

Vinati Organics (VO IN)

Sector leader in profitability

INDIA | SPECIALTY CHEMICALS | Initiating Coverage

29 March 2016

Stronger and wider moat in ATBS

VO is a global leader of 2-acrylamido 2-methylpropanesulfonic acid (ATBS, 46% of total sales) in the world with a capacity of 26,000TPA and ~45% market share. Global scale and backward integration in ATBS (it is the only integrated player in the world) has earned it cost/price leadership. Price leadership is evident – despite being a crude derivative, VO's ATBS prices remained stable over the 70% correction in crude prices in the last two years. VO's cost/price leadership puts up an entry barrier for others. It reported sales/volumes CAGR of 28%/23% in ATBS over FY10-15 and we estimate 15% sales CAGR over FY16-18 to Rs 3.35bn, led by steady progress in construction chemicals, paints, and water-treatment chemicals.

To maintain global leadership in IBB, but with muted growth

VO is the largest manufacturer of isobutyl benzene (IBB) in the world with a capacity of 14,000TPA and >70% of global market share, thanks to its technological collaboration with Institut Francais du Petrole (IFP), that earned it global scale and accreditation. IBB is largely a pharma intermediate used in the preparation of ibuprofen (an anti-inflammatory, anti-arthritic, analgesic medicine) and in the perfume industry. It is a mature but steadily growing product with a demand of ~20,000TPA globally. We estimate 6% sales CAGR over FY16-18 to Rs 1.98bn.

Well-integrated product portfolio

VO launched innovative and cost-competitive products (ATBS, IBB, and IB-Isobutylene) supported by its technological tie-ups. Subsequently, leveraging its in-house research, it introduced new products such as N-Tertiary Butylacrylamide (TBA), N-Tertiary Octyl Acrylamide (TOA), High purity Methyl-Tertiary Butyl Ether (HP-MTBE), and Diacetone Acrylamide (DAAM) – these product-lines make up about 15% of its revenue share currently. The new products are fully integrated to its existing line (as by-products, or co-products, or downstream products), which makes it the most cost-effective producer in the world.

Expansion into downstream products and new alliances to sustain value growth

To further its growth plans, VO is undertaking capital expenditure of Rs 2bn over FY16-17 for backward integration and introduction of new downstream products. Additionally, it has entered into a long-term tripartite agreement with USA and Japan-based chemical companies for supplying customised products. We expect VO's new initiatives to be value accretive and to contribute Rs 1bn in FY18.

Technocrat management ensures sustained business progress

Hands-on expertise of Mr Vinod Banwarilal Saraf (founder, BITS Pilani graduate, industry veteran) in new chemical/petrochemical projects identification and technical tie-ups helped VO deliver 5/8-fold growth in revenue/profit over the last eight years. His leadership will ensure sustained business progress.

VO to maintain its earning supremacy; initiate Buy with TP of Rs 495

We estimate VO to deliver 16%/21% revenue/profit CAGRs over FY16-18 to touch Rs 8.21/1.45bn in FY18. Considering its sector leadership in terms of earning efficiency and with future growth led by continuing expansions into value-added downstream products, we value VO at 10x FY18 EV/EBITDA to arrive at our TP of Rs 495. Initiate with a Buy rating.

BUY

CMP RS 395

TARGET RS 495 (+25%)

COMPANY DATA

O/S SHARES (MN) :	52
MARKET CAP (RSBN) :	20
MARKET CAP (USDBN) :	0.3
52 - WK HI/LO (RS) :	668 / 361
LIQUIDITY 3M (USDMN) :	0.3
PAR VALUE (RS) :	2

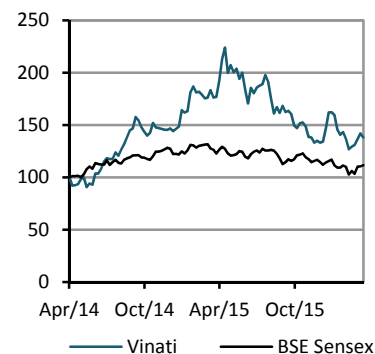
SHARE HOLDING PATTERN, %

	Dec 15	Sep 15	Jun 15
PROMOTERS :	72.3	72.3	72.3
FII / NRI :	1.1	1.1	1.0
FI / MF :	6.9	6.9	6.9
NON PRO :	3.0	3.0	3.1
PUBLIC & OTHERS :	16.7	16.7	16.8

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABS	6.4	-12.3	-22.2
REL TO BSE	-0.2	-10.5	-11.7

PRICE VS. SENSEX



Source: Phillip Capital India Research

KEY FINANCIALS

Rs mn	FY16E	FY17E	FY18E
Net Sales	6,047	7,189	8,410
EBIDTA	1,701	2,049	2,476
Net Profit	994	1,209	1,496
EPS, Rs	19.3	23.4	29.0
PER, x	20.5	16.9	13.6
EV/EBIDTA, x	12.1	10.0	7.9
P/BV, x	4.0	3.3	2.8
ROE, %	19.4	19.8	20.3
Debt/Equity (%)	12.2	9.4	7.0

Source: PhillipCapital India Research Est.

