CD EquisearchPvt Ltd

CHANGING DIMENSIONS
CD EQUISEARCH

March 27, 2020

Vinati Organics Ltd.	
No. of shares (m)	102.8
Mkt cap (Rscrs/$m)	8072/1073
Current price (Rs/$)	785/10.4
Price target (Rs/$)	832/11.1
52 W H/L (Rs.)	1197/651
Book Value (Rs/$)	117/1.6
Beta	0.7
Daily NSE volume (avg. monthly)	118760
P/BV (FY20e/21e)	6.4/5.3
EV/EBITDA (FY20e/21e)	17.7/16.2
P/E (FY20e/21e)	25.0/24.5
EPS growth (FY19/FY20e/21e)	96.8/14.3/1.9
OPM (FY19/FY20e/21e)	36.4/38.8/40.1
ROE (FY19/FY20e/21e)	31.8/28.4/23.5
ROCE(FY19/FY20e/21e)	31.5/28.3/23.4
D/E ratio (FY19/FY20e/21e)	0.0/0.0/0.0
BSE Code	524200
NSE Code	VINATIORGA
Bloomberg	VO IN
Reuters	VNTI.BO

Shareholding pattern%	
Promoters	74.0
MFs / Banks / FIs	6.0
Foreign Portfolio Investors	5.1
Govt. Holding	0.0
Total Public	14.9
Total	**100.0**

As on December 31, 2019.

Recommendation

HOLD

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Quarterly Highlights

- VOL posted a substantial fall in revenues measuring to 21.3% y-o-y in Q3FY20 (Rs. 238.47 cr vs Rs. 303.05 cr) on the back of lower realizations and stumbling revenues from its marquee product – ATBS due to stunted oil prices. VOL's clients' desire to keep truncated inventory levels in December also contributed to plummeting top line. IBB volumes remained low; given our understanding, BASF - a major customer is facing challenges with Ibuprofen manufacturing. With just a handful of customers in the global market, VOL is experiencing arduousness in its Endeavour to increase volumes.
- ATBS contributed more than 50% to revenue in the quarter gone by and the plant is operating at almost full capacity of 26 thousand tonnes per annum (ktpa). The brown field expansion of 14 ktpa, earlier expected to be completed by November, will most likely be operational by March not least due to a synchronized global slowdown affecting demand from oil and gas industry (globally oil and gas industry contribute to 25-30% of ATBS demand).
- Lower raw material costs in Q3FY20 (45.4% of sales vs 48.8% last year), resulting from lower crude oil prices managed to stop carnage, holding operating margins steady at 34.8% in Q3FY20, a tepid fall of 32 basis points y-o-y. Albeit, it fell drastically from a margin of 41.7% last quarter holding at Rs. 82.99 cr (fall of 22% y-o-y). An increase in other income by over Rs. 8 cr galvanized PBT, which still fell by 16.6% to Rs. 88.86 cr. Favorable tax break, succored profits which fell not so heavily by 5.5% y-o-y to Rs. 66.82 cr.
- The stock currently trades at 25x FY20e EPS of Rs 31.41 and 24.5x FY21e EPS of Rs 32.00. The company faces huge product concentration risk (more than 75% of revenues come from sales of ATBS and IBB). In an attempt to overcome this challenge, company is coming up with Butyl Phenol (revenue potential at full capacity of over Rs. 400 cr) to widen its product portfolio. Despite capacity expansion of ATBS and new product launches (Butyl Phenol), we expect revenues to grow by just 4% next fiscal not least due to nerve wrecking fall in crude oil prices. Thence, earning cut has become a natural outcome- FY21 earnings slashed by over 21%. On balance, we advice hold rating on the stock with a target of Rs 832 (previous target: Rs 1262 - adjusted for stock split) based on 26x FY21e earnings over a period of 12 months.

