

Aug 26, 2021

PICK OF THE MONTH

VOL-7, NO-10

Industry: Other NFM

Pondy Oxides & Chemicals Limited

BUY

CMP: Rs.383

TARGET PRICE: Rs.525

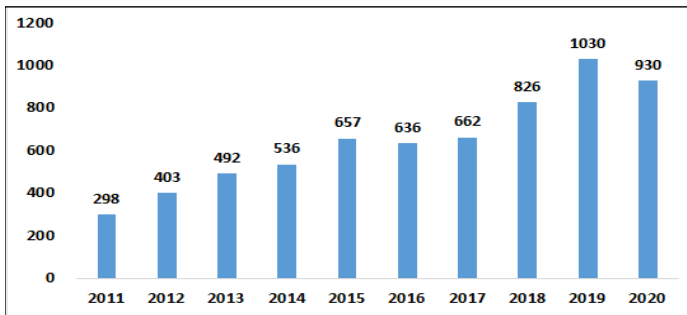
TIME : 12 months

OVERVIEW:

Non-Ferrous Metals (NFM) Industry Overview:

The metallurgical industry is broadly classified as ferrous and non-ferrous which can be further bifurcated into base metals (aluminium, copper, zinc, lead, nickel, tin), precious metals (silver, gold, other platinum group metals), minor metals (tungsten, tantalum, niobium, chromium) and specialty metals (cobalt, germanium, indium, tellurium, antimony, and gallium). NFM characteristics like high recyclability and thermal & electrical conductivity etc. (while replenishing the basic raw feed of key industries like defence, engineering, electrical, infrastructure, automobile and railways) makes the industry an eminent one for growing economies like India. The demand for NFM is greatly influenced by government initiatives such as Make in India and Smart City projects. On the flip, owing to underdeveloped metal scrap collection, the industry is exposed to heavy dependence on scrap of metal imports. In order to tackle this situation, National Non-ferrous Metal Scrap Recycling Framework, 2020 is envisaging a framework to address the challenge of underdeveloped scrap recycling in the NFM sector.

Exhibit O1: Import Value of NFM in India (in bn)



Source: statista.com/statistics/625832/import-value-of-non-ferrous-metals-india, Progressive Research

Circular Economy: With the mushrooming use of batteries for many commercial and industrial applications, the concern of sourcing of the battery raw materials and recyclability keeps mounting. Also, it is obvious that recyclability and the availability of raw materials are inseparably linked to each other. The basic stages for battery recycling include, (i) collection and delivery of old battery units to the site, (ii) battery breaking and segregation of basic lead-bearing material, metallic grid granules, plastic bits and acid components etc., (iii) desulfurization where the paste or lead active material is treated with soda ash to remove the sulfur, (iv) smelting and LAB active material recycling (v) refining the lead bullion and calcining to produce either soft (pure) lead or hard (alloy) lead. Lead Acid Batteries (LAB) and Lithium ion (Li-ion) battery are two technologies that dominate the current battery market. The LAB recycling sector is indeed a model for a circular economy and can also act as a blueprint suitable for different battery chemistries. There are challenges related to toxicity of lead, control of emissions and managing the informal sector which does not fulfill the legal requirements of the local governments. While LAB recycling may be the current standard, but the industry is still striving to improve the processes for cleaner, safer and more environment friendly methods. Complete battery recycling of all the internally generated battery scrap with methods which produce less CO₂, remove the slag and minimize pollution is the way forward. The rapid growth rate of Li-ion batteries and the concerns related to the lack of a commercial recycling process is something what the industry is constantly working towards, as there may be insufficient materials to manufacture batteries for the growing demand. When one starts looking at the feasibility for profitable recycling of Li-ion, these processes need to be economically and financially viable.

SNAPSHOT				
52 week H / L	Mcap (INR mn)			
499/181	2,227			
Face value: 10				
BSE Code	NSE CODE			
532626	NA			
Annual Performance				
(Rs mn)	FY19	FY20	FY21	FY22E
Total Revenue	10,489	12,199	10,043	11,014
EBITDA	643	355	234	452
EBITDA (%)	6.1	2.9	2.3	4.1
Other Income	40	35	33	33
Interest	112	99	45	57
Depreciation	52	79	84	79
PBT	519	212	138	349
PAT	337	163	108	269
Equity (Rs mn)	56	58	58	58
EPS (INR)	60.5	28.3	18.5	46.3
Quarterly Performance				
Parameters (Rs mn)	Sept-20	Dec-20	Mar-21	June-21
Sales (Net)	2,638	2,926	2,985	2,440
EBITDA	44	76	66	146
EBITDA (%)	1.7	2.6	2.2	6.0
Other Income	1	2	24	4
Interest	12	13	15	16
Depreciation	21	21	21	17
PAT	11	32	45	86
Equity (Rs mn)	58	58	58	58
Ratio Analysis				
Parameters (Rs mn)	FY19	FY20	FY21	FY22E
EV/EBITDA (x)	5.6	7.5	15.7	8.1
EV/Net Sales (x)	0.3	0.2	0.4	0.3
M Cap/Sales (x)	0.2	0.2	0.2	0.2
M Cap/EBITDA (x)	3.5	6.3	9.5	4.9
Debt/Equity (x)	1.1	0.4	0.9	0.8
ROCE (%)	52	21	11	21
Price/Book Value (x)	1.6	1.5	1.4	1.2
P/E (x) TTM	6.3	13.6	20.7	8.4
Shareholding Pattern as on 30th June, 2021				
Parameters	No of Shares	%		
Promoters	2,833,165	48.74		
Institutions	0	0		
Public	2,979,225	51.26		
TOTAL	5,812,390	100.00		

