



# 5 MINUTE STOCK IDEA

BY SMART SYNC INVESTMENT ADVISORY SERVICES

## FAIRCHEM SPECIALTY

### WHAT WE LIKE

#### DOMINANT PLAYER IN A NICHE MARKET

Privi Organics India Ltd (POIL) is the largest aroma chemical manufacturer in India with a production capacity of about 22000 MTPA. Strong clientele coupled with strong export. Export forms about 70% of its revenue.

Adi Finechem Ltd (AFL) is a leading producer of Fatty Acids from natural oils and fats derived from renewable raw materials such as Soya, Sun Flower, Corn and Cotton

#### STRONG MOAT IN POIL

The two key routes for making for Pinene based aroma chemicals include a.) Tapping pine tree to get Gum turpentine oil (GTO) and b.) Using Crude Sulphate Turpentine (CST) which is a waste from pulp and paper industry. GTO's prices are highly volatile with China being the largest supplier. CST is a more profitable but it requires many complex chemical processes. POIL is the only Asian player with the necessary expertise and infrastructure to execute the CST route .

#### FAIRFAX INVESTMENT

Fairfax (India) Holdings Corporation (FIH) is the prime shareholder in this company. Fairfax has had a good track record of acquiring and developing many good companies around the world. Thus this investment inspires investor confidence in the company.

#### STRONG TAILWINDS IN THE INDUSTRY

Global Flavours & Fragrance (F&F) Industry is expected to reach \$ 28 billion by 2022 (Source: Leffingwell report). Aroma Chemicals has been the fastest growing segment within F&F industry at CAGR of ~6.21%. Developing countries like India are witnessing much higher growth of >13%.

Other major tailwinds include:

- o Higher consumer willingness to experiment with new flavours and fragrances
- o A shift in perception of fragrance from being a nonessential attribute to an indispensable part of personal care
- o Rural Penetration of FMCG
- o Premiumisation

### WHAT WE DON'T LIKE

#### RAW MATERIAL PRICE VOLATILITY & FOREX RISK

Vegetable oil distillate and acid oil are the main raw materials for FSL. The prices of both these oils have historically remained volatile. While raw material is sourced domestically, sales are also made outside India thereby leading to forex risk as well. However, acid oil prices have witnessed relatively lower volatility over the past four years.

#### COMPETITION FROM CHINA

FSL faces competition from low cost manufactured products in China, especially in Dimer Acid. However, as of now, FSL has been able to gain significant market share in Dimer Acid in India.

#### POLLUTION CONTROL NORMS & TECHNICAL OPERATIONS

The company is involved in very technical & risky operations in its chemical processing units. Moreover, these chemical processes are also highly polluting to the environment. Government is becoming more and more stringent on the pollution norms which may raise operational costs for disposal of waste materials in the future.

#### COMPLEXITY IN HOLDING STRUCTURE

Fairfax investment in the company has been through a fairly complex route. Initially, Fairfax acquired a significant stake in AFL. Then they bought a significant stake in POIL. Later they merged a division of POIL with AFL and formed Fairchem Specialty. And now, Fairfax has decided to demerge the two businesses of

1. Aroma Chemicals
2. Oleo Chemicals and Nutraceuticals

The operations and requirements of both these divisions are separate and independent and thus the previous merger is not yielding the synergistic benefits as expected. In the long run, demerging the two businesses should bring operational focus and augur well for both the businesses.