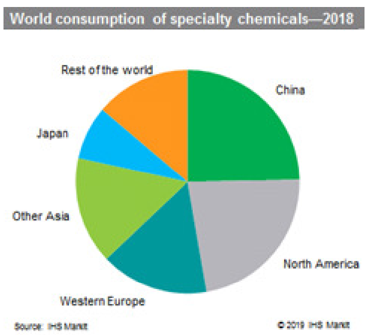
Standalone (Rs crs)	FY17	FY18	FY19	FY20e	FY21e
Income from operations	640.79	729.68	1108.14	1041.70	1082.87
Other Income	12.48	30.70	49.95	40.25	49.61
EBITDA (other income included)	229.43	227.95	453.57	443.92	483.49
Profit after EO	140.28	143.88	282.49	322.85	328.88
EPS(Rs)*	13.59	13.97	27.48	31.41	32.00
EPS growth (%)	6.7	2.7	96.8	14.3	1.9

*adjusted for stock split

Outlook & Recommendation

Industry Overview

Speciality chemicals are manufactured for specific performance and functions in different end-use industries. Increasing urbanization in emerging economies is driving public infrastructure and housing projects, which in turn has increased the consumption of speciality construction chemicals such as protective coatings, adhesives and sealants, concrete admixtures, and asphalt additives. The market for speciality chemicals is expected to register a CAGR of around 4%, during the forecast period of 2020-2025 according to Mordor Intelligence. The major factors driving the growth of the market studied are the robust growth of construction activities, especially in the Asia-Pacific and the Middle East & African regions, and the growth of oil exploration and production activities. On the flip side, increasing environmental regulations and decreasing fossil fuel reserves are the restraints hampering the growth.



Paints and coatings dominated the speciality chemicals market and is expected to grow during the forecast period, with robust growth in the construction industry, which is majorly driven by the growth in residential construction across the world. Global speciality chemicals market size was valued at $211.2 billion in 2018 and is expected to reach $316.5 billion by 2026, registering a CAGR of 5.2% during the analysis period according to an industry report published in December. The construction chemicals industry is booming in emerging economies such as Asia-Pacific, the Middle East, Africa, Central and South America. Water treatment chemical is projected to be one of the fastest-growing segments during the forecast period. Stringent government regulations for proper utilization of water compel industries and municipal corporations to adopt water treatment solutions, which in turn is fueling the demand for water treatment chemicals.

Source: Allied Market Research

Indian Specialty Chemical Industry sub-segment:

Sub Segment	Growth Driver	User Industry
Paints and Coatings	Has grown at 1.5-2X GDP growth rate with CAGR of 13.5% in last five years and is likely to maintain over 15%	Construction, Automotive
Specialty Polymers	Growth in plastic demands resulting from increased usage in packaging, construction and automotive	Packaging, Automotive
Construction Chemicals	Current expenditure on admixtures is very low in India as compared to other countries	Infrastructure, Real estate
Paper Chemicals	Paper industry is expected to grow at 8-10% on growing demand	Printing, Packaging
Textile Chemicals	Industry has benefited from currency depreciation and has strong growth potential	Apparel, Technical Textile
Water Chemicals	Growing urbanization has led to higher needs for water purification and treatment	Industrial water, Municipal water
Cosmetic chemical	Personal care is getting extremely sophisticated and increasing awareness and evolving consumer driven growth	Bath, Shower, Hair Care
Flavors & Fragrances	India is lagging behind but rapidly catching up	Food Processing, Personal Care
Agro Chemicals	Strong growth in CRAMS and domestic agrochemical industry as pesticide consumption is low in India	Agriculture, Exports
Home Care Surfactants	Growth is primarily driven by increased consumption	Laundry Care, Dishwashing
Colorants	Exports from India is about 80% of total consumption	Textile, Exports

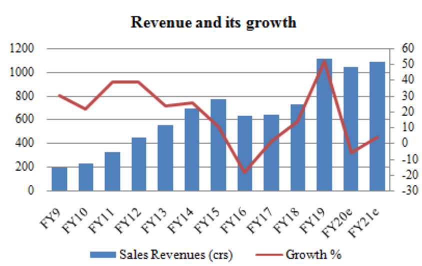
Source: Maier-Vidorno

Adding to its use in butyl phenols as a major raw material, Isobutylene has high demand from end-use industries such as agrochemicals and food additives, which is expected to drive industry growth for Isobutylene. The chemical is widely used in rubber tyres & tubes and as a fuel additive in aerospace applications.The importance of IBB prospects have recently been accentuated due to the Covid-19 outbreak – one of the key raw materials in making Ibuprofen is IBB. Ibuprofen is used in the pharma industry for making pain killers. In December, Indian ratings agency – ICRA projected Indian pharma industry to grow at – 10-12% up to FY22 while maintaining a stable outlook on the sector. The domestic pharma industry has gained adequate scale and generic drug development capabilities over a decade of growth will keep them in good stead to capture opportunities in the future. Currently, the supply of IBB is crucial for the pharma industry and Vinati Organics has a considerable market share in its manufacturing.