Source: Annual Report

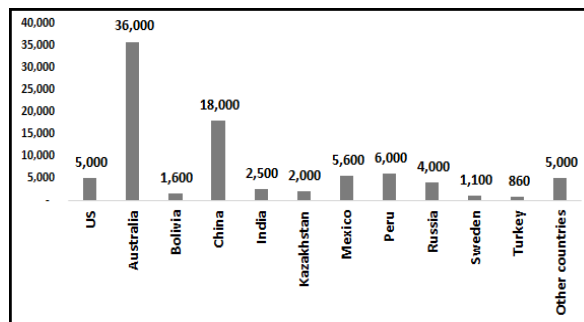
Note: All the data is calculated as per Market Price on 25th Aug, 2021

OVERVIEW: Industry (contd.)

Lead: is a soft, gray, lustrous metal that possess high density and low melting point and is used as a vital constituent in electronics, solders, batteries, photovoltaic cells, metal alloys etc. In addition to this, Lead is used in manufacturing automotive batteries, cable sheathing for electrical & telecom cables, used counterweights, battery clamps and other cast products like bearings, ballast, gaskets and foil. Lead metals can generally be classified into **primary** (produced directly from mined lead ore and later refined) and **secondary** (recovered from scrap lead products and recycled). Lead is one of the highest recycled metals and can be re-melted umpteen times without losing its properties. Recycled lead accounts for more than 85% of the total lead production in India.

Global Lead Industry: According to MarketWatch.com, the global lead market is categorized into mechanical, construction, electronic, defence industries. The drivers for growth will be attributed to the rising awareness regarding the benefits of using lead batteries in advanced and hybrid vehicles as well as encouragement from renewable energy generation. Global lead market is expected to flourish at a CAGR of ~6.8% by 2027. According to the International Lead and Zinc Study Group (ILZSG), the global demand for refined lead is projected to increase to 11.7 million tonnes (MT) in the current year with an increase in its usage being witnessed in Europe, India, Japan and South Korea. Lead markets global size on the annual consumption is anticipated to exceed 13mn tonnes by 2025. (Source AR2021-POCL). The organization envisions that the global supply of refined lead metal would exceed the demand by 96,000 tonnes in 2021. The global lead market is also thriving on the back of building & construction industry. Further, the rising demand for LAB for automotive applications is also expected to showcase a steady growth of the market.

Exhibit 02: World Mine Reserves (in '000 MT)



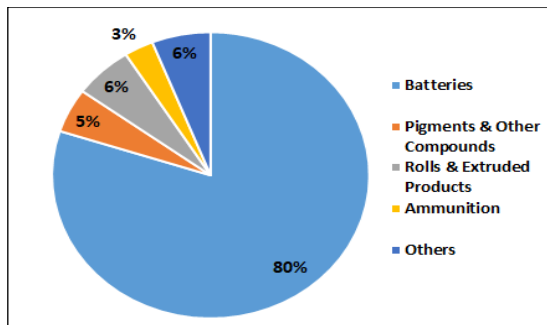
Source: pubs.usgs.gov/periodicals/mcs2021/mcs2021.pdf, Progressive Research

Exhibit 03: Demand-Supply Statistics (in '000 MT)

	2017	2018	2019	2020	2021
Mine Output	4.59	4.59	4.73	4.52	4.75
Metal Production	11.89	12.18	12.19	11.68	12.07
Metal Usage	12.04	12.23	12.16	11.52	11.97

Source: thehindubusinessline.com/news/national/as-supplies-improve-lead-prices-could-head-south-by-year-end/article34750961.ece, Progressive Research

Exhibit 04: End-user Based Classification



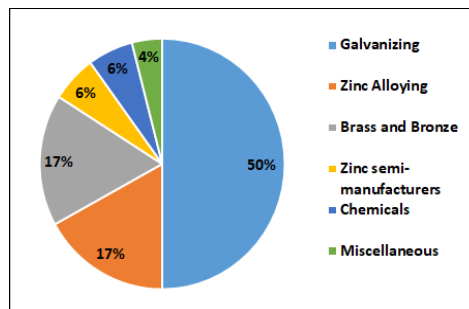
Source: POCL Annual Report-2021, Progressive Research

The global LAB industry is worth USD65bn annually, however, recycling processes of these batteries is the most polluting in the world. According to the Society of Manufacturers of EV, at present there are ~250,000 EVs that use Li-ion batteries, of which 2Ws account for 80%, 3Ws are nearly 25,000-30,000 and the rest are 4Ws. As per JMK Research, the recycling market is anticipated to observe more generations of end-of-life batteries from 2022-23, as the annual Li-ion battery market is expected to grow at a CAGR of 37.5%. The report further stated that by 2030, EV batteries are anticipated to account for 80% market share in lithium-ion battery market as against the present 35% share. According to Wood Mackenzie, in 2020, about 12.4MT of refined lead was produced, (including primary and secondary sources) and the lead metal value from smelters (that mainly recycle used batteries), is expected to be USD17.5bn in 2021. According to estimates by the ILZSG, about 86% of refined lead is used in LAB production where China was the biggest market player (lead consumption for batteries) followed by Europe and the United States. The demand for Lead in **India** has been increasing at a CAGR of ~3.8% while there has

been a consistent level of import over the last 5 years since 2016 (Source AR2021-POCL). The Indian lead market is estimated at ~USD7bn which is driven by automotive sector which consumes almost 60% of the LAB. The volume of secondary refined lead produced across India in 2020 was over 0.65MT while the total lead production (including primary and secondary refined, alloys and oxides) is estimated to be over 1.4MT in 2020, India occupies a major pie of the industry.