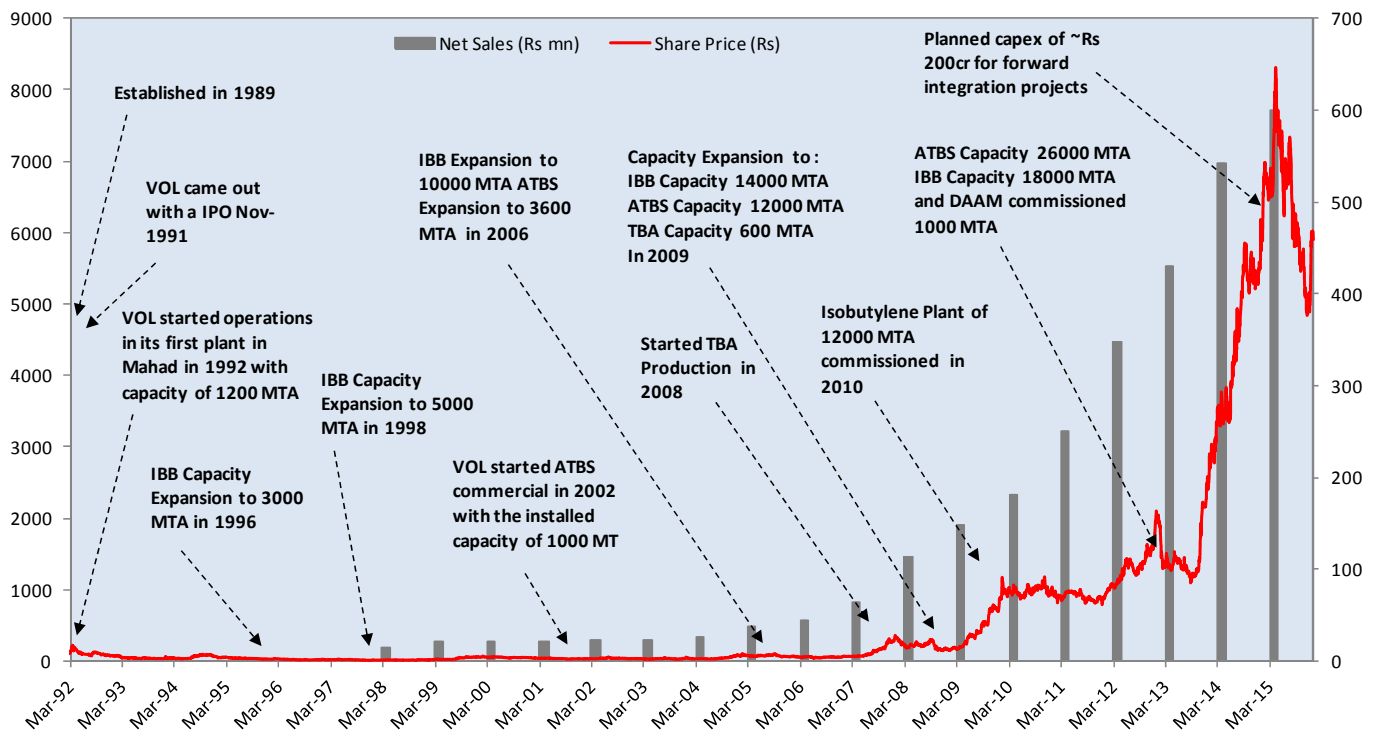
Surya Patra (+ 9122 6667 9968)
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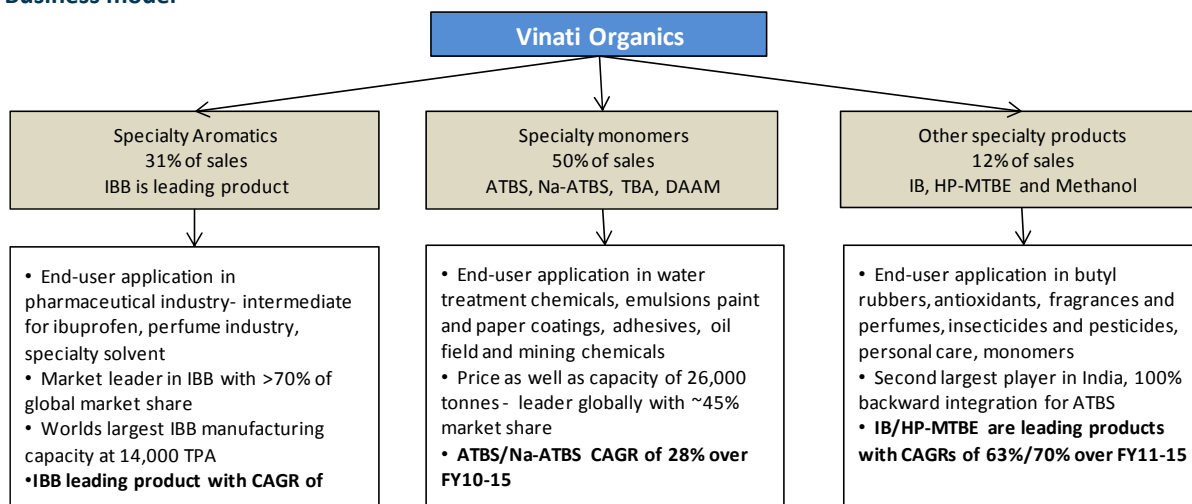
About the company

- Established in 1989.
- Specialty chemical company producing aromatics, monomers, and polymers.
- Started operations with its first plant in Mahad (Maharashtra) in 1992, with focus on isobutyl benzene (a raw material for making ibuprofen, an anti-inflammatory analgesic bulk drug) and achieved global scale.
- In 2002, it started commercial production in its second plant in Lote Parshuram (Maharashtra), producing ATBS, and emerged the largest producer in the world.
- Reasons for success – continued focus on product/process optimisation with in-house R&D, successful substitution of external input materials to in-house sources, converting by-products to marketable ones, and strong marketing strategies.
- With its move towards downstream products, VO is set to maintain its earning supremacy in the Indian specialty chemicals sector.

Evolution of Vinati



Business model



Source: Company, PhillipCapital India Research

Investment Rationale

Global leadership in ATBS is the key to profit supremacy

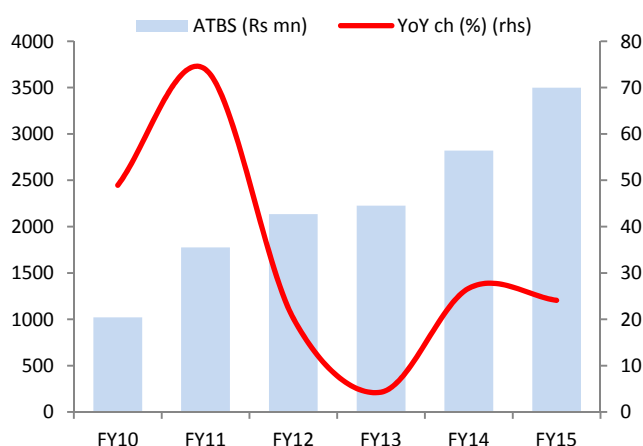
Largest manufacturer of ATBS in the world

VO entered ATBS manufacturing by getting technology developed from National Chemical Laboratories, Pune, and setting a manufacturing plant with an initial capacity of 1,200tpa in 2002. VO was the third company globally to enter ATBS (after Lubrizol and Toagosei). Acrylamide tertiary butyl sulfonic acid is a vinyl polymer.