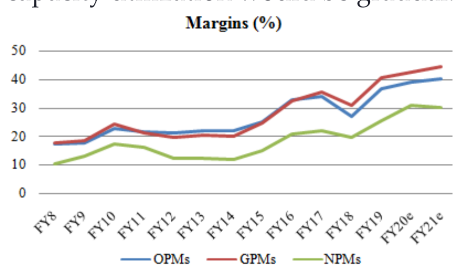
Generally, the margins for speciality chemicals are higher than basic chemicals thus making the business more attractive along with the fact that very few companies are into this business most of whom are involved in different products. Aided by high entry barriers, speciality chemicals are a group of "relatively high-value low volume chemicals, known for its end-use performance-enhancing applications". Recently published report by Maier-Vidorno estimates the size of speciality chemicals industry in India at $24.9 bn with a potential to grow at 13-14% every year. Some of the key products driving growth are water chemicals, agrochemicals etc;

Financials & Valuation

Accentuated by the increasing demand for ATBS, VOL's market share increased to 65% - in anticipation of strong demand, for some time now, Vinati has been working on capacity addition for ATBS, increasing it from 26000 tonnes to 40000 tonnes; the plant was expected to be completed by November 2019, but owing to subdued demand in the global market not least due to strained crude oil prices it is expected to start commercial production in March 2020. The total capital expenditure incurred on the project is Rs. 110 cr and ramp-up in capacity utilization would be gradual.



Sources: Vinati Organics Ltd., CD Equisearch



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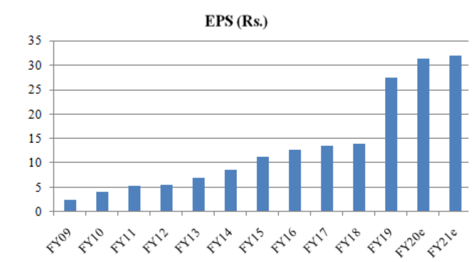
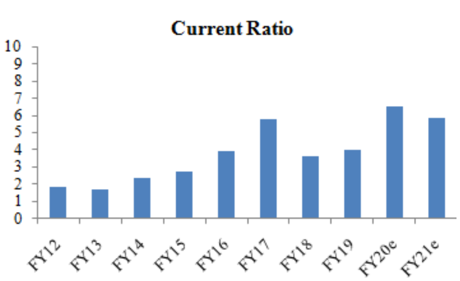


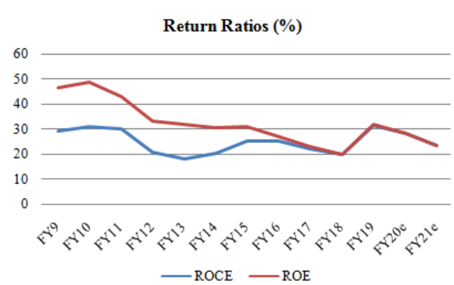
Sources: Vinati Organics Ltd., CD Equisearch

In India, currently, there is no major capacity for Butyl Phenols. Earlier, a few companies tried to manufacture the product, but, marred by a lack of scale and inconsistent supply of Isobutylene, it couldn't be manufactured economically. Vinati Organics, propelled by regular supply of Isobutylene (capacity of 15000 tonnes) - a major raw material in the manufacture of Butyl Phenol (BP), undertook a greenfield expansion, of Rs. 240 cr for setting up a BP plant with an annual capacity of 35000 tonnes (optimum revenues at full capacity of over 400 cr.). The plant will make two types of phenols which are mostly used in manufacture of fragrances, plastics etc.