Zinc: is the 4th most widely used metal in the world after iron, aluminum and copper. Zinc possesses strong anti-corrosive properties and bonds well with other metals. According to the preliminary data by ILZSG, the global market for refined zinc metal was in surplus by 31KT in the first four months of 2021 with total reported inventories increasing by 142KT. The world zinc mine production rose by a substantial 11.3%, influenced by increase in Australia, Bolivia, China, India, Ireland, Mexico, Peru, South Africa and the United States. In Canada, Finland, Kazakhstan, Namibia and Poland, however, output was lower compared to the same period of 2020. An increase of 10.1% in global usage of refined zinc metal was mainly a consequence of a substantial rise in demand in China. Usage was also higher in a number of other countries, including Brazil, India, Japan, the Republic of Korea, Taiwan (China), Thailand and Turkey. In Europe, usage rose by 1.6% but in the United States, apparent consumption fell by 2.1%.

Exhibit 05: Global Category Classification



Source: statista.com/statistics/240626/share-of-zinc-consumption-by-category/, Progressive Research

OVERVIEW: Industry (contd.)

Exhibit 06: World Refined Supply Zinc Usage (2016-2021)

000 Tonnes	2016	2017	2018	2019	2020	2020	2021	2021			
						Jan-Apr	Jan	Feb	Mar	Apr	
Mine Production	12668	12681	12810	12856	12236	3713	4134	1011.4	977.4	1083.4	1061.7
Metal Production	13560	13486	13101	13480	13700	4435	4634	1175.4	1148.3	1148.2	1162.2
Metal Usage	13670	13944	13663	13737	13212	4179	4603	1179.2	1086.8	1147.5	1189.1

Source: ILZSG, Progressive Research

Exhibit 07: Indian Scenario

	10MFY20	10MFY21	y-o-y growth
Production	578.3	586.3	1.4%
Import	137.6	103.1	(25.1%)
Export	157.6	248.7	57.9%
Avg LME Price	2518	2365	(6.1%)

Source: CARE Ratings, Ministry of Mines, Department of Commerce, Progressive Research

LAB v/s Li-ion: LABs are generally sub-categorized under rechargeable and secondary batteries that make use of lead peroxide and sponge to convert chemical energy into electrical form especially while focusing on automotive and industrial applications. The charging efficiency of LAB stands at 75% (which means it needs more energy for a recharge than it delivers). The main competitors to a LAB are nickel-cadmium and lithium-ion batteries (Li-ion) which is an advanced battery technology with significantly higher life cycle. All Li-ion cells are deep cycle i.e. they have the ability to be fully charged and discharged. When one looks at the Electric Vehicle (EV) opportunities, the battery cost and battery capacity are the key factors in determining the usage of EVs. Of all the choices available in terms of battery usage i.e. Li-ion, molten salt (Na-NiCl₂), nickel-metal hydride (Ni-MH), lithium sulphur (Li-S), lead acid, etc., Li-ion and LAB are the two most commonly battery types put to use in the EVs.

Both the battery chemistries, LAB and Li-ion have their own advantages which then depends on the choice of chemistry for specific applications. Along with significant cost advantages, lead batteries are a slightly superior choice for numerous applications such as powering advanced manufacturing facility backup power systems, telecommunications power storage systems, automotive SLI (starting, lighting and ignition) & auxiliary power, electric forklifts etc. LAB provide 70% of the global rechargeable battery capacity and is already delivering performance as a truly renewable battery energy storage technology. Many players in the market also prefer Li-ion batteries over LAB in EVs as the former has a comparatively better life cycle and is safer in charging and discharging. With the growing awareness that EVs can become more common and as the first generation of lithium batteries are reaching end of life, there is no ideal recycling solution for these batteries and many developed countries are hoping to find innovative solutions to in order to collect, store and transport discarded lithium-ion batteries for eventual recycling. Under such circumstances, the circular economy of lead batteries continues to serve as a model for newer battery chemistries.

Lead batteries continue to project an unmatched sustainability story as the world moves quickly toward electrification. All the major components of a lead battery i.e. lead, plastic and electrolytes can be recycled and reused to make new batteries while being the most recycled product in the world with 99% recycling rate which is an enviable achievement. Lead batteries truly are a part of the circular economy where the materials recovered from used lead batteries are used to manufacture new lead batteries (typical new lead batteries are built from 80% or more recycled content). In many developed countries like US, nearly 95% of the lead used to make new lead batteries comes from battery recycling.

