Good	Great	
Quality of plant			X		Quality to be maintained; to follow Japanese standards.
Capacity			X		Increase based on Maruti's expansion. New engine-management systems project in the
R&D			X		3% of domestic sales to be paid as royalty to Denso, Japan, for technology supplied.
Suppliers		X			58% of total raw material and components was imported in FY97.
Production time					NA
Bottlenecks		X			Legal procedure and time to import components.
Throughput efficiency					NA
Inventory control			X		Better inventory control as a result of monthly sales.
Distribution method			X		Close to Maruti and Hero Honda.

Comment: Proximity to Maruti and Hero Honda ensures check on inventory levels, lower transport costs and timely deliveries.

Denso India

Management	Bad	Poor	Good	Great	
Management style			x		MD, deputy MD, six Japanese directors, look after the day-to-day management.
Layers of management					NA
Key people			x		Generally, the directors and general managers provide information.
Management (% of equity)			x		Denso and ASMO of Japan hold 51% of the total equity.
Family members				x	Non-contributors are not on the paylist.

Comment: We think Denso's interest in the Indian arm will give a fillip to quality products and provide transparency to retail investors in the long term.

Financial control	Low			High	
Subsidiary information					No subsidiary company.
Consolidation					
Timeliness		x			Audited results are normally announced three months after the close of the financial year.

Drivers	--	-	+	++	
Political	x				A macro level ban on collaborators raising their stakes will have a direct impact on Denso India. We do not foresee any change at these levels.
Technological	x				No macro level technological changes have been foreseen.
Social			x		Increasing spending limits as a result of economic recovery will lead to more sales.
Environmental			x		No environmental problems foreseen as assembling is the main work.

Comment: There is no macro-level policy change which might affect collaborations in India.

Inputs	Low	Medium	High	V High	Value added by inputs
Raw material and components				x	58% of sales.
Excise duty		x			A 2% cut in excise duty to 18% for most of the products helped to marginally boost sales.
Wages	x				There are 847 workers whose average age is 27; the average term of service is four years.

Comment: Although the excise duty has been reduced by 2% for most of its products, it does not boost sales much. There are 10 Japanese and 24 locals in the management team; there was a low absenteeism ratio of 6% in FY97 and the employer-employee relationship is good.

Classification	Dog	Safe	Star	UFO	Comment
Beta box			x		A beta of 1 and a two-year EPS growth of over 30%.
Cash box				x	[illegible] over 35% with maiden dividends.
Sentiment	x				[illegible] broker visits and it is 12% above its 12-month low.
Valuation	x				[illegible] price-to-cash flow and steep premium to small cap index PER.

Comment: Overall, the company deserves the defensive stock rating because of a beta of 1 with a strong historic RoE of 49% and RoCE of 33%. Although we feel that there will be negative EPS growth in FY98F, it should revive in FY99F following economic recovery and higher volumes.

Economic effects	US	Japan	China	HK	Indon	Mal	Phil	Sing	Taiw	Thai	S Korea	India	Pak	Sri
Foreign exchange		x												
Consumption												x		
Investment (government)												x		
Political changes												x		
Interest rates												x		
Tourism												x		

Comment: Currently, 58% of raw material and components are imported. Because of the weak rupee (against the US$ and hence against the yen), net margins are expected to fall in FY98.

Financial data

Rs m	3/94	3/95	3/96	3/97	% CAGR	Comment
Profit and loss						
Sales	596	957	1,306	1,534	37	Easier auto financing with additional products; new ca… Honda SIEL. Net sales target is Rs 1,540 m for FY98 and … for FY99, with Rs 356 m from new products and custome…
EBIT	38	82	129	154	60	Largely internal efficiencies.
Net interest	–37	–26	–26	–23	–15	Repayment of loans as equity is raised to help finance ex… Loan conversion of Rs 4.68 m into equity started 15 May …
Tax	0	0	0	–17	–	Inadequate tax shield in FY97. Will fall in FY98 because of …
Net earnings	1	56	103	114	353	Volume growth with internal efficiencies ensures a stead… the net level.
EPS (Rs)	0.08	3.55	6.49	7.01	349	A whopping increase! Best in the sector.
DPS (Rs)	0	0	0	1.00	–	A maiden dividend.
Cash flow						
EBIT	38	82	129	154	60	Volume increase with internal efficiencies.
Depreciation	18	16	22	24	9	Expansion has yet to kick in.
Working capital	–25	18	–59	0	–86	Buoyancy in the auto industry with easier auto financing…
Operating cash flow	–5	90	66	155	–	Easier auto financing will boost operating cash flow.
Capex + other investments	–11	–72	–47	–47	61	Normal capex. Trial production from expansion has yet to…
Free cash flow	–16	18	19	108	–	Maintaining free cash flow with a rise in FY97. Will decline…
Financing	18	–22	–1	–127	–	Marginal repayment in FY96. Fresh loans ruled out as exp… will be funded by preferential and rights issue.
Change in cash	2	–4	18	–19	–	Timely repayment of loan. Prime lending rate coming dow…
Balance sheet						
Cash and equivalent	13	9	27	8	–15	Difficult to maintain in the medium term.
Receivables	54	118	167	135	35	
Investments	0	0	0	0	–	Investments in core operations.
Inventory	126	186	213	208	18	Increase in inventory.
Non-current assets	160	213	237	413	37	Expansion in auto electricals capacity.
Others	17	26	40	85	[illegible]	
Total assets	371	552	684	849	[illegible]	Increase in assets to boost sales.
Short-term debts	0	0	0	0	–	
Payables	55	62	95	125	31	Increase in trade terms.
Long-term debts	201	179	177	127	–14	Loan repayment coupled with loan converted into equity. Stressing on zero-debt company.
Miscellaneous	71	209	204	287	59	
Shareholders' equity	44	102	207	310	92	Increasing shareholders' wealth.
Total liabilities	371	552	684	849	32	
Interest rates (%)	15.50	16.50	14.50	14.50	–2	
Operating margin (%)	9.02	9.72	11.20	10.67	6	Margins to revive in FY99 after some pressure in FY98.
Non-current assets/sales (%)	26.84	22.24	18.16	15.47	–17	
RoCE (%)	21.98	33.05	38.03	37.45	19	Falling and will further reduce in FY98.
Net income/sales (x)	0.00	0.06	0.08	0.09	246	
Sales/assets (x)	1.61	1.73	1.91	1.81	4	Internal efficiencies.
Assets/equity (x)	8.44	5.39	3.30	2.74	–31	
RoE, pre-tax (%)	2.80	54.78	49.54	42.30	147	Reducing. Will reduce further in FY98.
Total debt/equity (%)	457.19	174.66	85.67	41.03	–55	Stress on zero-debt company. Equity being raised to …
Net debt/equity (%)	427.27	165.75	72.67	38.46	–55	
RoE/RoA, both after-tax (x)	8.44	5.39	3.30	2.74	–31	
Dividend/FCF (x)	NA	0	0	0	–	Poor because of marginal residual profit.
FCF per share (Rs)	NA	1.14	1.21	6.65	–	A sharp increase.
P/FCF per share (x)	NA	61.91	58.15	10.61	–	
NAV/share (fully diluted)	2.80	6.50	13.10	19.04	90	Good management reflected in share price. High premi…