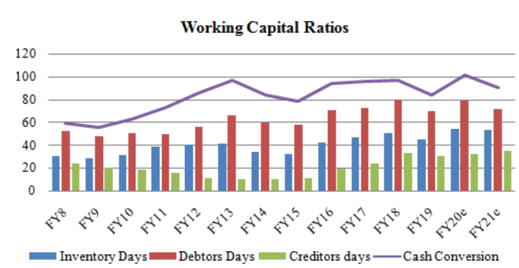
The butyl-phenol plant started running from October but needed some modifications. Revenues are expected to start coming in from Q4FY20; Vinati Organics is primarily looking at this segment as an import substitution opportunity. We expect gradual ramp-up in capacity utilization, yielding revenues of over Rs. 100 cr in FY21. Going forward, in contrast to ATBS, BP is a slightly low margin product and will have some impact on the bottom line (marginal though).



Sources: Vinati Organics Ltd., CD Equisearch



Sources: Vinati Organics Ltd., CD Equisearch



Sources: Vinati Organics Ltd., CD Equisearch

Lower raw material costs triggered by subdued crude oil prices stoked revenues which declined by 3.5% for the nine months ended December 2019. The rift in OPEC+ cartel between Russia and Saudi Arabia has resulted in huge increases in oil output from the Saudis who offered grave discounts too, which triggered herculean drop in crude oil prices to almost $30/barrel. It is expected to have some impact on Q4FY20 revenues and which would further pull down FY20 revenue growth. The last time crude oil prices contracted this majorly in FY16, the revenues of Vinati fell by more than 18% while its ROE fell from 31.2% to 26.9%. Pending ramp up in capacity utilization of new plants of ATBS and butyl phenol, ROE is expected to fall sharply to 28.4% and 23.5% in FY20 and FY21 respectively from 31.8% in FY19. Despite strain on liquidity and unforeseen pandemic, inventory and debtor days will remain subdued not least due to sharp fall in crude oil prices.

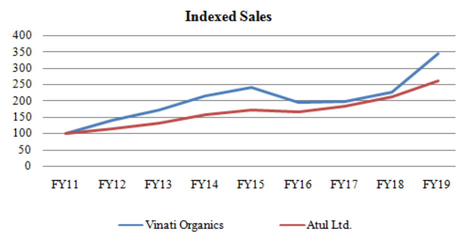
The stock currently trades at 25x FY20e EPS of Rs 31.41 and 24.5x FY21e EPS of Rs 32.00. Despite the government's identification of specialty chemicals as a key priority segment, unseen fall in crude oil prices has made VOL's objective of achieving 15-20% annual growth over the next 4 years looks difficult. Revenue as a consequence would grow by sub 5% next fiscal stoking earnings growth to just 2%. Wherefore, return on capital would barely remain elevated. On balance, we advice hold rating on the stock with a target of Rs 832 (previous target: Rs 1262 - adjusted for stock split) based on 26x FY21e earnings over a period of 9-12 months. For more information, refer to our September 2019 report.

Cross Sectional Analysis

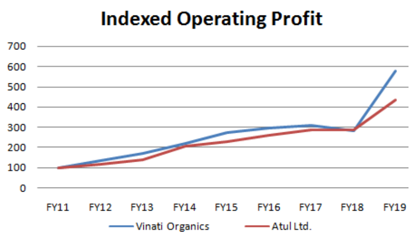
Company	Equity *	CMP	MCAP *	Sales *	Profit *	OPM (%)	NPM (%)	Int Cov	ROE (%)	Mcap/Sales	P/BV	P/E
Vinati	10	785	8072	1080	342	40.0	31.6	414.2	30.6	7.5	6.7	23.6
Atul Ltd	30	3976	11794	4186	638	21.9	15.2	95.8	22.7	2.8	3.9	18.5

*figures in crores; calculations on ttm basis; adjusted for stock split wherever applicable
Book value adjusted for goodwill and revaluation reserve wherever applicable;

While the Performance and other chemicals segment, which contributes over 70% to the topline, held steady (drop of 0.25% y-o-y), abatement in Atul's Life Sciences division by 5.6% in the December quarter led to flat-lining of revenues over the same period last year. This was during a year when declining raw material prices have pushed industry revenues downwards. Fall in raw material prices (raw material to sales ratio declined to 47.7% from 51.7% a year ago) pushed up operating margins which showed noteworthy improvements rising to 23.9% - an increase of 326 basis points over last year. Profits were mainly driven by an increase in margins of performance chemicals by 360 bps to 22.1% at the EBIT level. PBT rose by an impressive 26.4% but helped by the recent tax cuts, the profits increased massively to Rs. 169 cr – a rise of 44.3% y-o-y.