Exhibit 08: LAB v/s Li-ion

	LAB	Li-ion
Collection	Large Volumes	Smaller Volumes
	Established Transportation Infrastructure Already	Ad-hoc Collection System
Disassembly	Uniform Shapes and Materials	Non-Uniform Shapes and Materials
	Batteries Crushed to Separate Components	Plastic Cases Are Crushed
Reuse	Lead Used in New Batteries	High Value Metals Are Used in Other Applications
	Plastic Sometimes Used in New Battery Cases	Mixed Plastic Difficult to Use
Material Recovery	Lead Melted and Reused	Lithium Currently Not Recycled
	Plastic Reused	Plastic Used As Fluffs
		Cobalt, Copper and Aluminium can be Extracted
Strength	Work Better in High Power Vehicles	Work Better in Low Power e-Vehicles
Cost	Cheaper Than Lithium Ion	Historically Expensive
Life	Lesser Than Li-ion	Better Than LAB

Source: ila-lead.org/wp-content/uploads/2021/03/MMR-February-2021-Issue_compressed1-1.pdf, Progressive Research

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OVERVIEW: Industry (contd.)

While the world is moving out of the LAB recycling frying pan, it is entering into the Li-ion fire. As the electric vehicle market grows slowly, the auto industry has a golden opportunity to leave lead-acid technology behind, however, this does not erase the recycling problem; it only creates newer challenges with EV battery recycling that needs to be addressed quickly. Till now Li-ion batteries had been used mainly in handheld devices, small electronics, and now the problem to scale up recycling on a global level arises. According to analysts from WoodMac, though the use of lithium batteries is increasing (with increased manufacturing of electric vehicles), limited availability of lithium will force battery manufacturers to continue relying on lead batteries in this decade. **The Ongoing Debate** has many experts who advocate, the E-vehicles batteries are likely to replace the conventional lead/biofuel batteries in the next 20 years which will primarily depend on the cost and availability of alternative batteries. To be competitive enough, these batteries should have high energy densities, power density, long life, support the motors/motor controllers with a fairly mature and cost-competitive charging stations/infrastructure. In the current scenario, Li-ion, Li-poly and zinc-air batteries have demonstrated energy densities which are high enough to deliver range and recharge times, but the debate opens to speculation here is, whether these will be cheap enough to entirely replace lead-acids batteries. While many developed and Asian countries are gradually moving towards battery-operated or plug-in or hybrid vehicles, the absence of infrastructure and dictating legislation keep the options open for a large part of the market to continue to have LAB. At least for now Lead will continue to still be the king in the Indian context. The crux of the problem continues to persist in the fact that substituting the LAB is not yet technically possible as lead is the active electrochemical component in the unit while it is delivering good performance for the industry. The consistent demand for LAB which is also linked to the rise in India's automobile sector unsurprisingly drives the demand for lead in years to come. **If one carefully studies the demand-supply mismatch, usage has always been more than the production.**

Exhibit 09: Manufacturing Process



Source: innovationnewsnetwork.com/what-role-lead-acid-batteries-play-circular-economy/12639/, Progressive Research

About the Company:

Incorporated in 1995, Pondy Oxides & Chemicals Ltd (POCL) is India's leading secondary lead smelter while being a lead, lead alloys and plastic additives producer. POCL has 3 business segments i.e. metals, metal oxides and plastic additives. POCL operations are spread across an extensive product basket that spreads across categories of lead manufacturing, litharge, red lead, zinc oxide, lead sub oxide metallic oxides, PVC stabilizers (solid and liquid), lead metals and alloys that are supplemented with various industrial applications. Some of the main products manufactured by the company include lead, lead alloys, master alloys, tin alloys, babbitt alloys, zinc oxides etc. POCL extracts lead and other metals from scrap batteries and reuses the same after refining. POCL has been able to refine lead to 99.99% purity. The customers list mainly includes battery manufacturers, chemical manufacturers and PVC extruded and moulded products. The manufacturing units of POCL are (Smelter Division) SMD I at Kancheepuram in Tamil Nadu; SMD II at Chittoor in Andhra Pradesh and (Zinc Refining Division) ZRD at Kancheepuram in Tamil Nadu. Over the years, the company has established its brand image both in the domestic and international markets. About 50% of the company's production is exported to numerous international customers mainly not limited to the Asian region like South Korea, Japan, Indonesia and to Middle East. POCL has been awarded the prestigious status of STAR EXPORT HOUSE by the Ministry of Finance and Commerce. POCL is the one of the two leading manufacturers which has its brand registered in LME (London Metal Exchange). LME is a global brand and its recognition or acceptability is a definite advantage to POCL when it markets its production. The total number of permanent employees on the rolls of the company as on 31st March 2021 stood at 468. Mr. Anil Kumar Bansal is the Chairman and Whole Time Director and Mr. Ashish Bansal is the Managing Director of the company.

INVESTMENT RATIONALE:

(A) India and LAB:

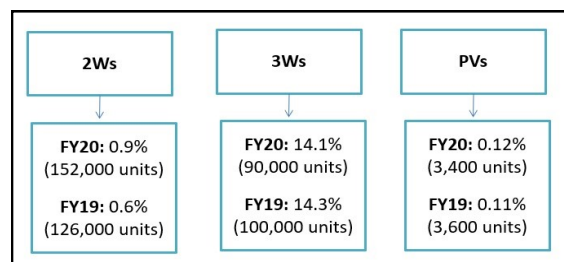
The lead and the lead battery industries are set to play a significant role in India's rapidly growing economy and will be critical to India's plans for sustainable economic growth. Many analysts are predicting the market for lead batteries to grow at around 8-10% CAGR by 2024 which is basically due to the expansion of the automobiles market, telecommunication infrastructure, solar power projects and IT industry. The automobile industry contributes nearly 7% to the country's GDP and by 2025, India is expected to replace Japan to become the third-largest auto market on a global level. Majority of these vehicles will require at least one lead battery and thus adding more than 1 billion vehicles worldwide. If one looks at the area of e-mobility, there is significant growth seen in electric rickshaws (using lead batteries) in many cities and towns. At the same time, the demand for battery energy storage is expected to triple by 2030; lead batteries are one of two major technologies capable of meeting this requirement. Globally, many analysts predict the lead battery market to grow from 360GWh in 2020 to 430GWh in 2030. India's target is to achieve 175GWh of renewable energy by 2024 and the lead battery supported inverter market which provides back-up energy is already experiencing steady growth. As countries are moving away from reliance on fossil fuels to renewable sources of energy, lead batteries are an important part which delivers wide scale renewable electrification. Lead provides longevity and reliability to solar panels, while lead batteries help balance the power grids and save surplus energy. Lead batteries is the dominant technology for telecommunications back-up demand with an anticipated growth of 5GWh predicted between 2015 and 2030. Lead batteries also dominate the UPS battery market while catering to nearly 92% of the demand, with a 7.5GWh increase predicted between 2015 and 2030. Gradually the world is moving towards sustainable energy and technologies that embody circular economy principles which are valued high where Lead batteries are designed to be recycled infinitely with no loss of quality or performance.

INVESTMENT RATIONALE (contd.):

The Official Approach: The concept and benefits of a circular economy are known to all where the most critical part is not just recycling processes but also to be able to have an established, safe infrastructure for collection and transport of the scrap materials. From an environmental standpoint, Flooded Lead Acid (FLA) batteries are at the top of the list when considering recyclability and more than 99% of the materials are recycled into new batteries. When you break up a LAB to recover the lead, the first step of recycling process is to break down the outer polypropylene casings, they are then washed, melted, and extruded into small pellets. Many manufacturers use these pellets to produce new battery cases as well as other plastic products. The sulfuric acid in the battery's electrolyte is neutralized and purified into water that meets EPA clean water standards before being recirculated (a government regulated recycler will neutralise the acid). The acid can also be converted into sodium sulfate, a compound commonly used in laundry detergent, glass, textiles industries etc. The lead oxide and lead grids of the battery are melted in a smelting furnace to form lead ingots to make new battery components. This process creates a sustainable energy source that is the model of recycling in many countries.

(B) Factors To Spur Growth: POCL is a secondary lead smelter which means the company manufactures and recycles lead from metal scrap and ores. The lead products find major applications in the LAB industry. Additionally, these lead products are also been put to use in radiation, shielding, ammunitions, roofing sheets and automotive industry. As per the Electric Vehicle Opportunity Report- March 2021, EVs account for less than 1% of the total vehicles sales in India. 90% of the current 4Ws are willing to make a shift to an EV based approach provided the right infrastructure to aid its growth are in place. In the auto space, 2Ws account for the largest share of the EV market at 62% followed by 3Ws at 37%. The EV sales grew by nearly 38% in 2020 and a strong growth is probable in 2021 again, as the world economies are targeting a greener recovery. No doubt, Li-ion battery will be the favored technology for EVs but almost all models still use lead batteries, which highlights to the fact, the future still seems bright for lead-batteries.

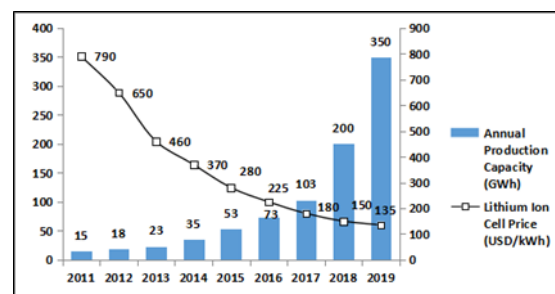
Exhibit 10: Segment Based EV Penetration in India



Source: CPC India Report, Progressive Research

(i) Future Outlook on Lead Demand: The price of lead is an important aspect to be vigilant about which is mostly driven by factors like the global stocks, demand outlook, the Chinese demand, competing technologies and health concerns. While one is analyzing the lead market, one must focus on the battery industry which accounts for approximately 85% of lead demand. Data from both emerging and developed economies suggests that energy demand is expected to double in the next decade and if the demand for these technologies continues to grow, the prices of lead could move higher. To meet this upcoming demand, China and India have started trading in smart grid technology and these traders are responsible for the expanded use of LAB in electric and hybrid vehicles. In 2011, environmental concerns had curtailed the production of lead-acid batteries, but now the production is on an upswing. In addition to this, the new applications of grid storage for renewable energy generation can also fuel the demand for LAB.

Exhibit 11: Li-ion Batteries-Cell Level Price Trend



Source: IESA Energy Report, Progressive Research

(ii) Capacities: In order to be on par with the growth in the automotive demand, POCL over the years has increased annual production of lead metals and alloys at a CAGR of ~13% over FY16-20. In FY21, the annual production of **lead metal and alloys** was 58,613MT in all its units apart from the job work quantity of 4,771MT handled. POCL has received consent from Tamil Nadu pollution board to increase the plant capacity to 48000MT in Tamil Nadu and is in process of competition of installation of machineries and utilities at higher capacity thereby overall lead manufacturing capacity of all units together will reach 132,000MT per annum. In FY21, the capacity utilization of **zinc oxide** was ~80% as against the installed capacity of 3,600MT per annum. The company is also seeing some vendor approval from various Zinc oxide manufacturers and has also started supplying materials to them. Based on the commercial viability, POCL is slowly increasing the capacity utilization in Zinc and Zinc oxide plant.