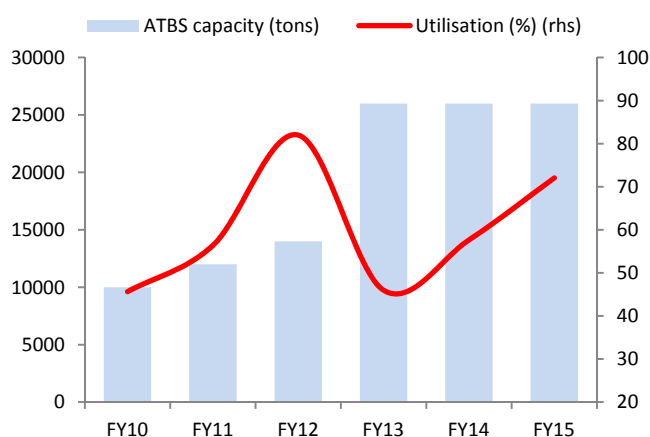
Led by its excellent hydrolytic and thermal stability properties, ATBS finds wide application in emulsions for paints and paper coatings, water treatment chemicals, adhesives, hydrogels and super absorbents, textile auxiliaries, detergents and cleaners, acrylic fiber, construction polymers, and oil field polymers. But due to the captive manufacturing practice of Lubrizol and Toagosei, ATBS was not available at the right price/quantity for other applications. Leveraging the short-supply position in ATBS, VO continuously expanded its capacity to 26,000tpa in FY13 and emerged as the largest manufacturer of ATBS in the world with over 45% of global market share.

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Sales maintained at high-teen rate



Gradual pick-up in capacity



Source: Company, PhillipCapital India Research

Vinati is a global leader in-term of capacity

Company	ATBS Capacity (tons)	Remark
Vinati	26000	Global leader, holds 45% market share
Lubrizol	14000	Majority of production for captive consumption
Toagosei	6000	ATBS is not a major focused product

Source: Company, PhillipCapital India Research

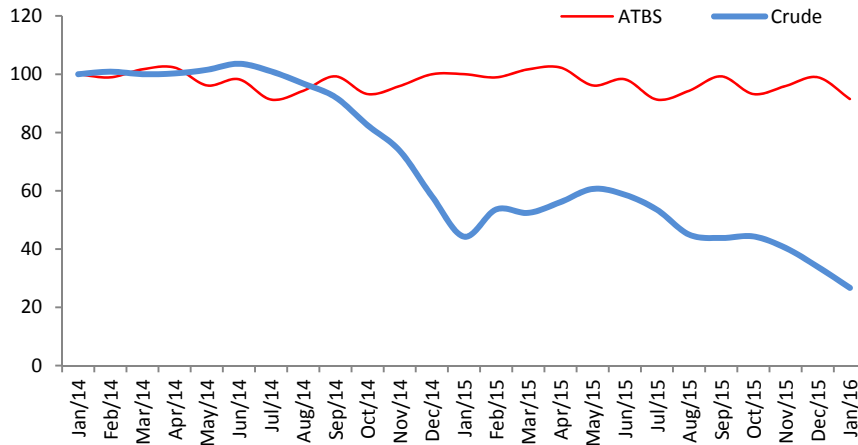
Its robust client base across various markets – including the US, Europe, Asia, the Middle East, and China – has been a key to VO’s success in ATBS. It has some of the world’s largest specialty chemical companies in its client list, including BASF, Dow Chemicals, Nalco Company (USA), AkzoNobel, SNF Floerger, Ciba, and Clariant Chemicals, among many others.

Price leadership in ATBS is a key to VO’s supremacy in profitability

While steady expansion in geographic reach and client base offered scale to VO’s ATBS operation, its strategic backward integration to IB (Isobutylene) manufacturing (one of the key raw materials for ATBS, which used to be imported) made it the price leader. It is the only backward-integrated ATBS manufacturer in the world. VO’s price leadership in ATBS (which contributes 46% of its total sales) is a key to its sector leadership in profitability.

VO's price leadership is evident – it could retain ATBS prices despite sharp correction in input prices led by crude.

Retained ATBS prices despite sharp correction of ~70% in price of crude



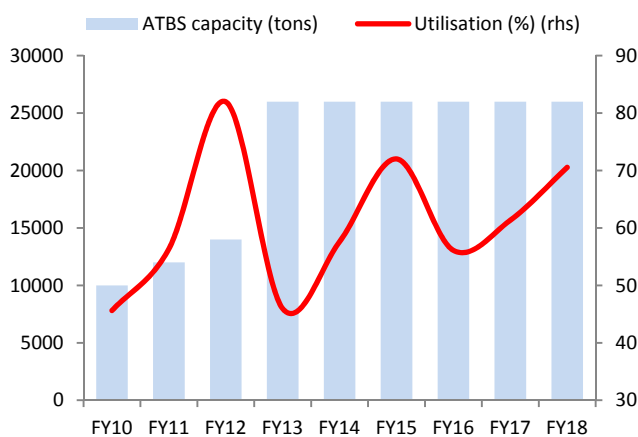
Despite being a crude derivative, ATBS prices have remained stable in the face of +70% corrections in crude prices over the last two years