Sources: Companies, CD Equisearch ; FY11=100



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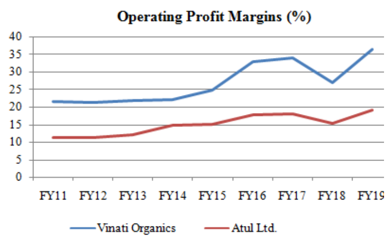
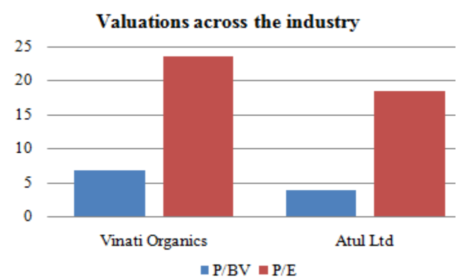


Sources: Companies, CD Equisearch



Sources: Companies, CD Equisearch

Financials

Quarterly Results

Figures in Rs crs

	Q3FY20	Q3FY19	% chg.	9MFY20	9MFY19	% chg.
Income From Operations	**238.47**	**303.05**	**-21.3**	**783.53**	**811.53**	**-3.5**
Other Income	15.40	7.28	111.5	28.77	39.68	-27.5
Total Income	**253.88**	**310.34**	**-18.2**	**812.31**	**851.21**	**-4.6**
Total Expenditure	155.49	196.62	-20.9	471.26	527.69	-10.7
EBITDA (other income included)	**98.39**	**113.72**	**-13.5**	**341.04**	**323.52**	**5.4**
Interest	0.25	0.28	-11.2	0.83	0.71	16.9
Depreciation	9.28	6.92	34.1	23.46	20.57	14.0
PBT	**88.86**	**106.51**	**-16.6**	**316.75**	**302.24**	**4.8**
Tax	22.03	35.84	-38.5	57.56	102.27	-43.7
PAT	**66.82**	**70.68**	**-5.5**	**259.20**	**199.96**	**29.6**
EO	-	-	-	-	-	-
Adjusted Net Profit	**66.82**	**70.68**	**-5.5**	**259.20**	**199.96**	**29.6**
EPS(Rs)*	6.50	6.88	-5.5	25.22	19.45	29.6

Income Statement

Figures in Rs crs

	FY17	FY18	FY19	FY20e	FY21e
Income From Operations	**640.79**	**729.68**	**1108.14**	**1041.70**	**1082.87**
Growth (%)	1.6	13.9	51.9	-6.0	4.0
Other Income	12.48	30.70	49.95	40.25	49.61
Total Income	**653.28**	**760.38**	**1158.09**	**1081.95**	**1132.48**
Total Expenditure	423.84	532.43	704.52	638.03	648.99
EBITDA (other income included)	**229.43**	**227.95**	**453.57**	**443.92**	**483.49**
Interest	1.86	1.21	0.94	1.12	1.18
Depreciation	21.61	23.36	27.39	33.68	42.81
PBT	**205.97**	**203.37**	**425.24**	**409.12**	**439.50**
Tax	65.69	59.49	142.75	86.27	110.62
PAT	**140.28**	**143.88**	**282.49**	**322.85**	**328.88**
EO	-	-	-	-	-
Adjusted Net Profit	**140.28**	**143.88**	**282.49**	**322.85**	**328.88**
EPS (Rs)*	13.59	13.97	27.48	31.41	32.00