(iii) New Plant: The company continues to emphasize on the importance of recycling, support and focus on environmental responsibility and recently in July, 2021, the company has informed the exchanges about intentions of the Management to set up a Copper Recycling/Melting facility at the Andhra Pradesh plant as part of the expansion strategy for 2021 at an estimated investment of Rs120mn in the first phase at SMD-II. With a view to enhance the existing portfolio of non-ferrous metals of Lead and Zinc, the company has recognized opportunities to recycle Copper. Along with the existing specialization in Lead and Zinc Segment, the company intends to add copper segment to its portfolio to help meet the growing demand of Copper in diverse modern sectors. The production capacity for the same is expected to be 30,000 MT per annum. The company is in the process of obtaining necessary Government approvals to commence the said activities as well as initiate the process for acquiring all the relevant state of the art machinery. In the press release, the company mentions the machinery to be installed and commissioned in FY22E itself. The intention of the Management is to meet the requirements of the industry as also to consolidate its position in the market. This project is anticipated to be strategic and beneficial to the company as it will open a new avenue related to copper which is seeing good traction as well as demand in the market. As per the press release, the new project is strategically located with connections to appropriate geography, transportation (ports, airways and highways) for the raw material, finished goods and labor flexibility.

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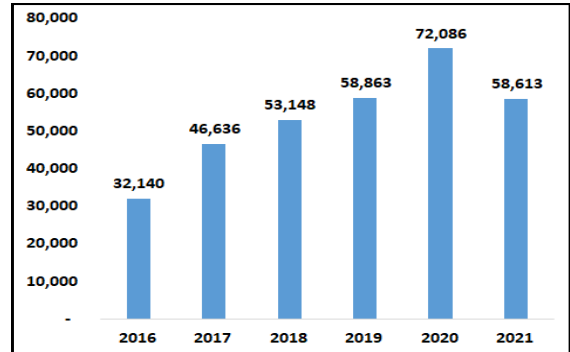
INVESTMENT RATIONALE (contd.):

(C) Why Organized Players? The Indian automotive battery market has been driven by dominant players like Exide Industries Ltd, HBL Power Systems, Eveready Industries, Amara Raja Batteries etc., which boasts as prestigious Automotive OE. The rise in battery sales in India has been driven by the automotive industry which is one of the largest and fastest growing sectors. In India, the life of LAB is estimated to be 21-24 months and then replaced to maintain the peak efficiency. The SLI (starting, lighting and ignition) batteries used in cars, trucks, buses, etc. represent the largest category of end-use for lead followed by batteries to power electric vehicles such as fork lift trucks, airport ground support vehicles, delivery vans, golf carts etc. In the industrial batteries segment, standby power supply system, electrical energy supplies for telephone exchanges, public buildings, hospitals etc. occupy the largest category. While there are many other sectors using LAB, according to some sources, the automobile sector consumes nearly 70% of the total battery production. More than 50% of the battery consumption is by the government sectors such as Defence, State Transport Authorities, Railways, Telecommunications etc. and the Railways is the second largest consumer of LAB. With so many batteries in use, their disposal and recycling are an important factor to be addressed. The spent battery is 99% recyclable if processed in a proper facility. Lead is the most recycled metal and more than 50% of world demand is met by the secondary lead. The spent battery is seen as a lead resource (batteries contain 70% lead, 20% acid and 10% plastic case) and nearly 5kg of lead can be recovered from each battery. It is quite evident these LAB have to be safely smelted and recycled to minimize their harmful effects on environment and health. There are very few legitimate Indian lead companies in the organized sector involved in the metals recycling business; majority of the competition / players are found in the unregulated sector. These secondary unregulated lead smelting plants in India are the biggest threat to the environment adding to lead contamination. The old batteries are reused in some cases but most of them are sold to auction operator or scrap dealers who are least interested in keeping a check on who buys or where the batteries are likely to be smelted. This same approach is also seen with India's railway system where the spent batteries are simply auctioned to any bidder irrespective of their smelting facilities. Thus, the need for legal and organized LAB smelter will arise.

Informal Industry under Detector: Reports indicate that informal lead battery recycling still occurs throughout India and immense work needs to be done to prevent informal and substandard lead battery recycling. The International Lead Association (ILA) and partner associations are working with various NGOs to form a global alliance to help improve standards in LAB manufacturing as well as recycling. ILA supports a sustainable future for lead while promoting responsible manufacturing, use and recycling of lead throughout the entire value chain on a global level, specifically in India. ILA has been working with India Lead Zinc Development Association in areas related to informal recycling and battery technology via various awareness programs. As an industry, they have invested significantly in environmental and workplace health-safety controls and intends to gradually eradicate informal and inappropriate practices. The alliance ILA has created aims to minimise exposure to lead in all regions of the globe and are committing to business practices that support environmentally sound manufacturing and recycling of lead batteries. Members of this program have also made a commitment to ensure that inappropriately recycled lead does not enter their supply chains. ILA continues to work with organisations including WEF, Pure Earth and UNICEF to help eradicate dangerous informal battery recycling practices. This also needs the help of the local governments to adopt legislation and enforcing standards to ensure the safe manufacturing and recycling of lead batteries. The lead and lead battery industry can look forward to significant growth over the next few years.