Source: PhillipCapital India Research

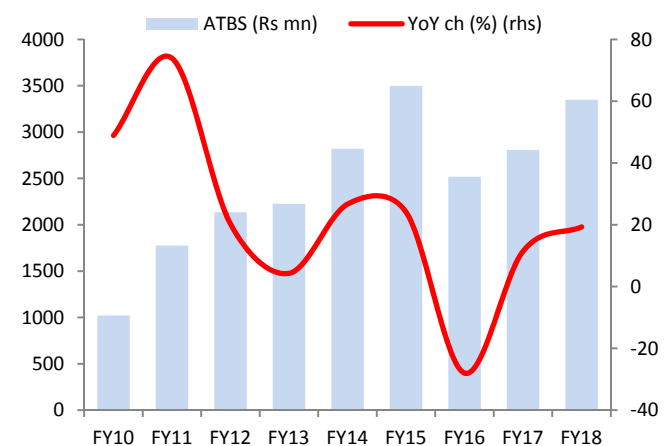
ATBS sales to see 15% CAGR over FY16-18, despite dip in EOR application

VO delivered sales/volumes CAGR of 28%/23% in ATBS over FY10-15. Over the last four quarters, sales volume saw an average decline of ~8% as enhanced oil recovery (EOR) application faced slowdown with a slump in crude prices. EOR application accounts for about ~15% of the ATBS application. However, we see rising demand in segments such as water treatment, construction chemicals, and personal care covering up for the lost business soon. We build 12% volume growth for ATBS over FY16-18, which will improve capacity utilisation to 84% by FY18 from 66% in FY16. Hence, we estimate 15% CAGR in ATBS sales over FY16-18 to Rs 3.35bn.

Utilisation level to improve gradually



FY16 impacted due to slump in global oil exploration activity

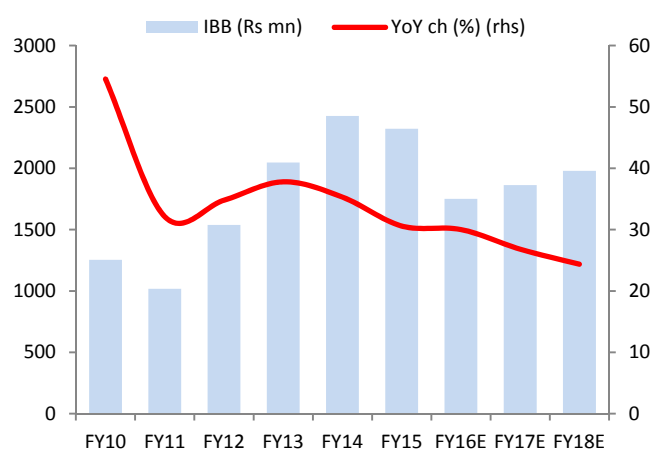


Source: Company, PhillipCapital India Research Estimates

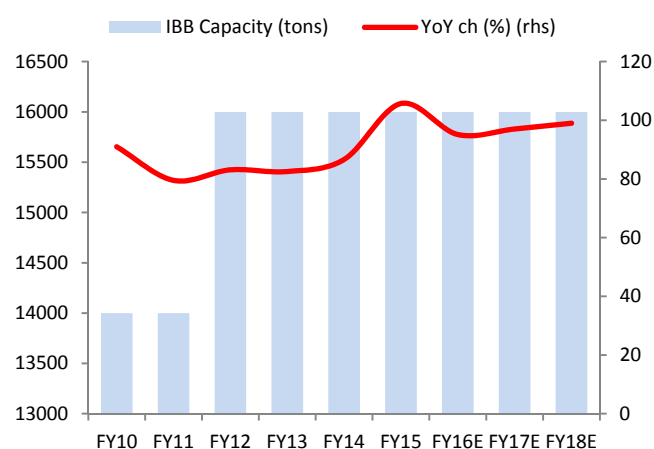
IBB to maintain its global leadership, but with muted growth

Isobutyl Benzene (IBB) was VO's first product. It is a specialty chemical widely used as an intermediate in the preparation of Ibuprofen, an anti-inflammatory/anti-arthritic/analgesic medicine for pain relief. Ibuprofen is primarily manufactured in India, China, and in the USA. It is also used in the perfume industry. VO is a market leader in IBB with >70% global market share. It has the largest IBB manufacturing capacity in the world at 14,000TPA at Mahad, Maharashtra. It has acquired the technology to produce IBB from Institut Francais du Petrole (IFP), France. This is a mature product with demand of ~20,000 TPA globally, growing at ~5% p.a. We estimate 6% sales CAGR over FY16-18 to Rs 1.98bn.

Mature business, will have stable growth



Capacity is at highest level of utilisation



Source: Company, PhillipCapital India Research Estimates

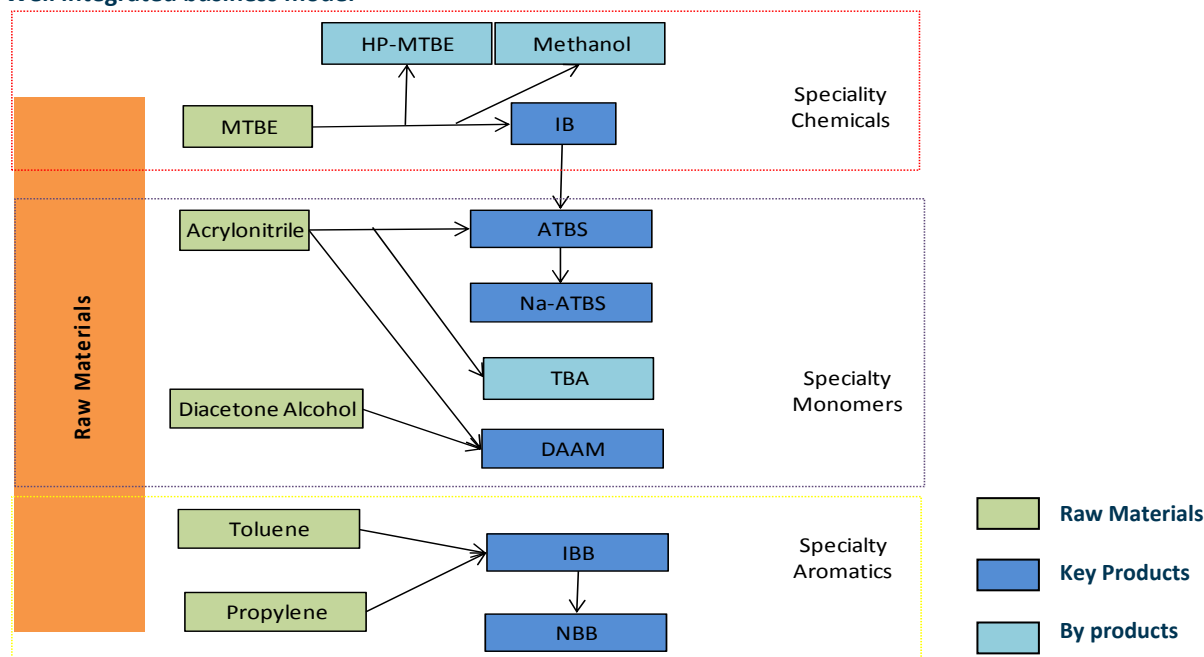
Technology-led integrated product portfolio earns global accreditation