*adjusted for stock split

Balance Sheet

Figures in Rs crs

	FY17	FY18	FY19	FY20e	FY21e
Sources of Funds					
Share Capital	10.32	10.28	10.28	10.28	10.28
Reserves	669.69	786.39	1041.00	1258.53	1587.41
Total Shareholders' Funds	**680.01**	**796.66**	**1051.28**	**1268.81**	**1597.69**
Long Term Debt	0.00	0.00	0.00	0.00	0.00
Total Liabilities	**680.01**	**796.66**	**1051.28**	**1268.81**	**1597.69**
Application of Funds					
Gross Block	489.19	502.26	547.25	748.42	898.42
Less: Accumulated Depreciation	21.59	45.41	72.74	106.42	149.23
Net Block	**467.60**	**456.84**	**474.51**	**642.00**	**749.19**
Capital Work in Progress	7.38	34.88	191.18	150.00	20.00
Investments	61.83	131.74	96.47	215.00	555.00
Current Assets, Loans & Advances					
Inventory	65.07	82.23	92.39	97.01	92.16
Trade receivables	140.54	177.11	243.98	207.38	217.75
Cash and Bank	4.75	5.24	3.80	5.56	13.48
Short term loans (inc. OCA)	54.86	66.56	94.43	89.10	94.79
Total CA	**265.22**	**331.16**	**434.60**	**399.05**	**418.18**
Current Liabilities	50.72	96.61	85.56	89.79	97.00
Provisions-Short term	2.68	2.67	3.24	3.97	4.44
Total Current Liabilities	**53.40**	**99.28**	**88.80**	**93.76**	**101.44**
Net Current Assets	211.82	231.88	345.80	305.30	316.73
Net Deferred Tax Liability	-69.55	-80.86	-84.57	-67.86	-70.24
Net long term assets (net of liabilities)	0.92	22.18	27.89	24.37	27.01
Total Assets	**680.01**	**796.66**	**1051.28**	**1268.81**	**1597.69**

Key Financial Ratios

	FY17	FY18	FY19	FY20e	FY21e
Growth Ratios(%)					
Revenue	1.6	13.9	51.9	-6.0	4.0
EBITDA	7.8	-0.6	99.0	-2.1	8.9
Net Profit	6.7	2.6	96.3	14.3	1.9
EPS	6.7	2.7	96.8	14.3	1.9
Margins (%)					
Operating Profit Margin	33.9	27.0	36.4	38.8	40.1
Gross profit Margin	35.5	31.1	40.8	42.5	44.5
Net Profit Margin	21.9	19.7	25.5	31.0	30.4
Return (%)					
ROCE	22.4	19.8	31.5	28.3	23.4
ROE	23.0	19.9	31.8	28.4	23.5
Valuations					
Market Cap/ Sales	6.1	6.4	7.6	7.7	7.5
EV/EBITDA	16.8	19.8	18.4	17.7	16.2
P/E	27.9	32.3	29.9	25.0	24.5
P/BV	5.8	6.0	8.4	6.4	5.3
Other Ratios					
Interest Coverage	111.6	169.0	451.5	366.6	375.0
Debt Equity	0.0	0.0	0.0	0.0	0.0
Net Debt-Equity Ratio	-0.1	-0.2	-0.1	-0.2	-0.4
Current Ratio	5.8	3.6	4.0	6.5	5.9
Turnover Ratios					
Fixed Asset Turnover	1.5	1.6	2.4	1.9	1.6
Total Asset Turnover	1.0	1.0	1.2	0.9	0.8
Inventory Turnover	7.8	7.2	8.1	6.7	6.9
Debtors Turnover	5.0	4.6	5.3	4.6	5.1
Creditor Turnover	15.4	11.1	12.1	11.4	10.6
WC Ratios					
Inventory Days	46.7	50.5	45.2	54.2	53.2
Debtor Days	72.7	79.4	69.3	79.1	71.6
Creditor Days	23.7	33.0	30.2	31.9	34.5
Cash Conversion Cycle	95.7	97.0	84.4	101.3	90.3