Financials: The business in which POCL is involved is essentially driven by volumes, where the margins are many a times constant, and the cost of sourcing the raw materials eats away a major part of the gross margins. The value of imported raw materials over the years has been in the range of 80-85%. Pricing of the products, growing demand, and ongoing market volatility are some of the major challenges faced by the industry as well as POCL where cash generation and preservation remain the key focus. The usual policy of POCL to sell its products while taking into account the monthly average prices linked with LME. Also, in addition to minimize the price risk involved in procurement of major raw materials for the manufacture of finished goods, monthly average hedging is also done. The reduced reliance on imported scrap can help improve the company's working capital. The company has been a consistent dividend paying entity over the past 4-5 years except in the year 2021 wherein the company adopted a conservative approach in order to retain its profits owing to the pandemic. The reliance on imported scrap is gradually seen easing and it is expected that over the next few years, the ratio of scrap from imports to domestically recycled material will be 30:70, from the current levels of 70:30. Around 50-55% of the company's production is exported to international customers in South Korea, Japan, Indonesia and Middle-East. Being a commodity driven business segment, the company is exposed to price fluctuations and exchange rate movements. As majority of raw materials get imported, exports provide a natural hedge to the company. Considering the localized lockdowns that occurred on account of the second wave, the company too witnessed its impact on the supply chain and shipping lines that led to rescheduling of orders to the customers, increased stock in transit and raw materials translating into a lower inventory ratio of 10.35x in FY21 as against 13.50x in FY20. On the other hand, the company has been in a position to bring a slight improvement in its ICR ratio (stood at 4.05x in FY21 v/s 3.13x in FY20) that is evident with reductions made in the finance cost. Average cost of borrowings for the company has been retained at 8% for FY21-22. Moreover, the finance cost has decreased from Rs99.45mn in FY20 to Rs45.14mn in FY21. During the year there has been an increase in certain related party transactions that are considered as loans. The company has been constantly looking at various alternative measures to reduce the cost of energy, reducing the cost of production and trying to improve the quality of products through its normal R&D system.

Exhibit 12: Lead Annual Production Trends (in MT)



Source: Annual Reports, Progressive Research

Aug 26, 2021

PICK OF THE MONTH

VOL-7, NO-10

Industry: Other NFM

Pondy Oxides & Chemicals Limited

BUY

CMP: Rs.383

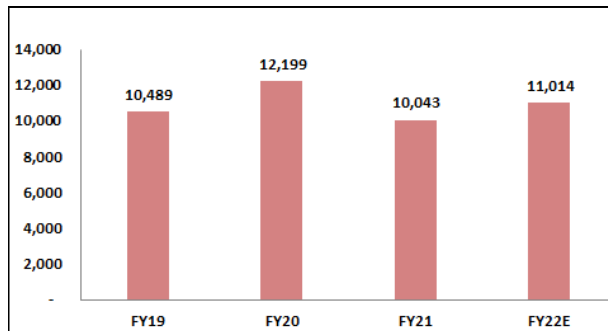
TARGET PRICE: Rs.525

TIME : 12 months

Financials (contd.):

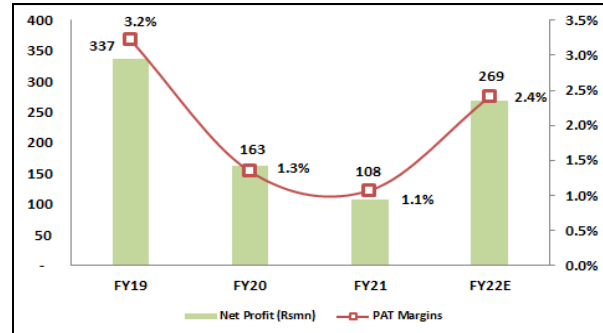
POCL is constantly focusing on energy conservation through upgradation of process technology, effective production scheduling and various energy saving initiatives including installation of energy efficient equipments. The company is also exploring the possibility of usage of gas instead of diesel as a fuel (substitute) to substantially save energy costs. The growth and or the capex plans of the company are directly linked to the growth of the clients. The lead based organized recyclers in India are recycling nearly 40-50% of the domestic scrap and this is anticipated to increase to approximately 75-80% over the next 3-4 years, thus providing good visibility for revenue generation. The stock is listed only on the Bombay Stock Exchange platform.

Exhibit 13: Sales Trend (Rs mn)



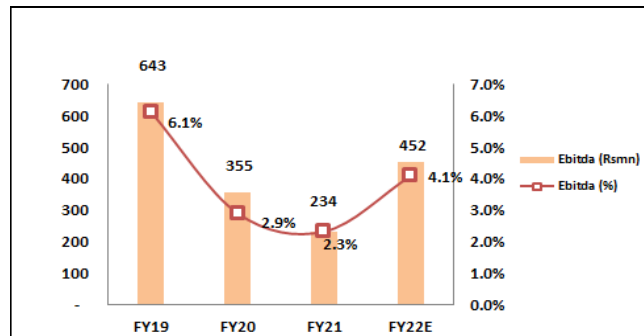
Source: Annual Reports, Progressive Research