VO launched innovative and cost competitive products like ATBS, IBB, and IB – supported by its technological tie-ups with National Chemical Laboratories (India), Institut Francais du Petrole (France), and Saipem S.p.A. (Italy), respectively. Its continued captive research on productivity and efficiency earned it global leadership in ATBS and IBB. VO is the largest manufacturer of IB India.

Leveraging its in-house research, it introduced new products, which like N-Tertiary Butylacrylamide (TBA), NTertiary Octyl Acryl amide (TOA), High purity Methyl-Tertiary Butyl Ether (HP-MTBE) and Diacetone Acryl amide (DAAM) – and these new product lines make up about 15% of its revenue share. The new products are fully integrated with existing ones (as by-products, co-products, or their further processed products), which make VO the most cost-effective producer of these products.

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Well integrated business model



Source: Company, PhillipCapital India Research

Expansion into downstream products and new alliances to sustain value growth

Although VO is globally known for ATBS and IBB, it has an integrated portfolio of 15 products; for many of these, it is the largest manufacturer in India. In order to further its growth plans, it is undertaking capital expenditure of Rs 2bn over FY16-17 to expand existing products and to introduce new downstream products. The new projects include – (1) capacity expansion of IB, (2) new plant for producing para Tertiary Butyl Toluene and para Tertiary Butyl Benzoic Acid, (3) new plant for producing Isobutyl Aceto Phenone, (4) couple of export oriented custom synthesis products, and (5) setting up a 5-MW co-generation plant at the company's Lote (Maharashtra) facility. Most of these projects are for downstream products of existing ones; the expanded IB capacity and the power plant would also aid backward integration.

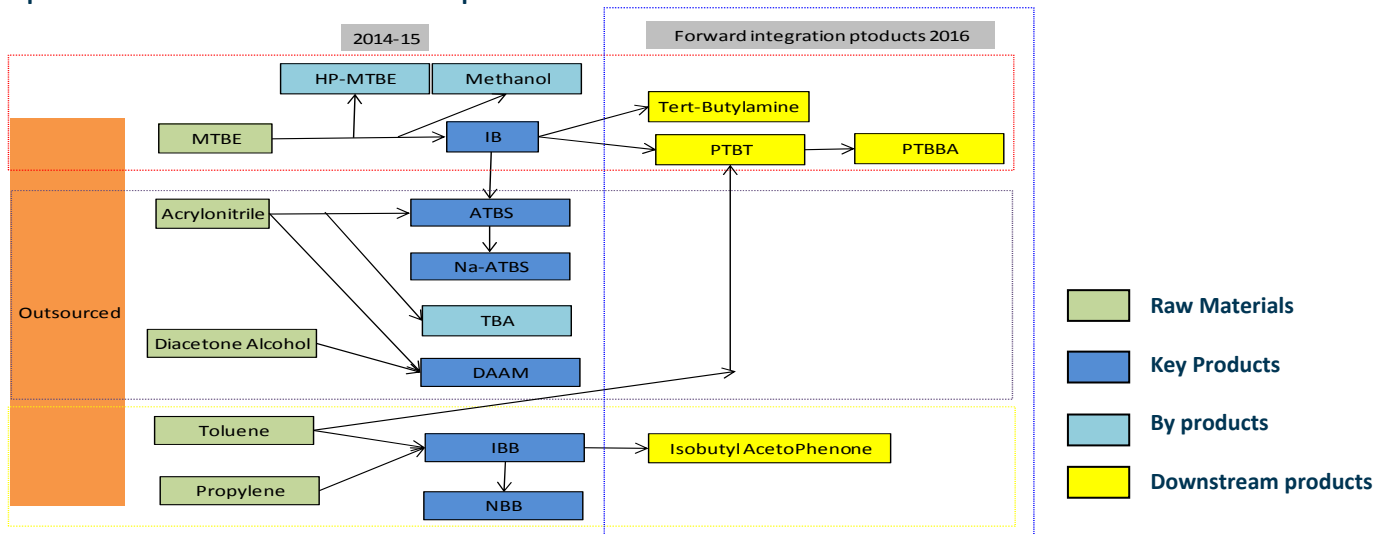
IB is a hydrocarbon of significant industrial importance, used as key intermediate for VO's leading product ATBS and it will remain a key intermediate for VO's new downstream product such as - Tertiary Butyl Toluene, para Tertiary Butyl Benzoic, couple other products

New projects targets both upstream and downstream products

New projects	Comments
New plant for producing Isobutyl Aceto Phenone (IBAP)	Product is an intermediary between IBB and Ibuprofen
Capacity expansion of IB	Backward integration for ATBS, about 50% capacity expansions which will be used as captive for new pipeline products.
New plant for producing para Tertiary Butyl Toluene / para Tertiary Butyl Benzoic Acid (PTBT/PTBBA)	Products are IB based derivatives and find application in perfumery, personal care and as polymer additives
New plant for producing Tertiary Butyl Amine (TB Amine)	Used in the rubber and pharmaceutical industry
Setting up of 5 MW Co-generation plant at the company's Lote facility	5 MW Co-generation power plant is expect to reduce power cost by Rs 80mn per annum from 2018

Source: Company, PhillipCapital India Research

Expansion into value-added downstream products



Source: Company, PhillipCapital India Research

VO has entered into long-term tripartite agreements with USA and Japan-based chemical companies for supplying customised product, which it expects will contribute incremental sales of Rs 450mn in FY17, and should see a scale-up subsequently. We expect its new initiatives to sustain value growth and estimate these to contribute Rs 1bn in FY18.