Ratios adjusted for stock split

Cumulative Financial Data

	FY10-12	FY13-15	FY16-18	FY19-21e
Income from operations	1002	2021	2001	3233
Operating profit	217	465	621	1241
EBIT	217	442	607	1277
PBT	196	402	596	1274
PAT	147	269	416	934
Dividends	25	54	56	169
OPM (%)	21.7	23.0	31.0	38.4
NPM (%)	14.7	13.3	20.8	28.9
Interest coverage	10.5	11.2	55.5	394.4
ROE (%)	38.9	28.9	23.0	27.0
ROCE (%)	22.8	22.9	22.0	26.9
Debt-Equity*	0.9	0.2	0.0	0.0
Fixed asset turnover	3.5	2.9	1.7	1.8
Debtors turnover	5.9	6.3	4.4	5.5
Inventory turnover	9.5	10.6	6.7	7.6
Creditors turnover	29.6	34.1	10.8	10.4
Debtor days	62.1	58.2	83.8	66.9
Inventory days	38.4	34.3	54.2	47.9
Creditor days	12.3	10.7	33.7	35.1
Cash conversion	88.1	81.8	104.3	79.7
Dividend payout ratio (%)	16.9	19.8	13.4	18.1

FY10-12 implies three year period ending fiscal 12
*as on terminal year

Impressive capacity expansions and product selection led to imperious revenue proliferation in FY13-15 over the previous period partially aided by higher crude oil prices. ATBS volume expansion has been the recipe of success for Vinati Organics, especially after the exit of Lubrizol, a global player in the manufacture of ATBS. Margin expansion – cost optimization along with better raw material sourcing has resulted in improved operating margins over the last few years from 21.7% in FY10-12 to 31% in FY16-18 and further to 36.4% in FY19. Low amounts of debt have helped the company keep low finance costs and high interest coverage ratio – Debt Equity fell from 0.9 in FY10-12 to 0 in FY16-18 (see table).

The revenue is expected to jump by a mammoth 62% (though most gains were reported in FY19) in the period ending FY21 on the back of robust capacity expansion in ATBS and new capacity additions in the form of butyl phenol towards the fag end of FY20. Not so tepid improvement in return on equity over the previous period is a result of high margins and tax cut implemented by the Government of India in September. Notwithstanding effect of value added products, Vinati's margins generally tend to rise when crude oil prices fall. Yet the sharp fall in crude oil prices has obscured any chance of meaningful recovery in revenue next fiscal. Better debtors' management is expected to shrink the cash conversion cycle.

Financial Summary- US dollar denominated

million $	FY17	FY18	FY19	FY20e	FY21e
Equity capital	1.6	1.6	1.5	1.4	1.4
Shareholders' funds	104.4	118.2	145.7	168.6	203.9
Total debt	0.4	2.3	0.5	0.7	0.7
Net fixed assets (incl. CWIP)	73.3	75.6	96.2	105.3	102.2
Investments	9.5	20.3	13.9	28.6	73.8
Net current assets	32.2	31.4	43.7	40.6	33.6
Total assets	104.4	118.2	145.7	168.6	203.9
Revenues	95.5	113.2	158.6	138.5	143.9
EBITDA	34.2	35.4	64.9	59.0	64.3
EBDT	33.9	35.2	64.8	58.9	64.1
PBT	30.7	31.6	60.8	54.4	58.4
PAT	20.9	22.3	40.4	42.9	43.7
EPS($)	0.20	0.22	0.39	0.42	0.43
Book value ($)	1.01	1.15	1.42	1.64	1.98

Figures adjusted for stock split wherever applicable
Income statement figures translated at average rates; balance sheet at year end rates; projections at current rates (Rs 75.24/$).
All dollar denominated figures are adjusted for extraordinary items.

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buy: >20%	accumulate: >10% to ≤20%	hold: ≥-10% to ≤10%	reduce: ≥-20% to <-10%	sell: <-20%

Exchange Rates Used- Indicative

Rs/$	FY14	FY15	FY16	FY17	FY18	FY19
Average	60.5	61.15	65.46	67.09	64.45	69.89
Year end	60.1	62.59	66.33	64.84	65.04	69.17

All $ values mentioned in the write-up translated at the average rate of the respective quarter/ year as applicable. Projections converted at current exchange rate. Cumulative dollar figure is the sum of respective yearly dollar value.