Exhibit 14: PAT (Rs mn) v/s PAT Margins



Source: Annual Reports, Progressive Research

Exhibit 15: Ebitda (Rs mn) v/s Ebitda Margins



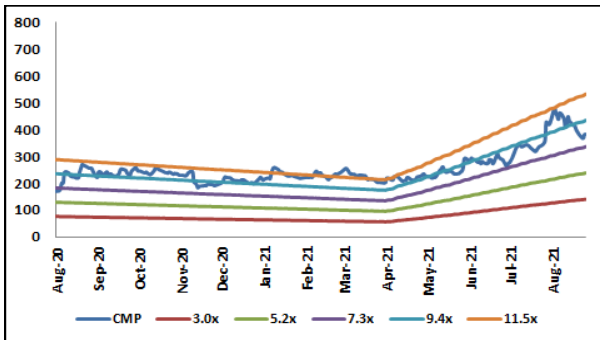
Source: Annual Reports, Progressive Research

Risks and Concerns: Pricing, growing demand and ongoing market volatility are the major challenges faced by the company. While there will be demand for the recycled lead / batteries in order to cut costs and improve operational efficiency, some players are looking at setting up their own smelters for recycling lead. This can be a potential threat to the company and one may see drainage of market share and as well as loss of some customers. Environment agencies like Pure Earth and Green Cross (Switzerland) consider lead battery recycling as the most polluting industry in the world. There are many health hazards related to improper handling of lead and related substances, and hence the industry as a whole has always been on the radar of the environment & health activists. There are a large number of informal recyclers in India, Africa, Bangladesh, Indonesia etc., which follow poor standards for recycling which are competitors to the organized players in their own way. A surplus supply in the secondary output can adversely affect the prices on a global level and or the realizations earned on recycled lead. Indian based battery recycling companies have started looking at entering the electric vehicle battery (lithium-ion) recycling businesses which seems to be the new flavor of the market. The demand for recycling lithium batteries is expected to become feasible in the next six to seven years depending upon the margins or profit made by such players and bring about a sea change in the operations and demand of lead, zinc or copper recyclers. POCL's domestic market clientele includes Amara Raja Batteries (ARBL), Exide Industries, J K Tyres, MRF Ltd, Supreme Industries etc. with ARBL accounting for a greater proportion of its sales. ARBL has few of its expansions in place which would lead to a decent growth in POCL share in times to come. However, in some of the recent developments, as a part of the capex and backward integration processes, ARBL has shown interest in setting up a lead recycling unit. The prices of the company's finished goods are linked to international benchmark i.e. LME and are strongly influenced by global economic conditions and global demand supply for the products; volatility in commodity prices and lack of demand may adversely affect the earnings, cash flow and reserves of the company. The impact of the lockdowns if any, in future, coupled with issue related to shipping lines affecting the supply chain of the company need to be watched closely. Any disruption in this domain can impact the inward of raw materials and can lead to delay/ rescheduling of the orders to the customers.

Outlook and Recommendations:

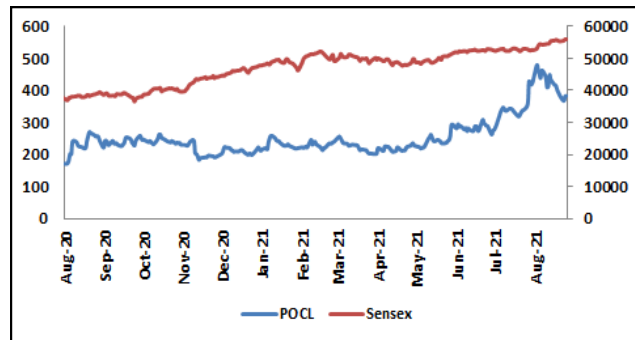
The Management of the company has an established track record of more than three decades in the industry with strong relationships with reputed clientele, expertise and technical knowledge of the manufacturing process which helps in strategic planning, effective decision making and mitigating operational risks. The global business experience also helps in driving business success in markets around the world, while understanding various global markets, industry verticals and regulatory jurisdictions. Over the years, POCL has built an unmatched brand image for its quality, high level of efficiency, reliability, technical support and service. While the focus of many organized players in the market will aim at streamlining collection, disposal and recycling of lead, the same will also help in increased lead recovery in an eco-friendly manner. The Indian based battery recycling companies are also looking at entering the electric vehicle battery (lithium-ion) recycling business where the demand is expected to become viable in the next six to seven years. The EV sales grew by nearly 38% in 2020 (despite the pandemic) and a strong growth is probable in 2021 again, as the world economies are targeting a greener recovery. No doubt, Li-ion battery will be the favored technology for EVs but almost all models still use lead batteries, which highlights the fact, the future still seems bright for lead-batteries. We remain positive about demand for lead as a metal with sustained support from the automotive and construction industries. The metal industry has been on an uptick supported by supply-demand deficit as well as backed by bullish global growth indicators and supply related reforms. POCL primarily operates in the commodity sector which is characterized by high volume, low margins with immense dependence on global growth scenario, global demand-supply conditions, international trade environment, strength of USD against other currencies, domestic growth scenario etc. to drive the revenues and profitability. The demand for the metals provides the opportunities to see some more financial strengthening of the company as the business will grow with volumes in the upcoming future, thus we initiate a BUY on the stock with a target price of Rs525.

Exhibit 16: One Year Forward P/E



Source: Ace Equity, Progressive Research

Exhibit 17: Price v/s Sensex



Source: Ace Equity, Progressive Research

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