Technocrat management ensures sustained business progress

Vinod Banwarilal Saraf (a BITS Pilani graduate and an industry veteran) has been the key driving force behind the successful introduction of products such as IBB/ATBS and in the scaling up to global levels. He has hands-on expertise in Grasim Industries in new chemical and petrochemical projects identification, technical tie-ups, and feasibility studies. He worked as Managing Director in Mangalore Refinery & Petrochemicals Ltd. Mr Saraf’s decades of hands on industry expertise helped VO deliver 5-8-fold growth in revenue/profits over the last eight years. His leadership would ensure sustained business progress.

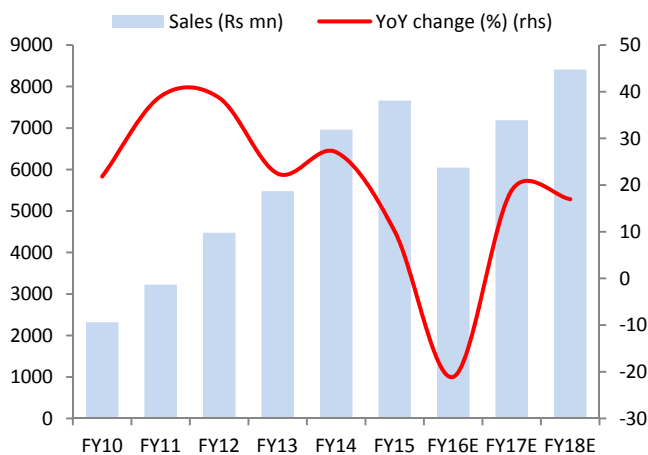
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Financial performance

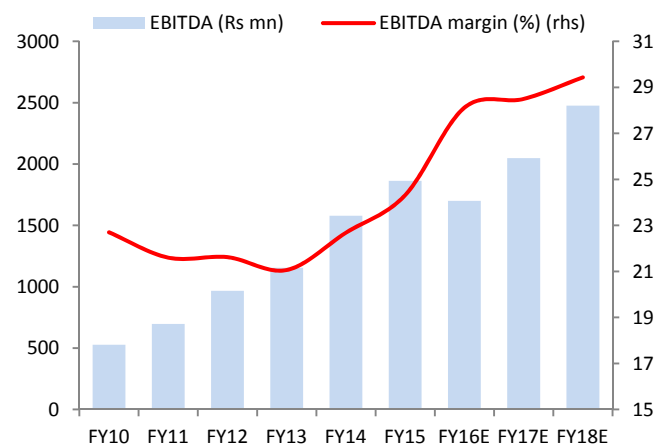
ATBS to remain a leading contributor to sales

Amt (Rs mn)	FY11	FY12	FY13	FY14	FY15	FY16E	FY17E	FY18E
IBB	1018	1539	2047	2426	2322	1750	1863	1980
YoY change (%)	-19	51	33	19	-4	-25	6	6
% of sales	55	32	35	38	35	31	30	27
ATBS	1109	1488	1536	1780	2349	1596	1810	2145
YoY change (%)	94	34	3	16	32	-32	13	18
% of sales	34	33	28	26	31	26	25	26
Na-ATBS (Salts)	666	647	691	1040	1151	923	997	1203
YoY change (%)	49	-3	7	51	11	-20	8	21
% of sales	21	14	13	15	15	15	14	14
IB	126	346	560	867	887	603	642	739
YoY change (%)	0	176	62	55	2	-32	6	15
% of sales	4	8	10	13	12	10	9	9
other	74	292	528	684	836	1179	1780	2231
YoY change (%)	144	296	80	30	22	41	51	25
% of sales	2	7	10	10	11	20	25	27
Sales (Rs mn)	3226	4475	5480	6961	7663	6047	7189	8410
YoY change (%)	39	39	22	27	10	-21	19	17

Revenue to see CAGR of 18% over FY16-18

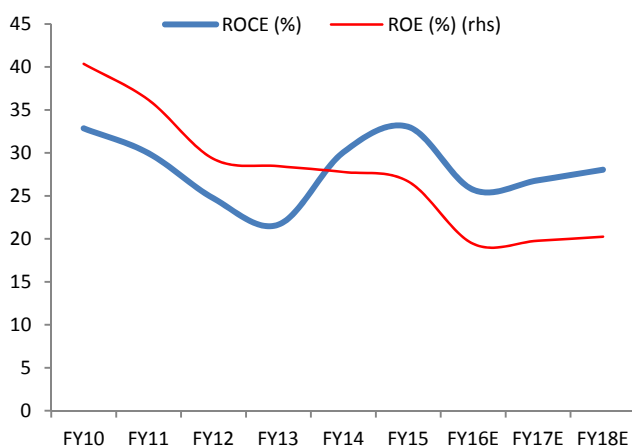


Vinati to maintain margin leadership

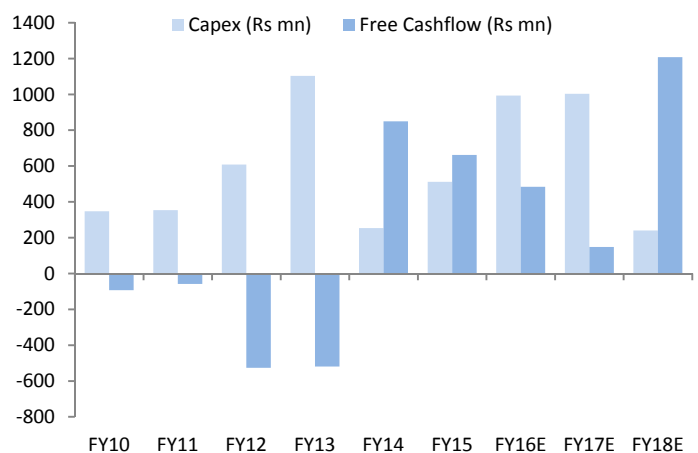


Source: PhillipCapital India Research

Superior return ratios vs. industry peers



Strong cash position to continue



Source: Company, PhillipCapital India Research Estimates

Valuation and outlook

We estimate VO to deliver 16%/21% revenue/profit CAGR over FY16-18 to Rs 8.21/1.45bn in FY18. Looking at VO's EBITDA margin performance of 22-24% over the last five years, we believe it will maintain its sector leadership in terms of profitability supported by – (1) global volume/value leadership in ATBS and IBB, (2) visible lower crude price, and (3) capex plan for forward integrated products. We estimate VO's EBITDA margin at 27-28% over FY16-18.

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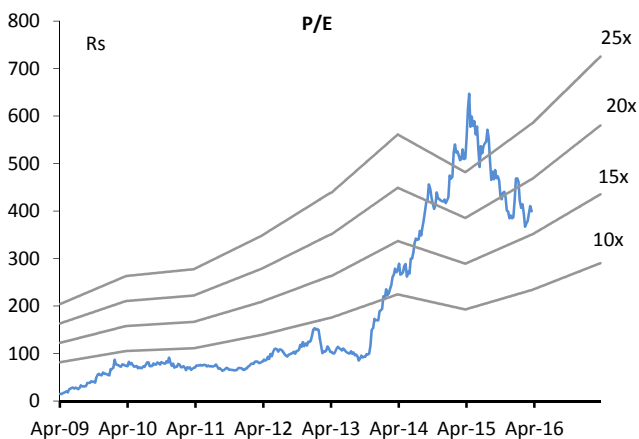
The company trades at 14x FY18 EPS and 8x EV/EBITDA. Considering that (1) it is a sector leader in terms of earning efficiency, and (2) its future growth will be led by continuing expansions into value-added downstream products, we value VO at 10x FY18 EV/EBITDA to arrive at a TP of Rs 495. We initiate coverage with a BUY rating.

Valuation table

Particulars	Value (Rs mn)
EBITDA (Rs mn)	2476
EV/EBITDA target Multiple (x)	10
EV (Rs mn)	24756
Net debt (Rs mn)	-806
Mcap (Rs mn)	25562
No of shares (mn)	52
Target Price (Rs)	495
CMP (Rs)	395
Upside	25%

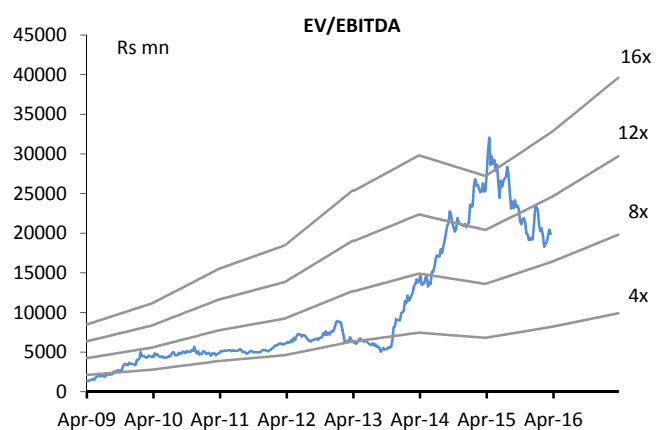
Source: Company, PhillipCapital India Research Estimates

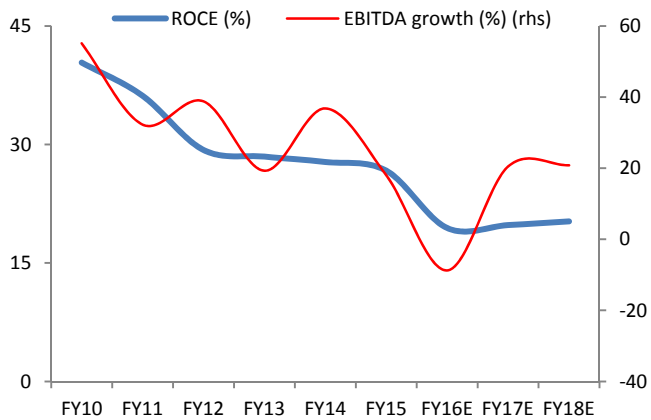
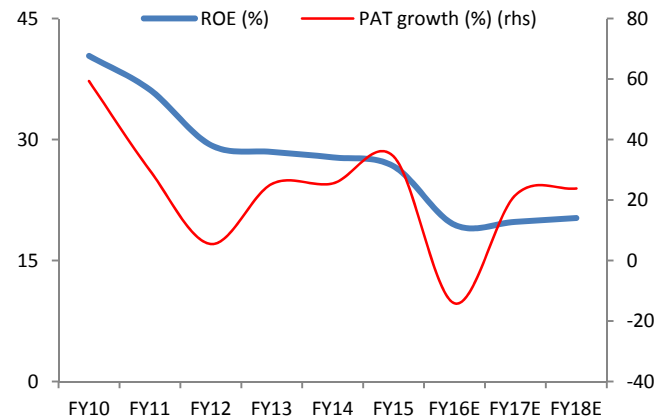
One-year forward PE band



Source: Bloomberg, PhillipCapital India Research Estimates

One-year forward EV/EBITDA band



Recovery in operating performance in near future

Earnings efficiency also sees steady progress


Source: Company, PhillipCapital India Research Estimates

Downside risk to valuation

- Further slowdown in domestic and world economies can impact the user industries VO's such as agro chemicals, dyes and pigments, paints and polymers.
- 50% of Vinati's sales are export oriented; any adverse movement in currency can fluctuate earnings.
- Volatility in crude could fluctuate Vinati's revenue and profitability as it is key input materials are crude derivatives.

Financials

Income Statement

Y/E Mar, Rs mn	FY15	FY16e	FY17e	FY18e
Net sales	7,663	6,047	7,189	8,410
Growth, %	10	-21	19	17
Total income	7,663	6,047	7,189	8,410
Raw material expenses	-4,565	-3,088	-3,681	-4,264
Employee expenses	-319	-356	-431	-505
Other Operating expenses	-915	-902	-1,028	-1,166
EBITDA (Core)	1,864	1,701	2,049	2,476
Growth, %	18.0	(8.7)	20.5	20.8
Margin, %	24.3	28.1	28.5	29.4
Depreciation	-177	-181	-222	-231
EBIT	1,687	1,520	1,827	2,245
Growth, %	18.3	(9.9)	20.2	22.9
Margin, %	22.0	25.1	25.4	26.7
Interest paid	-63	-71	-66	-59
Other Non-Operating Income	91	57	70	82
Pre-tax profit	1,735	1,506	1,831	2,267
Tax provided	-577	-512	-623	-771
Profit after tax	1,158	994	1,209	1,496
Net Profit	1,158	994	1,209	1,496
Growth, %	34.4	(14.2)	21.6	23.8
Net Profit (adjusted)	1,158	994	1,209	1,496
Unadj. shares (m)	52	52	52	52
Wtd avg shares (m)	52	52	52	52

Balance Sheet

Y/E Mar, Rs mn	FY15	FY16e	FY17e	FY18e
Cash & bank	271	512	393	1,325
Debtors	1,291	1,072	1,268	1,463
Inventory	545	476	563	650
Loans & advances	351	302	359	420
Other current assets	33	33	33	33
Total current assets	2,492	2,395	2,616	3,892
Investments	27	27	27	27
Gross fixed assets	4,123	4,914	5,913	6,150
Less: Depreciation	-850	-1,031	-1,253	-1,484
Add: Capital WIP	200	402	406	410
Net fixed assets	3,473	4,285	5,067	5,076
Total assets	5,992	6,708	7,710	8,996
Current liabilities	353	320	380	445
Provisions	256	256	256	256
Total current liabilities	609	575	636	700
Non-current liabilities	1,043	1,016	966	909
Total liabilities	1,651	1,591	1,602	1,609
Paid-up capital	103	103	103	103
Reserves & surplus	4,237	5,014	6,005	7,284
Shareholders' equity	4,341	5,117	6,108	7,387
Total equity & liabilities	5,992	6,708	7,710	8,996

Cash Flow

Y/E Mar, Rs mn	FY15	FY16e	FY17e	FY18e
Pre-tax profit	1,735	1,506	1,831	2,267
Depreciation	177	181	222	231
Chg in working capital	-161	303	-279	-279
Total tax paid	-519	-512	-623	-771
Other operating activities	-223	-217	-217	-217
Cash flow from operating activities	1,009	1,261	934	1,231
Capital expenditure	-507	-993	-1,003	-241
Chg in investments	0	0	0	0
Cash flow from investing activities	-507	-993	-1,003	-241
Free cash flow	662	485	148	1,207
Debt raised/(repaid)	-963	-27	-49	-58
Cash flow from financing activities	-658	-27	-49	-58
Net chg in cash	-156	240	-118	933

Valuation Ratios

	FY15	FY16e	FY17e	FY18e
Per Share data				
EPS (INR)	22.4	19.3	23.4	29.0
Growth, %	28.6	(14.2)	21.6	23.8
Book NAV/share (INR)	84.1	99.2	118.4	143.2
FDEPS (INR)	22.4	19.3	23.4	29.0
CEPS (INR)	25.9	22.8	27.7	33.5
CFPS (INR)	22.1	27.5	21.0	26.5
Return ratios				
Return on assets (%)	20.8	16.4	17.3	18.4
Return on equity (%)	26.7	19.4	19.8	20.3
Return on capital employed (%)	33.0	25.7	26.8	28.0
Turnover ratios				
Asset turnover (x)	1.5	1.1	1.1	1.2
Sales/Total assets (x)	1.3	1.0	1.0	1.0
Sales/Net FA (x)	2.3	1.6	1.5	1.7
Working capital/Sales (x)	0.2	0.3	0.3	0.3
Receivable days	61.5	64.7	64.4	63.5
Working capital days	88.9	94.4	93.6	92.1
Liquidity ratios				
Current ratio (x)	7.1	7.5	6.9	8.8
Quick ratio (x)	5.5	6.0	5.4	7.3
Interest cover (x)	26.8	21.3	27.8	38.0
Total debt/Equity (%)	15.0	12.2	9.4	7.0
Net debt/Equity (%)	8.8	2.2	3.0	(10.9)
Valuation				
PER (x)	17.6	20.5	16.9	13.6
PEG (x) - y-o-y growth	0.6	(1.4)	0.8	0.6
Price/Book (x)	4.7	4.0	3.3	2.8
EV/Net sales (x)	2.7	3.4	2.9	2.3
EV/EBITDA (x)	11.1	12.1	10.0	7.9
EV/EBIT (x)	12.3	13.5	11.3	8.7

Source: Company, PhillipCapital India Research Estimates

Rating Methodology

We rate stock on absolute return basis. Our target price for the stocks has an investment horizon of one year.

Rating	Criteria	Definition
BUY	>= +15%	Target price is equal to or more than 15% of current market price
NEUTRAL	-15% > to < +15%	Target price is less than +15% but more than -15%
SELL	<= -15%	Target price is less than or equal to -15%.

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